FOURTH REPORT PURSUANT TO SECTION 202(e) OF THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT PUB. L. NO. 111-203 (2010)

ADMINISTRATIVE OFFICE OF THE
UNITED STATES COURTS

WASHINGTON, D.C. 20544

JULY 2015

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Contents

I. Introduction 1

II. Executive Summary 2

III. AOUSC Reports Under Title II 3

- A. Summary of First Report: Overview of Bankruptcy Process 4
- B. Summary of Second Report: Overview of Bankruptcy Claims Administration Process 5
- C. Summary of Third Report: Overview of Bankruptcy "Best Interests of Creditors" Test 6
- D. Scope of Fourth Report: Going Concern Sale Process in Bankruptcy 6

IV. Resolving Financial Distress Through Going Concern Sales 7

- A. The Bankruptcy Code and ABI Commission Report 8
- B. Going Concern Sales Under the Bankruptcy Code 10
  1. Evolution of Going Concern Sales Under Section 363 10
  2. Potential Issues with Going Concern Sales: Sub Rosa Plans 12
  3. Potential Issues with Going Concern Sales: Structured Dismissals 13
  4. Potential Issues with Going Concern Sales: Quick Sales 14
  5. General Observations and Data Regarding Going Concern Sales 16
- C. The ABI Commission Proposal on Section 363 Going Concern Sales 17
  1. The Timing of Section 363x Sales 17
  2. The Standard for Approving Section 363x Sales 19
  3. Free and Clear Section 363x Sales 22
- D. OLA and SPOE Proposals 23
  1. The FDIC SPOE Proposal 24
  2. Chapter 14 and Subchapter V Proposals 26
- E. Similarities Between the SPOE Proposals and Section 363 Going Concern Sales 27

V. Conclusion 29

Appendix: List of Defined Terms Used in Report 30

I. Introduction

In response to the global economic turmoil that began in late 2007, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Act) introduced a broad array of regulatory reforms in the financial sector. This report focuses on the reforms in Title II of the Act, which are intended to mitigate risks posed by the failure of systemically important financial institutions. Title II directs the Administrative Office of the United States Courts (AOUSC) to study the resolution of these institutions and report on its findings. The AOUSC submitted its first three annual reports pursuant to 12 U.S.C. § 5382(e) on July 21, 2011 (First Report), July 17, 2012 (Second Report), and July 19, 2013 (Third Report). The AOUSC submits this report in compliance with the directive of section 5382(e).[1]

The report proceeds as follows:

- Part II provides an executive summary of the report's primary research, findings, and analysis.
- Part III describes the AOUSC's mandate under section 5382(e) of the Act and briefly summarizes the First, Second, and Third Reports, as well as the scope of this fourth report.
- Part IV focuses on the key issue explored in this report: the provisions of the U.S. Bankruptcy Code that permit a debtor to sell all or substantially all of its assets in a chapter 7 or chapter 11 bankruptcy case. The report reviews critiques of these provisions, including proposals for reform recommended by the American Bankruptcy Institute Commission to Study the Reform of Chapter 11 (ABI Commission), and compares them to similar mechanisms for resolving financial distress through transfers under the Act and certain bills introduced in both houses of Congress in 2014. The latter mechanisms are commonly referred to as "single point of entry" proposals. This section also describes and utilizes certain original empirical data generated by the Federal Judicial Center (FJC) for purposes of the AOUSC reports under the Act.
- Part V synthesizes the various proposals for rehabilitating or resolving a distressed company through a sale process.

1. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 202(e)(2), 124 Stat. 1376, 1449 (2010), codified under 12 U.S.C. § 5382(e)(2) (2014). The Act requires that the AOUSC summarize the results of its study in a report "[n]ot later than 1 year after the date of enactment of th[e] Act [and] in each successive year until the third year" and in every fifth year after date of enactment. The AOUSC appointed a Working Group to study the issues identified in section 5382(e). A list of defined terms used in this report is set forth in the Appendix.

II. Executive Summary

Traditionally, a distressed company had two options under the U.S. Bankruptcy Code—it could reorganize its business operations and capital structure under a plan of reorganization in chapter 11, or it could liquidate its assets under chapter 7. A distressed company's management and creditors often preferred to reorganize the business under chapter 11, thereby continuing the business as a going concern and, in turn, preserving value and jobs in the process. The chapter 11 process can, however, be slow and litigious, particularly compared to the speed often associated with an asset sale. But a chapter 7 liquidation turns over control of the company to a bankruptcy trustee and may not facilitate an efficient going concern sale. Consequently, parties in a chapter 11 case increasingly have sought court approval of sales of all or substantially all of a debtor's assets—i.e., a going concern sale—under section 363 of the Bankruptcy Code.

Section 363(b) permits a sale of a debtor's assets out of the ordinary course of business after notice and a hearing. Not all parties affected by the chapter 11 case receive notice of the sale, and no party receives a vote on the sale. Rather, creditors and certain other parties may object to a proposed sale, and the court typically reviews the proposed sale and any objections with some deference to the debtor's business judgment. As explained below, most courts review sales of all or substantially all of the debtor's assets under a slightly more stringent standard, commonly referred to as the "good business reason" standard. A going concern sale may in fact be the best way to preserve value for creditors, but it also significantly limits creditors' options in the bankruptcy case, as the sale replaces the debtor's productive assets with a fixed pool of money. A tension thus arises between rapid "reorganizations" through going concern sales in chapter 11 and the due process, notice, and other informational protections afforded all creditors in the chapter 11 plan context.

The ABI Commission studied this tension and the various issues related to permitting going concern sales in chapter 11. It received substantial written and oral testimony on the use of going concern sales to reorganize distressed companies and the potential benefits and risks to such sales—particularly those consummated on an expedited basis. The testimony and the Commission's report discuss the problem of distinguishing cases in which speed really is necessary to preserve value from those in which a more methodical sale or restructuring process that shares information with all affected parties would be beneficial. The ABI Commission recommended amending the Bankruptcy Code to expressly permit going concern sales, subject to certain time limitations and notice and due process requirements.

Notably, the discussion of going concern sales in chapter 11 echoes the approach and many of the issues surrounding rapid recapitalizations in the context of systemically important financial institutions under the Act and the Orderly Liquidation Authority (OLA). The FDIC has proposed a single point of entry process to implement the OLA. The proposal contemplates a very quick transfer of the covered financial company's assets and liabilities to a bridge company. The bridge company would then function to preserve the operations and value of the covered financial company's subsidiaries, as well as their

contracts. Congress has considered similar single point of entry proposals that would be incorporated into the Bankruptcy Code for systemically important financial institutions. Each of these proposals favors the expedited establishment of the new bridge company and its solvency, over concerns about notice, due process, and liquidity. A comparison of the current Bankruptcy Code, the ABI Commission report, and the single point of entry proposals offers insights and perspectives that may assist policymakers in fashioning a more nimble and effective reorganization legislation for distressed companies of all sizes. This report provides that comparison below, as well as commentary and data that also may benefit the process.

III. AOUSC Reports Under Title II

Title II of the Act mandates various studies to consider the implications and alternatives of the new insolvency scheme created for covered financial companies under the Act.[2] This report relates to the study mandated by 12 U.S.C. § 5382(e), "Study of Bankruptcy and Orderly Liquidation Process for Financial Companies."

Section 5382(e) requires the AOUSC to study the following three issues:

1. the effectiveness of chapter 7 or chapter 11 of the Bankruptcy Code in facilitating the orderly liquidation or reorganization of financial companies;
2. ways to maximize the efficiency and effectiveness of the Court [Title II defines "Court" to mean "the United States District Court for the District of Columbia, unless context otherwise requires"]; and
3. ways to make the orderly liquidation process under the Bankruptcy Code for financial companies more effective.

Section 5382(e) further requires the AOUSC to submit a report summarizing the results of the study "[n]ot later than 1 year after the date of enactment of the Act"—that is July 21, 2011.[3] The AOUSC must file two subsequent annual reports in July 2012 and 2013, and then a report "every fifth year after the date of enactment."[4]

The Act implemented a series of changes in the regulation of financial institutions, financial products, and various market participants, that were designed to promote financial stability and more adequately address the financial distress of large, complex financial institutions. The provisions most relevant to the AOUSC's reports under section 202(e) of the Act are Title I of the Act, Financial Stability, which creates the Financial Stability Oversight Council (FSOC); and Title II of the Act, Orderly Liquidating Authority (OLA), which creates a regulatory process for the FDIC to act as receiver and liquidate certain covered financial companies, as defined by the Act and implementing regulations.[5]

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2. 12 U.S.C. § 5382(e)–(g), and Pub. L. No. 111-203, § 217, 124 Stat. at 1519–20.
3. 12 U.S.C. § 5382(e).
4. *Id.*
5. *Id.* §§ 5321, 5383.

The First, Second, and Third Reports systematically and objectively evaluated the resolution of distressed financial institutions and compared processes under the Bankruptcy Code to procedures under the OLA. The First Report began by detailing the events preceding the Act, including the failure or near-failure of several large, complex financial institutions, and then provided a broad overview of reorganization provisions in the Bankruptcy Code compared to the OLA. The Second Report focused on one important component of the process that highlights differences between procedures of the Bankruptcy Code and the OLA by analyzing the claims process procedure. The Third Report considered one of the Bankruptcy Code's provisions for the treatment of stakeholders' claims and interests under a plan of reorganization—i.e., the best interests test of section 1129(a)(7) of the Bankruptcy Code.[6] This section briefly describes the substance of the First, Second, and Third Reports and the scope of this fourth report.

A. Summary of First Report: Overview of Bankruptcy Process

The core contribution of the First Report is its systematic and thorough analysis of the key provisions of the Bankruptcy Code that likely would affect the reorganization or liquidation of a financial institution. It also summarizes key provisions of Title II of the Act for purposes of comparison. The report then explains the potential advantages and disadvantages of each resolution scheme in the context of large, complex financial institutions.

The First Report does not draw conclusions about the "effectiveness" of the Bankruptcy Code in facilitating the "orderly" liquidation or reorganization of distressed financial institutions. Rather, it uses a combination of qualitative data (primarily interviews with restructuring professionals, judges, and clerks of court within the United States) and case studies to consider the options available to resolve distressed financial institutions. The First Report also reviews several of the proposals suggested by commentators for better accommodating the resolution of financial institutions under the Bankruptcy Code. These proposals generally focus on mitigating the impact of any large, complex financial institution's bankruptcy filing on the global economy and markets by, among other things, encouraging prebankruptcy planning, enhancing the involvement of the FDIC and other governmental agencies in the bankruptcy case, streamlining certain processes, and/or modifying the treatment of financial contracts in bankruptcy.

The research underlying the First Report suggests that many of the issues preceding the Act emerged not only because of the business attributes of large, complex financial institutions but also because of the dire economic conditions facing the United States and other countries beginning in late 2007. Accordingly, it likely was this confluence of circumstances that was the principal cause of the challenges for Lehman Brothers in its chapter 11 case and for the other financial institutions that failed or were resolved under the Bankruptcy Code or the Federal Deposit Insurance Act (FDIA). Nevertheless, certain aspects of the Bankruptcy Code (such as the Bankruptcy Code's treatment of financial and derivative contracts) and the FDIA likely made the challenges greater. The First Re-

6. 11 U.S.C. § 1129(a)(7).

port concludes that, on a preliminary basis, the Bankruptcy Code generally functions well to address corporate distress, including that of bank holding companies and non-bank financial institutions.

B. Summary of Second Report: Overview of Bankruptcy Claims Administration Process

The Second Report focused on a significant component of the resolution of distressed financial institutions—i.e., the claims resolution process. This process preserves and maximizes value by pursuing claims, causes of action, and other assets on behalf of, and scrutinizing claims asserted against, the distressed company. Consequently, increasing asset value and reducing the amount of allowed claims work in tandem to maximize returns to creditors. An efficient and effective claims resolution procedure is important to both distressed companies and their creditors.

The report analyzed the claims resolution process under the Bankruptcy Code and provided examples from select chapter 11 cases. The basic structure for filing and preserving claims under the Bankruptcy Code provides certainty to parties impacted by a distressed company. Bankruptcy courts and debtors in large, complex bankruptcy cases have streamlined the claims resolution process by implementing a variety of special claims processes such as alternative dispute resolution procedures, expedited claims objections and settlement procedures, and omnibus objection procedures. Although it can take years to resolve the tens of thousands of claims frequently asserted in large, complex bankruptcy cases, the court, from the outset, facilitates the resolution process and provides consistent parameters, and the parties understand the structured and clearly established procedures.

The Second Report then outlined the claims resolution process contemplated by Title II of the Act and, where relevant or useful, compared it to the federal bankruptcy scheme. Notably, the OLA claims resolution procedure adopts certain aspects of the bankruptcy claims resolution procedure by, among other things, requiring the creditors to file proofs of claim and allowing the FDIC, as receiver, to object to claims. The ex post judicial review process contemplated by the OLA, where a creditor's claim is deemed rejected unless the FDIC allows the claim within the 180-day review period, is contrary to the centralized claims resolution procedure fostered by the Bankruptcy Code. The efficiency of either the bankruptcy or the OLA claims resolution procedure may turn largely on the facts of the particular case and the parties managing the process. The report suggests that the flexibility and concurrent court supervision inherent in the bankruptcy claims resolution procedure may allow the process to adapt more easily to the variety of distressed companies that require a claims resolution scheme.

In addition to discussing the claims resolution process, the Second Report also highlighted a dataset that the FJC is compiling at the request of the AOUSC Working Group.

C. Summary of Third Report: Overview of Bankruptcy "Best Interests of Creditors" Test

Regardless of the debtor's path through chapter 11, the plan of reorganization process frequently plays a key role. A debtor must satisfy certain requirements set forth in section 1129 of the Bankruptcy Code to confirm its plan and emerge from bankruptcy. The Third Report focused on the best interests test of section 1129(a)(7), which sets the minimum distribution that stakeholders are entitled to receive under a chapter 11 plan.

The best interests test provides important protections for individual dissenting and non-voting stakeholders during the plan confirmation process. Under this test, unless every member of a class is deemed to accept or votes to accept the plan, each member of the class must receive or retain not less than it would receive or retain in a hypothetical liquidation of the debtor under chapter 7 of the Bankruptcy Code. A debtor or plan proponent bears the burden of satisfying the best interests test and typically does so through a liquidation analysis, and, in the relatively rare number of instances in which that analysis is disputed, expert testimony. The liquidation analysis, taking into account the priority of stakeholders' claims, compares the proposed distributions in chapter 11 to the expected creditor treatment in chapter 7.

The Third Report explained the elements of the best interests test and its application in practice. It also compared that aspect of chapter 11 to certain provisions in the OLA, including a protection for creditors known as "minimum recovery" that is similar to the best interests test. Specifically, the OLA requires that creditors receive at least as much in a resolution under OLA as they would otherwise in a hypothetical chapter 7 bankruptcy, and it contemplates the FDIC estimating recoveries in a bankruptcy setting for comparison to creditor distributions under the OLA. The challenge in comparing creditor recoveries is that unlike the similarity in priority and distribution schemes between chapter 11 and chapter 7, the OLA priorities and distribution schemes do not align as well with the relevant provisions of the Bankruptcy Code. The Third Report provided a detailed comparison of priority of claims under the OLA versus the Bankruptcy Code and highlighted potential inefficiencies created by any inconsistencies.

D. Scope of Fourth Report: Going Concern Sale Process in Bankruptcy

The AOUSC Working Group continues to evaluate issues relevant to the resolution of distressed financial institutions. Specifically, the Working Group has (1) continued to monitor developments relating to Title II and the resolution of distressed financial institutions; (2) reviewed the most recent academic and financial literature on the implementation of Title II and related issues; (3) engaged in targeted research analyzing going concerns sales under the Bankruptcy Code and similar mechanisms developed under "single point of entry" (SPOE) proposals for the resolution of financially distressed systemically important financial institutions (SIFIs);[7] and (4) with the assistance of the FJC, continued

7. The Act applies only to "covered financial companies." A "covered financial company" is "a financial company for which a determination has been made under section 5383(b)." 12 U.S.C. § 5381(a)(8).

to collect and systematically code information relating to bankruptcy cases of financial firms into a dataset.

The dataset includes information about the bankruptcy cases of financial institutions filed between 2000 and 2014. Part I of the database contains information about the cases, including filing date, voluntary versus involuntary status, filing chapter, case conversion, filing district, interdistrict transfer, assigned judge(s), jointly administered cases, lead debtor's type of business, involvement of federal agencies (e.g., FDIC, SEC, SIPC, CFTC), summary information about assets and liabilities from Schedules A, B, D, E, and F, and information about income from operation of business from the Statement of Financial Affairs. Coding of this information for cases filed through 2014 is essentially complete, although efforts are ongoing to augment information about pending cases as it becomes available, to supplement information that is missing in the electronic case files available on PACER, and to otherwise ensure the reliability of the information. An extensive coding manual has been developed to document coding strategies and decisions.

The data project is continuing to evolve in scope and targeted time period. Development of Part II of the databases is now underway, with information being coded about orders for sale of substantially all of the debtor's assets (e.g., sales of the debtor as a "going concern") and case resolution (including dismissal orders).

As the scope of the database further expands, the Federal Judicial Center will coordinate with the Working Group, the J.C.U.S. Committee on the Bankruptcy System, and the AOUSC so that over time policymakers will have the necessary information to inform debates regarding the resolution of financial firms under the Bankruptcy Code. Subsequent coding likely will focus on the claims resolution process as well as debtor-in-possession financing.

The following section describes the AOUSC Working Group's research and analysis concerning going concern sales in the context of bankruptcy and single point of entry proposals.

IV. Resolving Financial Distress Through Going Concern Sales

A company—whether large or small, and regardless of industry—can seek to resolve its financial distress by, among other things, restructuring its debt obligations and satisfying them, as a reorganized debtor, by the means set forth in its reorganization plan, or by liq-

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The act defines the term "financial company" broadly to include a bank holding company, a nonbank entity supervised by the Federal Reserve, an entity "predominantly engaged in activities that the [Federal Reserve] has determined are financial in nature or incidental thereto" under the Bank Holding Company Act, and certain subsidiaries of any of these. 12 U.S.C. § 5381(b). Section 5383(b) in turn gives the Secretary, in consultation with the President, the power to determine that a financial company should be subject to OLA based on certain identified factors. The AOUSC's mandate under section 5382(e) is not limited to covered financial companies. Accordingly, this report uses the term "systemically important financial institutions" or "SIFIs" to reference covered financial companies under the Act, as well as large, complex financial institutions more generally.

uidating its assets and using the proceeds to repay creditors. The Bankruptcy Code offers both of these options. Traditionally, chapter 11 of the Bankruptcy Code facilitated the former, and chapter 7 the latter. Parties also have, more recently, used chapter 11 to sell a debtor's business as a going concern and to distribute the sale proceeds to creditors. The going concern sale/restructuring model underlies the OLA, as well as the single point of entry (SPOE) proposals submitted to Congress. Each of these sale-based models present a potential opportunity to preserve value, but they also raise questions concerning, for example, due process, fair and equitable treatment of similarly situated creditors, and the impact of additional indebtedness incurred prior to a sale on value realization and allocation. This section explains the sale processes available by means of the Bankruptcy Code and the OLA, and as proposed in the Final Report and Recommendations of the ABI Commission (ABI Commission Report) and the SPOE legislation. It describes the strengths and weaknesses of each, and highlights potential inferences based on the similarities and differences among the various schemes. This section ends with observations that may help policy makers consider the utility of any sale-based restructuring model.

A. The Bankruptcy Code and ABI Commission Report

Chapter 11 of the Bankruptcy Code focuses on the rehabilitation of distressed companies. The original conception of this chapter contemplated, among other things: (1) a "breathing spell" for the distressed company, created by staying most actions against the company relating to its prepetition operations and financial obligations;[8] (2) enhanced protections for lenders willing to extend credit to the distressed company to support the company's postpetition operations and ultimate rehabilitation;[9] (3) tools for the distressed company to alleviate or restructure the financial burdens of its operations by, for example, rejecting burdensome contracts and selling non-core assets;[10] and (4) a plan process through which the company and its creditors could negotiate, vet, and implement a financial restructuring plan—i.e., the plan of reorganization—to achieve its "fresh start."[11] As

8. Section 362 of the Bankruptcy Code facilitates a debtor's breathing spell, providing, for example, that the filing of a bankruptcy petition "operates as a stay, applicable to all entities, of . . . the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title." 11 U.S.C. § 362(a). This section commonly is referred to as the bankruptcy "automatic stay."

9. For example, under section 364 of the Bankruptcy Code, a debtor, with court approval, can offer a postpetition lender an administrative or super-priority claim, or perhaps even a senior secured claim, in exchange for new credit extended to the debtor during the chapter 11 case. 11 U.S.C. § 364.

10. Section 365 of the Bankruptcy Code permits a debtor to elect to assume (i.e., maintain) or reject (i.e., disavow) its executory contracts and unexpired leases, subject to certain exceptions and court approval. 11 U.S.C. § 365.

11. The standards for confirming a chapter 11 plan are set forth in section 1129 of the Bankruptcy Code. 11 U.S.C. § 1129. The "fresh start" concept in bankruptcy frequently refers to the discharge a debtor may receive from its prepetition debts under the Bankruptcy Code. The chapter 11 discharge is set forth in section 1141, but is not available to a debtor that sells or liquidates its business during the case. Specifically, section 1141(d) provides "(3) The confirmation of a plan does not discharge a debtor if—(A) the plan

explained by the legislative history, "the purpose of a business reorganization case [under chapter 11] . . . is to restructure a business's finances so that it may continue to operate, provide its employees with jobs, pay its creditors, and produce a return for its stockholders."[12]

For many years, when companies were primarily financed by unsecured debt, chapter 11 proved to be an effective restructuring tool. Distressed companies used the automatic stay to assess their restructuring options and initiate (or continue) restructuring negotiations with their major stakeholders. These negotiations proceeded against the default rules of the Bankruptcy Code—e.g., to confirm a plan of reorganization, dismiss the case, or convert the case to a liquidation under chapter 7 of the Bankruptcy Code. Parties around the negotiating table understood that the plan confirmation provisions of the Bankruptcy Code allowed creditors to vote to accept or reject the plan, but also gave the debtor an opportunity to cram down the plan on dissenting creditors under certain circumstances.[13] This process often resulted in a consensual plan of resolution, or at least a plan that was feasible, supported by a majority of stakeholders, and consequently confirmable under the Bankruptcy Code.[14] But the plan process (whether fully consensual or only partly so) became much more difficult to accomplish in the increasingly common situations in which companies had become laden with secured debt, and thus little, if any, ability to maintain or acquire the liquidity needed to carry them through the confirmation of a plan. In such instances, quick sales of all or substantially all of those companies' assets were often the only practical alternative.

As noted above, a distressed company could sell assets as part of its chapter 11 case. Specifically, section 363(c) of the Bankruptcy Code allows a trustee or debtor in possession to sell, use, or lease assets in the ordinary course of business without court approval.[15] In addition, section 363(b) provides that a trustee or debtor in possession, "after notice and a hearing, may use, sell, or lease, outside the ordinary course of business, property of the estate."[16] In both instances, a trustee or debtor in possession can sell assets "free and clear of any interest in such property of an entity other than the estate" if: (1) "applicable nonbankruptcy law permits sale of such property free and clear of such

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provides for the liquidation of all or substantially all of the property of the estate; (B) the debtor does not engage in business after consummation of the plan; and (C) the debtor would be denied a discharge under section 727(a) of this title if the case were a case under chapter 7 of this title." 11 U.S.C. § 1141(d)(3).

12. Harvey R. Miller & Shai Y. Waisman, *Is Chapter 11 Bankrupt?*, 47 B.C. L. REV. 129, 181 (2005) (quoting H.R. REP. NO. 95-595, at 220 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6179); *accord NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 528 (1984) ("The fundamental purpose of reorganization is to prevent a debtor from going into liquidation, with an attendant loss of jobs and possible misuse of economic resources.")

13. *See* 11 U.S.C. §§ 1126 (detailing parties' right to vote on chapter 11 plan), 1129(b) (explaining circumstances under which debtor can confirm (or "cram down") chapter 11 plan over creditor opposition).

14. *See, e.g.,* Miller & Waisman, *supra* note 12 (discussing changes in chapter 11 practice, including consensual plans of reorganization).

15. 11 U.S.C. § 363(c)(1).

16. *Id.* § 363(b).

interest"; (2) "such entity consents"; (3) "such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property"; (4) "such interest is in *bona fide* dispute"; or (5) "such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest."[17] The scope of "free and clear" sales under section 363(f) was for a time subject to debate, with some courts limiting the effect of the section to *in rem* interests and others adopting a broader application that also frees the assets of claims against the debtor.[18]

A debtor in possession's ability to sell assets free and clear of interests, liens, and claims can be a valuable tool in its restructuring efforts. As distressed companies and their stakeholders explored the potential uses of section 363(b) sales in chapter 11 cases, their scope and purpose expanded. The following sections examine (1) the evolution of section 363 sales under the Bankruptcy Code and (2) a proposal from the ABI Commission to incorporate a more structured sale process into the Bankruptcy Code for sales involving all or substantially all of a debtor's assets.

B. Going Concern Sales Under the Bankruptcy Code

1. Evolution of Going Concern Sales Under Section 363

A sale of all or substantially all of a debtor's assets under section 363(b) of the Bankruptcy Code essentially monetizes the assets available to repay creditors—the sale (including the timing and the terms of the sale)[19] largely fixes the amount of claims that can be repaid in the bankruptcy case. Because such a sale is a value-realization event and removes any potential accretion in the value of the debtor's assets from the reach of the debtor's creditors, some courts and commentators question the utility of the going concern sale in chapter 11, outside of the plan context.[20] Notably, a debtor can transfer some or all of its

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17. *Id*. § 363(f).

18. *See generally* George W. Kuney, *Misinterpreting Bankruptcy Code Section 363(f) and Undermining the Chapter 11 Process*, 76 AM. BANKR. L.J. 235, 244 (2002). *See also In re* Trans World Airlines, Inc., 322 F.3d 283, 289 (3d Cir. 2003) ("[T]he trend seems to be toward a more expansive reading of 'interests in property' which 'encompasses other obligations that may flow from ownership of the property'") (citing 3 COLLIER ON BANKRUPTCY ¶ 363.06[1]).

19. For example, the treatment of executory contracts in connection with the sale and the value of any assets remaining with the estate also can impact the ultimate value of the estate and distributions available to creditors.

20. *See, e.g.,* Miller & Waisman, *supra* note 12 (discussing changes in chapter 11 practice, including use of section 363 to sell all of a debtor's assets); James H.M. Sprayregen et al., *Chapter 11: Not Perfect, but Better than the Alternative,* AM. BANKR. INST. J., Oct. 2005, at 1, 60 (discussing commentators who criticize "the increasing frequency and rise in importance of §363 sales"). *See also* Robert M. Fishman & Gordon E. Gouveia, *What's Driving Section 363 Sales After Chrysler and General Motors*, 19 J. BANKR. L. & PRAC. 351, 351 (2010) ("'In the early days of the Code, there was considerable debate on the issue of whether a debtor could sell substantially all assets out of the ordinary course during a Chapter 11 case pursuant to § 363(b) prior to filing a plan. Although several courts refused to approve sales of substantially all assets of a Chapter 11 debtor in the absence of a confirmed plan and approved disclosure statement, the overwhelming majority of courts have allowed such sales through motions to sell under § 363(b) . . . .'") (citation omitted).

assets under a plan, *see* 11 U.S.C. § 1123(b)(4), but as explained below, that often is a slower process and the proposed plan is subject to a creditor vote and the Bankruptcy Code's confirmation standards.

After the enactment of the Bankruptcy Code in 1978, most courts recognized going concern sales in limited, emergency situations, but generally did not approve going concern sales that arguably conflicted with, or attempted to short-cut, the chapter 11 plan process. One of the more frequently cited cases on these issues is the U.S. Court of Appeals for the Second Circuit's decision in *In re Lionel Corp.*[21] In *Lionel Corp*., the Second Circuit considered the permissibility of going concern sales, absent emergency circumstances, and the standard for approving any such sale. The Second Circuit traced the origins of the "emergency sale" concept to the 1867 Bankruptcy Act, which provided that "when it appears . . . that the estate of the debtor, or any part thereof, is of a perishable nature or liable to deteriorate in value, the court may order the same to be sold, in such manner as may be most expedient."[22] The Second Circuit declined to restrict going concern sales under section 363(b) to such emergency situations. It did, however, impose certain limitations on such sales through the approval standard. As explained by the Second Circuit, "Just as we reject the requirement that only an emergency permits the use of § 363(b), we also reject the view that § 363(b) grants the bankruptcy judge *carte blanche* . . . such construction of § 363(b) swallows up Chapter 11's safeguards. . . . [T]here must be some articulated business justification, other than appeasement of major creditors for using, selling or leasing property out of the ordinary course of business before the bankruptcy judge may order such disposition under 363(b)."[23]

Based largely on the Second Circuit's holding in *Lionel*, courts generally review proposed sales of all or substantially all of a debtor's assets outside of the plan context under the "good business reason" standard.[24] Although some jurisdictions articulate the test differently, most courts use a business judgment standard,[25] and they consider factors similar to those articulated by the Second Circuit in *Lionel*. These factors include:

> The proportionate value of the asset to the estate as a whole, the amount of elapsed time since the filing, the likelihood that a plan of reorganization will be proposed and confirmed in the near future, the effect of the proposed disposition on future plans of reorganization, the proceeds to be obtained from the disposition vis-à-vis any appraisals of the property, which of the alternatives of use, sale or lease the proposal envisions and, most importantly perhaps, whether the asset is increasing or decreasing in value.[26]

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21. *In re* Lionel Corp., 722 F.2d 1063 (2d Cir. 1983).

22. *Id.* at 1066 (internal quotation marks omitted).

23. *Id.* at 1069–70.

24. *Id.* at 1071.

25. *See*, *e.g.*, *In re* Daufuskie Island Props., LLC, 431 B.R. 626, 637–38 (Bankr. D.S.C. 2010) (requiring valid business justification for sale); *In re* Nicole Energy Servs., Inc., 385 B.R. 201, 231–37 (Bankr. S.D. Ohio 2008) (same).

26. *Lionel*, 722 F.2d at 1071.

Courts also have identified additional, less abstract factors relevant to the sale approval determination, including whether "the estate has the liquidity to survive until confirmation of a plan; the sale opportunity will still exist as of the time of plan confirmation; it is likely that there will be a satisfactory alternative sale opportunity, or a stand-alone plan alternative that is equally desirable (or better) for creditors; and there is no material risk that by deferring the sale, the patient will die on the operating table."[27]

2. Potential Issues with Going Concern Sales: Sub Rosa Plans

A major concern associated with a sale of all or substantially all of a debtor's assets under section 363 is the lack of notice and due process protections that creditors of the bankruptcy estate would otherwise receive in the chapter 11 plan process.[28] In addition, creditors are not entitled to vote on a section 363 sale, but they do get to vote on a chapter 11 plan.[29] For these reasons, early in the evolution of the section 363 going concern sale structure, creditors at times questioned whether the proposed sale was in essence a plan of reorganization that the sale proponents were seeking to implement outside of the section 1129 confirmation standards, and their objections were sometimes sustained by the courts. This concept—commonly referred to as the *sub rosa* plan doctrine—queries whether sales, in addition to monetizing the debtor's assets, also propose the distribution of the sale proceeds or incorporate other provisions akin to a chapter 11 plan, while disenfranchising creditors in the process. As explained by the U.S. Bankruptcy Court for the Fifth Circuit, a *sub rosa* plan argument may prevail where "it is clear that the terms of a section 363(b) sale would pre-empt or dictate the terms of a Chapter 11 plan."[30]

In the relatively few cases in which an objection is made that the terms of a 363(b) sale go beyond simply providing value that is then to be distributed in accordance with normal Bankruptcy Code priorities, bankruptcy courts evaluate whether a proposed going

27. *In re* Gen. Motors Corp., 407 B.R. 463, 490 (Bankr. S.D.N.Y. 2009).

28. In general, the debtor, trustee, all creditors, and indenture trustees must receive "not less than 28 days' notice by mail of the time fixed (1) for filing objections and the hearing to consider approval of a disclosure statement or, under §1125(f), to make a final determination whether the plan provides adequate information so that a separate disclosure statement is not necessary; and (2) for filing objections and the hearing to consider confirmation of a chapter 9, chapter 11, or chapter 13 plan." FED. R. BANKR. P. 2002(b). In addition, all creditors and equity holders generally are entitled to receive copies of the disclosure statement and plan of reorganization and the 28 days' notice described in Bankruptcy Rule 2002(b). Fed. R. Bankr. P. 3017(d).

29. Under section 1126(a) of the Bankruptcy Code, "[t]he holder of a claim or interest allowed under section 502 of this title may accept or reject a plan." 11 U.S.C. § 1126(a). In addition, section 1126(c) provides that "[a] class of claims has accepted a plan if such plan has been accepted by creditors, other than any entity designated under subsection (e) of this section, that hold at least two-thirds in amount and more than one-half in number of the allowed claims of such class held by creditors, other than any entity designated under subsection (e) of this section, that have accepted or rejected such plan." 11 U.S.C. § 1126(c). Finally, to confirm a plan under section 1129, "[i]f a class of claims is impaired under the plan, at least one class of claims that is impaired under the plan has accepted the plan, determined without including any acceptance of the plan by any insider." 11 U.S.C. § 1129(a)(10).

30. Pension Benefit Guar. Corp. v. Braniff Airways, Inc. (*In re* Braniff Airways, Inc.), 700 F.2d 935 (5th Cir. 1983).

concern sale under section 363(b) evades the chapter 11 plan process.[31] Nevertheless, they generally will approve a sale that is proposed with a valid business justification and does not dictate the terms of any subsequent chapter 11 plan.[32] It appears that debtors and parties proposing going concern sales under section 363(b) respect the parameters of the *sub rosa* plan doctrine, as articulated by the Fifth Circuit, and structure the proposed sale to avoid such issues.

3. Potential Issues with Going Concern Sales: Structured Dismissals

An issue similar in concept to the *sub rosa* plan doctrine is a more recent development commonly called a structured dismissal.[33] Parties may seek court approval of a structured dismissal order shortly after, or even simultaneously with, a sale of all or substantially all of the debtor's assets under section 363(b).[34] The requested structured dismissal order includes provisions beyond the straight dismissal of the chapter 11 case. It also includes other provisions similar to those found in a section 1129 confirmation order. These provisions often consist of the settlement and allowance of claims; distributions to creditors; third-party releases; and the dismissal of the case with the court's retention of jurisdiction over certain matters.[35] To the extent these objectives were pursued through the plan process, the plan proponent would have to, among other things, explain thoroughly each of the provisions in its disclosure statement, circulate the disclosure statement and plan to creditors, subject the plan to a creditor vote, and satisfy the "fair and equitable" and "absolute priority rule" of section 1129(b) if not all impaired classes voted in favor of the plan.[36] Courts approving structured dismissal orders following a section 363(b) sale often determine that the outcome is in the best interests of the bankruptcy estate and facilitates a distribution to unsecured creditors that otherwise would be unavailable in the case.[37]

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31. *See, e.g., In re* Trans World Airlines, Inc., 2001 WL 1820326, at *14 (Bankr. D. Del. Apr. 2, 2001) (rejecting *sub rosa* plan objection asserting that proposed sale evaded priority scheme of the Bankruptcy Code).

32. *See, e.g.*, *In re* Boston Generating, LLC, 440 B.R. 302, 331 (Bankr. S.D.N.Y. 2010).

33. For a general description of structured dismissals, see Michael J. Lichtenstein, *Asset Sales and Structured Dismissals in Chapter 11*, PRATT'S J. BANK. L. 22 (Jan. 2014); Norman L. Pernick & G. David Dean, *Structured Chapter 11 Dismissals: A Viable and Growing Alternative after Asset Sales*, 29 AM. BANKR. INST. J. 1 (2010).

34. *See, e.g.*, *In re* LCI Holding Co., No. 12-13319 (KG) (Bankr. D. Del. May 21, 2013) [Docket No. 773] (objection to motion requesting approval of a term sheet in aid of consummation of a court-approved sale).

35. *See, e.g.*, Charles M. Oellermann & Mark G. Douglas, *Taking a Stand Where Few Have Trodden: Structured Dismissal Held Clearly Authorized by the Bankruptcy Code*, 32 BANKR. STRATEGIST 2 (2014) (explaining common elements of structured dismissal orders and courts' approaches to such orders).

36. *See, e.g.,* 11 U.S.C. §§ 1125, 1129, 1141 (sections of Bankruptcy Code addressing the approval of a plan proponent's disclosure statement and chapter 11 plan).

37. *See, e.g.*, *In re* Jevic Holding Corp., No. 14-1465 (3d Cir. May 21, 2015) (affirming bankruptcy court's order approving a settlement agreement among the parties that resolved and dismissed the chapter 11 case and, among other things, authorized distributions to creditors in violation of the absolute priority rule); *In re* Aerospace & Indus. Mfg., Inc., 2008 WL 2705071 (Bankr. N.D. Tex. July 7, 2008) (dismissing

The structured dismissal process is arguably a quicker exit strategy to a chapter 11 case than a traditional plan of reorganization, and it may be coupled with an expedited or quick sale process. As explained in the next section, debtors often seek approval of going concern sales under section 363(b)—with or without structured dismissal orders—early in the chapter 11 case and on a very short timeline. These quick sales may not allow sufficient time for all affected parties to receive and review relevant information relating to the sale and the debtor's other restructuring alternatives.

4. Potential Issues with Going Concern Sales: Quick Sales

To sell, use, or lease assets outside of the ordinary course of business, a trustee or debtor in possession must provide notice of the proposed sale and the related hearing to certain parties in interest, give those parties an opportunity to object, and obtain an order of the court approving the proposed sale.[38] The notice required in most cases is 21 days' notice of the hearing on the motion to approve the proposed sale.[39] In addition, although not technically required by the language of the Bankruptcy Code, most courts require the trustee or debtor in possession to use a public auction process to sell assets under section 363 in order to maximize the value of the assets.[40] Subjecting a debtor's assets to an auction process typically requires exposure of the assets to the relevant market for a reasonable period of time, with active marketing of the assets and a bidding process designed to generate a competitive environment for the assets. Nevertheless, in certain cases, courts may forego such an exhaustive auction process, or reduce the required statutory notice period, to facilitate a quicker disposition of the assets. In addition, a court may approve an expedited timeline if the bankruptcy filing follows a lengthy prepetition marketing practice during which potential bidders have signed nondisclosure agreements, completed due diligence, and made their offers from which the debtor and its professionals have selected the highest and best.[41]

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case pursuant to a settlement agreement because dismissal will result "in a more favorable return to unsecured creditors . . . who otherwise risk receiving nothing in the case").

38. 11 U.S.C. § 363(b).

39. Fed. R. Bankr. P. 2002.

40. *See, e.g.,* Rachael M. Jackson, *Survey: Responding to Threats of Bankruptcy Abuse in a Post-Enron World: Trusting the Bankruptcy Judge as the Guardian of Debtor Estates*, 2005 COLUM. BUS. L. REV. 451, 469–70 (2005) ("The process of conducting an auction generally establishes that a successful bidder has paid the fair market value for the asset. Therefore, considering the tremendous emphasis that bankruptcy courts place on maximizing the value of the estate, auction sales are advisable because judges do not tend to scrutinize closely such transactions before approving the final sale. In addition, the security of an auction sale is enhanced because appellate courts review bankruptcy court confirmations with considerable deference and, therefore, disgruntled bidders are rarely successful in challenging a court-approved sale.").

41. For example, the court considered the extensive prepetition marketing process as an important factor that supported the requested expedited sale in the *Chrysler* chapter 11 cases. *See In re* Chrysler LLC, 405 B.R. 84, 108 (Bankr. S.D.N.Y. 2009) ("Prior to their filing for bankruptcy protection, there had been extensive marketing of the Debtors and their assets for approximately two years. That marketing took place in the context of the high profile setting of the federal government's involvement in the process. By the time

In general, courts require the parties to present evidence that the debtor's assets are likely to decline in value to warrant any deviation from what might otherwise be considered a reasonable or necessary time period to market the assets adequately. Such cases are commonly referred to as "melting ice cube" cases.[42] A melting ice cube case is one in which the trustee or debtor in possession asserts that the debtor's assets must be sold under section 363(b) on an expedited timeframe or the assets will lose all substantial value and, consequently, the estate and all of the debtor's creditors will suffer significant losses. Perhaps the most notable cases referred to as melting ice cube cases are the section 363 sales in the chapter 11 cases of *General Motors* and *Chrysler*, which were consummated in their entirety within 41 days, and the sale of Lehman Brothers' broker-dealer business to Barclays Capital within the first week of the Lehman Brothers' chapter 11 case.[43]

Although the unique facts of certain cases may justify an expedited sale, commentators and some courts suggest that these cases should be the exception rather than the rule.[44] Reasons cited for this general principle include the information asymmetry between sale proponents and some (or many) creditor groups present early in a chapter 11

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of the Bidding Procedures Hearing, viable potential purchasers with any interest already had obtained relevant information or due diligence."), *appeal dismissed*, 592 F.3d 370 (2d Cir. 2010).

42. For a general discussion of melting ice cube cases, see Melissa B. Jacoby & Edward J. Janger, *Ice Cube Bonds: Allocating the Price of Process in Chapter 11 Bankruptcy*, 123 YALE L.J. 862, 922–23 (2013).

43. *See, e.g., In re* General Motors Corp., 407 B.R. 463 (Bankr. S.D.N.Y. 2009), *stay pending appeal denied*, 2009 WL 2033079 (S.D.N.Y. July 9, 2009), *appeal dismissed and aff'd sub nom* Campbell v. General Motors Corp., 428 B.R. 43 (S.D.N.Y. 2010) *and* Parker v. General Motors Corp., 430 B.R. 65 (S.D.N.Y. 2010), *appeal dismissed*, No. 10–4882–bk (2d Cir. July 28, 2011) (*per curiam*), *cert. denied*, ––– U.S. ––––, 132 S. Ct. 1023 (2012); *In re* Chrysler LLC, 405 B.R. 84, 96 (Bankr. S.D.N.Y. 2009), *appeal dismissed*, 592 F.3d 370 (2d Cir. 2010); *In re* Lehman Bros. Holding Inc., 445 B.R. 143, 148–49 (Bankr. S.D.N.Y. 2011) (describing the Lehman Brothers' sale as "largest, most expedited and probably the most dramatic asset sale that has ever occurred in bankruptcy history").

44. *See, e.g., In re* Fisker Auto. Holdings, Inc., 510 B.R. 55, 60–61 (Bankr. D. Del. 2014) ("It is the Court's view that Hybrid's rush to purchase and to persist in such effort is inconsistent with the notions of fairness in the bankruptcy process. The Fisker failure has damaged too many people, companies and taxpayers to permit Hybrid to short-circuit the bankruptcy process."); *In re* Humboldt Creamery, LLC, 2009 WL 2820610, at *2 (Bankr. N.D. Cal. Aug. 14, 2009) ("[T]he problem with the 'melting ice cube' argument is that it is easy enough for the debtor to unplug the freezer prior to bankruptcy."); *In re* Gulf Coast Oil Corp., 404 B.R. 407, 423 (Bankr. S.D. Tex. 2009) ("The Court must be concerned about a slippery slope. Not every sale is an emergency, and, as discussed more fully below, the reliability of uncontested evidence (and particularly the reliability of testimony that is not adequately cross-examined) is suspect."); Jessica Uziel, *Section 363(b) Restructuring Meets the Sound Business Purpose Test with Bite: An Opportunity to Rebalance the Competing Interests of Bankruptcy Law*, 159 U. PA. L. REV. 1189, 1214 (2011) ("Section 363 sales' expedited process and lesser disclosure requirements make investigation of the purchaser's behavior vital in order to protect creditors, equity security holders, and debtors from exploitation. Increased potential for abuse threatens creditors' interests as well as the debtor's ability to maximize the value of the estate."); Elizabeth B. Rose, *Chocolate, Flowers, and § 363(b): The Opportunity for Sweetheart Deals Without Chapter 11 Protections*, 23 EMORY BANKR. DEV. J. 249, 272 (2006) ("Without comprehensive information available to the court and the committee the sale is vulnerable to sweetheart deals or unfair dealing.").

case, the depressed value of the assets at the time of the chapter 11 filing, and a concern that quick sales may misallocate value among the debtor's creditors. Nevertheless, commentary and data suggest that parties are proposing and closing section 363 going concern sales on a much quicker timeframe than when the Code was first enacted in 1978—principally because of the modern prevalence of secured debt and debtors' lack of liquidity. For example, according to the ABI Commission Report, "[t]he median number of days between the petition date and the sale order approving a section 363 sale has declined from a high of 1,982 days in 1992 to 51 days in 2012."[45]

5. General Observations and Data Regarding Going Concern Sales

Despite the concerns outlined above, section 363 going concern sales occur with some frequency. Data on large public chapter 11 cases suggest that such cases are increasingly ending in section 363 going concern sales.[46] Some commentators observe that this trend is not necessarily a negative development and that such sales can be an effective "reorganization" tool for some distressed companies.[47] Other commentators posit that section 363 going concern sales—particularly those conducted early in a case and on an expedited basis—undervalue distressed companies, often to the detriment of junior creditors and at least part of the debtor's prepetition workforce and business partners.[48]

The data being collected and analyzed by the FJC will provide valuable information concerning the role of section 363 sales in financial debtor chapter 11 cases. These data are particularly relevant as Congress considers the effectiveness of the OLA and possible alternatives to the OLA, based on a sale-reorganization model.

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45. ABI Commission Report, Section IV.C.2.

46. *See* ABI Commission Report, Section VI.B (highlighting data chart that "demonstrates a positive linear trend … in the number of section 363 sales in chapter 11 cases, but it also is limited to large public companies"). *See also* Michelle M. Harner, *The Value of Soft Variables in Corporate Reorganizations*, 2015 ILL. L. REV. (forthcoming) (discussing increase in chapter 11 asset sales and potential value allocation issues).

47. *See, e.g.,* Sprayregen, *supra* note 20 (discussing use of section 363 sales in chapter 11); *First Report of the Commercial Fin. Ass'n to the ABI Comm'n to Study the Reform of Chapter 11: Field Hearing at Commercial Fin. Ass'n Annual Meeting*, at 5 (Nov. 15, 2012) ("CFA submits that promoting an efficient sale of collateral to a purchaser who is able to continue to use those assets in a productive form is good for the economy in general and for the selling debtor's stakeholders in particular."), *available at* Commission website: www.commission.abi.org.

48. *See, e.g.,* Jacoby & Janger, *supra* note 42 ("Speed comes at a cost. Early in a bankruptcy case, information is limited on two separate axes: the value of claims against the firm and the cost of taking time to learn more. Characterizing the company as a melting ice cube ratchets up the perceived costs of learning more and enables a prospective purchaser to present its terms as 'now or never,' or 'my way or the highway.'").

C. The ABI Commission Proposal on Section 363 Going Concern Sales

In December 2011, the American Bankruptcy Institute (ABI) formed the ABI Commission.[49] The ABI Commission was composed of 22 experienced practitioners, judges, and academics.[50] It undertook an extensive study process that included, among other things: 17 public field hearings at which over 90 witnesses testified;[51] extensive research not only by the ABI Commission members and reporter, but also 150 practitioners, judges, and academics who served on topical advisory committees;[52] and extended deliberations on the need for, and recommendations concerning, the reform of chapter 11 of the Bankruptcy Code.[53] The ABI Commission issued the ABI Commission Report in December 2014.

During its study process, the ABI Commission evaluated the increasing use of section 363 going concern sales as a viable exit strategy for chapter 11 debtors.[54] It considered many of the issues discussed in the previous section, and it thoroughly analyzed the differing perspectives on the utility of section 363 going concern sales. As discussed below, the ABI Commission ultimately proposed principles that recognize section 363 going concern sales (which the Commission calls "section 363x sales") as an acceptable reorganization tool and propose a more defined framework for courts to consider and approve such sales.[55]

1. The Timing of Section 363x Sales

The ABI Commission proposes a 60-day moratorium on section 363 sales in chapter 11. Specifically, the principle provides: "The trustee should not be permitted to conduct an auction of, or to receive final approval of a sale transaction involving, all or substantially all of the debtor's assets within 60 days after the petition date or date of the order for relief, whichever is later."[56] The moratorium is designed to promote greater transparency and dissemination of information to the court and all affected parties before all or sub-

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49. According to its website, "The American Bankruptcy Institute is the nation's largest association of bankruptcy professionals, made up of over 12,000 members in multi-disciplinary roles, including attorneys, auctioneers, bankers, judges, lenders, professors, turnaround specialists, accountants and others." www.abi.org.

50. The ABI Commission had eighteen voting members and four *ex officio* members. The names and professional biographies for each of the ABI commissioners are set forth in the ABI Commission Report and at the ABI Commission's website: www.commission.abi.org. The reporter for the commission, Professor Michelle Harner, is a member of the AOUSC Working Group.

51. Transcripts from each of the hearings and written witness testimony are available at the ABI Commission's website: www.commission.abi.org.

52. One of the members of the AOUSC Working Group, Judge Robert E. Gerber, was a member of the ABI Commission's advisory committee on sales.

53. For a full description of the ABI Commission's study and deliberation process, see ABI Commission Report, Sections III.C–D.

54. *See* ABI Commission Report, Section VI.B. Notably, the ABI Commission's report considers, and proposes principles for, going concern sales under section 363 of the Bankruptcy Code for chapter 11 debtors of all sizes and in all industries.

55. *Id.*

56. ABI Commission Report, Section IV.C.2.

stantially all of the debtor's assets are removed from the bankruptcy estate and the reach of the debtor's creditors.[57] It also would allow for the appointment of a creditors' committee—and a short period during which the committee could review the relevant information—before the court approved the sale.

Although a debtor likely has shared information concerning the sale with its largest senior creditors prior to the chapter 11 filing, the ABI Commission Report suggests that parties not privy to these prepetition discussions and negotiations may be significantly disadvantaged by the process.[58] Accordingly, in addition to the 60-day moratorium, the report also would require the debtor to compile a "valuation information package" or VIP,[59] and to make that information available to any party in interest to the extent the parties request such information to evaluate, among other things, a motion to sell assets under section 363 of the Bankruptcy Code that is filed during the first 60 days of the case.[60] Notably, although the proposed moratorium prohibits the trustee or debtor in possession from conducting an auction or receiving final approval of a sale within that time period, it does not preclude the filing of a motion for such relief.

The ABI Commission Report also suggests that the terms of the debtor's postpetition financing facility may influence not only whether the debtor in possession pursues a section 363x sale, but also the proposed timing of that sale. According to certain data cited in the report, chapter 11 cases involving postpetition financing facilities that include milestones or benchmarks requiring the debtor to sell its assets under section 363 are more likely to end in a section 363 going concern sale.[61] In addition, these milestones or benchmarks typically require the debtor to obtain judicial approval of, if not also consummate, a section 363 sale by a date certain.[62] The ABI Commission thus recommends that the 60-day moratorium also apply to the approval of certain milestones and benchmarks in postpetition financing facilities.[63]

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57. *See* ABI Commission Report, Section IV.C.2 ("The Commissioners also acknowledged the problems with insufficient notice and opportunity for parties in interest to assert meaningful objections or perform reliable asset valuations within the abbreviated time frames of a quick sale.").

58. *See* ABI Commission Report, Section IV.A.6 ("The Commissioners analyzed the potential benefits of the requirement that debtors provide additional and earlier disclosures of meaningful financial data, particularly data that may assist parties in interest to assess valuation issues. Among other potential benefits, such disclosures may help reduce information asymmetries and allow parties to make better-informed decisions regarding the impact of the debtor's proposed exit strategy on their recoveries in the case.").

59. Under the Report, a VIP includes: "(i) tax returns for the previous three years (inclusive of all schedules); (ii) annual financial statements (audited if available) for the prior three years (inclusive of all footnotes); (iii) most recent independent appraisals of any of the debtor's material assets (including any valuations of business enterprise or equity); and (iv) to the extent shared with prepetition creditors and existing or potential purchasers, investors, or lenders, all business plans or projections prepared within the past two years." *See* ABI Commission Report, Section IV.A.6.

60. *See id*.

61. *See* ABI Commission Report, Section IV.C.1.

62. *See id.*

63. Specifically, the principle states: "A court should not approve any proposed postpetition financing under section 364 of the Bankruptcy Code that (i) is subject to milestones, benchmarks, or other provisions

Notably, the ABI Commission Report includes an exception to the 60-day moratorium if "(i) the trustee or a party in interest demonstrates by clear and convincing evidence that there is a high likelihood that the value of the debtor's assets will decrease significantly during such 60-day period, and (ii) the court finds that the proposed sale satisfies the standards set forth in the principles for section 363x sales."[64] This melting ice cube exception is intentionally more stringent than standards currently employed by courts to evaluate a debtor in possession's request for an expedited section 363 going concern sale. Among other things, the standard of review is "clear and convincing" and the potential loss of value must be significant and highly likely.[65] This proposed standard would require more or different evidence than what most parties currently present. It also suggests a heightened standard of review and, if it works as intended, highly expedited sales will become the exception rather than the rule.

2. The Standard for Approving Section 363x Sales

As noted above, the ABI Commission did not support maintaining the status quo with respect to the approval of section 363 going concern sales. Rather, it recommends a heightened standard of review and incorporates certain requirements that are generally applicable to the plan confirmation process under section 1129. The report explains:

> The Commissioners found little difference in the consequences to creditors' rights and claims under an order approving a section 363x sale or an order confirming a chapter 11 plan. They did find, however, significant differences in the creditor protections available under the two processes. Considering the potentially greater exposure to loss of value in the sale context where the assets are being removed from the estate, the Commission ultimately determined that creditors should be afforded at least the same level of protection in the section 363x sale process and in the chapter 11 plan process.[66]

Specifically, the ABI Commission's principles propose that "[t]he court should approve a sale of all or substantially all of a debtor's assets only if the court finds by a preponderance of the evidence that the proposed sale is in the best interests of the estate."[67] In addition, the trustee or debtor in possession would need to establish, at the hearing on the motion to approve a sale of all or substantially all of the debtor's assets under section 363, the following:

- The sale complies with the applicable provisions of the Bankruptcy Code. (Comparable plan provision found at 11 U.S.C. § 1129(a)(1).)

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that require the trustee to perform certain tasks or satisfy certain conditions within 60 days after the petition date or date of the order for relief, whichever is later, or (ii) otherwise conflict with another section of the Bankruptcy Code." *Id*.

64. ABI Commission Report, Section IV.C.2.

65. *Id.*

66. ABI Commission Report, Section VI.B.

67. *Id.*

- The proponent of the sale complies with the applicable provisions of the Bankruptcy Code. (Comparable plan provision found at 11 U.S.C. § 1129(a)(2).)
- The sale has been proposed in good faith and not by any means forbidden by law. (Comparable plan provision found at 11 U.S.C. § 1129(a)(3).)
- Any payment made or to be made by the debtor or by a person acquiring property in the sale for services or for costs and expenses in or in connection with the case, or in connection with the sale and incident to the case, has been approved by, or is subject to the approval of, the court as reasonable. (Comparable plan provision found at 11 U.S.C. § 1129(a)(4).)
- Except to the extent that the holder of a particular claim has agreed to a different treatment of such claim, the trustee proposes to use or reserve sufficient proceeds from the sale to satisfy in full allowed claims of a kind specified in section 507(a)(2) or (3) incurred through the date of the closing of the sale.[68] (Comparable plan provision found at 11 U.S.C. § 1129(a)(9)(A).)
- All fees payable under 28 U.S.C. § 1930, as determined by the court at the hearing on the sale, have been paid or the trustee provides for the payment of all such fees on the date of the closing of the sale. (Comparable plan provision found at 11 U.S.C. § 1129(a)(12).)
- The trustee has provided adequate notice and an opportunity to be heard to all creditors and equity security holders who may be affected by a release or discharge that provides claims protection for the purchaser in the order approving the sale.[69]

This proposal requires something more than the traditional "business judgment" standard of approval and will at least normally provide more due process for creditors not otherwise involved in the negotiation and decision to sell the debtor's assets.[70] It also provides for the payment of administrative expenses incurred through the date of the closing of the sale, but does not address other costs and expenses that may be necessary to wind down the debtor's estate and close the case.[71]

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68. Section 507(a)(2), by reason of its cross-reference to section 503(b) of the Code, requires administrative expenses to be paid. It protects estates and the judicial system from scenarios under which sale proponents (often secured creditors wishing to credit bid) can avail themselves of the benefits of the 363 sale without also bearing the expenses associated with the invocation of the bankruptcy system.

69. Section 507(a)(2).

70. As discussed above, courts often defer to the trustee's or debtor in possession's business judgment when approving an asset sale under section 363 of the Bankruptcy Code and, at most, require the trustee or debtor in possession to articulate a "good business reason" to justify the sale.

71. *See* ABI Commission Report, Section VI.B. The ABI Commission Report does not propose a surcharge or fixed percentage of costs to be funded by the purchaser or senior creditors in order to consummate a going concern sale under section 363. It does, however, note testimony before the Commission in support of such concepts. As a result, the proposed principles only provide for the payment of costs and expenses necessary to consummate the sale, but they do not account for other costs and expenses associated with, for example, pursuing claims on behalf of the estate to maximize creditor recoveries, reviewing and

The ABI Commission's recommendations do not require a going concern sale to be accompanied by a plan of reorganization or subject to a creditor vote. As such, the proposal does not eliminate all of the concerns voiced by courts and creditors under the *sub rosa* plan doctrine.[72] For example, creditors are still disenfranchised and the protections afforded by the absolute priority rule under section 1129(b) may not apply. The Commission attempts to address the latter concern in two respects: (1) in the context of larger cases, it proposes a modification to the absolute priority rule—the redemption option value—that would apply in both the plan and section 363x sale context;[73] and (2) it limits the use of "structured dismissal" orders, which can alter distribution schemes in violation of the absolute priority rule.[74]

With respect to redemption option value, the ABI Commission outlines a mechanism to allocate any potential upside value to a debtor's assets—above and beyond that necessary to pay in full the senior creditors' claims, plus any deficiency claims and interest—to a junior class of creditors. The mechanism uses an option valuation formula (based on a strike price set by the senior creditors' claim amount) to determine any such potential accretion in the assets' value.[75] The redemption option value concept would apply in both the section 363x sale and plan contexts, and it is generally intended to mitigate any depression in value caused by the timing of the value-realization event in the chapter 11 case. The concept appears to be a work in progress, as the ABI Commission notes the need for further research and refinement, particularly for debtors with larger, more complex capital structures.[76]

The ABI Commission also attempts to mitigate violations of the absolute priority rule in the sale context by reducing the scope of orders dismissing chapter 11 cases following asset sales under section 363. Although not a blanket prohibition, the principles state: "The Bankruptcy Code should be amended to clarify that a chapter 11 case can be resolved only in the following three ways: (i) confirmation of a plan under section 1129; (ii) conversion of the case under section 1112; and (iii) dismissal of the case subject to section 349."[77] The commentary in the ABI Commission Report explains that this princi-

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resolving claims asserted against the debtor's estate, or disposing of any non-core assets excluded from the going concern sale.

72. *See* discussion of *sub rosa* plan doctrine *supra* notes 28–32 and accompanying text.

73. *See* ABI Commission Report, Section VI.G.

74. *See* ABI Commission Report, Section VI.C.1.

75. *Id.* As further explained in the ABI Commission Report, the redemption option value mechanism uses an option valuation formula that uses a strike price based on the senior creditors' full claim (including any deficiency claim and interest), a three-year valuation period that commences on the petition date, a risk-free rate based U.S. Treasuries, and a volatility rate that would be based on market evidence at the time of the valuation. According to the report, the likelihood for any redemption option value being available to the junior class of creditors decreases as the duration of the case increases and the amount available to pay the senior creditors decreases. So in a chapter 11 case that continues for two years and only provides a 50% recovery to the senior creditors, the redemption option value for the junior creditors is effectively zero. *See id.*

76. *Id.*

77. *See* ABI Commission Report, Section VI.G.

ple is intended to limit the relief that a debtor, a purchaser, and other parties in interest can achieve through a dismissal order following a going concern sale under section 363. It specifically references violations of the absolute priority rule, non-consensual third party releases, and deviations from the general chapter 11 claims process as common issues in a structured dismissal order.[78] Nevertheless, the ABI Commission's recommendation only requires strict compliance with section 349, which notably does give the court discretion to grant relief in addition to a straight dismissal of the case.[79]

3. Free and Clear Section 363x Sales

The ABI Commission's Report also addresses if and when a going concern sale of the debtor's business should be approved free and clear of any interests and liens in, *and claims against*, the assets.[80] As noted above, the case law is unclear concerning the scope of section 363(f) of the Bankruptcy Code and whether the court has the authority to approve asset sales free and clear of claims.[81] The ABI Commission ultimately suggests that such a sale requires appropriate notice to all affected creditors and an opportunity for those creditors to object. Accordingly, under the ABI Commission's recommendations, a sale free and clear of all interests, liens, and claims would be permitted only in the section 363x context, in which the Commission incorporates additional notice and process requirements, or a lesser asset sale that nevertheless complies with the section 363x sale approval process.[82]

The ABI Commission further clarifies the standards for approving sales free and clear of interests and liens. For example, the ABI Commission Report provides, "A trustee should be able to sell assets free and clear of interests without the consent of any lienholder and regardless of whether the assets generate value in excess of the aggregate value of the liens in the assets, provided that the liens attach to the proceeds of the sale or the lienholder receives another appropriate form of adequate protection of the lien."[83] This principle would determine the value of a creditor's lien based on the market value of the underlying collateral as evidenced by the sale price. This amendment to section 363(f) would enable trustees and debtors in possession to sell assets free and clear of interests and liens even if the sale price does not exceed the value of all liens asserted against the assets.

The ABI Commission's proposed changes to section 363(f) are not without limit. The Commission does recognize certain limits on a court's authority to approve such sales. These limits include those imposed by the U.S. Constitution, as well as those traditionally

78. *Id.*

79. *See* 11 U.S.C. § 349(a) ("*Unless the court, for cause, orders otherwise*, the dismissal of a case under this title does not bar the discharge, in a later case under this title, of debts that were dischargeable in the case dismissed….") (emphasis added).

80. *See* ABI Commission Report, Section V.B.3.

81. *See* discussion of section 363(f) *supra* notes 17–18 and accompanying text.

82. *See* ABI Commission Report, Section V.B.3.

83. *Id.*

recognized by the courts. In the latter category, the Commission excluded the following from the reach of section 363(f): "(i) easements, covenants, use restrictions, usufructs, or equitable servitudes that are deemed to 'run with the land' under applicable nonbankruptcy law; (ii) environmental obligations that are deemed to 'run with the land' under applicable nonbankruptcy law; (iii) successorship liability for purposes of federal labor law; and (iv) partial, competing, or disputed ownership interests, except to the extent specified in section 363(h) or (i)."[84]

The ABI Commission's proposed clarifications to section 363(f) and its general recommendation that the Bankruptcy Code explicitly recognize a going concern sale as a viable exit strategy work to reduce impediments to a going concern sale and potentially generate additional value through the certainty of the process and the potentially expanded relief available to purchasers under section 363(f). Nevertheless, the proposed process does not completely mirror a plan process. Tort litigants (who normally are unsecured creditors) may well argue that removing successor liability claims from the assets through the sale process significantly impairs their rights. Other creditors may well argue that tort litigants should not get better treatment than other unsecured creditors.[85] The balance struck by the ABI Commission on these points is useful in analyzing potential options under the OLA and SPOE proposals with respect to SIFIs.

D. OLA and SPOE Proposals

The Act requires the FDIC to promulgate rules and regulations to facilitate the orderly resolution of covered financial companies under the OLA. With respect to any such rules and regulations, the Act directs the FDIC, "[t]o the extent possible, … to harmonize applicable rules and regulations promulgated under this section with the insolvency laws that would otherwise apply to a covered financial company."[86] In December 2013, the FDIC issued its single point of entry proposal (the "FDIC SPOE" proposal) for public comment.[87] The FDIC SPOE proposal establishes the mechanism by which the FDIC, as receiver, would accomplish the transfer of the assets of a financially distressed SIFI to a bridge company; that bridge company would continue key business operations and assume certain debt obligations.

Subsequent to the FDIC SPOE proposal, Congress considered two similar legislative proposals. The version introduced in the U.S. Senate contemplates a new chapter 14 to

84. *Id.*

85. *See, e.g., In re* Chrysler LLC, 576 F.3d 108, 124, 126 (2d Cir. 2009) (observing that permitting successor liability claims against a purchaser is "inconsistent with the Bankruptcy Code's priority scheme") (citing *In re* Trans World Airlines, Inc., 322 F.3d 283, 292 (3d Cir. 2003)), *judgment vacated by* 592 F.3d 370 (2d Cir. 2010).

86. 12 U.S.C. § 5389.

87. Resolution of Systemically Important Financial Institutions: The Single Point of Entry Strategy, 78 Fed. Reg. 76,614 (proposed Dec. 10, 2013). *See also* David A. Skeel Jr., *Single Point of Entry and the Bankruptcy Alternative*, *in* ACROSS THE GREAT DIVIDE: NEW PERSPECTIVES ON THE FINANCIAL CRISIS (Martin Neil Baily & John B. Taylor eds., 2014).

the Bankruptcy Code.[88] The version introduced in the U.S. House of Representatives would add a subchapter V to the existing chapter 11 (subchapter V) of the Bankruptcy Code.[89] (The FDIC SPOE proposal, the chapter 14 proposal, and the subchapter V proposal are referred to collectively as the "SPOE Proposals.") In many respects, the SPOE Proposals resemble the section 363 going concern sale discussed above. Each SPOE Proposal is discussed further below.

1. The FDIC SPOE Proposal

The Act authorizes the FDIC, as receiver of a financially distressed SIFI,[90] to liquidate the assets of, and resolve the claims against, the SIFI.[91] The FDIC SPOE proposal restricts the scope of the receivership and the liquidation mandate to the "top-tier U.S. holding company" in the SIFI's entity structure.[92] The SIFI's operating subsidiaries would continue as going concerns and would not be subject in any formal manner to the SIFI's OLA receivership.[93]

Specifically, upon its appointment as receiver, the FDIC would form a bridge company to assume certain assets and liabilities of the SIFI holding company.[94] For example,

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88. Taxpayer Protection and Responsible Resolution Act, S. 1861, 113th Cong. (1st Sess. 2013) [hereinafter Chapter 14 Bill], *available at* https://www.govtrack.us/congress/bills/113/s1861/text.

89. Financial Institution Bankruptcy Act of 2014, H.R. 5421, 113th Cong. (2d Sess. 2014) [hereinafter Subchapter V Bill], *available at* http://judiciary.house.gov/_cache/files/94c89efd-5d4c-46bc-bbe6-a3b8c6f74f56/webhr-5421-financial-institution-bankruptcy-act.pdf. A substantially similar bill has been introduced in the 114th Congress: the Financial Institution Bankruptcy Act of 2015, H.R. 2947, 114th Cong. (1st Sess. 2015), *available at* http://judiciary.house.gov/?a=Files.Serve&File_id=9E24226E-A94F-4525-AD90-8E429DC2671D.

90. A proceeding under Title II of the Act commences with a decision by the Secretary, two-thirds of the FDIC, and two-thirds of the Federal Reserve that such action is appropriate for a covered financial company. 12 U.S.C. §5383(a)(1)(A). Once the decision is made, the Secretary notifies the covered financial company and, upon consent by the company, appoints the FDIC as receiver for the company. If the board of directors of a covered financial company does not consent to the appointment of the FDIC as receiver, the Secretary must file a petition to take over the covered financial company and to appoint the FDIC as receiver in the U.S. District Court for the District of Columbia. 12 U.S.C. § 5383(a)(1)(A)(i). The Act directs the Secretary to file the OLA petition under seal, and no party is permitted to disclose the existence of the proceeding. 12 U.S.C. § 5382(a)(1)(A), (C). For a more extensive explanation of the OLA process, see the First Report.

91. For example, the FDIC has broad authority to take over the covered financial company, operate the company to the extent necessary and sell the company's assets in a piecemeal or going concern basis and obtain financing to facilitate the resolution. The Act also directs the FDIC to remove management and members of the board of directors "responsible for the failed condition of the covered financial company." 12 U.S.C. §§ 5390(a), 5386(4), (5). For further discussion of the FDIC's role under the Act and a comparison of that role to a bankruptcy trustee, see the First Report.

92. Resolution of Systemically Important Financial Institutions: The Single Point of Entry Strategy, 78 Fed. Reg. at 76,616.

93. *Id.*

94. "Upon its appointment as receiver of the top-tier U.S. holding company of the covered financial company, the FDIC would adopt articles of association and bylaws and issue a charter for the bridge financial company." *Id.*

the bridge company would assume the holding company's senior secured debt and take possession of any collateral related to that debt; assume any vendor contracts necessary to continue the SIFI's ongoing business; and assume any qualified financial contracts (or the parent company's obligations under its subsidiaries' qualified financial contracts). The holding company's subordinated debt, unsecured debt, and shareholders' equity would remain in the receivership. This transaction structure basically places the "good" assets of the holding company in the bridge company and leaves the "bad" assets with the receivership estate.[95] This structure, in turn, arguably strengthens the capitalization of the bridge holding company and, thereby, allows the SIFI's operating companies to continue to operate without interruption.[96]

The FDIC SPOE proposal focuses almost exclusively on financial distress at the SIFI holding company level, which some commentators have noted may not be the source of the SIFI's financial distress.[97] The proposal does provide for the forgiveness of all intercompany debt flowing from the SIFI's operating subsidiaries and moves the operating companies' liabilities upstream to the holding company. The proposal then appears to rely on the strength of the newly formed bridge company to attract outside financing to the extent funding is needed for the operations of the recapitalized SIFI. The FDIC also has authority under the OLA to provide limited funding to the bridge company.

With respect to obligations remaining in the receivership estate, the FDIC, as receiver, would issue new securities in the bridge company to creditors and shareholders in exchange for those debt claims against, and equity interests in, the SIFI holding company.[98] These new securities could include debt, equity, warrants, or some combination of the foregoing, and the amount of old debt and equity exchanged for these new securities would be based on a valuation of the bridge company as recapitalized. The FDIC also would review and resolve the claims and interests remaining in the receivership estate through the process and in accordance with the priority scheme set forth in the OLA.[99]

Notably, the formation of the bridge company under the FDIC SPOE proposal occurs very quickly, within one business day of the appointment of the FDIC as receiver.[100] The extent and timing of the notice regarding the receivership and the formation of the bridge

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95. *Id. See also* Skeel, *supra* note 87; Stephen J. Lubben, *OLA After Single Point of Entry: Has Anything Changed?*, *in* AN UNFINISHED MISSION: MAKING WALL STREET WORK FOR US (Mike Konczal & Marcus Stanley eds., 2013).

96. Resolution of Systemically Important Financial Institutions: The Single Point of Entry Strategy, 78 Fed. Reg. at 76,615.

97. *See* Skeel, *supra* note 87; Lubben, *supra* note 95.

98. Resolution of Systemically Important Financial Institutions: The Single Point of Entry Strategy, 78 Fed. Reg. at 76,616. Some commentators have suggested that the "bail-in" procedure utilized in SPOE should mitigate systemic risk. *See* Joseph H. Sommer, *Why Bail-In? And How!*, Economic Policy Review, Special Issue: Large and Complex Banks, Federal Reserve Bank of New York, March 2014, at 29, *available at* http://www.ny.frb.org/research/epr/2014/1403somm.pdf.

99. Resolution of Systemically Important Financial Institutions: The Single Point of Entry Strategy, 78 Fed. Reg. at 76,616.

100. *Id.*

company are less clear, but presumably these actions would be public once the period for the District Court to review the receivership request expired. The claims review process and the debt-for-securities exchange in the receivership would occur after consummation of the bridge company transaction and on a longer timeline.[101]

2. Chapter 14 and Subchapter V Proposals

The chapter 14 and the subchapter V proposals introduced in Congress during 2014 are similar in certain key respects to the FDIC SPOE proposal and to each other. Both proposals focus on the SIFI holding company; they contemplate the quick formation of, and transfer of certain of the SIFI's assets and obligations to, a new entity; and they allow the SIFI's operating companies to continue as going concerns.[102] They also leave senior secured debt, unsecured debt, and equity interests with the holding company's bankruptcy estate, and likely would satisfy these claims through a debt-for-securities exchange, similar to that described above under the FDIC SPOE proposal.[103]

Several differences, however, do exist. For example, the chapter 14 and subchapter V proposals would resolve the SIFI under new provisions of the U.S. Bankruptcy Code (and not under the OLA). Another key difference is that the Senate's chapter 14 proposal would repeal the OLA in its entirety.[104] The House subchapter V proposal, on the other hand, would appear to complement the OLA. As explained by the chair of the U.S. House of Representatives Judiciary Committee, Bob Goodlatte, "The Financial Institution Bankruptcy Act [subchapter V] is a bipartisan, balanced approach that increases transparency and predictability in the resolution of a financial firm."[105]

Designated federal judges would hear cases filed under the proposed chapter 14 and subchapter V.[106] The FDIC and certain other agencies would have standing to be heard on issues in the case. Similar to the FDIC SPOE proposal, activities in the chapter 14 or subchapter V case would proceed very quickly, at least early in the case. For example, the judge must approve the transfer of the debtor's assets and obligations to the new entity within the first 48 hours of the bankruptcy case, provided that the FDIC receives at least

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101. *Id.* at 76,617.

102. *See* Subchapter V Bill, *supra* note 89; Chapter 14 Bill, *supra* note 88. *See also* Statement of Donald S. Bernstein Before Subcommittee on Regulatory Reform, Commercial and Antitrust Law, The Committee on the Judiciary, U.S. House of Representatives, July 15, 2014, at 15 ("By recapitalizing the firm's operating subsidiaries with holding company assets at the outset of the process, the single-point-of-entry approach preserves the continuity and value of those operating businesses and pushes the firm's operating losses up to the old holding company to be absorbed by the holding company's shareholders and creditors.").

103. *See* Subchapter V Bill, *supra* note 89; Chapter 14 Bill, *supra* note 88.

104. *See* Chapter 14 Bill, *supra* note 88, at 1 ("(a) In General.—Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Public Law 111-203) is repealed and any Federal law amended by such title shall, on and after the date of enactment of this Act, be effective as if title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act had not been enacted."). Notably, the chapter 14 proposal also would impose limitations on the ability of the Federal Reserve to act as lender of last resort.

105. *Id.*

106. *See* Subchapter V Bill, *supra* note 89; Chapter 14 Bill, *supra* note 88.

24 hours' notice of the proposed transfer.[107] In most cases, this transfer would include the debtor's qualified financial contracts. Both proposals would extend the automatic stay during this period to prevent counterparties from terminating or otherwise exercising their rights under qualified financial contracts.[108] The process seeks to preserve the SIFI's business by moving it in and out of the bankruptcy case quickly. The bankruptcy case then would proceed similarly to a more traditional chapter 11 case, with creditors whose claims are left with the bankruptcy estate receiving the benefit of the claims administration and resolution process, absolute priority rule, and other notice and procedural protections afforded creditors under chapter 11.

Neither the chapter 14 nor the subchapter V proposal addresses whether funding sources would be available for the newly formed entity or the SIFI debtor.[109] Although the SIFI debtor may be able to utilize section 364 of the Bankruptcy Code to try to secure postpetition financing, it is unclear whether lenders would extend credit to the SIFI subsequent to the bridge company transaction.[110] Without postpetition financing, the SIFI debtor may not be able to administer its chapter 11 case to accomplish the debt-for-securities and other objectives of the proposals for the SIFI and all of its stakeholders. The proposals also do not address the feasibility of providing adequate notice to relevant parties and holding the bridge company transaction hearing on the required expedited timeline.[111]

E. Similarities Between the SPOE Proposals and Section 363 Going Concern Sales

Some commentators suggest that the SPOE Proposals are modeled after the *General Motors* and *Chrysler* bankruptcy cases.[112] As discussed above, General Motors and Chrysler

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107. *See* Subchapter V Bill, *supra* note 89; Chapter 14 Bill, *supra* note 88.

108. *See* Subchapter V Bill, *supra* note 89; Chapter 14 Bill, *supra* note 88.

109. *See* Stephen J. Lubben, *OLA and Bankruptcy: A Critique* (Proposed Chapter 14 and the Future of Large Financial Institution Resolution) (abiLIVE Webinar Series), July 15, 2014, at 38; Peter Grushkin, *Dodd-Frank, Bailout Reform, and Financial Crisis Ambiguities*, Kennedy School Review, May 2, 2013, http://harvardkennedyschoolreview.com/dodd-frank-bailout-reform-and-financial-crisis-ambiguities/.

110. Notably, the Senate version of SPOE would amend the Federal Reserve Act to provide that "a Federal Reserve bank may not make advances to any covered financial corporation that is a debtor in a pending case under chapter 14 of title 11, United States Code, or to a bridge company, for the purpose of providing debtor-in-possession financing pursuant to section 364 of such title." Chapter 14 Bill, *supra* note 88, at Sec. 6. At least one commentator has questioned the feasibility of private financing in this context: "There are serious questions whether private financing could be raised quickly enough in the midst of a systemically important financial institution's distress to satisfy its liquidity needs." Skeel, *supra* note 87.

111. In general, the proposed legislation requires "electronic or telephonic notice of not less than 24 hours" of any proposed special transfer of assets to certain identified parties, including the debtor's 20 largest unsecured creditors, the debtor's 20 largest unsecured creditors, and counterparties to any contracts being transferred as part of the sale. Chapter 14 Bill, *supra* note 88, § 1406; Subchapter V Bill, *supra* note 89, § 1185. *See also* Skeel, *supra* note 87 ("Bankruptcy's rule-of-law protections make a quick sale more difficult. The most obvious solution to the timing issue is to provide for a much quicker sale than is usually the case, with notice given to regulators and a group of the largest creditors.").

112. *See supra* note 43; Skeel, *supra* note 87 ("Although the exact genealogy of the single-point-of-entry strategy is unclear, it bears a striking resemblance to the transactions that were used to bail out and

were reorganized under chapter 11 through sales of substantially all of their assets under section 363 of the Bankruptcy Code.[113] The purchasers of the assets assumed certain contracts and other obligations of each debtor; the debtors' other obligations were left with the bankruptcy estate to be administered in due course under chapter 11. The transfers of General Motors' and Chrysler's respective businesses out of the bankruptcy estate were completed within 41 days of commencing the bankruptcy case and allowed the companies to continue business without any significant disruption.[114]

The SPOE Proposals follow a similar blueprint, but on an even more accelerated timeline. Proponents of the SPOE Proposals assert that such speed is required to preserve the value of a SIFI's assets and to reduce the potential systemic impact of the SIFI's failure on the financial system.[115] The end objective is, however, the same—use the resolution or bankruptcy process to cleanse and transfer the debtor's assets to a new entity quickly, removing those assets (and their value) from the reach of many of the debtor's existing creditors and all of their equity holders. In the context of SIFIs, proponents justify the result by emphasizing that the debtor's creditors and shareholders, and not U.S. taxpayers, should bear the burden of the SIFI's failure.[116] As with any debtor, however, a quick sale that imposes losses on prepetition creditors who likely did not cause the debtor's failure raises questions about the timing, valuation, and process invoked to facilitate the sale.

As policy makers and commentators consider "reorganizing" distressed companies through going concern sales—whether under the Bankruptcy Code or the OLA—they may benefit from a comprehensive and coordinated discussion that considers all types of debtors. Indeed, for most companies, including financial institutions, distress typically does not develop overnight. Although a systemic shock or industry event may trigger the distress, most companies should be engaged in periodic risk management practices that

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restructure Chrysler and General Motors in 2009.") (citations omitted); Lubben, *supra* note 95 ("The latter allows the FDIC to split the good assets from the bad, in a process that is very much like that used in '363 sales' under chapter 11, widely publicized by the automotive bankruptcy cases.").

113. *See supra* note 41 and accompanying text.

114. Importantly, however, the success of the *General Motors* and *Chrysler* cases resulted in material part from their estates' ability to obtain pre-sale liquidity from outside sources (in those cases, the U.S. Treasury)—a matter as to which the Bankruptcy Code (like Bankruptcy Code alternatives) is silent other than to authorize postpetition financing, and to provide statutory protections for those providing it.

115. *See, e.g.,* Randall D. Guynn, *Framing the TBTF Problem: The Path to a Solution*, *in* ACROSS THE GREAT DIVIDE: NEW PERSPECTIVES ON THE FINANCIAL CRISIS (Martin Neil Baily & John B. Taylor eds., 2014) ("The key to solving the TBTF problem without taxpayer-funded bailouts is a high-speed recapitalization of the failed financial group that imposes losses on shareholders and other stakeholders but avoids unnecessary value destruction and preserves the group's going-concern value.").

116. *See, e.g.,* Daniel K. Tarullo, Speech at the Federal Reserve Board and Federal Reserve Bank of Richmond Conference, *Planning for the Orderly Resolution of a Global Systemically Important Bank*, Washington, D.C., Oct. 18, 2013 ("The aim of the single-point-of-entry approach is to stabilize the failed firm quickly, in order to mitigate the negative impact on the U.S. financial system, and to do so without supporting the firm's equity holders and other capital liabilities holders or exposing U.S. taxpayers to losses.").

help managers anticipate or at least respond to such events. Policy makers and commentators may want to consider ways to encourage managers to embrace more robust risk management practices, more proactive steps if financial distress is identified, and a bankruptcy reorganization process—invoked before emergency measures are necessary—that provides appropriate notice and creditor protections while preserving the value of the debtor's ongoing business operations.

Notably, the Act incorporates requirements for SIFIs to monitor and manage risk levels more closely and to prepare and file "living wills" that identify how the firm will address any financial distress under existing law.[117] The ABI Commission has recommended principles to strengthen the due process, notice, and value allocation to creditors in chapter 11 cases involving going concern sales.[118] Moreover, the SPOE Proposals follow a similar sale model for resolving financially distressed SIFIs, but with greater focus on asset value preservation and less attention to the rights and remedies of creditors. By reviewing and adopting the best aspects of each of these various models, as well as emerging empirical data and other proposals for mitigating financial distress and systemic risk, policy makers may be able to fashion a more holistic approach to the resolution of financially distressed firms.

V. Conclusion

The U.S. Bankruptcy Code offers alternatives for preserving going concern value rather than mandating the liquidation of distressed companies. As judges and practitioners explore the parameters of those alternatives in the contexts of chapter 11 plans and section 363 going concern sales, policy makers are trying to develop those parameters in the context of SIFIs and SPOE proposals. Although the conversations involve different kinds of distressed companies and SIFIs pose systemic issues not present for non-SIFI debtors, many of the issues overlap. Considering the commonalities may help policy makers better understand each issue and develop more targeted and refined solutions. Indeed, the end objectives are the same—invoke a scheme that minimizes disruption, preserves the most value, and treats all parties as fairly as possible.

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117. The Act requires certain bank holding companies and non-bank financial institutions to submit resolution plans, "commonly known as a living will, [that] describe the company's strategy for rapid and orderly resolution in the event of material financial distress or failure of the company, and include both public and confidential sections." Board of Governors of the Federal Reserve System, Resolution Plans (explaining the content of resolution plans and the implementation of the related provisions of the Act), available at http://www.federalreserve.gov/bankinforeg/resolution-plans.htm (last visited on May 23, 2015).

118. *See* ABI Commission Report, Section VI.B.

Appendix: List of Defined Terms Used in Report

Defined Acronyms and Abbreviations

ABI: American Bankruptcy Institute
Act: Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010
AOUSC: Administrative Office of the United States Courts
Bankruptcy Code: Title 11 of the United States Code
FDIA: Federal Deposit Insurance Act
FDIC: Federal Deposit Insurance Corporation
FJC: Federal Judicial Center
FSOC: Financial Stability Oversight Council
Lehman Brother: Lehman Brothers Holding, Inc
OLA: Orderly Liquidating Authority
SIFIs: Systemically Important Financial Institutions
SPOE: Single Point of Entry
VIP: Valuation Information Package

Other Defined Key Terms

Absolute Priority Rule: A distribution rule, generally codified through sections 726 and 1129(b) of the Bankruptcy Code, that requires the full satisfaction of a senior class of creditors or interest holders before any distributions are made to the next junior class of creditors or interest holders.

Best Interests of Creditors Test: The requirement under section 1129(a)(7) of the Bankruptcy Code that, unless every member of a class is deemed to accept or votes to accept the plan, each member of the class must receive or retain not less than it would receive or retain in a hypothetical liquidation of the debtor under chapter 7 of the Bankruptcy Code.

Bridge Company: A company that holds the assets and certain liabilities of a debtor or financially distressed company until a third-party purchaser is identified for such assets and liabilities.

Business Judgment Standard: A standard of review that generally defers to the substantive decision of a company's board of directors if the procedures followed by the board to render that decision are satisfactory. Under this standard, a rebuttable presumption in favor of the board of directors exist that the board acted in good faith, on an informed basis, and in the best interests of the company.

Covered Financial Companies: "[A] financial company for which a determination has been made under section 203(b) [12 U.S.C. § 5383(b)]." 12 U.S.C. § 5381(a)(8).

Cram Down: The procedure that a debtor in possession may follow under section 1129(b) of the Bankruptcy Code to confirm a chapter 11 plan even if one or more classes of holders of impaired claims votes to reject the plan.

Free and Clear Sale: The ability of a trustee or debtor in possession to sell the debtor's assets free and clear of interests, liens, and perhaps claims asserted against those assets under certain circumstances set forth in section 363(f) of the Bankruptcy Code.

Going Concern Sale: A sale of all or substantially all of a company's assets as an assembled or operating unit. A going concern sale often is contrasted with a piecemeal sale or liquidation in which a company's assets are sold off individually or in smaller units.

Redemption Option Value: As defined and used in the ABI Commission Final Report, that value "attributable to such immediately junior class is the value of a hypothetical option to purchase the entire firm with an exercise price equal to the redemption price [a defined term in report] and a duration equal to the redemption period [a defined term in report]."

Section 363x Sale: As defined and used in the ABI Commission Final Report, "a sale of all or substantially all of a debtor's assets."

Single Point of Entry Proposal: A proposal for resolving financially distressed financial institutions by focusing the resolution process on the holding or parent company. This process typically seeks to remove operating assets from the holding or parent company through a sale or quick transfer process, thereby mitigating disruption at operating company level.

Structured Dismissal: An order dismissing a chapter 11 case following a sale of all or substantially all of the debtor's assets under section 363 of the Bankruptcy Code that includes provisions other than those specifically referenced by section 349 of the Bankruptcy Code.

***Sub Rosa* Plan:** A doctrine that considers whether the terms of an asset sale under section 363 of the Bankruptcy Code implement distributions to creditors and resolution of other matters in the chapter 11 case that should be facilitated under the section 1129 plan process.

Systemically Important Financial Institutions: Generally refers to non-bank institutions that the Financial Stability Oversight Council determines to be "systemically important" and banks with more than $50 billion in assets.

ADMINISTRATIVE OFFICE OF THE UNITED STATES COURTS