



A CHANGE IN PLANS

Chrysler and General Motors cases reveal popularity of Section 363 sales

By **JULIE A. MANNING**
and **ERIC S. GOLDSTEIN**

This year has seen the filing of two of the largest business bankruptcy cases in history. The Chrysler and General Motors Chapter 11 cases were both filed in the Southern District of New York during the worst economic climate our country has experienced since the Great Depression. The steps taken by Chrysler and GM to address their financial difficulties have resulted in several interesting bankruptcy issues appearing in the national headlines. These issues, although not new, could impact the future of Chapter 11 cases for years to come.

While the reports of a “quick” and “speedy” exit from bankruptcy by Chrysler and GM were many, the fact remains that the Chrysler and GM Chapter 11 cases are still pending and will continue for some time. What was not fully reported and is particularly interesting about the Chrysler and GM cases was the process employed by both companies to address their serious financial problems, commonly known as the “Section 363” sale.

Section 363 of the U.S. Bankruptcy Code allows a debtor to sell substantially all of its assets at any time during its Chapter 11 case without the need to file a disclosure statement and plan of reorganization. Rather than address the claims of creditors through the traditional means of a disclosure statement and plan, Chrysler and GM sought immediate approval from the bankruptcy court to sell substantially all of their assets free and clear of claims and interests

of creditors pursuant to Section 363. In both cases, the Section 363 sales were quickly approved, despite the filing of numerous objections by creditors and other interested parties. Following the approval of its Section 363 sale in June, Chrysler representatives told *The Detroit News*, “We found that the game plan that had been designed in the March time period actually worked.” In July, following approval of its Section 363 sale, GM’s CEO Fritz Henderson said that GM completed its bankruptcy proceedings under court supervision much “faster than anyone thought it could.” Despite the unprecedented circumstances surrounding the Chrysler and GM cases, many now argue that the quick approval of the Section 363 sales proves that obtaining confirmation of a plan, the ultimate goal in a Chapter 11 case, has been replaced by the Section 363 sale.

Lack Of Credit

Has the plan of reorganization been replaced by the Section 363 sale? Not necessarily, but the Section 363 sale has been used effectively by many businesses to address serious financial conditions. Although Chrysler and GM are the most well-known examples of the use of Section 363 sales in Chapter 11 cases, the number of Section 363 sales in Chapter 11 cases has increased over the last several years. The reasons for the increase are many and too numerous to list here. Yet, some of the reasons are obvious.



Julie A. Manning



Eric S. Goldstein

First, due to the struggling economy and the lack of credit, many companies have not been able to obtain debtor-in-possession financing to operate their businesses during the Chapter 11 process. Without financing or some other means of generating additional revenue, a debtor often cannot continue to operate during the months, and sometimes years, it takes to file and obtain confirmation of a plan of reorganization. Many companies have concluded that in the absence of available credit, the best course of action is to seek bankruptcy court approval to sell its assets to the highest bidder. In addition, depending upon the type of business filing the Chapter 11 case, a sale of the underlying assets may need to occur in a short time frame in order to maintain the “going concern value.” For example, a company that could not obtain financing, but has an interested buyer, may seek approval of a Section 363 sale if it has enough money to continue its operations through the closing of the sale.

Second, a Section 363 sale can be accomplished in a short period of time as was true in the Chrysler case (42 days) and the GM case (40 days). In any Chapter 11 case in which a Section 363 sale is proposed, it is essential

Julie A. Manning is a partner in Shipman & Goodwin’s Hartford office and is chair of the Bankruptcy and Creditors’ Rights Practice. Eric S. Goldstein is an associate in Shipman & Goodwin’s Hartford office and practices in the areas of bankruptcy and creditors’ rights and corporate trust.

for creditors and other interested parties to understand that a debtor will quickly seek an order from the bankruptcy court establishing the procedures for parties to: (i) make any higher and better offers for the purchase of assets; (ii) object to the proposed sale; and (iii) determine if existing contracts will be assumed or rejected. The approval and closing of the Section 363 sale often occurs within weeks of the filing, not months or years. The traditional timeframe for creditors to review a disclosure statement and plan of reorganization and object thereto does not exist in Section 363 sales.

In addition to the expedited nature of Section 363 sales, another reason they appear to be more common is the realization by potential buyers that the purchase of assets from a Chapter 11 debtor are free and clear of any interests or liens of third parties. A successful buyer in a Section 363 sale pays value for the purchase of the assets, yet often obtains the assets without any pre-petition liabilities attached to them. In some cases, like in Chrysler and GM, the buyer agrees to assume certain liabilities and cure defaults under existing

contracts entered into by the debtor prior to the filing of the Chapter 11 case. In many cases, the buyer has the power to choose which contracts and agreements it will assume. The financial impact of assuming liabilities under those contracts are heavily negotiated by the parties before the Chapter 11 case is filed and often is reflected in the purchase price.

Maintaining Employees

The approval of a Section 363 sale early in the Chapter 11 process can decide substantive issues important to creditors and other parties that would ordinarily be addressed over a much longer period of time in the disclosure statement and plan of reorganization process. Depending upon the party impacted by the Section 363 sale, the sale process eliminates some of the protections available in determining the value of a debtor's assets and the feasibility of the debtor's business operations during and after the Chapter 11 case. However, there are several reasons why a Section 363 sale can and should be approved by the bankruptcy court, including maximizing the going concern value of the

company through the sale and maintaining as many employees of the debtor's business in connection with the sale.

Given the uncertain economic times in which we live, and the lack of credit available in this climate, it is likely that Section 363 sales will be utilized more frequently in Chapter 11 cases. Section 363 provides businesses with a valuable tool to achieve an expeditious resolution of financial difficulties. Parties involved in such cases must be aware that substantive rights and procedures are often determined early in the Section 363 sale process—in the Chrysler and GM cases the substantive rights and procedures were determined in the first few weeks. In every case, all interested parties must understand the specific Section 363 sale procedures approved by the bankruptcy court in order to protect and preserve their rights in the Chapter 11 case.

Despite the noticeable increase in Section 363 sales and the high-profile Chapter 11 cases in which they have been used, the plan of reorganization may not be gone, but it is likely to be forgotten during these difficult economic times. ■