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Ice Cube Bonds: Allocating the Price of Process in Chapter 11 Bankruptcy

ABSTRACT. In Chrysler's Chapter 11 bankruptcy, a finding that the debtor was losing $100 million per day justified the hurry-up sale of the company to Fiat. The assertion that a firm is a melting ice cube is frequently offered, soon after a bankruptcy filing, to justify a quick sale of the firm under § 363(b) of the Bankruptcy Code. This raises a policy question: is this speed and the attendant streamlining of process a bug or feature? Do hurry-up going-concern sales maximize value for the bankruptcy estate, or do they facilitate collusive deals among incumbent managers, senior creditors, and potential purchasers? The answer is a little bit of both. It is crucial to distinguish between sales where the court and parties have good information about the value of the company and the costs of delay, from those in which melting ice cube leverage is used to exploit information asymmetries and to lock in a favored deal. To accomplish this sorting and reduce opportunistic use of transactional leverage, we seek to allocate the increased risks of forgone process to the beneficiaries of the sale rather than to the bankruptcy estate. We propose that a reserve—the Ice Cube Bond—be set aside at the time of sale to preserve any potential disputes about valuation and priority for resolution after the sale has closed. This approach retains expedited § 363 sales as a useful way to quiet title in complex assets and maximize value, while preserving the opportunities for negotiation and adjudication contemplated by the Bankruptcy Code.

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INTRODUCTION

Financially distressed companies can melt like ice cubes: every day that a company burns through more cash than it earns, it loses value.[1] In Chrysler's Chapter 11 bankruptcy, the bankruptcy court's finding that the car company was losing $100 million per day justified a hurry-up going-concern sale of all of its assets under § 363(b) of the Bankruptcy Code.[2] The Second Circuit agreed that these exigent circumstances justified the procedural shortcuts taken to accomplish the sale, citing the "melting ice cube" theory.[3]

Though the Supreme Court vacated the Second Circuit decision in *Chrysler*,[4] the Second Circuit's use of the melting ice cube argument was well within the judicial mainstream.[5] The government's role as a source of debtor-in-possession and exit financing was novel, but the expedited sale of all the company's assets outside a plan of reorganization was not. Hurry-up all-asset sales under § 363 of the Code ("363 sales") are now a common feature in the bankruptcies of large public companies.[6] A decade ago, Douglas Baird and Robert Rasmussen declared the classic business reorganization dead; the going-concern sale had replaced the traditional Chapter 11 reorganization.[7] While the claim may have been overstated as an empirical matter, many high-profile Chapter 11 cases, including the bankruptcies of Enron, Adelphia, and

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1. *See, e.g.*, Transcript of Sale Hearing at 177, *In re* Polaroid Corp., No. 01-10864 (Bankr. D. Del. June 28, 2002), Docket No. 1255 (characterizing Polaroid as a melting ice cube).

2. *In re* Chrysler LLC, No. 09-50002, 2009 WL 5131534, at *7 (Bankr. S.D.N.Y. June 1, 2009) ("Currently, the Debtors are losing over $100 million dollars per day."). For an argument contesting that Chrysler was a melting ice cube, see Mark J. Roe & David Skeel, *Assessing the Chrysler Bankruptcy*, 108 MICH. L. REV. 727, 751 (2010).

3. *In re* Chrysler LLC, 576 F.3d 108, 114 (2d Cir. 2009), *vacated sub nom.* Ind. State Police Pension Trust v. Chrysler LLC, 558 U.S. 1087 (2009).

4. *Id.*

5. Lynn M. LoPucki & Joseph W. Doherty, *Bankruptcy Fire Sales*, 106 MICH. L. REV. 1, 30-31 (2007) (reporting that sixteen of the thirty § 363 cases in their sample of large public company bankruptcies made melting ice cube arguments).

6. *See infra* notes 63-67 and accompanying text.

7. *See* Douglas G. Baird & Robert K. Rasmussen, *Chapter 11 at Twilight*, 56 STAN. L. REV. 673, 674 (2003) [hereinafter Baird & Rasmussen, *Chapter 11 at Twilight*]; Douglas G. Baird & Robert K. Rasmussen, *The End of Bankruptcy*, 55 STAN. L. REV. 751, 784-85 (2002) [hereinafter Baird & Rasmussen, *The End of Bankruptcy*]. *But see* Lynn M. LoPucki, *The Nature of the Bankrupt Firm: A Response to Baird and Rasmussen's* The End of Bankruptcy, 56 STAN. L. REV. 645, 648 (2003) (demonstrating that traditional reorganizations have increased since the 1980s, not disappeared).

Lehman Brothers, have disposed of major assets through sales outside of a Chapter 11 plan.[8] Members of Congress were sufficiently concerned after the Gulf oil spill that BP would try to engineer a quick 363 sale to shed liabilities that they preemptively sought to change the Code.[9] Pleas for quick 363 sales frequently feature the melting ice cube argument—a "strong assertion of non-viability" because of an alleged rapid wasting of assets—as a justification for short-circuiting the Chapter 11 plan process.[10] The practical effect is to lock up the proposed sale package, and to raise the cost of investigating alternatives.

Although the largest cases attract public attention, small- and mid-market cases also feature proposals for quick all-asset sales.[11] Smaller debtors may have fewer assets to burn, fewer financing options, a weaker corporate infrastructure to help keep the business together, less publicly available financial information, and a lower likelihood of an active creditors' committee to counterbalance other forces. A going-concern sale may be the best, or only, option, but, as these cases often involve non-public companies, concerns about leverage resulting from timing-related information asymmetries may be even greater.[12] In such cases, the disclosure regime associated with Chapter 11 plan confirmation may be of particular value.

Quick sales, therefore, raise a policy question in bankruptcies of all sizes: is Chapter 11's speed and flexibility a bug or a feature? Do these sales maximize value for the bankruptcy estate? Or do they facilitate collusive deals between incumbent managers, senior creditors, and potential purchasers? The answer is a little bit of both. Some companies really are melting away—worth far more today than they will be tomorrow. Acting quickly will benefit all stakeholders. But calling something a melting ice cube does not make it one. And, even the

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8. *See infra* notes 117-119 and accompanying text.

9. Securing Protections for the Injured from Limitations on Liability Act, H.R. 5503, 111th Cong. § 5 (2010) (seeking to impose new successor liability requirements on debtors that file for bankruptcy with significant Oil Pollution Act liabilities and that move to sell assets under § 363 of the Bankruptcy Code). This bill passed the House of Representatives but was never taken up in the Senate.

10. LoPucki & Doherty, *supra* note 5, at 30-31.

11. *See, e.g., In re* Gulf Coast Oil Corp., 404 B.R. 407, 419 (Bankr. S.D. Tex. 2009) (noting that smaller cases have "followed the lead" of big cases and "the result has been a huge increase in motions to sell substantial parts (or all) of the estate under § 363(b) prior to plan confirmation").

12. For a recent example, see Erik Larson, *Journal Register Approved to Sell Assets in Bankruptcy Court*, BLOOMBERG (Mar. 21, 2013, 5:23 PM), http://www.bloomberg.com/news/2013-03-21/journal-register-approved-to-sell-assets-in-bankruptcy-court-1-.html.

fact of a melting ice cube does not justify exploitation of the resulting transactional leverage to disadvantage other claimants. It is, therefore, crucial to distinguish a case in which the court and claimants have good information about the company's value and the costs of delay, from a case in which sale proponents[13] are seeking to exploit information asymmetries and crisis-created leverage to strong-arm a deal that opportunistically appropriates value.[14]

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." The melting ice cube argument is, thus, a tool that can be used to lock-in or strong-arm a particular deal.[15] In this regard, we join a number of corporate and bankruptcy scholars who have raised concerns about management-sponsored corporate sales, in which parties with leverage cement a favored deal through devices such as lock-up agreements, topping fees, bidder protections, or breakup fees.[16]

13. The debtor-in-possession (a term the Code uses for a business in Chapter 11 that does not have its management displaced by a trustee) formally proposes the sale. But a 363 sale is unlikely to have momentum and go forward unless other parties—incumbent managers (who may be seeking to preserve their own interests rather than looking out for the best interest of the company), some key creditor constituency, or a secured lender—believes a particular sale to be in its own best interest. The term sale proponent refers to whatever coalition of parties, other than the buyer, supports the sale.

14. The subject of this Article therefore has important resonances with the corporate mergers and acquisitions literature on devices embedded in negotiated sales agreements that deter other bidders. These can come in the form of break-up fees, topping fees, or lock-up agreements. *See, e.g.*, Stephen M. Bainbridge, *Exclusive Merger Agreements and Lock-ups in Negotiated Corporate Acquisitions*, 75 MINN. L. REV. 239, 323-32 (1990); Stephen Fraidin & Jon D. Hanson, *Toward Unlocking Lockups*, 103 YALE L.J. 1739, 1742 (1994); David A. Skeel, Jr., *Lockups and Delaware Venue in Corporate Law and Bankruptcy*, 68 U. CIN. L. REV. 1243, 1245, 1247 (2000); Robert Daines & Jon D. Hanson, *The Corporate Law Paradox: The Case for Restructuring Corporate Law*, 102 YALE L.J. 577, 594 (1992) (reviewing FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE CORPORATE LAW PARADOX: THE CASE FOR RESTRUCTURING CORPORATE LAW (1991)).

15. *See supra* note 14 (noting resonances with the corporate literature on lock-ups); *infra* Subsection III.C.5 (comparing the "melting ice cube" argument with other lock-up related proposals).

16. Anthony J. Casey, *The Creditors' Bargain and Option-Preservation Priority in Chapter 11*, 78 U. CHI. L. REV. 759, 787 (2011); Fraidin & Hanson, *supra* note 14; Daines & Hanson, *supra* note 14.

As currently applied, the Code and case law are inadequate to address the challenges posed by expedited all-asset sales. Section 363(b) of the Code provides, in relevant part, that the debtor may sell property of the estate "other than in the ordinary course of business" with court approval after "notice and hearing."[17] This language applies equally to sales of a single company car as it does to the sale of an entire car company. The Code provides no substantive guidance or remedial nuance to enable the court or creditors to sort between positive and negative value sales, or to determine when delaying the sale would be beneficial to the estate.[18]

The leading decision in the Second Circuit, *Lionel*, overturned a bankruptcy court order approving the sale of stock in a subsidiary because the debtor-in-possession proffered no "business justification" for short-circuiting the Chapter 11 plan process.[19] Yet, the *Lionel* standard has evolved to provide a blueprint for hurry-up sale motions.[20] Under current practice, if the sale proponent offers a plausible business justification, the court can (and, we believe, usually does) approve it.[21] Some courts have issued guidelines or local rules of procedure to put more flesh onto the sale review process.[22] Sales sometimes do not go forward due to other challenges. But when a proposed sale is presented as a unique, time-limited opportunity, judges understandably are reluctant to stand in the way. If delay risks destroying millions of dollars in value, that is a high price to pay for process.[23] Those pushing the quick sale can thus exploit this Hobson's choice to their advantage.

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17. 11 U.S.C. § 363(b) (2012).

18. *See infra* Section I.A.

19. Comm. of Equity Sec. Holders v. Lionel Corp. (*In re* Lionel), 722 F.2d 1063, 1070-72 (2d Cir. 1983).

20. *See infra* Section I.A; *see also* LoPucki & Doherty, *supra* note 5, at 12-13 (discussing courts' requirements for § 363 approval in the context of competitive pressures on bankruptcy courts).

21. Stephanie Ben-Ishai & Stephen J. Lubben, *Sales or Plans: A Comparative Account of the "New" Corporate Reorganization*, 56 MCGILL L.J. 591, 621 (2011) (asserting that the risks associated with manipulating the bankruptcy process are now "more extreme in the United States because courts will now allow a section 363 sale to replace a plan in almost every case"). For examples of rejected sale motions, see *infra* note 74.

22. *See, e.g.*, *In re* Adoption of Amended Guidelines for the Conduct of Asset Sales, General Order Amending M-331, M-383 (Bankr. S.D.N.Y. Nov. 18, 2009); *see also infra* note 253 (citing guidelines and local rules of procedure).

23. *See In re* Gen. Motors Corp., 407 B.R. 463, 493 (Bankr. S.D.N.Y. 2009) (discussing the reluctance of the bankruptcy court to play "Russian Roulette" in the GM case).

Recent empirical work by Lynn LoPucki and Joseph Doherty suggests that this concern is not merely theoretical. After finding that 363 sales yielded a substantially lower percentage of book value than reorganizations in large public company bankruptcies, they concluded that quick all-asset sales were working to the benefit of purchasers (and senior creditors), but to the detriment of other claimants and the bankruptcy estate.[24] Other commentators have interpreted LoPucki and Doherty's results as showing that § 363 allows senior secured creditors to push for "inefficient fire sale[s]."[25]

Chrysler notwithstanding, in recent years, senior secured creditors have more typically played a significant, if not dominant, role in the decision to pursue a 363 sale.[26] Frequently, the secured creditor asserts a first-priority lien on all of the company's assets and further asserts that the company is worth less than the amount of its claims.[27] If other claimants are deeply under water, why should they have anything to say about the sale's timing and terms?

We see several reasons. First, a so-called blanket lien may not be comprehensive due to creditor error, gaps in the scope of statutory schemes, and value that is not lienable at all or not traceable to the lender's collateral.[28] Second, it is not obvious that the secured creditor is entitled to the firm's reorganization premium or the speed premium allegedly created by a quick sale.[29] Early all-asset sales also foreclose any hope for junior claim or interest

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24. LoPucki & Doherty, *supra* note 5, at 44-45.

25. *See, e.g.*, Casey, *supra* note 16, at 761. For critiques of *Bankruptcy Fire Sales* and responses, see *infra* note 271 and accompanying text.

26. *See, e.g.*, Casey, *supra* note 16, at 760-61, 782. Opponents of the Chrysler sale complained it was being used to transfer value to employees at the expense of secured creditors. *See infra* Section I.B. This assertion is atypical for 363 sales. *See* Richard M. Hynes, *Reorganization as Redemption*, 6 VA. L. & BUS. REV. 183, 199 (2011) (discussing why senior creditors usually support quick sales). A more typical objection is that the sale reallocates value to secured lenders at the expense of unsecured claimants. This concern loomed large in the so-called "gifting" cases where undersecured senior creditors sought to reallocate sales proceeds to specific unsecured creditors in order to procure their support for the sale. *See, e.g.*, *In re* DBSD N. Am., Inc., 634 F.3d 79 (2d Cir. 2011).

27. *See* Kenneth M. Ayotte & Edward R. Morrison, *Creditor Control and Conflict in Chapter 11*, 1 J. LEGAL ANALYSIS 511, 513-14 (2009); *infra* note 195; *cf.* Randall Klein & Danielle Juhle, *Majority Rules: Non-Cash Bids and the Reorganization Sale*, 84 AM. BANKR. L.J. 297, 298 (2010) (discussing how senior secured creditors must decide whether to assert liens on the company's collateral).

28. *See infra* Subsection II.C.2.b.

29. *See infra* Subsection II.C.2.b. Baird and Jackson argued that a secured creditor should be able to bargain for its security interest to include the going-concern (or enterprise) value of

holders that the assets will increase in value during the case, either by waiting to sell at a later date, or by reorganizing the business. This reorganization option has monetary value, and therefore should be considered when analyzing the costs of a quick sale.[30] All-asset sales outside a Chapter 11 plan constitute a realization on the debtor's assets, foreclosing the reorganization option, and transferring any upside to the purchaser.[31] These points undercut the argument that a senior secured creditor should be treated functionally as a sole owner of a bankrupt firm for governance purposes.[32]

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the debtor, although they did not assert that this view reflected the law at the time of their publication:

> Thus, we believe, a secured creditor with a security interest in specific "hard" assets should be treated as having a claim to the asset's liquidation value. Its secured claim should reach no further....
>
> This conclusion, however, does not undercut the idea that a creditor should be able to bargain for a priority interest in the going-concern surplus in priority to other creditors.

Douglas G. Baird & Thomas H. Jackson, *Bargaining After the Fall and the Contours of the Absolute Priority Rule*, 55 U. CHI. L. REV. 738, 782-83 (1988) (footnotes omitted); *see also* Douglas G. Baird & Anthony J. Casey, *No Exit? Withdrawal Rights and the Law of Corporate Reorganizations*, 113 COLUM. L. REV. 1, 17 n.59 (2013) (citing *Bargaining After the Fall* as defending the liquidation value as the creditor's entitlement).

30. Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 N. LaSalle St. P'ship, 526 U.S. 434, 455 (1999) ("The right to get an equity interest for its fair market value is 'property' as the word is ordinarily used. Options to acquire an interest in a firm, even at its market value, trade for a positive price." (quoting DOUGLAS G. BAIRD, THE ELEMENTS OF BANKRUPTCY 261 (rev. ed. 1993))); *see* Stephen J. Lubben, *Real Options and the Other Liquidation Decision* 17-18 (Am. Law & Econ. Ass'n, Working Paper No. 26, 2005), http://law.bepress.com/cgi/viewcontent.cgi?article=1510&context=alea (noting the value of having an option that allows an investor to capture upside potential while avoiding downside risk).

31. For example, in *Lionel*, the debtor ultimately sold the subsidiary at issue for a significant premium over the original proposed sale price. *See infra* Section I.A. While that increase was not guaranteed, in a quick sale the bankruptcy estate would have lost that "option value."

32. Although we often speak, for convenience, of a single secured lender, the credit facility might have been extended by a coalition or syndicate of lenders, especially in larger Chapter 11 cases. *See, e.g.*, Kenneth Daniels & Gabriel G. Ramirez, *Information, Credit Risk, Lender Specialization and Loan Pricing: Evidence from the DIP Financing Market*, 34 J. FIN. SERVICES RES. 35, 45 & tbl.2 (2008) (reporting on the frequency of syndicated debtor-in-possession loans in its sample of bankruptcy cases, and finding that "about 69% of the DIP loans to small firms are syndicated in contrast to 84% and 91% syndication rate for loans to medium and large firms, respectively"); Klein & Juhle, *supra* note 27, at 313 (noting the proliferation of both syndicated and non-syndicated senior secured debt facilities). As explained further *infra* note 255, while there might be disagreements within the syndicate about the best course of action for the debtor, this does not affect the syndicate members' rights or incentives vis-à-vis the debtor.

The recent literature on 363 sales has been polarized, especially after *Chrysler*. Some critics have focused on speed and failure to expose the proposed deal to the market.[33] Others have argued that the Chrysler sale was inconsistent with existing bankruptcy law.[34] Stephen Lubben, by contrast, has contended that Chrysler's bankruptcy was "no big deal"; hurry-up all-asset sales have gone on for years, after all.[35] We take a different approach. We acknowledge that all-asset 363 sales are not new. In some cases, full-blown process must give way to the need for speed. Flexibility, however, creates opportunities for abuse. The difficulty is devising a mechanism to permit quick sales that are beneficial, while discouraging their opportunistic use.

Our proposal – the Ice Cube Bond – preserves not only the finality of sale, but also the possibility of ex post judicial factfinding and negotiation about valuation and entitlements. We propose a mandatory holdback of a portion of 363 sale proceeds to allow later resolution of disputes about value and priority. The holdback would not be required for sales conducted pursuant to a Chapter 11 plan. The reserved funds would be retained by the bankruptcy estate and distributed as unencumbered funds unless the claimant could show that (1) the estate had not been harmed by the procedural shortcut (e.g., that the ice cube was indeed melting), and (2) it was entitled to the reserved funds as proceeds of its collateral or under applicable priority rules. The Ice Cube Bond does not

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33. Barry E. Adler, *A Reassessment of Bankruptcy Reorganization after* Chrysler *and* General Motors, 18 AM. BANKR. INST. L. REV. 305 (2010); Roe & Skeel, *supra* note 2.

34. Ralph Brubaker & Charles Jordan Tabb, *Bankruptcy Reorganizations and the Troubling Legacy of* Chrysler *and* GM, 2010 U. ILL. L. REV. 1375, 1377-79; *see also* Adler, *supra* note 33, at 306 ("[T]he sale in *Chrysler* was . . . inconsistent with the principles that undergird the [Bankruptcy] Code.").

35. Stephen J. Lubben, *No Big Deal: The GM and Chrysler Cases in Context*, 83 AM. BANKR. L.J. 531 (2009); *see also* Daniel J. Bussel & Kenneth N. Klee, *Recalibrating Consent in Bankruptcy*, 83 AM. BANKR. L.J. 663, 666 (2009) (critiquing *GM* and *Chrysler* but acknowledging that they "are only the most extreme examples" of the contemporary practice of displacing Chapter 11 reorganization plans with 363 sales). In the opinion approving the sale order in the *General Motors* case, the bankruptcy court noted,

> While because of the size of this case and the interests at stake, GM's chapter 11 case can hardly be regarded as routine, GM's proposed section 363 sale breaks no new ground. This is exactly the type of situation where under the Second Circuit's many holdings, there is good business reason for an immediate sale. GM does not have the luxury to wait for the ultimate confirmation of a plan, and the only alternative to an immediate sale is liquidation.

In re Gen. Motors Corp., 407 B.R. 463, 493 (Bankr. S.D.N.Y. 2009).

foreclose the possibility of quick sales, but reduces the ability to use the melting ice cube threat to strong-arm a sweetheart deal.

The Ice Cube Bond works by limiting the extent to which sale proponents can externalize the increased valuation risk associated with quick all-asset sales, as well as the extent to which they can use crisis leverage to reallocate value. The Bond does not disturb the finality of the sale, as the sale order would grant the purchaser clear title. However, the reservation of funds shifts at least some of the risk associated with such sales to those who seek to conduct the sale outside of the Chapter 11 plan process, and preserves for later determination, any disputes about perfection or priority. Our approach thus reinforces the separation between governance decisions about value *maximization* from those about value *distribution*, and should help courts sort between sales in which speed is essential, and those in which it is merely tactical.

Conceptually, at least, the Ice Cube Bond is neither unfamiliar nor complicated. Although there might be benefits to statutory implementation, courts could implement the Ice Cube Bond today, either on a case-by-case basis or through local rules or guidelines. Outside of bankruptcy, it is standard practice for federal courts to require that a bond be posted in association with preliminary injunctive relief.[36] Courts already have the power to surcharge a secured creditor's collateral under § 506(c), to compensate the bankruptcy estate for sale expense, as well as the power to preserve disputes about liens and priority, by creating disputed claims reserves.[37]

The Ice Cube Bond also reflects principles common in state foreclosure law. Procedural noncompliance with state foreclosure law can result in the loss of the secured creditor's right to collect a deficiency judgment even if the sale stands.[38] When the melting ice cube argument is used to forgo the protections associated with confirming a Chapter 11 plan, this should be considered a

36. *See infra* Section III.A.

37. *See infra* Section III.A.

38. For personal property foreclosures under the Uniform Commercial Code, a commercially unreasonable sale leads to the loss of the right to collect a deficiency unless the secured party can prove that the improper sale did not depress the purchase price. U.C.C. § 9-626 (2010). For real property, the Restatement rule is that the mortgagee can always reduce the deficiency by proving that the fair market value was greater than the foreclosure price. RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 8.4 (1997). Noncompliance with state law procedures plus even a slightly below-market sale price may cause the sale to be set aside. *Id.* § 8.3 cmt. c, illus. 11; *see infra* Subsection III.B.3.

procedurally aberrational disposition of estate assets.[39] With an Ice Cube Bond, the sale can go forward and be protected against reversal, but release and distribution of the holdback will be determined later.

This Article is divided into three Parts. In Part I, we lay out the doctrinal framework for expedited all-asset sales in bankruptcy under § 363 of the Code. We extend the insight of Baird and Morrison that Chapter 11 cases have an informational sweet spot at which point the parties and court have learned enough about the debtor to make an intelligent decision about the disposition of the assets.[40] We illustrate how the bankruptcy estate currently bears the increased risk of erroneous undervaluation caused by hurry-up sales, thus distorting both governance incentives and normative distributional commitments in the Code. In Part II, we systematically identify benefits and harms of hurry-up all-asset sales, and discuss how they should be allocated. In Part III, we explore the Ice Cube Bond's capacity, by setting aside a portion of the sale proceeds, to reallocate the risk associated with expedited sales and preserve the ability of the judge to resolve the *legal* issues raised by the case.

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39. *See, e.g.*, *In re* Merit Grp., Inc., 464 B.R. 240, 250-51 (Bankr. D.S.C. 2011) (raising concerns that even justifiable speed ends up trumping anticipated Chapter 11 procedures); *In re* Cloverleaf Enters., No. 09-20056, 2010 WL 1445487, at *2 (Bankr. D. Md. Apr. 2, 2010) ("Sales of substantially all of a debtor's assets are authorized under 11 U.S.C. § 363(b)(1) of the Bankruptcy Code. However, as the Bankruptcy Code contemplates in chapter 11 that sales of all of a debtor's asset[s] take place under 11 U.S.C. § 1123(b)(4) after disclosure of and balloting on a Plan of Reorganization or Liquidation, sales of all assets outside of a plan in a case under Chapter 11 are extraordinary and should be viewed as an exception to the rule."); *In re* Gulf Coast Oil Corp., 404 B.R. 407, 422 (Bankr. S.D. Tex. 2009) (outlining the existing jurisprudence, including the sale of "crown jewel assets," and noting that it would be very helpful if the Fifth Circuit would take another look at the boundaries of § 363(b) sales); *id.* at 423-24 ("Proposals for quick sales, understood only by a few parties who would benefit from the sale, are inherently suspect."); *id.* at 424 (discussing negotiation and acceptance under a Chapter 11 plan process as the "*quid pro quo* for extraordinary bankruptcy benefits"); *In re* On-Site Sourcing, Inc. 412 B.R. 817, 822 (Bankr. E.D. Va. 2009) (discussing the procedural differences between 363 sales and sales after Chapter 11 plan confirmation); *In re* Channel One Commc'ns, Inc., 117 B.R. 493, 496 (Bankr. E.D. Mo. 1990) (discussing the need for heightened scrutiny due to the fact that 363 sales do not incorporate Chapter 11 plan protections). For a discussion of the intended deliberative process for Chapter 11 at the time of and shortly after its enactment, see John C. Anderson & Peter G. Wright, *Liquidating Plans of Reorganization*, 56 AM. BANKR. L.J. 29, 51 (1982); and J. Ronald Trost, *Business Reorganizations Under Chapter 11 of the New Bankruptcy Code*, 34 BUS. L. 1309 (1979).

40. Douglas G. Baird & Edward R. Morrison, *Bankruptcy Decision Making*, 17 J.L. ECON. & ORG. 356 (2001); Edward R. Morrison, *Bankruptcy Decision Making: An Empirical Study of Continuation Bias in Small-Business Bankruptcies*, 50 J.L. & ECON. 381 (2007) (presenting an empirical study modeling the optimal decisionmaking point, and showing an absence of continuation bias in cases filed in the Northern District of Illinois).

The Ice Cube Bond proposal embraces and utilizes a court's ability to serve as an ex post decisionmaker in a variety of contexts that purely market-based proposals cannot. This both simplifies the task of operationalizing the proposal, and allows a healthy agnosticism about which version of the Ice Cube Bond will work best in a particular case.

I. EXPEDITED SALES OF ALL OR SUBSTANTIALLY ALL ASSETS: ARTICULATING THE PROBLEM

A. *The Doctrinal Framework for Chapter 11 Sales*

Firms are permitted to operate—to use and sell their assets—while in Chapter 11 bankruptcy.[41] This power to use and sell property of the bankruptcy estate serves several distinct functions. On the one hand, it permits the debtor to stay in business. Thus, for example, a debtor retailer generally can continue to sell inventory in the ordinary course of business without seeking court permission.[42] On the other hand, it also permits the debtor-in-possession to liquidate by selling assets outside the ordinary course of business, if *that* is the best way to realize on the value of the estate.[43] But sales outside the ordinary course must either be conducted under a confirmed Chapter 11 plan or, with court approval, after notice and a hearing.[44] Since this court supervision arises ex ante, the debtor's business decisions are subject to constraints beyond those of ordinary corporate law.[45] The sales at issue might involve a single asset, such as a corporate car or jet, entire subsidiaries of the debtor, or substantially all of a debtor's assets. A sale may be part of an overall liquidation, or incidental to reorganization. While the stakes of approval or rejection of a sale rise with the centrality of the asset to the debtor's business, the Code provides no more

41. 11 U.S.C. § 1107(a) (2012) (giving a debtor-in-possession the powers of a trustee); *id.* § 1108 (authorizing the debtor's business to operate in Chapter 11 unless the court orders otherwise); *id.* § 363 (setting forth rules about the use, sale, and lease of property of the estate by the trustee).

42. *See id.* § 363(c).

43. *Id.* § 363(b); *see also* Fla. Dep't of Revenue v. Piccadilly Cafeterias, Inc., 554 U.S. 33, 37 n.2 (2008) (describing the 363-sale process).

44. 11 U.S.C. § 363(b).

45. *See* Marshall Huebner & Rajesh James, *Duties and Obligations of Officers and Directors in §363 Sales*, AM. BANKR. INST. J., Dec. 2009-Jan. 2010, at 36 (discussing operationalizing the obligation to maximize the value of the bankruptcy estate).

specific guidance for a going-concern sale than it does for the sale of a spare pizza oven.[46] Section 363 is a provision of general applicability to all kinds of bankruptcies, untailored to specific types of cases and circumstances.[47]

Out of this generality has emerged flexibility. Compared to state foreclosure law, bankruptcy is a congenial place to sell assets. In any kind of bankruptcy case, the court has the power to approve sales of assets free and clear of liens and encumbrances.[48] The asserted liens and priority claims are simply shifted to the sale proceeds.[49] Thus, the assets can be sold in bundles that are calculated to maximize value, even if multiple liens and lenders have

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46. *See generally* Kenneth N. Klee & Richard Levin, *Rethinking Chapter 11*, 21 NORTON J. BANKR. L. & PRAC. 1, 12 (2012) (discussing the lack of guidance in § 363). Current § 363(b) provides that the debtor may sell property of the estate "outside of the ordinary course of business" with court approval after "notice and hearing." 11 U.S.C. § 363(b). Federal Rule of Bankruptcy Procedure 6003(b) provides that a motion to sell property of the estate cannot be approved within the first twenty-one days after the filing of a bankruptcy petition unless necessary to avoid immediate and irreparable harm. FED. R. BANKR. P. 6003(b). Federal Rule of Bankruptcy Procedure 6004 governs motions for sale of property more generally. For example, subsection (a) cross-references the rules that stipulate the notice requirements, while subsection (f) provides that sales outside the ordinary course of business may be by private sale or by public auction. *Id.* R. 6004. Districts provide local rules of procedure or guidelines to supplement the federal rules.

47. Section 363 governs a trustee's or debtor-in-possession's use, sale, and lease of property of the estate in all chapters of the Code. The provision distinguishes between actions that are, or are not, in the ordinary course of business, *see* 11 U.S.C. § 363(b)-(c), and its applicability also depends on whether the action involves the expenditure of cash collateral, which triggers special protection for secured creditors whose interests encumber that cash collateral, *see id.* § 363(a), (c). Section 363 also entitles secured creditors to seek adequate protection of their interests in other respects, *id.* § 363(e), and gives them the right to credit bid their debt unless the court orders otherwise, *id.* § 363(k).

48. *Id.* §§ 363(b), (f), 1141(c); *In re* Gulf Coast Oil Corp., 404 B.R. 407, 424, 427 (Bankr. S.D. Tex. 2009) (comparing the benefits of a bankruptcy sale, including cleaner title, to state law sale); AM. BANKR. INST., A COMPARISON SHOPPING GUIDE FOR 363 SALES § 2.3.2 (Jonathan P. Friedland ed., 2009) [hereinafter "COMPARISON SHOPPING GUIDE"] (discussing the opportunity for cleaner title in bankruptcy than in state law sales, and the circumstances under which future claimants might try to sue the purchaser and ways to reduce this risk). For the confusion that otherwise ensues over the potential liability of asset purchasers under state law, see John H. Matheson, *Successor Liability*, 96 MINN. L. REV. 371 (2011) (proposing a federal successor liability statute). *But see* Michael Busenkell & Ryan Cicoski, *At the Intersection of Successor Liability and the Bankruptcy Code*, AM. BANKR. INST. J., Mar. 2012, at 22 (discussing a recent South Carolina state supreme court decision that refused to enforce a bankruptcy court order approving a 363 sale free and clear of all claims and interests arising before the sale).

49. 11 U.S.C. § 363(f).

claims against the property, while saving any bickering over distribution for later.[50] The power to transfer clean title backed by a federal court sale or plan confirmation order is considerably more attractive than the quitclaim deed one generally gets following a state law foreclosure sale.[51] Moreover, by design, challenging a bankruptcy court's confirmed sale order is very difficult; absent a showing of bad faith, even a successful appeal of a sale order will not result in reversal of the sale.[52] Due to the design of the statute as well as the overall

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50. *See, e.g.*, *In re* Motors Liquidation Co., 482 B.R. 485, 487-88 (Bankr. S.D.N.Y. 2012) (describing the process of reserving proceeds in an escrow account pending a dispute over the extent of lenders' rights); *In re* Taneja, No. 08-13293-SSM, 2011 WL 1045286, at *4 (Bankr. E.D. Va. Mar. 16, 2011) (vacating a portion of the sale order directing payment of proceeds to a specific party, and requiring that the proceeds of the sale be available pending the resolution of adversary proceedings about the validity of the lien); *In re* Bos. Generating, LLC, 440 B.R. 302, 335 (Bankr. S.D.N.Y. 2010) (instructing debtors to establish a reserve funded from proceeds pending further agreement or resolution); *In re* Balco Equities Ltd., 323 B.R. 85, 100 (Bankr. S.D.N.Y. 2005) (authorizing a sale and stating that funds will be held in escrow pending the outcome of the specific adversary proceeding); *In re* Surplus Furniture Liquidators, Inc., 199 B.R. 136, 145 (Bankr. M.D.N.C. 1995) (approving a sale free and clear under § 363(f)(4) and providing that the contested lien will attach to the proceeds of the sale pending resolution).

51. Section 1141 makes clear that a confirmed plan vests the assets free and clear of existing claims. 11 U.S.C. § 1141. Section 363(f) provides that property may be sold free and clear of any interest if one of several requirements is satisfied, but does not explicitly speak of sales free and clear of "claims." *Id.* § 363(f). Yet, the leading circuit decisions on the matter have concluded that the provision also applies to creditors' claims, cutting off successor liability. *See, e.g.*, *In re* Trans World Airlines, 322 F.3d 283 (3d Cir. 2003); *In re* Leckie Smokeless Coal Co., 99 F.3d 573 (4th Cir. 1996); George W. Kuney, *Misinterpreting Bankruptcy Code Section 363(f) and Undermining the Chapter 11 Process*, 76 AM. BANKR. L.J. 235, 267 (2002) (describing dominant case law as being "363(f) can be used to sell property free and clear of claims that could otherwise" be asserted under state law theories of successor liability, and criticizing this interpretation); Harvey R. Miller & Shai Y. Waisman, *Is Chapter 11 Bankrupt?*, 47 B.C. L. REV. 129, 156 (2005) (discussing the attractiveness of bankruptcy sales due in part to their "unique ability to cleanse the assets of a distressed company" by "remov[ing] the uncertainty of successor liability, fraudulent transfer claims, and lien issues"). The range of claims that courts have held can be cut off goes beyond those of private claimants. *See, e.g.*, *In re* WBQ P'ship, 189 B.R. 97, 99 (Bankr. E.D. Va. 1995) (holding a 363 sale of a nursing home free and clear of claims of the Virginia Department of Medical Assistance Services); Stephanie Ben-Ishai & Stephen J. Lubben, *Involuntary Creditors and Corporate Bankruptcy*, 45 U.B.C. L. REV. 253, 255 (2012) (discussing the use of bankruptcy sales to "cleanse" assets of environmental liabilities). Section 363 sales are also thought to bring more value than tax sales. *See, e.g.*, *In re* Strategic Labor, Inc., 467 B.R. 11, 19 (Bankr. D. Mass. 2012).

52. 11 U.S.C. § 363(m); *In re* Westpoint Stevens, Inc., 600 F.3d 231, 248 (2d Cir. 2010) (interpreting § 363(m) as a limit on the jurisdiction of the court of appeals to review sales beyond challenges relating to the good faith finding, noting the importance of sale finality, and that other circuits have held similarly). It also is difficult to unwind a Chapter 11 plan

direction of case law on sales free and clear, these benefits are available for sales under § 363, as well as sales under a liquidating Chapter 11 plan. Due to this ability to quiet and convey title in complex assets, bankruptcy courts have become favored locations for selling business units or whole companies.

Although the Code drafters contemplated that going-concern sales could be conducted through Chapter 11 plans,[53] such sales now often occur under § 363 instead.[54] The well-known *Lionel* case provides the standard typically applied to significant sales of assets through § 363 in Chapter 11 cases. Instead of the "business judgment" standard typical for less significant sales, the debtor must present a "business justification." In *Lionel*, the debtor, with the support of the creditors' committee, sought approval of a sale of its majority stock holding in a subsidiary.[55] The debtor and the creditors' committee wanted that sale to occur prior to completion of the plan confirmation process.[56] The SEC filed an objection, and the shareholders, represented by an equity committee, appealed the court's order.[57]

The Second Circuit reversed the lower court's approval of the sale because the creditors' committee's insistence was the only reason given for accelerating the sale of the subsidiary—not a sufficient justification for a sale outside a

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confirmation order absent a stay pending appeal. *See In re* Charter Commc'ns, Inc. 691 F.3d 476 (2d Cir. 2012) (explaining and applying the doctrine of equitable mootness).

53. 11 U.S.C. § 1123(b)(4); *see also supra* note 39 (listing cases that discuss differences between 363 sales and sales through Chapter 11 plans).

54. ROBERT E. GINSBERG, ROBERT D. MARTIN & SUSAN V. KELLEY, GINSBERG & MARTIN ON BANKRUPTCY § 5.05 (2013) (explaining that 363 "sales have become the norm, and include sophisticated technologies to allow potential buyers to perform due diligence and a standardized procedure for approving the sale procedures and conducting the sale"); Bussel & Klee, *supra* note 35, at 730-31 (comparing the early days of the 1978 Bankruptcy Code, when substantial 363 sales were "exceptional situations," to today, when they are more common); Lubben, *supra* note 35, at 532 (noting that "quick lender-controlled § 363 sale[s] . . . are entirely within the mainstream of chapter 11 practice for the last decade"). One hundred and fifty large public company Chapter 11 cases filed between 1978 and 2012 included 363 sales of substantially all assets. This figure is based on the UCLA-LoPucki Bankruptcy Research Database. *See UCLA-LoPucki Bankruptcy Research Database*, UCLA SCH. L., http://lopucki.law.ucla.edu (last visited Sept. 3, 2013). A list of nearly seventy all-asset 363 sales of large public companies from 1980-2003, with filing-to-sale times, can be found in LYNN M. LOPUCKI, COURTING FAILURE 170-71 tbl.11 (2005). As noted in 2007, "[i]n the 1990s, section 363 sales of large public companies grew from a trickle to a flood." LoPucki & Doherty, *supra* note 5, at 14.

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

56. *See id.* at 1065.

57. *Id.* at 1065-66.

Chapter 11 plan. The panel majority set forth a standard that future courts would invoke frequently: approval of sales of significant assets outside of a Chapter 11 plan did not require an emergency, but did require a good *business* justification.[58] The court admonished that "a bankruptcy judge must not blindly follow the hue and cry of the most vocal special interest groups; rather, he should consider all salient factors pertaining to the proceeding and, accordingly, act to further the diverse interests of the debtor, creditors and equity holders, alike."[59] One hallmark of the *Lionel* majority opinion, which other courts note, is that courts need flexibility to do what is best under the circumstances.[60]

Lionel also illustrates the valuation risk associated with all-asset sales outside a plan, as well as the value of the reorganization option. In dissent, Judge Winter argued that the objection to the sale was a last-ditch effort by out-of-the-money equity holders to get some value out of this case, and that the majority's ruling would be costly for Lionel's creditors.[61] In this case, though, the asset did not waste away: when the debtor later sold the subsidiary's stock, albeit two years later, the sale generated a price fifty-four percent higher than the bid that resulted in the earlier appeal.[62]

One might expect modern citations to *Lionel* to support courts' and creditors' concerns about quick going-concern sales outside of a Chapter 11 plan. Recent cases tend to involve assets far more difficult to value than a profitable subsidiary, and tend to be requested earlier in the case. In *Lionel*, the

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58. *Id.* at 1071.

59. *Id.* The majority decision specified factors that subsequent cases note regularly, including the time elapsed since the bankruptcy filing, the likelihood of a successful Chapter 11 plan in the near future, and the predicted valuation stability of the assets for which sale is proposed. *Id.*

60. *See, e.g.*, *In re* Fin. News Network, 980 F.2d 165, 169 (2d Cir. 1992) (citing *Lionel*, 722 F.2d at 1069); *In re* Bos. Generating, 440 B.R. 302, 321-22 (Bankr. S.D.N.Y. 2010) (identifying factors to consider based on *Lionel* and more recent cases).

61. *Lionel*, 722 F.2d at 1072 (Winter, J., dissenting); *see* Douglas G. Baird & Donald S. Bernstein, *Absolute Priority, Valuation Uncertainty, and the Reorganization Bargain*, 115 YALE L.J. 1930, 1932 (2006) (discussing how today's bankruptcy judges are unlikely to let junior interests "play for time"); *id.* at 1944 n.36 (noting the efforts by out-of-the-money creditors to seek to delay a sale to shift distribution).

62. The initial price was $50 million. *Lionel Corp. to Sell 82% Stake in Dale*, N.Y. TIMES, Sept. 27, 1983, http://www.nytimes.com/1983/09/27/business/lionel-corp-to-sell-82-stake-in-dale.html. Two years later, after an auction process, the same stock sold for $76.9 million. Reuters, *Lionel-Dale Pact*, N.Y. TIMES, Sept. 20, 1985, http://www.nytimes.com/1985/09/20/business/lionel-dale-pact.html.

debtor moved for the sale well over a year after the initiation of bankruptcy. But today, it is common for debtors to enter bankruptcy announcing an intended going-concern sale,[63] and to file a sale motion within hours, days, or weeks of filing. Looking across the largest public company Chapter 11 cases involving 363 sales since the Code became effective in October 1979, the median time between filing and final sale approval is 110 days.[64] Roughly a quarter of all such cases have sales approved in sixty days or fewer, and approximately ten percent have sales confirmed within forty-two days.[65] Focusing on cases since 2000, the median time from filing to substantial 363 sale drops by around two weeks.[66] Although similar data are not available for smaller and non-public cases, we have no reason to believe those sales move at a more deliberate pace, and, indeed, suspect they are prone to move more quickly, especially if the firm has severe liquidity constraints. For example, in a

63. *See, e.g.*, *In re* On-Site Sourcing, Inc., 412 B.R. 817, 819 (Bankr. E.D. Va. 2009) (filing a sale motion five hours after filing Chapter 11 petition); Motion for Interim and Final Orders at 3, *In re* Oreck Corp., No. 13-04006, 2013 WL 2242408 (Bankr. M.D. Tenn.) (describing an intended going-concern sale the day the Chapter 11 filing was made); Steven Church & Phil Milford, *Zacky Farms Files Bankruptcy, Cites Cost of Poultry Feed*, BLOOMBERG (Oct. 9, 2012, 4:33 PM), http://www.bloomberg.com/news/2012-10-09/zacky-farms-files-bankruptcy-cites-cost-of-poultry-feed.html (reporting on debtor-in-possession financing contingent on commencing going-concern sale process immediately); Katy Stech, *International Media Group Files for Bankruptcy to Sell Stations*, DOW JONES DBR SMALL CAP 2 (Jan. 11, 2012), http://turnaroundunderground.com/wp-content/uploads/2012/01/ShoreBankHolding.pdf ("International Media Group Inc. filed for bankruptcy protection to sell its multilingual television stations that broadcast throughout California and Hawaii."); Katy Stech, *Vacuum Maker Oreck Files for Bankruptcy*, WALL ST. J., May 7, 2013, http://online.wsj.com/news/articles/SB10001424127887323826804578469373481951496 (describing Oreck's simultaneous filings of a bankruptcy case and announcement of "plans to sell its operations . . . at a bankruptcy auction that the company could hold within weeks"); *Update 1 – Northstar Aerospace Seeks Creditor Protection*, REUTERS (June 14, 2012), http://www.reuters.com/assets/print?aid=USL3E8HE6Z220120614 (describing the debtor's announcement, on the same day it filed for Chapter 11 protection, that "it ha[d] entered into a 'stalking horse' agreement with Wynnchurch Capital Ltd to sell its assets").

64. *UCLA-LoPucki Bankruptcy Research Database*, UCLA SCH. L., http://lopucki.law.ucla.edu (last visited Sept. 3, 2013). As of April 2013, 150 cases met the 363-sale criteria in the UCLA-LoPucki Database. Eighteen were missing the date of the sale.

65. *Id.* Of the 150 363-sale cases in the dataset, 125 were filed in 2000 or later.

66. *Id.*; *see* FED. R. BANKR. P. 6003 (prohibiting courts from approving 363 sales in the first twenty-one days of a bankruptcy case unless relief is necessary to prevent immediate and irreparable harm); Jonathan M. Landers, *The Changing Face of Chapter 11 for Large Operating Businesses*, 8 PRATT'S J. BANKR. L. 99, 111-12 (2012) (discussing the quick-sale trend). Parties also are entitled to twenty-one days' notice of a motion for such a sale, although the period may be shortened for cause. FED. R. BANKR. P. 2002(a)(2).

sample of sixty asset sales, spanning a range of sizes, collected by the American Bankruptcy Institute, about forty-two percent of the sale transactions were approved within twenty-one to ninety-eight days after the filing.[67] One can read these results as suggesting that the *Lionel* standard has evolved to provide a blueprint for the successful motion for a quick sale of assets of all kinds.

In this regard, the facts of *Lionel* and the fate of its legal holding encapsulate a central concern that motivates this Article. As an empirical matter, we fear the melting ice cube metaphor is overused, and suspect that, in a relevant number of these cases, allowing additional time to price the assets and to evaluate potential deals would not impair the value.[68] In *Lionel*, the Second Circuit decision essentially called the creditors' committee's bluff, and the delay resulted in a larger distribution to stakeholders.[69] *Lionel*'s legal standard, however, is usually cited, discussed, and applied in written decisions for precisely the opposite proposition: to justify the approval, not the denial, of a sale motion.[70]

The written opinions in *Chrysler* and scores of other cases cite *Lionel* for the proposition that quick sales of substantial assets are fine so long as the debtor articulates a good business justification. Many sources, including the Second Circuit opinion upholding the Chrysler sale, have cited *Lionel* while observing

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67. COMPARISON SHOPPING GUIDE, *supra* note 48, at § 1.4.2 n.21. The sale orders were entered between 2000 and 2008, with transaction purchase prices ranging from $200,000 to $4 billion. *Id.* at 23. These sales may not have been limited to those of all or substantially all assets of the bankruptcy filer, but the book featuring this study is focused on purchasing "distressed businesses," not just discrete assets. *Id.* at 46.

68. In *Lionel*, the advocates of the sale presented no evidence of its need for speed other than that the creditors' committee preferred the sale to go forward preplan. *In re* Lionel Corp., 722 F.2d 1063 (1983). In today's cases, the debtor often makes an affirmative melting ice cube argument. *See* LoPucki & Doherty, *supra* note 5, at 30-31. The question is whether this allegation would hold up to challenge and scrutiny outside the rushed environments of these sale motions, especially to the extent these companies were marketed at a more leisurely pace before bankruptcy.

69. *See supra* note 62.

70. Hundreds of courts, and thousands of commentators, have cited *Lionel*. For a few recent examples of decisions in the Southern District of New York discussing sales under the *Lionel* standard, see *In re GSC, Inc.*, 453 B.R. 132 (Bankr. S.D.N.Y. 2011); *In re Lehman Bros. Holdings, Inc.*, 445 B.R. 143 (Bankr. S.D.N.Y. 2011); *In re Boston Generating*, LLC, 440 B.R. 302 (Bankr. S.D.N.Y. 2010); *In re Motors Liquidation Co.*, 430 B.R. 65 (S.D.N.Y. 2010); and *In re Metaldyne Corp.*, 409 B.R. 671 (Bankr. S.D.N.Y. 2009). *Lionel* is frequently cited outside the Second Circuit as well. *See* Jacob A. Kling, *Rethinking 363 Sales*, 17 STAN. J.L. BUS. & FIN. 258, 272 & n.91 (2012) (observing the broader influence of the *Lionel* standard and citing other circuit court decisions).

the commonplace nature of 363 sales of significant assets outside of a Chapter 11 plan.[71] The Second Circuit's *Chrysler* decision noted the benefits of quick all-asset sales under § 363, including efficiency and the quieting of title through the power to sell free and clear of liens and interests.[72] As a practical matter, Judge Winter's dissent in *Lionel* may have carried the day.

Rejections of sale motions can and do arise when a powerful creditor objects, arguing that the evidence of value, marketing, and business justification are lacking.[73] Few decisions can be found, however, reporting a court's denial of a request to sell all or substantially all assets.[74] Sale orders and

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71. *In re* Chrysler LLC, 576 F.3d 108, 115 (2d Cir. 2009) (collecting secondary sources).

72. *Id.*

73. *See, e.g.*, *In re* Exaeris Inc., 380 B.R. 741, 744 (Bankr. D. Del. 2008) (noting that the "timing, relationship of [the purchaser] to [the debtor], the proposed release of [the purchaser], the dearth of evidence of marketing, the absence of any evidence of the value of assets, no evidence whatsoever about the negotiations between [the purchaser] and Debtor or the [unsecured creditors'] Committee, require the Court to proceed with extreme caution and applying the facts to the legal standards for the Sale mandates that the Court deny the Motion").

74. Recognizing that published decisions are an underinclusive reflection of court activity, we nonetheless searched in Westlaw and Lexis for decisions in which courts rejected proposed sales of all or substantially all assets under § 363(b), which generally arose in contested sale environments. *See, e.g.*, *In re* Cloverleaf Enters., No. 09-20056, 2010 WL 1445487 (Bankr. D. Md. Apr. 2, 2010); *In re* SCO Grp., No. 07-11337, 2009 WL 2425755 (Bankr. D. Del. Aug. 5, 2009); *In re* Gulf Coast Oil Corp., 404 B.R. 407 (Bankr. S.D. Tex. 2009); *In re* Exaeris, 380 B.R. 741; *In re* Encore Healthcare Assocs., 312 B.R. 52 (Bankr. E.D. Pa. 2004); *In re* Country Manor of Kenton, Inc., 172 B.R. 217 (Bankr. N.D. Ohio 1994); *In re* Stroud Ford, Inc., 163 B.R. 730 (Bankr. M.D. Pa. 1993); *In re* The Landing, 156 B.R. 246 (Bankr. E.D. Mo. 1993); *In re* Plabell Rubber Prods., Inc., 149 B.R. 475 (Bankr. N.D. Ohio 1992); *In re* George Walsh Chevrolet, Inc., 118 B.R. 99 (Bankr. E.D. Mo. 1990); *In re* Sovereign Estates, Ltd., 104 B.R. 702 (Bankr. E.D. Pa. 1989); *In re* Indus. Valley Refrigeration & Air Conditioning Supplies, Inc., 77 B.R. 15 (Bankr. E.D. Pa. 1987); *In re* Fremont Battery Co., 73 B.R. 277 (Bankr. N.D. Ohio 1987); *In re* Crutcher Res. Corp., No. 486-42209, 1986 LEXIS 4681 (Bankr. N.D. Tex. Dec. 31, 1986). In some other cases, courts have approved sales only after requiring changes in the terms of the sale order that went beyond what the law would allow. *See, e.g.*, *In re* On-Site Sourcing, Inc., 412 B.R. 817, 829-30 (Bankr. E.D. Va. 2009).

Sales are probably more likely to be rejected in response to a dispute over whether the sale can be ordered free and clear of an existing interest. *See, e.g.*, *In re* CDKP Dev., Inc., No. 12-06871-8-RDD, 2012 WL 5993219 (Bankr. E.D.N.C. Nov. 30, 2012); *In re* Dewey Ranch Hockey, LLC, 406 B.R. 30 (Bankr. D. Ariz. 2009). For additional cites, see Matthew A. Bruckner, *Improving Bankruptcy Sales by Raising the Bar: Imposing a Preliminary Injunction Standard for Objections to § 363 Sales*, 62 CATH. U. L. REV. 1, 12-13, 25 (2012). Bruckner joins us in noting that a request for a quick sale is a request for preliminary relief, akin to seeking a preliminary injunction. He argues that, as such, a quick sale motion should be handled in denials—like much activity in bankruptcy cases—do not necessarily result in searchable written decisions. Nonetheless, the brevity of this citation list is consistent with the conventional wisdom that denials of motions to sell assets are rare, particularly when no powerful creditor objects.[75] To the contrary, many contemporary 363 sales are driven by a prepetition secured creditor who provides only enough postpetition financing to achieve a quick sale.[76] Lawyer Michael Richman has been quoted as saying that lenders want to keep distressed debtors on a "short leash" and "requir[e] that a sale . . . happen [quickly]."[77] Moreover, creditors who initially object to a sale might ultimately decide not to pursue such objections, leaving a concerned court without the

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an adversary proceeding rather than as a contested matter, and be subjected to the Posner/Leubsdorf standard for granting preliminary relief. *Id.* at 6 (citing Am. Hosp. Supply Corp. v. Hosp. Prods. Ltd., 780 F.2d 589 (7th Cir. 1986)); *see also* John Leubsdorf, *The Standard for Preliminary Injunctions*, 91 HARV. L. REV. 525, 541-44 (1978) (describing the standard and its rationale). In his view, an injunction should only be granted if the value of the quick sale exceeds the increased error cost. We see Bruckner as being on the right track, but his proposals have a number of important flaws. First, his approach does not address the informational asymmetries that exist early in the case or limit the effect of melting ice cube leverage. Second, in our view, courts already attempt to apply something akin to the Posner/Leubsdorf standard through the requirement that the quick sale be in the best interest of the estate. Third, opening an adversary proceeding will require the imposition of the strictures of the rules in the 7000 portion of the Federal Rules of Bankruptcy Procedure, which may limit the ability to move quickly in the cases in which the business really is a melting ice cube. FED R. BANKR. P. 7001-87 (rules applicable to adversary proceedings).

75. LoPucki & Doherty, *supra* note 5, at 40 ("[W]e know of no modern case in which a large public company debtor proposed a sale and the court refused to approve it."); *see also* David A. Skeel, Jr., *Competing Narratives in Corporate Bankruptcy: Debtor in Control vs. No Time to Spare*, 2009 MICH. ST. L. REV. 1187, 1199 (discussing how the "no time to spare" narrative and talk of melting ice cubes make "second guessing unthinkable").

76. *See* George W. Kuney, *Hijacking Chapter 11*, 21 EMORY BANKR. DEV. J. 19, 108-09 (2004); Lubben, *supra* note 35, at 535.

77. Diane Davis, *Business Bankruptcy Filing Trends to Remain Same in 2011, Restructuring Experts Say*, BNA Bankr. L. Rep., Dec. 8, 2010, ISSN 1522-5313; Jacqueline Palank, *Firms in Chapter 11 Face Fast Trip to Auction Block*, WALL ST. J., Jan. 14, 2013, http://online.wsj.com/article/SB10001424127887324595704578239501613326288.html (stating that "[m]ore companies that wind up in bankruptcy court are facing a stark demand from their banks: Sell yourself now" and offering specific examples of quick sales tied to pressure from prepetition secured lenders); *see also* Ben-Ishai & Lubben, *supra* note 21, at 596, 598, 622-23 (discussing concerns about the effects of lender-driven 363 sales); Landers, *supra* note 66, at 107, 112-13 (discussing the role of lenders); Lubben, *supra* note 35, at 535 (also discussing the role of lenders); Skeel, *supra* note 75, at 1200 (commenting that "[b]ankruptcy judges have usually insisted on bidding rules that allow several weeks, and often more, for the debtor to advertise the sale, look for other bidders, and perhaps negotiate a higher price," but that sale proponents implore judges to move things along more quickly).

optimal adversarial presentation of the issues.[78] Even if the judge or creditors suspect the purchaser is underpaying, or that someone is taking advantage of a melting ice cube argument, they do not, under current practice, have a workable mechanism for preserving the economic status quo while developing the facts.

B. Chrysler *and the Problem of Melting Ice Cube Leverage*

While post-*Lionel* practice has evolved over three decades, the Chrysler bankruptcy placed the *Lionel* court's concern about valuation in high relief, and raised a new concern—distribution. With regard to valuation, critics complained that the sale happened too quickly to determine asset values with confidence. To these observers, the speed of the sale signified insufficient exposure to the market to determine whether other purchasers might be willing to pay more.[79] Concerns about distribution in *Chrysler* were also closely related to the leverage created by the melting ice cube argument. That leverage, it was argued, allowed the U.S. government to dictate the manner in which the funds were distributed, short circuiting the protections of the Chapter 11 plan process, and allegedly violating the rights of secured bondholders.[80] Secured bondholders were receiving a smaller percentage distribution on their claims than employees who held unsecured pension claims, an apparent violation of normal priority principles. If secured creditors with liens on all assets were not

78. *See infra* notes 96-102 and accompanying text. Ben-Ishai and Lubben suggest that potential objectors may refrain from objecting in response to side payments from the debtor or the purchaser. Ben-Ishai & Lubben, *supra* note 21, at 621-22; *see also In re* On-Site Sourcing, Inc., 412 B.R. 817, 827-28 (Bankr. E.D. Va. 2009) (criticizing a proposed dedicated trust from 363-sale proceeds for unsecured creditors used to pave the way for a quick sale approval by eliminating a creditor committee objection).

79. *See, e.g.*, Adler, *supra* note 33, at 307-08 (arguing that the sale procedures did not maximize price or promote competitive bidding). The court noted, however, that Chrysler's owners had been trying to sell the company for over a year before the firm filed for bankruptcy. *In re* Chrysler LLC, 405 B.R. 84, 90 (Bankr. S.D.N.Y. 2009).

80. *In re* Chrysler LLC, 576 F.3d 108, 120 (2d Cir. 2009), *vacated sub nom.* Ind. State Police Pension Trust v. Chrysler LLC, 558 U.S. 1087 (2009) ("[T]he Indiana Pensioners argue . . . that the majority lenders were intimidated or bullied into approving the Sale in order to preserve or enhance relations with the government, or other players in the transaction. . . . The Pensioners argue that this renders the lenders' consent ineffective or infirm.").

paid in full, it was asked, how could a class of unsecured creditors receive a distribution at all, let alone a greater percentage payout?[81]

Extraordinary government intervention explains a lot. The U.S. Treasury pumped vast amounts of money into the *Chrysler* case—with seemingly little regard to the value of the assets—and sought to dictate where the money went. One can conceptualize two distinct transactions: (1) a purchase of Chrysler's assets, and (2) a (choose one:) payout, bailout, or buyoff to the (choose one:) employees, organized labor, or employee benefit plans to handle the company's unfunded pension liability. Under §§ 1113 and 1114 of the Code, Chrysler could not unilaterally modify those plans without either consent, or compliance with an involved, statutorily mandated, bargaining process.[82] In other words, part of the government financial contribution to facilitate a sale of Chrysler may not have been a payment for the assets at all, but a decision by the Treasury Department to use TARP funds to cover a portion of Chrysler's unfunded pension liability with New Chrysler stock, and thereby secure the necessary union support.[83]

The bankruptcy court appears to have recognized this when it found the liquidation value of the secured lenders' collateral was $800 million,[84] making the $2.2 billion paid to the secured bondholders more than adequate compensation for the value of their claims. Indeed, the agent of the bondholders consented to this distribution after a majority of secured bondholders agreed.[85] Thus, to the extent that the government offered payment to purchase labor peace and to ensure continued operation as a going concern, it is hard to characterize those funds as proceeds of the bondholders'

81. Todd Zywicki, *Chrysler and the Rule of Law*, WALL ST. J., May 13, 2009, http://online.wsj.com/news/articles/SB124217356836613091.html.

82. 11 U.S.C. §§ 1113, 1114 (2012) (providing special rights to unions and retirees); *see* Huebner & James, *supra* note 45, at 93 (discussing a court of appeals decision that held that giving equity in New Chrysler to the union benefit fund did not violate bankruptcy priority rules); Lubben, *supra* note 35, at 537-38 (same).

83. Zywicki, *supra* note 81, suggests that the payments to the unions were a political payoff to the unions. *Id.* ("The Obama administration's behavior . . . is a profound challenge to the rule of law. Secured creditors—entitled to first priority . . . have been browbeaten . . . into accepting only 30 cents on the dollar . . . . Meanwhile, the United Auto Workers union, holding junior creditor claims, will get about 50 cents on the dollar."). This payment was not mere politics, however; as noted in text, such support was necessary because the unions' bargaining rights created by §§ 1113 and 1114 of the Code gave the unions the power to hold up the sale. *See* 11 U.S.C. §§ 1113, 1114.

84. *In re* Chrysler LLC, 405 B.R. 84, 97 (Bankr. S.D.N.Y. 2009).

85. *Id.* at 102.

collateral. For better or worse, the government's willingness to fund the purchase appears to have ensured that claimants received more than they would have in any conceivable alternative liquidation, and probably in any conceivable reorganization.

The critical attention to *Chrysler* was useful, however, for casting light on a practice that is widespread in cases that receive neither this kind of government subsidy, nor this kind of publicity.[86] Although expedited all-asset sales usually do not raise *Chrysler*-type distributional issues so explicitly,[87] postpetition lenders and purchasers often seek to affect the distribution of sale proceeds to some extent. More importantly, these sales raise valuation questions that have substantial distributional consequences. In other words, for all of its unique features, *Chrysler* raises broad and important questions about when the temporal exigencies of a particular purchase should override the Code's protections against sweetheart deals and its distributional scheme.

Consider, for example, the first Polaroid bankruptcy sale.[88] As Lynn LoPucki has recounted, Polaroid's managers presented the company as a melting ice cube, and the confirmed sale, following a seventy-day sale process, was priced at a third of the company's book value.[89] The court declined to consider the creditors' committee's proposed evidence that would have illustrated the company was worth more.[90] The dynamics of all-asset sales in

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86. *See* Brubaker & Tabb, *supra* note 34, at 1377 (noting how "decisions rendered by the influential and respected federal courts in New York were framed as being squarely within the mainstream of currently accepted bankruptcy convention").

87. Roe & Skeel, *supra* note 2, at 759 (arguing that because the sale determined the distributional outcome, *Chrysler* was a sub rosa plan—a plan disguised as a sale—and is doctrinally distinct from cases where the sale is not so determinative of distribution).

88. *See generally In re* Polaroid Corp., No. 01-10864 PJW, Civ. A. 02-1353 JJF, 2004 WL 253479 (D. Del. Feb. 9, 2004) (reporting the facts of a 363 sale in April 2002, and granting the motion to dismiss the appeal of the sale as moot).

89. LOPUCKI, *supra* note 54, at 176-78.

90. *Id.* at 173-80 (citing the court's view that it should not second-guess a market valuation, but also reporting that third parties complained that they had wanted solicitation materials but had not been able to receive them); LoPucki & Doherty, *supra* note 5, at 13-14. The assessment of LoPucki, and LoPucki and Doherty, related to the 2002 sale of Polaroid, not to the 2009 sale in the Minnesota bankruptcy court. *See In re* Polaroid Corp., 424 B.R. 446, 448-49 (Bankr. D. Minn. 2010) (reporting on the 2009 sale and subsequent conversion of the case to a Chapter 7 case).

today's bankruptcy system put courts in an untenable position, especially when sale proponents make melting ice cube arguments.[91]

The perceived need for speed and the attendant power and danger of the melting ice cube argument is perhaps greater in cases with somewhat less debt and fewer assets, less information in the marketplace, and less public scrutiny. Cannondale, the bicycle manufacturer, filed for bankruptcy in 2003 and was on a fast track to a sale to a stalking horse bidder that left other creditors and potential investors with very little opportunity to evaluate the case.[92] A motion to sell On-Site Sourcing, a digital management company, to its senior secured lender came just five hours after its Chapter 11 filing, and was coupled with an aggressive proposed debtor-in-possession financing order going well beyond what was necessary to keep the debtor alive until a sale.[93] The court recognized that some of the most extreme portions of the sale order were rationally accepted by the debtor as the cost of moving things forward, but commented, "[p]ragmatism, though, does not convert a spoiler's argument into a legitimate business reason."[94] Even so, the court ultimately approved the sale to the secured creditor, albeit conditioned on some significant amendments.[95]

Humboldt Creamery was in the business of processing, distributing, and marketing dairy-derived products and filed for bankruptcy in late April 2009.[96] Less than ninety days into the Chapter 11 case, the debtor filed a motion to establish bid and sale procedures for substantially all of its assets and identified a stalking horse bidder (another dairy) that would pay $20.5 million or would receive a $300,000 breakup fee. The sale would leave little value for unsecured creditors.[97] The stalking horse bidder was the only bidder.[98] The creditors' committee and unsecured note holders filed objections. But at the full hearing

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91. *See, e.g.*, *In re* GSC, Inc., 453 B.R. 132, 165-66 (Bankr. S.D.N.Y. 2011) (citing case law in favor of approving sale of a "melting ice cube" to prevent further losses); Landers, *supra* note 66, at 101, 112 (discussing the pressure on courts to approve quick sales).

92. *See* Melissa B. Jacoby, *The Bankruptcy Code at Twenty-Five and the Next Generation of Lawmaking*, 78 AM. BANKR. L.J. 221, 235 n.81 (2004) (citing primary documents from Cannondale's bankruptcy case and proposed sale).

93. *In re* On-Site Sourcing, Inc., 412 B.R. 817 (Bankr. E.D. Va. 2009).

94. *Id.* at 829 n.8.

95. *Id.* at 829-30.

96. *In re* Humboldt Creamery, L.L.C., No. 09-11078, 2009 WL 2820610, at *1 (Bankr. N.D. Cal. Aug. 14, 2009).

97. *Id.*

98. *Id.*

scheduled for August, the debtor informed the court that all objections had been withdrawn, leading the judge to conclude he had no choice but to accept the debtor's representations about the propriety of the procedures used to market the assets and the detriment to the estate that might be caused by further delay.[99] The judge approved the motion, but not before offering pointed commentary on going-concern 363 sales, characterizing them as "court-approved financial restructuring[s] stripped of all the procedural safeguards built into Chapter 11 of the Bankruptcy Code by Congress, including disclosure and voting. Legal rights are reduced to the sole discretion of a lone and often over-worked bankruptcy judge."[100]

The judge went on to critique the melting ice cube argument, noting that the debtor could control the timing of filing to make any sale seem like more or less of an emergency: "it is easy enough," he noted, "for the debtor to unplug the freezer prior to bankruptcy."[101] He then returned to the challenges for the court:

> Unless the bankruptcy judge is willing to show exceptional judicial courage, he or she must approve the sale. While nominally "presiding" over the case, the judge is reduced to a figurehead without any meaningful discretion and might as well leave his or her signature stamp with the debtor's counsel and go on vacation or shift attention to consumer cases where the law may still mean something.[102]

Humboldt Creamery is hardly the only case where a judge has expressed frustration with being backed into a corner by the parties. For example, asked to approve sale procedures thirty-six hours into the case because of an absolute unwillingness for lenders or counter-parties to consider even a slight extension, a Delaware bankruptcy judge lamented in the *Digital Domain* case:

> I don't offend easily and you've managed it. I have been through many, many sales. I've said before I'm sympathetic to the circumstances that you present before me . . . .

99. *Id.* at *1-2; *see also In re* Gulf Coast Oil Corp., 404 B.R. 407, 427 (Bankr. S.D. Tex. 2009) (discussing the difficulty of evaluating 363 sales in the absence of an adversarial presentation of the issues).

100. *In re* Humboldt Creamery, L.L.C., 2009 WL 2820610, at *1.

101. *Id.* at *2.

102. *Id.*

> This is a faster transaction than anything I've seen. I'm concerned with respect to the process that's been employed. Don't tell me about Lehman; don't tell me about General Motors; don't tell me about Chrysler. They have no bearing on a case such as this.
>
> . . . .
>
> . . . I am satisfied that the options before me today are effectively to shut this company down. And I've [been] asked, I think, to call the bluff, and I'm not going to call that bluff.[103]

These comments highlight the problem.[104] Blame need not be entirely laid at the feet of the debtor: some courts and commentators see the secured lender as the one with the power to unplug the freezer when the timing is right.[105] In any

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103. Transcript of Hearing on First-Day Motions Before the Honorable Brendan L. Shannon, United States Bankruptcy Judge at 228-30, *In re* Digital Domain Media Grp., Inc., No. 12-12568, 2012 WL 6135353 (Bankr. D. Del. Dec. 7, 2012). As noted below, in the GM bankruptcy, the judge stated that he was not prepared to play "Russian roulette" with the estate. *See infra* text accompanying note 161.

104. As another example, a bankruptcy court in South Carolina received a request for an all-asset sale less than two months after the filing of the Chapter 11. An issue arose about the right of certain creditors to bid their debt under § 363(k). While overruling the objections, the court stated:

> The Debtors (without great opposition from other parties in interest) have demonstrated that moving with great speed is a priority in this case to increase the likelihood that asset values will be maximized and creditor distributions will result. Similar matters often move very quickly in bankruptcy proceedings to the advantage of all those involved. However, as in this case, urgency can raise significant challenges for the Court and the parties involved. These challenges can be problematic when the case involves a sale of substantially all of the Debtors' assets without the formality of a plan and a disclosure statement.

In re Merit Grp., Inc., 464 B.R. 240, 250-51 (Bankr. D.S.C. 2011).

105. *See In re* Channel One Commc'ns, Inc., 117 B.R. 493, 495 (Bankr. E.D. Mo. 1990) (stating that the debtor would have been forced to close, losing the value of an FCC license and facing significant diminution in value, if the lender refused to provide funds); Ben-Ishai & Lubben, *supra* note 21, at 623 (discussing how "secured lenders can create an emergency at will simply by freezing the debtor's access to the cash needed for daily operations" and how a "secured creditor with liens on all of the debtor's assets . . . has the option to set a timetable for the bankruptcy case that will preclude any other option than a quick sale"); Miller & Waisman, *supra* note 51, at 154 (discussing the capacity of prepetition lenders to impose severe conditions on the debtor); Skeel, *supra* note 75, at 1199 (discussing how lenders "have increasingly insisted that the court approve both the loan and an immediate sale of the company's most important assets"); Alla Raykin, Note, *Section 363 Sales: Mooting Due Process?*, 29 EMORY BANKR. DEV. J. 91, 128 (2012) (discussing the general concern that parties together are "manufacturing an emergency").

event, a judge presented with a fait accompli has two options as a practical matter, and neither is attractive. The judge can refuse to approve or delay the sale, but this produces the fear and risk that the buyer will decline to go forward, and that the estate will suffer either because of the wasting nature of the assets, or because this particular sale represents a unique (and time sensitive) business opportunity. Alternatively, the court can approve the sale. Here the court may be accused of being complicit in whatever deal the debtor's management, buyer, and potentially a particular lender have cooked up, but at least this is a bird in the hand and there will be value to distribute.[106] Although we know of no firm statistics on approval or denial of sale motions, the conventional wisdom is that judges tend to take the bird in hand.[107]

II. RETHINKING THE THEORETICAL DEBATE

Until recently, law and economics scholars consistently expressed a preference for bankruptcy auctions over lengthier and allegedly more costly reorganizations (or sales) under a Chapter 11 plan.[108] They emphasized three themes when speaking of the Chapter 11 process. First, corporate bankruptcy always involves a sale of some kind: either the estate is formally sold to outside purchasers (piecemeal or as a going concern), or functionally sold to its own

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106. Landers, *supra* note 66, at 101 (citing the "now or never" threat by debtors and sale supporters, and noting that "most" courts "reluctantly[] go along"); *see also In re* Gen. Motors Corp., 407 B.R, 463, 493 (Bankr. S.D.N.Y. 2009) ("This is hardly the first time that this Court has seen creditors risk doomsday consequences to increase their incremental recoveries, and this Court—which is focused on preserving and maximizing value, allowing suppliers to survive, and helping employees keep their jobs—is not of a mind to jeopardize all of those goals."); Transcript of Hearing, *supra* note 103, at 32 ("I don't believe that I have signed a bid procedures order on first-day, because I have expressed concern that that, frankly, can functionally disenfranchise a committee that has statutory and fiduciary responsibilities."); Palank, *supra* note 77 (reporting on the judge's reluctant approval of sale on an extremely short timeline in the Digital Domain bankruptcy). For evidence from an experimental study that bankruptcy judges prefer more certain outcomes for unsecured creditors when considering competing reorganization plans, even though this may result in a lower return for those creditors, see Jeffrey J. Rachlinski et al., *Inside the Bankruptcy Judge's Mind*, 86 B.U. L. REV. 1227, 1237-41 (2006) (reporting the results of a bankruptcy law version of Kahneman and Tversky's Asian Disease problem).

107. *See supra* Section I.A.

108. This Article is motivated by the costs and benefits of all-asset sales proposed and completed under § 363 as compared to those completed pursuant to the Chapter 11 plan confirmation process, not by the choice of whether the company is sold versus more traditionally reorganized in that plan.

stakeholders through a plan of reorganization.[109] Hybrids are possible, and indeed contemplated. Even companies that reorganize in the traditional sense emerge smaller, having sold assets or even divisions. Either way, the goal is understood as realizing the highest value for the company's investors rather than some broader conception of maximizing social welfare.[110] Second, value should, where possible, be determined by exposure to the market rather than by judicial assessment.[111] And, third, distributions of sale proceeds in bankruptcy should respect distributional priorities established by the Code and non-bankruptcy law.[112]

With regard to the third point, while economists tend to elevate allocative efficiency over distributional concerns, law and economics scholars in the bankruptcy context largely favor the concept of "absolute priority."[113] In some cases this is due to certain liberal commitments to property law—those with property rights in the debtor's assets should come ahead of contractual and other unsecured claimants, who should in turn come ahead of equity owners. In many discussions, though, the justification for priority is rooted not in distribution, but in governance—in the suggestion that respect for non-bankruptcy entitlements will create appropriate ex ante incentives, and that, ex

109. *See, e.g.*, Baird & Bernstein, *supra* note 61, at 1937 (citing a conception of the sale as the "single engine" that "drives law-and-economics accounts of corporate reorganization").

110. *See* Christopher W. Frost, *Bankruptcy Redistributive Policies and the Limits of the Judicial Process*, 74 N.C. L. REV. 75 (1996).

111. *See, e.g.*, Douglas G. Baird, *The Uneasy Case for Corporate Reorganizations*, 15 J. LEGAL STUD. 127, 136-37 (1986); *see also* Susan Block-Lieb, *The Logic and Limits of Contract Bankruptcy*, 2001 U. ILL. L. REV. 503, 555-56 (evaluating the preference of law and economics scholars for markets over courts in bankruptcy).

112. *See, e.g.*, Adler, *supra* note 33, at 316-17; Douglas G. Baird, *Loss Distribution, Forum Shopping, and Bankruptcy: A Reply to Warren*, 54 U. CHI. L. REV. 815 (1987); Thomas H. Jackson, *Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain*, 91 YALE L.J. 857 (1982).

113. When these scholars use the term "absolute priority," they seem to use it more broadly than bankruptcy doctrine does. *See, e.g.*, Baird & Bernstein, *supra* note 61, at 1944 (using the term to include priority of senior secured lenders over other claims and interests, even in a sale context). We use the term in its more limited sense: an elaboration on the "fair and equitable" standard for "cramdown" of nonconsensual plans under § 1129(b) of the Code. Outside of a plan, at issue is a more general version of bankruptcy priority—what a claimant would receive if the debtor were liquidated according to the priorities applicable under Chapter 7 of the Code.

post, governance rights should be given to the class of stakeholders that has the greatest interest in maximizing value – the residual claimant.[114]

These commitments, coupled with the empirical sense that bankruptcy is sometimes used by out-of-the-money owners to extort value from creditors (as Judge Winter worried in his *Lionel* dissent), have led law and economics scholars to prefer sales, whether piecemeal or as a going concern, to the pursuit of a reorganization.[115] These scholars also argue that their normatively preferred approach has empirically triumphed, with major public company bankruptcies frequently getting resolved through sales.[116] To the extent a Chapter 11 plan process followed these sales, the process merely allocated proceeds from sales of assets or unrelated sources (such as avoidance actions relating to transactions that occurred months or even years earlier). This pattern was followed by *Chrysler* and *GM*, as well as *Enron*, *Adelphia*, and *Lehman Brothers*.[117] The sales in *Chrysler* and *GM* each were approved in fewer than forty-five days,[118] and generated significant opprobrium. Commentators had less to say about the quick sale by Lehman Brothers, which sold its

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114. Barry E. Adler & Ian Ayres, *A Dilution Mechanism for Valuing Corporations in Bankruptcy*, 111 YALE L.J. 83, 88 (2001) ("But absolute priority is important, not because deviations would be unfair to investors, but because such priority, devised by contract, can create efficient investment incentives." (emphasis omitted)). The focus on governance, and an elevation of contract over property, *id.* at 90 ("[A] bankruptcy regime that honors contracts, then, allows investors to be the masters of the applicable distribution scheme and the consequent incentives, while a regime that dishonors contractual priority necessarily interferes with such a scheme and incentives."), has sometimes led to imprecision about legal priorities, which we address below. *See infra* Subsection II.C.2.

115. *See* Baird & Rasmussen, *Chapter 11 at Twilight*, *supra* note 7, at 687 ("The claim of *The End of Bankruptcy* was both that financially distressed businesses typically have little or no going-concern value *and* that, even when they do, sales provide the simplest and often the best way of preserving it."); Baird & Rasmussen, *The End of Bankruptcy*, *supra* note 7, at 764-69 (arguing that most firms in financial distress do not have going concern value to preserve, and where they do, they can be sold as a unit).

116. *See* Baird & Rasmussen, *Chapter 11 at Twilight*, *supra* note 7, at 679 (reporting that more than half the large public company Chapter 11s in 2002 were sales of one sort or another).

117. *See Bankruptcy Court Backs Adelphia Sale*, N.Y. TIMES, June 28, 2006, http://www.nytimes.com/2006/06/28/business/media/28adelphia.html (reporting on Adelphia's sale to Time Warner); David Teather et al., *Barclays Agrees $1.75bn Deal for Core Lehman Brothers Business*, GUARDIAN, Sept. 16, 2008, http://www.guardian.co.uk/business/2008/sep/17/barclay.lehmanbrothers (reporting on Barclays' purchase of Lehman Brothers' assets just a few days after Lehman's bankruptcy filing); *Enron Judge OKs UBS Buy*, CNNMONEY (Jan. 18, 2002, 8:50 PM), http://money.cnn.com/2002/01/18/deals/enron_ubs (reporting on the filing in December and the sale to UBS Warburg in January).

118. Brubaker & Tabb, *supra* note 34, at 1377.

brokerage division to Barclays just a few days after the (unplanned) bankruptcy filing. Although the timing was even more extreme, the sale by Lehman was, perhaps, perceived as necessary due to systemic risk implications.[119]

For the purposes of this discussion we accept the overall framework of the law and economics scholars, but challenge a number of their conclusions. We note that some of the same scholars who have historically favored bankruptcy auctions criticized the Chrysler sale because the short timeframe limited the ability of other parties to bid. These scholars have also raised concerns about subversion of bankruptcy's distributional scheme (particularly as it applies to secured creditors).[120] In general, we share their concerns about process as well as priority. With regard to speed, we recognize that a short timeframe may be necessary in certain cases. We believe, however, that there are ways to improve the courts' ability to sort between cases where speed is a necessity, and those where it is used tactically. With regard to distribution, careful attention to the scope of non-bankruptcy entitlements and equitable tracing rules leaves us giving rigorous, but somewhat narrower, protection to secured creditors than critics of *Chrysler*.[121]

A. *The Value Created by Bankruptcy (Sales)*

Notwithstanding our concerns, we acknowledge that asset sales are an important source of Bankruptcy-Code-created value. It is widely accepted that the availability of a federal bankruptcy forum has efficiency advantages over state law creditor remedies. State law debt collection is based on first-in-time priority and can precipitate a chaotic race to the courthouse followed by piecemeal liquidation. Chapter 11 bankruptcy, by contrast, provides a collective

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119. *See In re* Lehman Bros., 445 B.R. 143, 153 (Bankr. S.D.N.Y. 2011) ("At the time, the transaction was regarded by many as an admirable, even heroic, achievement that helped to salvage jobs, preserve going concern values and provide for the orderly transition of many thousands of brokerage accounts to a financially secure firm with the resources to manage and service the financial assets held in those accounts. . . . Nothing in the voluminous record presented to the Court in these protracted proceedings has done anything to change that undeniably correct perception."); Teather et al., *supra* note 117. Espen Eckbo and Karin Thorburn studied mandatory auctions in Sweden, and found that where small companies were involved, the survival rate was relatively high and the values received compared favorably with the book value of the company. B. Espen Eckbo & Karin S. Thorburn, *Bankruptcy as an Auction Process: Lessons from Sweden*, 21 J. APPLIED CORP. FIN. 38 (2009).

120. *See supra* Section I.B.

121. *See infra* Subsection II.C.2.

forum that helps preserve going-concern value and prevents inefficient liquidations. As stated in the House Report for the 1978 Bankruptcy Code:

> The purpose of a business reorganization case, unlike a liquidation case, 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. The premise of a business reorganization is that assets that are used for production in the industry for which they were designed are more valuable than those same assets sold for scrap. Often, the return on assets that a business can produce is inadequate to compensate those who have invested in the business. Cash flow problems may develop, and require creditors of the business, both trade creditors and long-term lenders, to wait for payment of their claims. If the business can extend or reduce its debts, it often can be returned to a viable state. It is more economically efficient to reorganize than to liquidate, because it preserves jobs and assets.[122]

While the House Report focuses on the capacity of a traditional Chapter 11 reorganization to preserve going-concern value, the same is true for going-concern bankruptcy sales, whether accomplished through a Chapter 11 plan or through a 363 sale. At least in theory, these sales can preserve going-concern value and transfer clear title to complex assets – from software licenses to whole companies, solving fragmentation and assemblage problems, and addressing issues of successor liability in relatively short order.

Some critiques of Chapter 11, and their attendant formulations of the baseline distribution to secured creditors, proceed from an unduly romanticized account of creditors' rights under state law.[123] Recoveries from forced sales under state law are not necessarily greater or faster than those obtained in bankruptcy; indeed, as Ronald Mann has recounted, lending officers are likely to see state law foreclosure as a true last resort, associated with significant loan losses.[124] Historically, state courts have been hostile to

122. H.R. REP. NO. 95-595, at 220 (1977).

123. The Code determines the baseline entitlement of a secured creditor based on the fiction that the secured party could have foreclosed on its collateral on the bankruptcy petition date. Whether that would have happened, however, depends on a variety of factors.

124. Ronald J. Mann, *Strategy and Force in the Liquidation of Secured Debt*, 96 MICH. L. REV. 159, 164, 221-22 (1997) (reporting findings, from seventy-two lender profiles, that lenders forcibly repossessed property in an extremely small minority of instances). We focus here on recoveries in commercial loans. However, the recent robo-signing crisis in the home

security. Real property foreclosures are often seen as cumbersome by mortgage lenders and servicers, subject to the delays of judicial process and to mortgagor protections that postpone finality.[125] Some jurisdictions (California, for example) impose complex election of remedy rules that can trap the unwary.[126] To the extent that a lender's security interest encumbers diverse types of collateral, foreclosure may require multiple proceedings under state real estate law, Article 9 of the Uniform Commercial Code (U.C.C.), and other more arcane schemes. Finally, foreclosure sales often transfer no more than a quitclaim deed, leaving title uncertain.

As it has developed in practice, the bankruptcy system improves the lot of the creditor hoping to benefit from a sale of the debtor's assets. We illustrated in Section I.A that bankruptcy sales, whether under § 363 or in a Chapter 11 plan, provide the buyer with greater certainty and clearer title, increasing the sale price, and creating value for the estate.[127] A federal court sale order can preempt state law, and can simultaneously quiet title to assets of an entity whose property and operations cross multiple state lines.[128] And, all this can be accomplished very quickly—before inventory and customer lists become obsolete, relationships with key employees and suppliers sour, or the debtor simply runs out of money.

Bankruptcy sales offer two distinct options that improve on coercive state law remedies: preserving going-concern value through reorganization or through a going-concern sale, under a plan or under § 363. This going-concern premium is a product of the federal bankruptcy regime. Sometimes, the going-concern premium can only be obtained by acting quickly. Thus, a Bankruptcy Code created speed premium exists (as part of the going-concern premium)

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mortgage context, and similar problems with collection of credit card debt, highlight the uncertainty associated with state law remedies. *See* Editorial, *Robo Redux*, N.Y. TIMES, Aug. 19, 2012, http://www.nytimes.com/2012/08/20/opinion/robo-redux.html; Nate Raymond, *Judge Tosses Foreclosure Suit by 'Living Dead' Bank IndyMac*, FORECLOSUREGATE GAZETTE (Oct. 8, 2012), http://foreclosuregate.prosepoint.com/story/judge-tosses-foreclosure-suit-living-dead-bank-indymac.

125. Wisconsin, for example, provides for a post-judgment period of twelve months (or six months if deficiency is waived) during which a debtor can redeem the property. WIS. STAT. §§ 846.10-846.101 (2011-12). *See generally* Melissa B. Jacoby, *The Value(s) of Foreclosure Law Reform*, 37 PEPP. L. REV. 511, 513-19 (2010) (cataloguing, and then critiquing, traditional complaints of real estate scholars that foreclosure takes too long and costs too much).

126. *See* Darren Conley, Comment, *The Sanction for Violation of California's One-Action Rule*, 79 CALIF. L. REV. 1601 (1991).

127. *See supra* note 51 and sources therein.

128. *See supra* note 48 and sources therein.

when a quick sale is necessary to preserve value. While both premia are worth preserving, we are concerned that parties not be able to exploit the perceived need for speed to distort the Code's distributional scheme.

B. Cataloguing the Problems with Expedited All-Asset Sales

In the preceding Sections, we have observed both that 363 sales can preserve value that would be lost under state law, and that they lack procedural protections associated with sales (or reorganizations) under a Chapter 11 plan. In this Section, we seek to identify more precisely the costs and risks associated with hurry-up 363 sales. First, we explore concerns related to information scarcity and asymmetry that create uncertainty about valuation and give sale proponents considerable transactional leverage. Second, we discuss the distributional consequences of this leverage.

1. Valuation Problems

In our view, hurry-up sales outside of a Chapter 11 plan present three related problems regarding value: (1) information is likely to be scarce early in the case; (2) the available information is often asymmetrically distributed; and (3) the prior two points enhance the leverage and chances for opportunistic behavior of informationally advantaged parties. These problems are compounded by coordination problems. Most debtors have multiple types of creditors whose interests are not all aligned.[129] The bankruptcy court has no more information than the informationally disadvantaged claimants. Consequently, the melting ice cube argument places the estate at the mercy of the sale's advocates—usually, although not always, incumbent managers, the senior secured lender, and the purchaser. This leverage may facilitate a sweetheart deal, and, as we will discuss later, may lead the court and parties in interest to accede to sale terms that distort the Code's distributional scheme. The estate (along with informationally disadvantaged creditors), therefore, bears the increased risk of erroneous undervaluation associated with the expedited sale, and absorbs the cost of the transactional leverage associated with the melting ice cube argument.

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129. As discussed *infra* Subsection II.C.2, we argue that this is the case even when an undersecured creditor claims a blanket lien on all assets and asserts that other claimants are "out of the money."

a. Information Scarcity and the Informational Sweet Spot

At the moment a debtor files for bankruptcy, it is axiomatic that valuations are uncertain. Insolvency itself interferes with the market for the debtor's products, the market for the debtor as a going concern, and the market for the debtor's discrete assets. Even if ownership of the debtor were in play or the debtor had negotiated over a restructuring before filing, the company is usually in crisis at the beginning of a bankruptcy case. It may be unclear how the company will function in bankruptcy, and whether it will be able to resolve its problems. The structure of Chapter 11 is specifically designed to address these concerns, providing breathing room for the debtor and its stakeholders to fix the business, gather information, and allocate value.[130] Hurry-up sales, by contrast, demand an immediate decision in an information-poor environment, sometimes before it has become clear whether the debtor is a likely candidate for reorganization.

In the early days of a case, some creditors, the as-yet unformed creditors' committee, and certainly the court, have relatively little information about the debtor, its value, and the prospect of successful reorganization.[131] Until the point of bankruptcy, trade creditors and other nonfinancial creditors probably viewed themselves as fixed claimants, rather than as parties with reason to evaluate competing business plans. Involuntary creditors, such as tort claimants or the taxing authority, are at an even greater informational

130. *See infra* Subsection II.C.1. Sometimes the filing of a bankruptcy petition is the last phase of an extended period of negotiation. In some instances, the case may not suffer from information asymmetries to the same degree. A sale under a prepackaged Chapter 11 plan—e.g., in which votes actually have been solicited under applicable non-bankruptcy law—does not require a holdback. Depending on the circumstances, parties might be able to make a credible case for a reduced holdback in a 363 sale, as discussed *infra* Part III.

131. Some financially distressed companies may have been thoroughly marketed before a bankruptcy filing. *See, e.g.*, COMPARISON SHOPPING GUIDE, *supra* note 48, ch. 2 (providing an overview of the 363 sales and marketing process). But when some third parties have had a full and fair opportunity to investigate the possibility of purchasing the company, it seems less likely that this company can accurately be presented as a melting ice cube to the bankruptcy court. Moreover, had there been time for ample vetting pre-bankruptcy, there also may have been time to solicit investors and conduct the sale under a prepackaged Chapter 11 plan. Thus, to the extent that a "thoroughly marketed" debtor is presented to the court as a melting ice cube, it may be a fair inference that this tactic is being used to benefit the stalking horse bidder, rather than to respond to an emergent crisis. *See In re* Gulf Coast Oil Corp., 404 B.R. 407, 423 (Bankr. S.D. Tex. 2009) ("Not every sale is an emergency, and . . . the reliability of uncontested evidence (and particularly the reliability of testimony that is not adequately cross-examined) is suspect.").

disadvantage. Official committees that might represent the various claims or interests are barely getting started.[132] The court may have first learned of the debtor on the petition date.

Adding to the information-gathering problems, larger corporate debtors routinely request significant extensions of time to file their bankruptcy schedules, which provide information to the court and third parties on assets, liabilities, claims, transactions, and other factors.[133] This delay further limits

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132. The median time between creditor committee appointment and 363-sale orders was about three months in public company Chapter 11 cases between October 1, 1979 and December 30, 2012, and the creditors' committee was appointed no more than two months ahead in about a third of these cases. *UCLA-LoPucki Bankruptcy Research Database*, UCLA SCH. L., http://lopucki.law.ucla.edu (last visited Sept. 3, 2013) (sample size of 114); *see also* 11 U.S.C. § 1102 (2012) (authorizing the U.S. Trustee, part of the Department of Justice, to appoint a creditors' committee and setting parameters for appointment). For more on committee problems, see Landers, *supra* note 66, at 101, 103, 107, which discusses how creditors' committees have difficulty performing their responsibilities when a Chapter 11 debtor moves so quickly from filing to sale. Because the available data suggest that creditors' committees do formally object to some sales with some frequency, *see* Ayotte & Morrison, *supra* note 27, at 531 tbl.9, we do not mean to suggest that *all* sales preclude organized response. The question is whether the committee is able to credibly respond in the cases where "secured lender preferences distort real economic outcomes." *Id.* at 533-34 (finding a higher proportion of objections to sale in cases involving oversecured creditors, though not tracking how these objections were resolved). In addition, to the extent private equity and hedge funds hold unsecured debt in Chapter 11 cases, they can push back against premature resolutions in some subset of Chapter 11 cases. *See* Wei Jiang, Kai Li & Wei Wang, *Hedge Funds and Chapter 11*, 67 J. FIN. 513 (2012) (analyzing various forms of active hedge fund participation in Chapter 11 cases, but not studying 363 sales). It remains unclear, however, whether such active creditors are involved in the cases most likely to feature melting ice cube arguments.

133. Lisa Hill Fenning & Craig A. Hart, *Measuring Chapter 11: The Real World of 500 Cases*, 4 AM. BANKR. INST. L. REV. 119, 135-36 (1996) (noting that the tendency of Chapter 11 debtors to seek extensions to file schedules reduces the adequacy of the information available to the courts); J. Bradley Johnston, *The Bankruptcy Bargain*, 65 AM. BANKR. L.J. 213, 289 & n.349 (1991) (discussing how schedules and statements are often filed months after a Chapter 11 case commences under the 1978 Bankruptcy Code). For an example of a court resisting a second request for an extension when the creditors' committee and other parties objected, see *In re* Robotic Vision Sys., No. 04-14151-JMD, 2004 Bankr. LEXIS 2048 (Bankr. D.N.H. Dec. 22, 2004). Rule 1007(c) of the Federal Rules of Bankruptcy Procedure requires the filing of schedules with the petition or within fourteen days after filing of the petition in voluntary cases and within fourteen days after the entry of relief in involuntary cases. FED. R. BANKR. P. 1007(c). Rule 1007(a)(5) also provides that extensions of time for filing schedules will be granted only on motion for cause shown and with notice to the U.S. trustee and other interested parties. *Id.* R. 1007(a)(5). Special timing rules apply to "small business" cases. *See* 11 U.S.C. § 1116(3) (requiring that small businesses file timely all

availability of relevant information about the debtor early in the case, especially with respect to debtors that are not publicly traded companies.

Baird and Morrison have posited the existence of an informational sweet spot in Chapter 11 cases. As the case proceeds, the judge and creditors gather more information by observing how the debtor operates in bankruptcy, and take advantage of the investigative powers of creditors' committees, the U.S. Trustee, and other stakeholders.[134] After a while, though, the amount of new information will hit a plateau, and the costs of waiting will exceed the benefit of learning more. This is the sweet spot—a presumptively optimal point at which an entity's stakeholders can make the decision whether and how to reorganize or liquidate.[135] Such an informational sweet spot means that there is little benefit to allowing a debtor to linger too long in bankruptcy, but it also means there are informational costs to culling cases too early. The exact timing of the informational sweet spot may vary depending on the size or the nature of the business, whether it is publicly or privately held, and other factors. For present purposes, however, the crucial point is that an informational sweet spot exists.[136]

Baird and Morrison's discussion of the optimal decision point focused on the reorganize-or-liquidate decision of a firm. But the sweet spot will also

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schedules and statements of financial affairs unless the court grants an extension, and imposing a high burden on extensions of longer than thirty days).

134. Morrison, *supra* note 40, at 383 ("[P]atterns characterizing the duration to shutdown . . . are consistent with an economic model of optimal decision making developed by Morrison (2003) and Baird and Morrison (1999, 2001)."); *see also* Baird & Morrison, *supra* note 40, at 364-65 & n.18 (predicting a hump-shaped probability of shutdown in Chapter 11 by competent decisionmakers, with the highest probability associated with the period when information becomes thicker, and finding empirical support for this proposition in their preliminary analysis of cases in the Eastern Division of the Bankruptcy Court for the Northern District of Illinois).

135. In discussing primarily smaller cases, Baird and Morrison place that point at a few months after the petition date. Baird & Morrison, *supra* note 40, at 364-65. The Code gives a debtor the exclusive power to propose a plan for 120 days and the same amount of time to decide whether to assume or reject its real property leases. 11 U.S.C. §§ 1121(b), 365(d)(4).

136. In his study of Chapter 11 cases filed in 1998 in Chicago, Morrison found that the decision to dismiss or convert a case among businesses that were shut down occurred within three months of filing for fifty percent of the cases and within five months for seventy percent of the cases. Morrison, *supra* note 40, at 382. Morrison notes that these findings may not be generalizable to large public company bankruptcies due to the small size of the businesses in his sample. *Id.* at 383, 386. In any event, the sweet spot is likely longer than the twenty-one-day period that currently requires a higher level of justification of a preplan 363 sale under Federal Rule of Bankruptcy Procedure 6003(b). FED. R. BANKR. P. 6003(b).

affect judgments about the price and timing of any significant asset sale and whether such a sale should occur pursuant to § 363 or under a Chapter 11 plan. In a rushed preplan going-concern sale, those with an interest in the bankruptcy estate have less-than-optimal information about price and whether the asset is wasting. To the extent that the sale request precedes the informational sweet spot, interested parties may not be able to evaluate price, the possibility of other bidders, or the very assertion that the debtor is a melting ice cube. Under current practice, however, the melting ice cube argument makes it risky and expensive for claimants to seek additional information or additional time.[137]

b. *Information Asymmetry*

There is, therefore, a pernicious interaction between the lack of information at the beginning of a case and the melting ice cube argument. While bankruptcy may come as a surprise to many creditors, and the aggregate amount of information held by creditors on the petition date is low, the filing is not a surprise to everybody. Incumbent management, a key secured lender, or a favored purchaser may have (relatively) good information about a debtor at the inception of a bankruptcy case. The debtor's management may have been preparing for bankruptcy for a while, or have spent considerable time in discussions with the proposed purchaser and evaluating the risks and rewards associated with a sale. Whether management will use this knowledge in a manner consistent with its fiduciary duties to the company, or instead to feather its own nest, is a significant concern.[138]

Consider the Derby Cycle bankruptcy sale. An earlier owner of Derby, Alan Finden-Crofts, had sold the company in 1999, and came back as a CEO/turnaround manager in 2001.[139] Later in 2001, Finden-Crofts and other members of management sought to buy the company. Derby filed for bankruptcy in August with an amended offer from Finden-Crofts and associates in hand and the allegation that the company was a melting ice

137. Casey, *supra* note 16, at 786 (arguing that "the speed with which the going-concern sales are occurring exaggerates the imperfections within capital markets").

138. *See, e.g.*, LoPucki, *supra* note 54, at 173-80 (discussing management's alleged incentives for a sale strategy in Polaroid's 2002 bankruptcy sale); Ben-Ishai & Lubben, *supra* note 21, at 621-22 (discussing the difficulty of detecting management collusion with purchasers).

139. LoPucki, *supra* note 54, at 169, 172-73.

cube.[140] The sale ultimately was approved, over objection, albeit a month later than the debtor had insisted was necessary to preserve its value. About this set of facts, LoPucki asks: "If it took Finden-Crofts – the former owner of Derby – five months to evaluate the company from the inside and prepare a bid, how were competing bidders supposed to do it from the outside in five weeks?"[141] Why, after months of due diligence by a management-led group, had the company suddenly become a melting ice cube?

The information gap is asymmetric with regard to both price and urgency. As a result, it is difficult and risky to assess or challenge the melting ice cube argument. The hurry-up sale may also chill bidding. Investing the time and resources to challenge the sale (or submit a bid) might therefore be doubly self-defeating. While so-called "stalking horse" bidders are sometimes thought to prime the pump for subsequent bids by signaling that somebody is willing to bid, bidder protections and other lock-up devices may combine with the short timeframe to limit the abilities of other bidders to take advantage of that signal.[142] In addition to potentially depressing the price, the absence of

140. *Id.*

141. *Id.* at 172.

142. Bidder protections such as breakup fees or topping fees are usually explained as reimbursing the expenses of the stalking horse bidder, but are nonetheless controversial. *See* COMPARISON SHOPPING GUIDE, *supra* note 48, § 2.1.3 (explaining the compensatory function of breakup fees and why a purchaser may want to be a stalking horse bidder, and also discussing the potential for overbidding and possible reactions of creditors and the court). Courts in the Second and Third Circuits have applied different standards to evaluate bidder protections. Bankruptcy courts in the Second Circuit apply variations on a "fair and reasonable" standard or the "business judgment" rule. *See In re* Ray Realty Fulton, Inc., No. 1-09-41225-dem., 2009 WL 2600760 (Bankr. E.D.N.Y. Aug. 21, 2009); *In re* Metaldyne Corp., 409 B.R. 661, 667, 668 (Bankr. S.D.N.Y. 2009); *In re* Integrated Res., Inc., 147 B.R. 650, 656-57 (Bankr. S.D.N.Y. 1992); *In re* 995 Fifth Ave. Assocs., L.P., 96 B.R. 24 (Bankr. S.D.N.Y. 1989). The Third Circuit requires the protections to be "necessary" to preserve the value of the estate. *See In re* Reliant Energy Channelview LP, 594 F.3d 200 (3d Cir. 2010); *In re* O'Brien Envtl. Energy, Inc., 181 F.3d 527 (3d Cir. 1999). *See generally* COMPARISON SHOPPING GUIDE, *supra* note 48, § 5.1 (surveying the legal standards for buyer protections including the business judgment rule, the best interests of the estate test, and the administrative expense test). In LoPucki's sample of 363 sales of large public companies, breakup fees averaged $5 million per case. LoPucki & Doherty, *supra* note 5, at 38 n.158. In the American Bankruptcy Institute sample of cases of a greater variety of sizes, breakup and topping fees, grouped together, ranged from 1.25-5 percent of the stalking-horse proposed purchase price, and in amounts from $150,000 to $55 million per case. COMPARISON SHOPPING GUIDE, *supra* note 48, § 5.2.1; *see also* Huebner & James, *supra* note 45, at 36 (noting that "[b]reak-up fees in the range of 2-4 percent are not uncommon in (and out of) the bankruptcy context").

additional bidders limits the generation of information about value beyond the offer already on the table.[143] To the extent expedited all-asset sales have become routine in the current bankruptcy system, they may lead to a "lemons problem" or a persistent bad information equilibrium.[144]

c. Leverage

Informational scarcity and asymmetry lead directly to a leverage problem. The debtor formally controls the moment of filing a voluntary bankruptcy petition. Therefore, the debtor can join with a potential purchaser to opportunistically exploit the fear associated with a crisis to capitalize on the informational disadvantage and strong-arm a favored deal. A determined purchaser might time its offer to coincide with an apparently deep (but in reality transitory) crisis for the company and set a short take-it-or-leave-it deadline. An oversecured creditor that would like to exit the case quickly may be indifferent to maximizing value beyond its own payment.[145] Such a creditor may extend debtor-in-possession financing just long enough for a quick sale.[146] Debtor-in-possession financing (and its control features) became considerably more common in the 1990s,[147] increasing the avenues through which to lock up quick sales. Indeed, debtor-in-possession financing by an existing incumbent lender has a common nickname among practitioners—the "defensive DIP"—a

143. *See* LoPucki & Doherty, *supra* note 5, at 35-36, 38 (offering explanations for why the 363-sale process deters additional bidders).

144. *See* Casey, *supra* note 16, at 787-88.

145. Ayotte & Morrison, *supra* note 27, at 528 (discussing this incentive of oversecured creditors); *see also* Sarah Pei Woo, *Simultaneous Distress of Residential Developers and Their Secured Lenders: An Analysis of Bankruptcy & Bank Regulation*, 15 FORDHAM J. CORP. & FIN. L. 617, 620-21 (2010) (discussing how secured creditor control and the pursuit of foreclosure and liquidation "do[] not necessarily lead to an optimal utilization of assets during this economic downturn").

146. *See supra* notes 76-77 and accompanying text.

147. Sandeep Dahiya et al., *Debtor-in-Possession Financing and Bankruptcy Resolution: Empirical Evidence*, 69 J. FIN. ECON. 259, 260 (2003); Kenneth Daniels & Gabriel G. Ramirez, *Information, Credit Risk, Lender Specialization and Loan Pricing: Evidence from the DIP Financing Market*, 34 J. FIN. SERVICES RES. 35, 37 tbl.1 (2008) (documenting the rise in debtor-in-possession loan volume and frequency). Dahiya et al. focus on the relationship between debtor-in-possession financing, speed, and Chapter 11 emergence, and do not discuss 363 sales specifically.

debtor-in-possession financing order used to defend the secured creditor's favored liquidation strategy from interference by others.[148]

The short timeframe works as a defensive strategy by limiting the ability of other bidders to gather information or participate in the process. If the debtor really is a melting ice cube, these problems may have to be tolerated. We are concerned, however, with opportunistic use of the melting ice cube argument (by unplugging the freezer) to strong-arm a particular sale.[149]

d. Conflicts and Principal-Agent Problems

The leverage created by the melting ice cube argument is thus a tool. Who uses this tool, and how, can vary from case to case. The debtor-in-possession (or the trustee) is the party authorized to formally propose a sale under § 363.[150] The debtor-in-possession has a fiduciary duty of loyalty to the estate, but generally gets the protection of the business judgment rule and the wide discretion it entails absent a conflict of interest.[151] The evidence is fairly strong that senior creditors often impose considerable pressure on debtors in ways that directly affect corporate governance,[152] often through a debtor-in-

148. *See* James S. Rankin, Jr., *Business: DIP Financing*, AM. BANKR. INST. (Mar. 15-17, 2012), http://www.abiworld.org/committees/newsletters/financialadvisors/vol9num1/dip.pdf.

149. For a discussion of other situations in which claimants seek to exploit informational asymmetries and melting ice cube leverage to lock up distributional advantages, see *infra* notes 171-177 and accompanying text (discussing cross-collateralization, critical vendor orders, and other examples of redistributive attempts beyond what is contemplated by the Code). Also, senior lenders sometimes seek to share value with shareholders when the unsecured creditors are not getting a distribution. Ralph Brubaker, *Taking Chapter 11's Distributional Rules Seriously: "Inter-Class Gifting is Dead! Long Live Inter-Class Gifting!,"* BANKR. L. LETTER, Apr. 2011, at 1-15.

150. Section 363(b) gives the power to request a sale of property of the estate to the trustee, which is the debtor-in-possession in most Chapter 11 cases. *See generally* 11 U.S.C. § 1107 (2012) (giving a debtor-in-possession the rights and duties of a trustee). Sales through a Chapter 11 plan can be proposed by parties other than the debtor once the debtor's "exclusivity" period to file a plan has expired or has been shortened by the court. *Id.* § 1121.

151. *In re* L.A. Dodgers LLC, 457 B.R. 308, 313 (Bankr. D. Del. 2011) (refusing to defer to management's business judgment and imposing an entire fairness standard because of the lack of disinterestedness of corporate management).

152. Michael R. Roberts & Amir Sufi, *Control Rights and Capital Structure: An Empirical Investigation*, 64 J. FIN. 1657 (2009); Michael R. Roberts & Amir Sufi, *Renegotiation of Financial Contracts: Evidence from Private Credit Agreements*, 93 J. FIN. ECON. 159, 160 (2009). To the extent this is so, it may limit the descriptive fit of the team production model to some kinds of Chapter 11 cases. *See* Lynn M. LoPucki, *A Team Production Theory of Bankruptcy*

possession financing order.[153] Melting ice cube leverage might be used, however, by others—incumbent management,[154] the buyer, or someone else. From the outside, it may not be transparent who is setting the terms.

Embedded within every business bankruptcy case are numerous conflicting interests. An oversecured creditor may prefer a quick sale to a more time-consuming traditional reorganization because it will get paid in full in any event.[155] An undersecured creditor also may prefer a quick sale for a host of reasons. The creditor might be concerned that some of its asserted security interests are unperfected (rendering them vulnerable to avoidance in bankruptcy), or may seek to skirt questions about the amount of bankruptcy estate value properly attributable to its collateral. Alternatively, a potential buyer may have already purchased controlling positions across the capital structure. The speed associated with the quick sale may reduce the likelihood that such objections can be identified, raised, and considered.[156] Unsecured

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Reorganization, 57 VAND. L. REV. 741 (2004) (extending to bankruptcy the insights of Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247 (1999)). Team production theory, a contractarian theory, starts from the premise that each constituent group associated with a corporation (shareholders, creditors, employees, suppliers, and others) has explicitly delegated the direction of the business and the allocation of rents and surpluses to the corporation's board of directors, but that other expectations, including legally unenforceable expectations, flow to each of these constituencies.

153. *See, e.g.*, 11 U.S.C. § 364 (authorizing financing and usually requiring notice and a hearing and specific findings); David A. Skeel, Jr., *The Past, Present and Future of Debtor-in-Possession Financing*, 25 CARDOZO L. REV. 1905 (2004) (discussing control associated with debtor-in-possession financing).

154. COMPARISON SHOPPING GUIDE, *supra* note 48, at § 2.1.5.4 (discussing potential conflicts of interest of managers in negotiating going-concern sales); Kuney, *supra* note 76, at 110-11 (arguing that 363 sales "primarily serve[] the interests of secured creditors and . . . insiders"); LoPucki & Doherty, *supra* note 5, at 32-34 (discussing ways in which management benefits from 363 sales, and conceding that they "probably have only scratched the surface of managerial corruption in these cases" because of the lack of public disclosures once they decided to sell).

155. *See* sources cited *supra* note 145.

156. *See infra* Section II.C. For a recent example of a 363-sale order that seeks to definitively establish that secured lenders' claims are not subject to avoidance actions, see Order (I) Authorizing the Sale of Substantially All of the Debtors Assets Free and Clear of All Liens, Claims, Encumbrances and Interests; (II) Authorizing the Assumption and Assignment of Certain Executory Contracts and Unexpired Leases; and (III) Granting Certain Related Relief at 8, *In re* LCI Holding Co., No. 12-13319 (KG) (Bankr. D. Del., Apr. 4, 2013). In other cases, debtor-in-possession financing orders that fund a debtor pending a 363 sale might eliminate the debtor-in-possession's ability to challenge these issues and give only a short

creditors might wish to squeeze out equity interests in the debtor, and could do so by cutting off the potential upside that lingers as a case heads toward a plan.[157] They might even capture some of that upside for themselves by agreeing to take some of their own distribution in the form of stock in the new (purchased) debtor.

We could conjure many other hypotheticals. For example, incumbent management might prefer a buyer likely to continue their employment, even if it is not offering the best price.[158] Or the purchaser might wish to favor certain unsecured creditors over others (as the government did in *Chrysler*). Shareholders of the debtor might team up with the buyer and use the terms and covenants of proposed debtor-in-possession financing to squeeze out unsecured creditors. Whatever the scenario, the leverage and informational asymmetry associated with a hurry-up sale make it more difficult for the court or other stakeholders to smoke out and neutralize unsavory arrangements, and may cause claimants to be more accepting of priority deviations, assuming they become aware of them.

e. *Institutional Capacity (Ex Ante)*

The combined effect of information and incentive problems limits a court's capacity to protect the estate regardless of a particular judge's experience or sophistication. Poor information plus the (possibly manufactured) crisis create an untenable situation for courts. Judges are faced with the Hobson's choice of permitting a potentially opportunistic sale or possibly overseeing the destruction of value by insisting on the diagnostic process that would reveal the truth.[159] Although the purchaser might be bluffing about time being of the

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period of time (and perhaps limited funding) to a creditors' committee to pursue them instead. *See* sources cited *infra* note 193.

157. Lynn M. LoPucki & William C. Whitford, *Bargaining Over Equity's Share in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 139 U. PA. L. REV. 125, 153 (1990).

158. LOPUCKI, *supra* note 54, at 174 (discussing the tendency of debtors' senior management to get lucrative employment from buyers after all-asset 363 sales). *See generally* Kenneth N. Klee, *Barbarians at the Trough: Riposte in Defense of the Warren Carve-Out Proposal*, 82 CORNELL L. REV. 1466, 1480-81 (1997) (discussing historic concerns about collusion between secured lenders and debtors' managers in a foreclosure sale context).

159. *See supra* Sections I.A, I.B.

essence, the risk associated with calling that bluff is considerable.[160] In the *GM* case, for example, the bankruptcy court explained the discomfort:

> GM's counsel noted in summation that the F & D Bondholders Committee was expecting this Court to play Russian Roulette, and the comparison was apt. So that the F & D Bondholders Committee could throw GM into a plan negotiation process, the Court would have to gamble on the notion that the U.S. Government didn't mean it when it said that it would not keep funding GM. There is no reason why any fiduciary, or any court, would take that gamble.[161]

To the extent that expedited going-concern sales under § 363 precede the informational sweet spot, they force the court (not to mention potential objecting creditors and potential alternative bidders) to make a key "reorganize/liquidate/hurry-up sale" decision prior to the optimal moment. Engineers of a sale increase their leverage by using the melting ice cube argument to make it seem dangerous to collect more information and explore other options. And, as the judges in *Humboldt Creamery*, *GM* and *Digital Domain* observed, judges and judicial process have little choice but to give way to this practical fait accompli.[162]

2. *Distributional Consequences*

The cases that raise the most explicit distributional issues involve sale orders that contain explicit instructions about how to allocate value. These sales are often attacked as "sub rosa" plans—plans of reorganization disguised as sales in order to evade the requirements of plan confirmation.[163] The procedures that govern the Chapter 11 plan process do not apply to the debtor-

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160. Landers, *supra* note 66, at 112 (reporting that courts have "generally gone along with a fast track process, and resisted pleas for more time to produce more value. And, maybe they are right—sale objectors are notorious for seeking delay to obtain leverage or support for individual agendas, without much concern for whether the sale produces the truly best bid. But, we will never know"). For a discussion of how corporate and bankruptcy law scholars such as Adler & Ayres, Daines & Hanson, and Casey, have sought to use market-based proposals to address management lock-ups, see *infra* Subsection III.C.5. As we note there, however, in insolvency situations, markets are imperfect, and we see judicial oversight and fact finding as unavoidable, and even desirable.

161. *In re* Gen. Motors Corp., 407 B.R. 463, 493 (Bankr. S.D.N.Y. 2009).

162. *See supra* notes 96-103 and accompanying text.

163. *E.g.*, *In re* Braniff Airways, Inc., 700 F.2d 935, 940 (5th Cir. 1983).

in-possession's powers to administer the estate, such as the power to sell and use property of the estate under § 363, or the power to incur debt under § 364. But when the power to sell includes selling everything, and the power to borrow includes terms that predetermine the distribution of proceeds, the plan process can be rendered irrelevant. Thus, early sales, coupled with restrictive financing, facilitate the use of transactional leverage for individualized benefit, particularly by creditors holding prepetition undersecured claims. But even sales that lack obvious sub rosa features can have significant distributional consequences and are procedurally noncompliant, in that they short-circuit the safeguards of Chapter 11.

As we describe below, the Code contains well-developed procedures, with a long historical provenance, that allows parties to negotiate an allocation of enterprise value in the shadow of an established disclosure regime (applicable to Chapter 11 plans), a mandatory set of legal findings, and a distributional scheme established by state law and the priority rules for Chapter 7 liquidations. The Chapter 11 plan confirmation process imposes important limits on the use of transactional leverage to divert value.

Section 1125 of the Code requires a disclosure statement that provides claimants with "adequate information" to make an informed decision whether to support or oppose a plan of reorganization.[164] Section 1129(a)(7) requires a finding that each claimant will receive at least as much under the plan as they would if the debtor were liquidated under Chapter 7.[165] This means that the distributions under the proposed plan must respect the distributional priorities contained in Chapter 7.

Code-authorized priorities among unsecured claims are rooted both in the exigencies of bankruptcy, and in other public policy considerations. For example, unpaid employee wage claims get special priority,[166] and Chapter 11 entitles such claimants to payment in full in cash on the effective date of a confirmed plan.[167] The Code also requires the debtor-in-possession to cure defaults in executory contracts that will be assumed and performed. The

164. 11 U.S.C. § 1125 (2012).

165. *Id.* § 1129(a)(7).

166. *Id.* § 507 (providing priority to certain kinds of prepetition claims and for administrative claims that benefit the bankruptcy estate during the case).

167. *Id.* § 1129(a)(9) (requiring cash payment on the effective date of a Chapter 11 plan other than for tax claimants who have a different entitlement). For a discussion of how our Ice Cube Bond proposal intersects with proposals to further regulate sub rosa sales, see *infra* note 230.

estate's counterparty goes from being entitled to only a pro rata share of the debtor's unencumbered assets, to being entitled to one hundred percent payment of its prepetition claim.[168] Debtors-in-possession can seek court permission to give super-priority or secured status to lenders offering to extend credit to the bankruptcy estate.[169] These Code-authorized liens and priorities subordinate prepetition creditors in the interest of a successful reorganization.

Yet, a common theme of these Code-authorized priorities is that they do not exacerbate, and are often designed specifically to limit, the leverage of prepetition creditors on the eve of, and early in, a bankruptcy case. The employee wage priority protects people who often have little leverage.[170] The executory contract provisions allow the debtor to hold a non-debtor to its contract notwithstanding bankruptcy, and sometimes require the non-debtor to accept a contractual assignment, even if the non-debtor would prefer to do business with someone else. The financing provisions are meant to prevent prepetition creditors from placing a credit stranglehold on the debtor.

Other mechanisms for redistributing value have developed (sometimes on shaky statutory grounds) through bankruptcy practice or been placed into the statute as a result of interest group lobbying.[171] Rather than reducing

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168. 11 U.S.C. § 365(b); 3 COLLIER ON BANKRUPTCY ¶ 365.06 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2013).

169. 11 U.S.C. § 364(d).

170. *Id.* § 507(a)(4). This provision and issue is distinct from the rights of unionized employees under § 1113 of the Code. Section 1113 was enacted following *NLRB v. Bildisco & Bildisco*, 465 U.S. 513 (1984), to reinstate the negotiating power of unionized employees when a debtor employer seeks to modify (or nullify) the collective bargaining agreement with its employees. That provision was meant to promote the transactional leverage that unions have outside of bankruptcy and to manage the interaction between two important federal policies. Daniel Keating, *The Continuing Puzzle of Collective Bargaining Agreements in Bankruptcy*, 35 WM. & MARY L. REV. 503 (1994) (discussing § 1113 as a response to the rejection of collective bargaining agreements under *Bildisco*); Daniel L. Keating, *Good Intentions, Bad Economics: Retiree Insurance Benefits in Bankruptcy*, 43 VAND. L. REV. 161, 185-87 (1990) (discussing § 1114 as a response to LTV Steel Corporation's rejection of retiree medical benefits).

171. Notable examples of interest group pressure include the "shopping center" amendments limiting the ability to assume and assign leases under § 365, as well as the safe harbors for derivatives inserted into §§ 362 and 546, enacted to a limited extent in 1984 and substantially expanded in 2005. 11 U.S.C. §§ 362(b)(17), 365, 546(e)-(g); *see* Jeffrey A. Wurst & Michael S. Amato, *Treatment of Franchisee Leases Under § 365*, AM. BANKR. INST. J., July-Aug. 2011, at 47 ("In response to strong lobbying efforts by real property owners, landlords and managing agents, § 365(d) was amended, setting defined limitations on the time period to assume or reject nonresidential real property leases.").

stakeholder leverage, many reflect the power of certain participants in the bankruptcy process. *Texlon*-type cross-collateralization and critical vendor motions, discussed below, are two prominent examples.

Texlon-type cross-collateralization, named for the first case to criticize it,[172] involves the granting of postpetition liens to secure unsecured prepetition debt. The postpetition priorities and liens authorized in § 364 speak only of security for new postpetition loans and do not disturb the *relative* priority of prepetition obligations.[173] The Code does not expressly authorize debtor-in-possession financing orders that use new liens to secure, and effectively pay, prepetition debt. But the case law of some jurisdictions permits cross-collateralization or arrangements such as roll-ups, if deemed to be in the best interest of the estate after considering multiple factors.[174] Just like the melting ice cube sale, the call for financing deals with these terms typically depends on an assertion that the situation is dire, that there is no other possible financing, and no other prospect of preserving value for stakeholders.[175]

Similarly, some courts permit debtors to invoke the equitable "doctrine of necessity" to give special treatment to so-called critical vendors, with whom business relationships must be preserved, by paying their prepetition debts in

172. Otte v. Mfrs. Hanover Commercial Corp. (*In re* Texlon Corp.), 596 F.2d 1092 (2d Cir. 1979). In this case, Judge Friendly raised concerns about this financing technique and declined to approve it under the circumstances of the particular case. *Id.* at 1098. The opinion did not, however, disallow cross-collateralization per se. *Id.* ("In order to decide this case we are not obliged, however, to say that under no conceivable circumstances could 'cross-collateralization' be authorized."); *see also* Charles J. Tabb, *A Critical Reappraisal of Cross-Collateralization in Bankruptcy*, 60 S. CAL. L. REV. 109, 115 (1986) (showing that the *Texlon* court declined an opportunity to permanently prohibit cross-collateralization).

173. 11 U.S.C. § 364.

174. Roll-ups use postpetition loans to pay off prepetition debt in one hundred percent dollars. For a relatively recent discussion, see Craig R. Bucki, *Cracking the Code: The Legal Authority Behind Extrastatutory Debtor-in-Possession Financing Mechanisms and Their Prospects for Survival*, 2005 COLUM. BUS. L. REV. 357, 373-74. For a discussion of variations on roll-ups, such as a creeping roll-up, see Conclusions of Law, *In re Capmark Financial Group, Inc.*, 438 B.R. 471, 511 n.15 (Bankr. D. Del. 2010).

175. *See, e.g.*, Tiffany Kary, *Lyondell Chemical Wins Approval for $8 Billion Bankruptcy Loan*, BLOOMBERG (Feb. 28, 2009, 12:01 AM), http://www.bloomberg.com/apps/news?sid=akq3.skbZ13o&pid=newsarchive (describing this dynamic as manifested in Lyondell's bankruptcy); Squire Sanders & Andrew M. Simon, *Lyondell Chemical Company – The Impact of Tight Credit Markets on Debtor-in-Possession Financings*, LEXOLOGY (Aug. 26, 2009), http://www.lexology.com/library/detail.aspx?g=49d92842-abc4-4e3d-b8ee-d481d16889d0 (same).

full and early in a case.[176] Supporters of these payments assert, sometimes without much evidence, that the deviation from priority makes creditors better off as a whole—a small price to pay, they say, if the absence of critical vendor cooperation will undermine the entire reorganization. But if too many parties exploit their leverage, and courts do not enforce the "critical" standard rigorously, those demands for cash and special treatment early in the bankruptcy case will have the opposite effect: smaller payouts for other creditors and a lower likelihood of reorganization.[177]

Quick all-asset sales raise the same kinds of questions as these suspect types of priority.[178] Indeed, the push for a quick sale can be tightly intertwined with proposed debtor-in-possession financing by a prepetition secured creditor, with the financing order (rather than the sale order) realigning statutory priorities. It is possible that the transaction is still in the best interest of creditors notwithstanding the distortion of bankruptcy priorities. Highly charged sale environments, in which parties proclaim the need for speed, make it difficult to determine whether the buyer is walking away with more than its share, leaving others with less.[179]

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176. *See, e.g.*, *In re* Just for Feet, Inc., 242 B.R. 821 (D. Del. 1999) (authorizing payment of prepetition claims to vendors judicially deemed "critical"). *But see In re* Kmart Corp., 359 F.3d 866 (7th Cir. 2004) (affirming the reversal for lack of evidence of a bankruptcy court's determination that a particular vendor was "critical"). For an early analysis proposing that such payments be prohibited, or at least more tightly restricted, see Charles Jordan Tabb, *Emergency Preferential Orders in Bankruptcy Reorganizations*, 65 AM. BANKR. L.J. 75 (1991).

177. *See* STRATEGIC ALTERNATIVES FOR DISTRESSED BUSINESSES § 5:25 (Jonathan Friedland ed., 2012) (discussing how "the 'churn' of trade creditors and likelihood that a company failing to pay trade creditors will not survive the solicitation process requires 'ride through'" of trade claims in prepackaged Chapter 11 cases); Douglas G. Baird, *Bankruptcy from Olympus*, 77 U. CHI. L. REV. 959 (2010) (discussing Judge Easterbrook's decision in *Kmart*).

178. Brubaker & Tabb, *supra* note 34, at 1378 ("[T]here is nothing about capturing reorganization value via a § 363 sale rather than a plan that is in itself problematic."); *id.* at 1379 ("[W]hether reorganization value is captured by 'sale' or by 'plan' is not the critical question, as long as the method chosen preserves and upholds Chapter 11's distributional norms.").

179. When thinking about what is appropriately the creditors' share, it is necessary to distinguish the distribution a creditor would receive in a hypothetical Chapter 7 liquidation from the incrementally greater distribution, based on a debtor's going-concern value, available as the result of a successful reorganization. The liquidation value is the irreducible minimum to which the secured creditors are entitled. In a consensual case, the reorganization surplus is properly the subject of negotiation. Chaim J. Fortgang & Thomas Moers Mayer, *Valuation in Bankruptcy*, 32 UCLA L. REV. 1061, 1106 (1985). *See generally* LoPucki & Whitford, *supra* note 157 (discussing negotiation practices in Chapter 11 reorganization).

While we do not inherently prefer reorganizations over going-concern sales, we do favor sales with more information and opportunity for bargaining in the shadow of the Code over sales concluded with less. We therefore favor going-concern sales accompanied by the procedural protections of a Chapter 11 plan to those conducted under § 363 without disclosure, solicitation, voting, and judicial confirmation. If a going-concern sale is proposed as part of a Chapter 11 plan, the plan proponent must provide "adequate information" in a disclosure statement, usually including an explicit comparison to a Chapter 7 liquidation, as well as adequate time to evaluate the proposal.[180] Expedited 363 sales, by contrast, run the risk of cutting short the opportunity to compare the value of the assets to the proposed price, to compare the proposed price to what might be offered were the debtor to be exposed to the market over a longer period of time, or to consider the benefits of a true reorganization. In other words, expedited all-asset sales of alleged melting ice cubes shift the risk of undervaluation to the estate and allow distributional distortions – even if the sale does not expressly dictate allocation as the Chrysler sale did. Our Ice Cube Bond proposal in Part III seeks to reduce this reallocation of risk and seeks to limit the leverage associated with a melting ice cube crisis.

C. *Quantifying and Allocating the Costs and Benefits of Expedited All-Asset Sales*

The discussion so far, reduced to its essentials, suggests that the bankruptcy estate benefits from a quick 363 sale under some but not all conditions, and that parties with conflicts of interest may use the melting ice cube argument to distort the choice between a quick sale outside a plan, a sale under a plan, and a reorganization under a plan. In this next Section, we explore how to sort between value-maximizing and opportunistic quick sales.

1. *The Speed Premium and Increased Error Costs – Kaldor-Hicks Efficiency*

Chapter 11 can help maximize the value of a debtor in a number of ways. As explored in Part I, Chapter 11 captures value that would have been lost in a

180. *See, e.g.*, 11 U.S.C. § 1125 (2012) (requiring that claim holders receive a court-approved disclosure statement containing adequate information to enable informed judgment about the Chapter 11 plan). Whether courts' sale process orders can or do accomplish a similar objective is likely to be the subject of debate. *See* Kuney, *supra* note 76, at 107-08 (comparing the procedural aspects of sales under Chapter 11 plans to 363 sales).

piecemeal sale under ordinary state law mechanisms or in a Chapter 7 liquidation. This value can be preserved through a traditional plan of reorganization, or through a Chapter 11 plan with a going-concern sale as its centerpiece. This sale-created value derives in part from the flexibility of Chapter 11, which in practice allows pragmatic structuring of sales, a short timeframe (even under a plan), and, most importantly, the transfer of clear title.[181]

Sometimes, however, preservation of this Chapter-11-created value may require a quick 363 sale prior to plan confirmation; this increment of preserved value is what we call the "Speed Premium." The Speed Premium is the difference between the proposed "Expedited Sale Price,"[182] and the present value of the price if one delays the sale until approval of a Chapter 11 plan or substitutes a traditional reorganization (the "Hypothetical Plan Price"):

$$\text{Speed Premium} = \text{Expedited Sale Price} - \text{Hypothetical Plan Price}$$

The asserted benefit of a quick sale does not exist unless, at the very least, the quick sale price exceeds the anticipated price under a Chapter 11 plan.[183] In other words, the value of the assets are declining. The ice cube is melting.

This is not the end of the inquiry, however. It is important to distinguish melting ice cube risk from the risk of erroneous valuation. Melting ice cube risk is based on the concerns about perishability reviewed in Part I. For example, fresh produce, customer lists, and other types of assets may quickly decline in value. Some firms run the risk that firm-specific value will dissipate quickly. Key employees may leave, for example. There are many reasons a Speed

181. *See supra* Sections I.A, II.A.

182. Here, we mean a sale of all or substantially all assets that occurs under § 363 in a Chapter 11 case but outside the context of a confirmed Chapter 11 plan.

183. In response to a prior draft, Stephen Lubben asked whether the comparison should be to the foreclosure process under state law. This highlights an important distinction. The Speed Premium, which is relevant for governance purposes, is distinct from the concept of bankruptcy-created value. As discussed below, bankruptcy-created value can consist either of the difference between the Expedited Sale Price and the price realized through foreclosure outside of bankruptcy, or the difference between the value of the reorganized entity and the value of the assets as determined through a state law foreclosure process. The concept of bankruptcy-created value is important to determine the distributional baseline for secured creditors, but it is not relevant to the decision whether to conduct a hurry-up going-concern 363 sale or confirm a Chapter 11 plan. Both are expected to produce greater values than state law foreclosure. The governance choice on the table is between competing dispositions of the assets *within* a bankruptcy case.

Premium *may* exist. However, a quick sale reduces the level of information available to interested parties to value the company, and therefore increases the risk of erroneous valuation. In particular, because of the information asymmetries discussed above, we assume that the sale proponents and debtor's incumbent management have better information than the creditors and the court. We are therefore particularly concerned with the increased risk of undervaluation imposed on the estate by the quick sale. We will refer to this cost, along with the other reasons for increased likelihood of erroneous valuation, as the "Increased Probability of Undervaluation."

The governance question raised by a quick sale is to determine whether the Speed Premium's value exceeds the costs imposed by the Increased Probability of Undervaluation. Information scarcity increases the probability that the quick sale will harm rather than benefit the bankruptcy estate. A quick 363 sale is not desirable if the Speed Premium is less than the cost imposed by the procedural shortcut.[184] This is a more rigorous assertion of the governance holding in *Lionel*—that a good business justification is needed.[185]

The costs imposed by a quick sale could be calculated by multiplying the increased probability that the Expedited Sale Price is too low times the anticipated undervaluation ("Undervaluation Amount"). Thus the Quick Sale Cost would be:

$$\text{Increased Probability of Undervaluation} \times \text{Undervaluation Amount} = \text{Quick Sale Cost}$$

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184. This is true as a matter of efficiency. For reasons of fairness, discussed elsewhere, a sale should not be approved where leverage is being used to distort distributional priorities.

185. *See supra* note 19 and accompanying text. The *Lionel* court phrased the standard as a "good business justification," but early commentators equated this standard with the "best interests of the estate" test. *See, e.g.*, John J. Hurley, *Chapter 11 Alternative: Section 363 Sale of All of the Debtor's Assets Outside a Plan of Reorganization*, 58 AM. BANKR. L.J. 233, 246 (1984) (noting that *Lionel*'s business justification test "appears to be compatible with the 'best interests of the estate' test announced by other courts"). Increased Probability of Undervaluation is distinct from the possibility that the value of the company may change over time for extrinsic market reasons. The quick sale allocates all of the "market upside," or what is sometimes called "optionality," to the buyer. By fixing the value, the 363 sale eliminates this market risk for the debtor's prepetition creditors and investors, for better or for worse. But, so long as that risk allocation is made on the basis of symmetric information, without the influence of melting ice cube leverage, the ability to choose the timing of the sale is a benefit.

In sum, the increment of value created by a going-concern sale under § 363 ("363 Sale Value") can be quantified as the difference between the Speed Premium and the Quick Sale Cost:

Speed Premium – Quick Sale Cost = 363 Sale Value

If the 363 Sale Value is positive, then a quick sale is preferable to a sale under a Chapter 11 plan. If it is negative—that is, the Quick Sale Cost exceeds the Speed Premium—then there is no valid reason to shortcut the ordinary plan confirmation process to conduct a hurry-up sale under § 363.[186] Unfortunately, under current practice, the court must decide on the fly, without sufficient information and sometimes without an adversarial presentation, whether to declare the melting ice cube argument a bluff. As previously explained, this is too much to expect. As a result, there is a considerable risk that the court's ad hoc estimate of a positive 363 Sale Value at the time of sale will turn out to be wrong. Under current law, this risk lies entirely with the bankruptcy estate.

In our view, if the advocates of the quick sale are seeking a procedural shortcut, they should, at some level, insure the estate against the possibility that the value of the sale is negative. In other words, as we argue in Part III, those pushing for a sale outside the Chapter 11 plan process should be required to put their money where their mouths are and demonstrate, after the fact, that the estate has not been harmed by forgone process.

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186. The concept of optionality offers another way to quantify some of the harm to the estate caused by quick all-asset sales. As previously mentioned, equities of insolvent companies and underwater debt securities of bankrupt companies continue to sell at positive values. *See* Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 N. LaSalle St. P'ship, 526 U.S. 434, 455 (1999) ("The right to get an equity interest for its fair market value is 'property' as the word is ordinarily used. Options to acquire an interest in a firm, even at its market value, trade for a positive price." (quoting BAIRD, *supra* note 30, at 261)). Until the case is over, and the claims or interests in the debtor are cancelled, there remains a chance of some type of distribution to such claims or interests under a consensual plan. *See generally* LoPucki & Whitford, *supra* note 157. Early all-asset sales foreclose this optionality, eliminating the possibility of a traditional reorganization, an upward market shift, or the emergence of a buyer willing to pay a higher price. This was an issue in *Lionel*, the seminal Second Circuit decision, where the estate ultimately realized a substantial premium over the price offered in the proposed Quick Sale. *See supra* note 62. The option value is the price someone might pay for a call on the assets at some point in the future. If the equation described above produces a positive 363 Sale Value, then this implies that there is no option value or that it is negative. These are the only cases in which a Quick Sale is desirable.

2. *Distributional Consequences – Pareto Optimality and Bargaining over the Speed Premium*

Early sales can produce two types of harm. Valuation harm is absolute. Distributional harm is relative. Or, to put it another way, when one asks if the benefit of the Speed Premium outweighs the cost to the estate, one is asking if the early sale is Kaldor-Hicks efficient. By contrast, when the melting ice cube leverage is used to alter the relative distribution, the sale is not Pareto optimal. Efficiency is being achieved at the expense of one or more holders of claims or interests.

Parties can, and frequently do, use the value preservation argument (e.g., "We must buy/sell before the ice cube melts") to capitalize on their informational advantages. This use of transactional leverage has both efficiency and fairness consequences. As we discuss below, baseline entitlements cannot be modified without individual claimholders' consent. By contrast, bankruptcy-created value is properly the subject of bargaining, subject to the protections of the Chapter 11 plan process.

a. *Baseline Distributions – Best Interests and Pareto Optimality*

To be confirmed, a Chapter 11 plan of reorganization must satisfy a condition colloquially known as the "best interests of creditors" test: each holder of a claim (or interest) must receive in the Chapter 11 plan at least as much as it would have received in a liquidation of the assets in Chapter 7.[187] Section 363 does not have its own "best interest of creditors" test. Under current law, the proponent must simply demonstrate that it has a good business justification for the sale, or to put it another way, that it appears the sale will be in the best interest of the estate as a whole. Thus, if courts permit the distribution of 363-sale proceeds *outside* of a Chapter 11 plan, claimants do not get the same protection they would have received in a sale within a plan.[188]

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187. 11 U.S.C. § 1129(a)(7) (2012). The holder of a claim is, of course, permitted to consent to lesser treatment by accepting a plan that so provides. *Id.*

188. For various assumptions about the timing of the distribution of 363-sale proceeds, see Ayotte & Morrison, *supra* note 27, at 520 (describing plans that disburse money from going-concern sales); LoPucki & Doherty, *supra* note 5, at 26-27 (noting that some secured creditors probably were paid upon sale closing while other creditors probably had to await Chapter 11 plan consummation); and James J. White, *Death and Resurrection of Secured Credit*, 12 AM. BANKR. INST. L. REV. 139, 164 (2004) (suggesting that 363 sales produce quicker payouts to creditors).

Yet, where a sale of all assets is effectively determining the distributions in the case, it makes sense to impose a similar condition of Pareto Optimality.

To establish whether the sale meets the Pareto condition, we need both a baseline valuation and a baseline distribution. To compare a quick 363 sale to a sale under a Chapter 11 plan, one ought to ask the same question: what would creditors receive if the debtor were liquidated or sold pursuant to a plan? Crudely stated, the secured creditors are entitled to receive the value of their collateral, and the unsecured creditors share pro rata in the remainder.[189] In *Chrysler*, secured creditors argued that unsecured creditors were receiving value that should have gone to them.[190] The bankruptcy court concluded, however, that the secured creditors were receiving considerably more than piecemeal liquidation would have yielded.[191] So, in that case, the Pareto condition was satisfied. More typically, a secured creditor will claim it holds a first priority lien on all of a debtor's assets, rendering everything sold in the quick sale its collateral. If this naked assertion were dispositive, most quick sales would satisfy the Pareto condition. As we will further explain, however, alleged blanket liens may be less complete than secured creditors frequently contend.[192]

Thus, while Pareto Optimality requires protecting the secured creditors' entitlements as of the petition date, it similarly requires protecting the unsecured creditors, by preserving any distribution they might have received. Spurious claims of priority or security reallocate assets that would (and sometimes should) have been available for distribution to others. The speed demanded in an alleged melting ice cube sale can preclude adequate investigation of the perfection and scope of the secured creditor's lien, either as a term of the sale, as a term of an associated debtor-in-possession financing order, or as a practical matter.[193] Such an improvement of the secured creditor's

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189. 11 U.S.C. §§ 502, 506, 726, 1129(b).

190. *See* Adler, *supra* note 33, at 306-07; Roe & Skeel, *supra* note 2, at 733.

191. *In re* Chrysler LLC, 405 B.R. 84, 97 (Bankr. S.D.N.Y. June 1, 2009) ("[T]estimony, which is unrebutted, is that the $2 billion New Chrysler is paying for the Debtors' assets exceeds the value that the First-Lien Lenders could recover in an immediate liquidation. . . . [T]he Debtors' financial advisor, Capstone . . . concluded that liquidation would generate between zero and $1.2 billion."); *see also* Lubben, *supra* note 35, at 544 (discussing why most secured lenders in *Chrysler* supported a sale giving them $2 billion in cash).

192. *See infra* Subsection II.C.2.b.

193. Some parties seek to condition a sale (or condition financing, whether or not associated with a sale) on a transfer or a waiver of avoidance actions and curing of any lien imperfections. *See* AM. BANKR. INST., DEBTOR-IN-POSSESSION FINANCING: FUNDING A CHAPTER 11 CASE 290-96 (Felicia Gerber Perlman ed., 2013) [hereinafter DEBTOR-IN-POSSESSION FINANCING]

position reallocates unencumbered value from the bankruptcy estate to the secured creditor without any clear basis for the entitlement.

b. *Allocating the Speed Premium*

Property rights in the bankruptcy estate's assets and entitlement to the Speed Premium may vary from case to case. We cannot definitively allocate the cost and distribute the Speed Premium in a one-size-fits-all way.[194] Ideally, the Chapter 11 plan process protects the ability of stakeholders to negotiate over the allocation of the various elements of value that are up for grabs. Quick sales short circuit the balancing of interests and opportunity for deliberation inherent in the plan process. So, in considering the distributive consequences

(reviewing contract clauses and court orders that seek to prevent subsequent litigation about defects in lenders' prepetition claims); Klee & Levin, *supra* note 46, at 9 (noting that debtor-in-possession lenders typically request that the court make findings in the financing order about the validity of their prepetition liens); Kuney, *supra* note 76, at 64-65; Jonathan M. Landers, *The Future of Avoidance Powers in Commercial Cases*, NORTON BANKR. L. ADVISER, Nov. 2012, at 1, 3 (discussing how some debtor-in-possession financing orders "admit the validity of liens and the absence of claims . . . against favored parties, limit the use of funds advanced by the DIP lender for investigation and litigation, and provide shortened periods for investigation of potential claims"). Federal Rule of Bankruptcy Procedure 4001(c) sets forth, among other things, what a motion to obtain credit must disclose, including "a determination of the validity, enforceability, or priority for a claim that arose before the commencement of a case." FED. R. BANKR. P. 4001(c)(1)(B)(iii). Some waivers in debtor-in-possession financing orders do not bar creditors' committee action outright, but might impose strict time limits or monetary limits. *See, e.g.*, *In re* FCX, Inc., 54 B.R. 833 (Bankr. E.D.N.C. 1985); Final Order, *In re* Caribbean Petrol. Corp., No. 10-12553 (KG), 2010 WL 6982178 (Bankr. D. Del. Aug. 12, 2010); Final Order, *In re* Champion Enters., No. 1:09-bk-12553 (Bankr. D. Del. Aug. 12, 2010); Final Order at 31, *In re* Wellman, Inc., No. 08-10595 (Bankr. S.D.N.Y. Apr. 7, 2008); Interim Order, *In re* DJK Residential LLC, No. 08-10375 (Bankr. S.D.N.Y. Feb. 5, 2008). Courts want adequate disclosure of efforts to obtain waivers within debtor-in-possession financing agreements, at least when sought on a very expedited basis. *See, e.g.*, Local Rules of the United States Bankruptcy Court for the District of Delaware, Rule 4001-2, Cash Collateral and Financing Orders (effective Feb. 1, 2013) (requiring that parties highlight provisions in debtor-in-possession orders that "bind the estate or other parties in interest with respect to the validity, perfection or amount of the secured creditor's prepetition lien" that do not allow a window of time for a creditors' committee to investigate); Kuney, *supra* note 76, at 58. Nonetheless, the leverage associated with melting ice cube arguments could pressure courts to approve orders containing these features and other claimants not to oppose them as rigorously.

194. As we discuss *infra* Subsection III.C.5, this problem is not fully addressed in other proposals, such as Adler & Ayres, *supra* note 114; and Casey, *supra* note 16.

of quick sales, it is essential to identify the possible beneficiaries and cost bearers.

i. *Who Is Entitled to the Speed Premium?*

Consider the senior secured lender who asserts a blanket lien on all of a debtor's assets. When such a creditor advocates for an early going-concern sale it will likely argue that it has the right to determine what to do with the estate's assets, all of which the creditor believes are collateral for its loan.[195] Here, however, we question the assumption that the senior secured creditor owns the Speed Premium.

This assertion is first cast into doubt by the concept of optionality. As we have noted, in the absence of a bankruptcy filing, the secured creditor would have the right to foreclose under state law.[196] Bankruptcy law cuts off this right. As such, the distributional baseline starts with the value a creditor would receive if it conducted a foreclosure sale of the liened assets under state law. A secured lender does not necessarily own an increase in value above this baseline, created by the efficiencies of the bankruptcy system.[197] Anthony Casey, who has described option value in great detail, agrees that bankruptcy-created value is not necessarily proceeds of the secured creditor's collateral, and

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195. Academic articles often document lenders' efforts to obtain blanket liens on the property of a business. *See, e.g.*, Claire A. Hill, *Is Secured Debt Efficient?*, 80 TEX. L. REV. 1117, 1118, 1125, 1138 (2001) (discussing the propensity among lenders to firms of lower financial quality to encumber "all their assets" even if some have little worth, although noting that some lending agreements carve out assets such as real estate, receivables, or a particular piece of equipment financed through a purchase-money transaction); Jay Lawrence Westbrook, *The Control of Wealth in Bankruptcy*, 82 TEX. L. REV. 795, 799, 810-12 (2004) (describing the dominant security interest as necessary to allow the creditor the ability to sell the business as a going concern without considering other stakeholders, but acknowledging barriers to fully capturing value, such as need for manager's expertise); *id.* at 856 (noting that control in bankruptcy by a secured creditor might be appropriate if it is the only class of beneficiary, such as when a dominant creditor is undersecured). However, Westbrook's analysis does not address whether dominant creditor control is possible under U.S. law.

196. *See supra* Subsection II.A; *see also* U.C.C. § 9-610 (2010) (authorizing commercially reasonable disposition of personal property collateral after default).

197. Ronald J. Mann, *Bankruptcy and the Entitlements of the Government: Whose Money Is It Anyway?*, 70 N.Y.U. L. REV. 993, 1000 (1995) (arguing that "the government's role in creating and supervising the bankruptcy system entitles it to use any value created by that system to further any legitimate interest of the government" and that any such value therefore does not inherently belong to any particular creditor group).

thus might not be owned by the secured creditor.[198] He suggests that a secured creditor asserting a blanket lien should have to purchase the option value of the unsecured creditor's claim if it is pursuing a sale, rather than a reorganization, through a Chapter 11 plan.[199] Casey is concerned with post-confirmation option value in sales conducted pursuant to a plan. We are concerned with "optionality" during a different time period—between the quick sale and reorganization or sale under a plan. The logic is the same, however. The quick sale cuts off any option value that might be held by other claimants. And unlike Casey, the option value we seek to protect is already allocated to the estate by the Code. The key point is that the option value is not "owned" by the senior secured creditor. For this and other reasons, the asserted blanket lien may not encumber the full value of the enterprise, leaving value for others.

ii. *Delayed Realization, Chapter-11-Created Value, and the Limits of Proceeds*

The terms "realization" and "option value" denote two components of firm value: the value of the firm if sold today, and the value of an option that would allow the sale to be delayed to a future date—the price of a bet that the value of the firm will go up. The price of equity shares of a solvent firm contains both values. The officers and directors retain the ability and obligation to maximize firm value by choosing when to liquidate assets.

The situation changes when a firm becomes insolvent but is not yet in bankruptcy. Outside of bankruptcy, creditors have the power to force realization by liquidating assets to satisfy their debts. Unsecured creditors can obtain judgments and, to the extent state law permits, pursue unencumbered assets of the debtor to satisfy those judgments.[200] Secured creditors that have contracted for collateral can repossess and foreclose on the assets securing the

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198. Casey, *supra* note 16, at 797.

199. *Id.* at 791. If a senior secured creditor seeks a sale, says Casey, the senior creditor should have to make a proposal to junior creditors to buy out their option value (what he calls an "option-preservation priority"). In effect, the junior creditors would have a veto over the sale. It is important to note that while Casey is concerned with option value generally, we focus on the option value associated with the comparison between a quick sale and a sale or reorganization pursuant to a confirmed Chapter 11 plan.

200. *E.g.*, N.Y. C.P.L.R. 5202, 5232-34 (McKINNEY 2013).

debt.[201] These are the state law entitlements of the secured and unsecured creditor on the bankruptcy petition date.[202]

Conceptualized this way, the secured creditor is entitled to the value of its collateral on the bankruptcy petition date.[203] As a practical matter, this dating rule is a legal fiction. Liquidation outside of bankruptcy (or even in Chapter 7) would take considerable time. Foreclosures outside of bankruptcy are subject to time delays by design or circumstances, and uncertainty about the title purchased.[204] Because different systems govern the lender's remedies upon a debtor's default, cobbling together a nonconsensual, going-concern sale may be difficult, if not impossible.

Chapter 11 offers a number of tools designed to enhance the value of the firm beyond what it would be worth if liquidated on the petition date. Some examples:

- It gives the debtor-in-possession enhanced powers to sell the debtor as a going concern and to transfer those assets with clear title.[205]
- It provides significant incentives to third parties to provide financing to the Chapter 11 debtor.[206]
- It establishes mechanisms to allocate value.[207]

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201. *E.g.*, U.C.C. § 9-610 ("After default, a secured party may sell, lease, license, or otherwise dispose of any or all of the collateral in its present condition or following any commercially reasonable preparation or processing.").

202. It also is the interest entitled to "adequate protection" against the decline of value during the bankruptcy case. 11 U.S.C. § 361 (2012) (defining adequate protection); *id.* §§ 362-364 (listing instances in which secured creditors are entitled to request adequate protection).

203. The concept of realization upon insolvency is even clearer under non-U.S. law. Many jurisdictions retain a concept of liability for "wrongful trading" or "trading while insolvent." The officers and directors have a duty to commence insolvency proceedings upon discovery that the entity is insolvent. *See, e.g.*, Insolvency Act, 1986, c. 45, § 362 (U.K.). *See generally* Perry S. Granof, Presentation Before the New York City Bar Association: Insolvency and D&O Liability Around the World (June 11, 2009), http://www.granofinternational.com/documents/Presentation_NY.pdf (reviewing director insolvent-trading liability in Western Europe, Australia, and Canada). For a proposal to impose a similar requirement under U.S. law, see A. Mechele Dickerson, *A Behavioral Approach to Analyzing Corporate Failures*, 38 WAKE FOREST L. REV. 1 (2003).

204. *See supra* notes 123-126 and accompanying text.

205. 11 U.S.C. § 363(b), (f).

206. *Id.* § 364.

- It overcomes coordination problems by limiting the power of individual holdouts through the class approval process and binding dissenting classes of claims or interests through the "cram down."[208]
- It delays realization (at least for junior claimants in cases where the debtor reorganizes) until completion of the Chapter 11 plan negotiation and confirmation process.[209]

These tools can preserve value through a reorganization or sale under a Chapter 11 plan.

Chapter 11 creates two possible routes for increasing the value of the estate beyond this baseline: a going-concern sale or a reorganization. Each, in its own way, preserves firm-specific investment and going-concern value and can be accomplished under a Chapter 11 plan of reorganization. The Chapter 11 plan may provide for the recapitalization of the firm, or for the sale of the firm and distribution of the proceeds. In some cases, an increment of the going-concern premium may arise because Chapter 11 provides a breathing spell and a chance to fix the business. Cases like *Chrysler* illustrate that just the opposite may be true in other cases: an increment of the going-concern premium may be attributable to the ability to accomplish a sale quickly and with finality. The Speed Premium arises postpetition, as a product of federal bankruptcy law. It is Chapter 11 that creates the ability to conduct a going-concern sale, and to do so before the firm loses value.[210] As previously discussed, the Speed Premium sometimes can be obtained in a sale under a plan, either by moving quickly, or if the plan is prepackaged. In such cases, the Speed Premium is merged into the going-concern premium, and can be distributed through the plan process as the parties have negotiated. However, when it is claimed that a sale must be completed before plan confirmation, the Speed Premium must be weighed

207. *Id.* These include claims allowance, *id.* §§ 502, 506, priorities, *id.* §§ 507, 726, plan formulation, *id.* § 1122, and plan confirmation, *id.* §§ 1125, 1126, 1129.

208. *See id.* § 1126(c) (providing that a class of claims has accepted a plan if the plan has been accepted by creditors holding at least two-thirds in amount and more than one-half in number, with some limitations); *id.* § 1129(b) (binding non-accepting classes of creditors where the plan is "fair and equitable" and does not "unfairly discriminate").

209. The effective date of the plan is the point at which securities issued pursuant to a plan of reorganization replace the prepetition claims. *Id.* § 1141.

210. *See supra* Section II.A.

against the attendant increased error cost.[211] The key point here is that both a traditional reorganization and a going-concern sale create value that would be lost using state law remedies.

So, to what extent is Chapter 11-created value the collateral of a secured creditor, as opposed to an unencumbered asset of the bankruptcy estate? State law provides the foundation for what a secured creditor can demand in bankruptcy.[212] To the extent a debtor is worth more as a going concern than in a piecemeal liquidation—because of its talented workforce, unique assemblage of contractual and non-contractual relationships, or other factors—it is not clear that this extra value is tethered to, or subsumed in, the secured creditor's collateral. Section 1129(b)(2)(A) allocates any increase in value in the collateral between the petition date and the effective date of the Chapter 11 plan to the secured creditor. However, § 552, and the concept of equitable tracing, ensure that this entitlement applies only to the value of the collateral itself, not to the value of the enterprise as a whole.[213] Oversimplifying slightly, the filing of a bankruptcy petition cuts off the effectiveness of floating liens, which otherwise would attach to a debtor's interest in property when the debtor acquires it.[214]

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211. *See supra* Section II.C.1. When sale is through a quick 363 sale, the enhanced power to sell, the ability to obtain financing, and the silencing of holdouts are all present. The procedures for allocating value, the protections associated with the power to bind holdouts, and the delay of realization are forgone.

212. Under 11 U.S.C. § 506(a), the allowed secured claim is equal to the creditor's interest in the debtor's interest in the collateral. That value is determined by reference to applicable non-bankruptcy law.

213. For a court's analysis of why a lender's claimed security interest in the contract rights of a business could not be construed to encumber every single dollar that the business generates, see *In re Las Vegas Monorail*, 429 B.R. 317, 335-36 (Bankr. D. Nev. 2010). The sometimes-divergent case law interpretations of this provision have been captured in a brief article by attorneys who advocate for a more expansive view of secured creditor entitlements. Erin Casey & Randy Klein, *The Pre-Petition Right to Post-Petition Income Streams and the Misinterpretation of § 552*, AM. BANKR. INST. J., Dec.-Jan. 2011, at 59. In arguing in favor of broader security interests post-bankruptcy, Casey and Klein state in another article, "when a secured lender underwrites and prices its loan based on the value of the borrower's business (including the earning power of the collateral package) and seeks repayment from its security in that 'source of value,' there is no windfall." Erin Casey & Randy Klein, *Income Streams: An Economic Analysis of Rents as Proceeds*, J. CORP. RENEWAL, Oct. 2011, at 34, 36, http://www.goldbergkohn.com/media/site_files/129_JCR_Oct2011_IncomeStreams%20_2_.pdf. This may be the case as a matter of contract law, establishing the rights of the creditor against the debtor. This does not, however, mean that such a "promise" can necessarily be tied to all of the debtor's property, or to property that the debtor acquires after filing for bankruptcy.

214. 11 U.S.C. § 552(a).

The prepetition secured creditor's collateral extends to traceable proceeds of the lender's prepetition collateral. For example, if a piece of inventory is sold, then the security interest continues in the identifiable cash proceeds. By contrast, if flour, sugar, and eggs, collateral of the secured creditor, are used to make an elaborate wedding cake, the value of the cake that is the product of postpetition labor of at-will employees is not proceeds of the secured creditor's collateral. Allocation may be difficult, but is not a new or unique challenge in bankruptcy law. The Code authorizes the court to use equitable tracing principles to allocate the value of work-in-progress, for example, between the creditor's collateral and other sources, such as human capital.[215] Proceeds have a tendency to expand, as collateral is converted to cash proceeds and cash proceeds are used to buy inventory and pay employees or otherwise run the business. The effect of equitable tracing called for in § 552 is to limit the extent to which assets will be reallocated to a prepetition secured creditor as the case moves forward.

In sum, the Speed Premium and the going-concern premium both constitute Chapter-11-created value.[216] In either event, the secured creditor's right to this value is limited to the market increase in the value of its collateral and any traceable proceeds.[217] As such, even a secured creditor with a purported blanket lien on the debtor's assets is not likely to be entitled to all of the debtor firm's enterprise value.

iii. Gaps in Security and Priority

The suggestion that a secured creditor is entitled to the entire Speed Premium may be inaccurate for a second reason. Prior to the debtor's bankruptcy a lender may have sought to obtain, and the debtor may have

215. *Id.* § 552(b)(1); *see also* Westbrook, *supra* note 195, at 812 n.55 ("[A] manager may . . . have a level of credibility and technical respect among customers that makes him or her essential to the business. Because personal services may not be legally commandeered in our society, even a dominant secured party cannot realize going-concern value in such a business without the cooperation of key personnel.").

216. The Code sometimes grants a secured creditor an entitlement to later upside value. Two prominent examples are what is known as the "Section 1111(b) election," which allows the secured creditor to avoid lien stripping, and § 1129(b)(2)(A), which calls for valuing the collateral on the effective date of the Chapter 11 plan. 11 U.S.C. §§ 1111(b), 1129(b)(2)(A).

217. *Id.* § 552.

agreed to convey, a first priority lien on all of a debtor's assets.[218] Yet, the mechanics of making such consensual liens binding on third parties is rooted in state property law generally, and real and personal property mortgages more specifically. Article 9 of the U.C.C. governs security interests in personal property.[219] The scope of Article 9 is broad, but it may or may not encompass such things as franchise licenses, government-issued licenses, or certain causes of action.[220] Security interests in collateral automatically extend to the identifiable proceeds of that collateral.[221] Yet, not all property can be encumbered by a security interest as a legal or practical matter. Whatever the intentions of the parties, the so-called blanket lien is likely to have gaps. As just noted, one should be wary of, for example, characterizing value created by the work of at-will employees postpetition, a claim for failure to obtain business interruption insurance, or the value of a state issued liquor license, as proceeds of prepetition collateral.[222]

Even if the debtor intended to grant the lender a security interest on all property interests that the law permits to be encumbered, the scope of the security interest is not ironclad. The security interest may not have attached to

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218. Ayotte & Morrison, *supra* note 27, at 513-14 (reporting that in nearly all senior secured financings obtained before entering bankruptcy, the parties claimed the loans to be secured by all of the firm's assets).

219. U.C.C. § 9-109 (2010).

220. *Id.* § 9-109 & cmt.

221. *Id.* § 9-203(f) (noting that attachment of a security interest to collateral automatically extends to proceeds); *id.* § 9-315 (providing rules for the attachment to proceeds and maintenance of perfection to proceeds); *id.* § 9-102(a)(64) (defining proceeds broadly).

222. While Article 9's definition of proceeds is broad, there are limits. The proceeds must be traceable to original collateral. *Compare In re* Wiersma, 283 B.R. 294, 308 (Bankr. D. Idaho 2002) (finding that business damages arising out of electrocution of cattle are proceeds), *with* Helms v. Certified Packaging Corp., 551 F.3d 675, 678-79 (7th Cir. 2008) (finding that claims for failure to obtain business interruption insurance were not proceeds of the collateral). Also, Article 9's concept of proceeds only reaches property. Some things of value to the enterprise (such as licenses) have been construed not to be property to which an Article 9 security interest can attach. *See In re* Chris-Don, Inc. 367 F. Supp. 2d 696 (D.N.J. 2005) (finding that a liquor license is not property for Article 9 purposes under New Jersey law); Banc of Am. Strategic Solutions, Inc. v. Cooker Rest. Corp., No. 05AP-1126, 2006 WL 2535734 (Ohio Ct. App. Sept. 5, 2006) (finding that liquor licenses are not property under Ohio law). *Compare* New Bank of New Eng., N.A. v. Tak Commc'ns, Inc., 138 B.R. 568 (W.D. Wis. 1992) (finding that the value of a broadcast license is not proceeds of secured creditor's collateral), *with In re* Ridgley Commc'ns, Inc., 139 B.R. 374 (Bankr. D. Md. 1992) (finding that the value of a broadcast license is proceeds of a secured creditor's collateral).

the collateral,[223] or may not have been perfected under applicable non-bankruptcy law, either due to defects in the original transaction or due to changes over time.[224] Methods of perfection vary by the type of collateral; the filing of a U.C.C.-1 financing statement in the correct government office perfects some, but by no means all, security interests in personal property.[225] It may be particularly difficult to maintain perfection and priority with respect to collateral requiring a non-filing method of perfection and collateral for which possession of the collateral can trump filing. The rules are technical, and lenders can and do make mistakes, rendering the security interests unperfected.[226] If a security interest is unperfected, it is vulnerable to an avoidance action in bankruptcy that frees the value of property that otherwise would have been collateral for distribution to other creditors.[227]

Thus, again, it is important to question the assumption that a creditor asserting a blanket lien actually has one. Where there are gaps in perfection, or unencumbered assets at the time of a Chapter 11 filing, an increase in value of the debtor during the bankruptcy case cannot necessarily be traced back to pre-bankruptcy collateral. This offers another reason to doubt that the senior secured lender is automatically entitled to all of either the going-concern premium or the Speed Premium. It is another reason that unsecured creditors should presumptively have a voice in the manner of asset disposition, and, if

223. U.C.C. § 9-203(b) (providing that the attachment of a security interest requires value being given, the debtor having rights in the collateral, and an authenticated security agreement containing a description of the collateral or a specified evidentiary alternative).

224. To perfect a security interest, one must take the steps that applicable law says are necessary to put the world on notice of the lien—often, but not always, the filing of a document in the public records. *E.g.*, *id.* § 9-308(a) (explaining that perfection requires attachment plus the requisite formality for the type of collateral at issue); *id.* § 9-315 (discussing maintaining attachment and perfection through dispositions of collateral and creation of proceeds); *id.* § 9-316 (discussing maintaining perfection through the transfer of collateral to debtors in another jurisdiction or the moving of a debtor to another jurisdiction).

225. *Id.* § 9-310 (identifying the financing statement filing as the primary method of perfection for security interests in personal property, and cataloguing exceptions to this method); *id.* § 9-311(a) (recognizing alternative methods of perfection to the extent that Congress preempts Article 9 or state legislatures so provide, such as the certificate of title system for motor vehicles). Real property leases can be perfected under Article 9 in some jurisdictions but not others, in which case they must be perfected in the land records.

226. *See, e.g.*, *In re* EDM Corp., 431 B.R. 459 (B.A.P. 8th Cir. 2010) (holding that a financing statement that included the trade name after the correct corporate name did not perfect the lender's security interest).

227. *See* 11 U.S.C. §§ 544, 550 (2012).

the plan process is displaced, that steps should be taken to ensure their rights are protected.

iv. Impact of Bankruptcy Priority Rules on Allocation of the Bankruptcy-Code-Created Value

In our view, the state law liquidation value of collateral establishes the distributional baseline for the purposes of fairness, and also perhaps constitutional purposes. The Code entitles the secured creditor to the value of its collateral plus the identifiable proceeds of its collateral, subject to equitable tracing as of the effective date of the plan of reorganization.[228] The remainder of the value of the debtor, consisting of the value allocated to unencumbered assets, postpetition effort of at-will employees and other unalienable value, and any appreciation that is not tied to encumbered assets, is up for grabs.

Declaring some portion of bankruptcy-created value as unencumbered does not determine who will receive it in the end. The drafters of the Code contemplated that Chapter 11-created surplus would be the subject of negotiation and compromise through the Chapter 11 plan process.

To the extent that transactional leverage is used to lock up a portion of that surplus early in a case, without going through the Chapter 11 plan process and its attendant negotiation, hurry-up sales facilitate an end-run around the Code's procedural protections. Chapter 11 seeks to give the debtor and its stakeholders time to stabilize the business, to resolve coordination problems among stakeholders, to consider different business options, and to negotiate over allocation of value.[229] In some contexts, the intended breathing spell of bankruptcy is simply unaffordable, and value will be preserved only with exceptional speed. But, based on our analysis in Part I, it is not hard to see why and how the temptation to exploit the leverage associated with a quick sale itself could arise. And based on Part II, we see those harms producing several kinds of risks to the bankruptcy estate: (1) that the bankruptcy estate currently bears the burden of error in assessments of 363 Sale Value; (2) that the sale may go forward when the increased error costs exceed the speed premium; and (3) that parties may use transactional leverage, and exploit information asymmetries, for redistributive ends.

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228. *See supra* Subsection II.C.2.b.ii.

229. *See, e.g.*, 11 U.S.C. § 362 (imposing a stay on collection of debt); *id.* § 1121 (initially giving the debtor the exclusive right to file a Chapter 11 plan).

Our proposal in Part III – the Ice Cube Bond – seeks to encourage quick 363 sales motivated by value creation or preservation and discourage those that are being used to strong-arm a particular distribution contrary to ordinary bankruptcy principles. It seeks to return the bargaining over bankruptcy surplus to the plan process, even if it is necessary to sell assets before the plan can be confirmed.

III. ICE CUBE BONDS

For the reasons discussed above, when a sale of substantially all assets takes place under § 363 and outside the purview of the Chapter 11 plan process, the bankruptcy court should require the sale proponent(s) to post a bond or reserve a portion of the sale price to cover any damages suffered by the estate.[230] We call this reserved fund the "Ice Cube Bond." An Ice Cube Bond requirement, if used consistently, will help courts and claimants sort between sales for which there is a need for speed and opportunistic use of the melting ice cube argument.

At the outset, we should note that the Ice Cube Bond is consistent with broader commercial law principles. Outside of bankruptcy, a creditor who conducts a procedurally noncompliant foreclosure sale under the U.C.C. can lose her right to a deficiency judgment (the remaining debt left unsatisfied by the sale of collateral) unless she can show that the debtor has not been harmed by a low sale price.[231] Some jurisdictions are harsher in the face of procedural

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230. Our proposal does not demand a rejection of alternative suggestions to make more robust the prohibition against sub rosa sales that are really restructurings in disguise. *See, e.g.*, Roe & Skeel, *supra* note 2, at 770-71. We assume that the existing sub rosa case law would remain intact. Ice Cube Bonds address an entirely different dimension of the 363-sale challenges. Our proposal is less restrictive than those prohibiting 363 sales outright absent real-time evidence of a wasting asset in the more traditional sense. *See* Bussel & Klee, *supra* note 35, at 732 (stating a preference for a similar proposal). Our proposal also should be distinguished from deals contemplating a purchase price adjustment, which creates risks for the buyer. *See* COMPARISON SHOPPING GUIDE, *supra* note 48, § 3.1.2 (discussing holdbacks from the purchase price). Even critics of the extensive use of 363 sales have recognized both a strong demand and an economic value for some non-plan all-asset sales. *See, e.g.*, George W. Kuney, *Let's Make It Official: Adding an Explicit Preplan Sale Process as an Alternative Exit from Bankruptcy*, 40 HOUS. L. REV. 1265, 1266-69 (2004).

231. U.C.C. § 9-626 & cmt. (2010) (creating a rebuttable presumption that the sale price equals the amount of the debt once the compliance of the disposition has been placed at issue). Whether lenders who actually foreclose on their collateral actually experience such penalties is, of course, a different matter. *See* Westbrook, *supra* note 195, at 846 (suggesting that

noncompliance in consumer transactions, requiring that the lender forfeit its entitlement to a deficiency judgment altogether.[232] Under the Restatement of Mortgages, for real property, even if a sale complies with state procedures, the deficiency may be adjusted to reflect the actual value of the property.[233] An improperly conducted real property foreclosure might even lead to an unwinding of the sale transaction.[234] In bankruptcy, the analogous procedural baseline is resolution pursuant to a Chapter 11 plan, whether the plan contemplates a sale or reorganization. The hurry-up sale under § 363 departs from that procedural baseline, and should be viewed as non-compliant. As we will explain below, the burden should therefore shift to the sale proponent to show that the quick sale did not cause harm, and the Ice Cube Bond should be released only upon a showing that no harm was caused by the procedural non-conformity.[235]

A bonding requirement is neither unusual, nor should it be particularly controversial. However, it raises important legal and operational questions. First, can courts impose the Ice Cube Bond under current law? If yes, then how should the amount of the reserve be set? What is the baseline for measuring harm? Who should have the burden of establishing entitlement to the funds? We address these issues in order.

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lenders manage to avoid sanctions for noncompliant sales); *see also infra* note 235 (citing and explaining additional provisions of Article 9 on secured party remedies).

232. LYNN M. LOPUCKI & ELIZABETH WARREN, SECURED CREDIT: A SYSTEMS APPROACH 72 (7th ed. 2012).

233. RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 8.4, cmt. a (1996) (providing that "[this Section] adopts the position of the substantial number of states that, by legislation or judicial decision, afford the deficiency defendant the right to insist that the greater of the fair market value of the real estate or the foreclosure sale price be used in calculating the deficiency").

234. *See id.* § 8.3.

235. At least in the context of dispositions of personal property collateral, the entitlement to a deficiency judgment is not questioned until a party in interest puts it at issue. U.C.C. § 9-626. Article 9 sales are generally conducted privately; there is no court overseeing the process. *Id.* § 9-610. Thus, Article 9 has no mechanism to withhold proceeds precisely parallel to the Ice Cube Bond in a bankruptcy sale. In addition, in going-concern sales under § 363 of the Code, competing claimants have a claim to the sales proceeds themselves. 11 U.S.C. § 363 (2012).

A. *Authorization Under Current Law*

While no provision of the Code specifically calls for an Ice Cube Bond, a variety of provisions could be used to authorize a court to impose one. Some of these provisions have general applicability. Others would apply to particular contexts.

When parties seek expedited affirmative relief in other contexts, judges must order the posting of a bond to insure against the harm caused by an erroneous order. Although courts sometimes have waived this requirement or imposed a nominal bond,[236] Federal Rule of Civil Procedure 65(c) generally requires the posting of a bond before a court can order affirmative preliminary relief.[237] Federal Rule of Bankruptcy Procedure 7065 incorporates Rule 65, with one difference: it eliminates the bonding requirement for debtors, debtors-in-possession, and trustees. It does not, however, prohibit a judge from requiring a bond. It simply leaves the issue to the bankruptcy judge's discretion because of the limited cash available to Chapter 11 debtors.[238] This cash concern does not apply when sale proceeds are being allocated. Furthermore, Rule 7065 applies only to adversary proceedings (akin to civil lawsuits within bankruptcy cases). Section 363 sales are pursued as contested matters, not through

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236. *See, e.g.*, Habitat Educ. Ctr. v. U.S. Forest Serv., 607 F.3d 453, 458-59 (7th Cir. 2010) (reviewing conflicting case law and arguments regarding the imposition of nominal bond and waiver of bond, and rejecting the argument that non-profit entities should be exempt from having to post injunction bonds); Natural Res. Def. Council v. Morton, 337 F. Supp. 167, 168-69 (D.D.C. 1971) (rejecting the government's request for a $750,000 bond and imposing a $100 bond, finding that requiring more than a nominal amount of security would "stifle the intent" of the environmental statute under which the suit was brought); Erin Connors Morton, Note, *Security for Interlocutory Injunctions Under Rule 65(c): Exceptions to the Rule Gone Awry*, 46 HASTINGS L.J. 1863, 1873-82, 1905 (1995) (reviewing a circuit split in Rule 65(c) interpretation and proposing far narrower exceptions to the bonding requirement than some courts have applied).

237. Federal Rule of Civil Procedure 65(c) provides:

> The court may issue a preliminary injunction or a temporary restraining order only if the movant gives security in an amount that the court considers proper to pay the costs and damages sustained by any party found to have been wrongfully enjoined or restrained. The United States, its officers, and its agencies are not required to give security.

FED. R. CIV. P. 65(c).

238. Federal Rule of Bankruptcy Procedure 7065 provides: "Rule 65 F.R.Civ.P. applies in adversary proceedings, except that a temporary restraining order or preliminary injunction may be issued on application of a debtor, trustee, or debtor-in-possession without compliance with Rule 65(c)." FED. R. BANKR. P. 7065.

adversary proceedings.[239] Our proposal is inspired by the philosophy of Rule 65—preserve issues for final adjudication by requiring the party seeking immediate relief to bear the risk of an erroneous preliminary order. The Ice Cube Bond is then available to compensate the bankruptcy estate for valuation error or proceeds misallocation that occurs as a result of the quick sale.

As discussed below, the power to use a bond to preserve issues for later adjudication rests comfortably within the bankruptcy court's ability to condition a sale order under § 363, to tax the secured creditor for the costs of liquidating its collateral under § 506(c), and, more generally, to exercise its authority under § 105 to preserve the estate.

First, § 363 does not explicitly authorize an Ice Cube Bond, but it does permit the court to impose conditions on the sale of property of the estate—such as through a lien or a holdback of a portion of proceeds—at the request of a party in interest to protect lienholders, including junior lienholders.[240] This provision contemplates the exercise of judicial discretion to protect against the decline in value of a secured creditor's collateral.[241] Thus, to the extent the Ice Cube Bond is construed as protecting junior secured parties, this subsection of 363 provides a partial source of statutory support. If the estate needs to be protected more broadly, courts can preserve disputes about lien priority by providing that a lien would attach to the proceeds of sale.[242] When a debtor negotiates debtor-in-possession financing, it is also not unusual for carveouts to be created to preserve disputes about the amount to be surcharged under § 506(c) or other matters.[243] We are concerned that hurry-up sales under § 363 may be closed, and, at least in some non-trivial subset of cases, the funds disbursed, before any such disputes about perfection or priority could be uncovered. The Ice Cube Bond anticipates the possibility of undiscovered legal

239. *See* FED. R. BANKR. P. 6003, 6004. Section 363 sales are contested matters under Federal Rule of Bankruptcy Procedure 9014.

240. 11 U.S.C. § 363(e).

241. *See id.* § 361 (giving examples of how to provide adequate protection, including periodic payments and replacement liens).

242. *See id.* § 363(f); *supra* note 50 and accompanying text.

243. *See, e.g., In re* Metro Fuel Oil Corp., No. 12-46913, 2013 WL 1495295, at *14 (Bankr. E.D.N.Y. Apr. 8, 2013) ("Nothing in this Order shall limit any rights to surcharge the Proceeds pursuant to section 506(c) of the Bankruptcy Code, nor does anything herein limit any parties' right to object to same."); *In re* Michael Day Enters., Inc., No. 09-55159, 2009 WL 8189421, ¶ 23 (Bankr. N.D. Ohio Nov. 10, 2009) ("Nothing in this Sale Order shall impair, modify or limit the rights of any party with respect to claims or defenses under Section 506(c) of the Bankruptcy Code . . . .").

disputes, rather than providing only for those already identified. It ensures that funds will be available should any such disputes arise.

In many, if not most, hurry-up 363 sales today, the collateral is liquidated principally for the benefit of a senior secured lender. Section 506(c) of the Code provides: "The trustee may recover from property securing an allowed secured claim the reasonable, necessary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to the holder of such claim."[244] To the extent that the estate is forced to absorb expenses, even in the form of increased valuation risk, one could argue that the additional risk faced by the estate benefits the secured creditor. As such, the estate should be compensated. In these instances, the Ice Cube Bond is consistent with, and in furtherance of, the existing mandate in § 506(c).

More broadly, the statutory requirement that sales outside the ordinary course of business require notice, hearing, and court approval carries with it the implicit mandate that the sale should be approved only if it is in the best interest of the bankruptcy estate as a whole.[245] Again, this leaves to case law and judicial innovation how to operationalize this mandate. The Ice Cube Bond provides the court with a useful tool for ensuring that the sale benefits the estate.

Finally, § 105 empowers the bankruptcy court to issue any order "necessary or appropriate to carry out the provisions" of the Code.[246] Congress explicitly authorized courts to exercise this power sua sponte.[247] A classic use of this kind of power by courts in other contexts is to issue a "status quo" injunction—an order that prevents irreparable harm, while preserving issues for litigation.[248] The use of § 105 is controversial when employed to authorize actions that contravene the statutory priority rules,[249] but our proposal does just the opposite. The Ice Cube Bond serves as a disputed claims reserve that can be used to give effect to the Code's priority and timing principles in the face of the temporal exigency associated with the quick sale.

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244. 11 U.S.C. § 506(c).

245. *See id.* § 363(b).

246. *Id.* § 105(a).

247. *Id.*

248. *See* Hoechst Diafoil Co. v. Nan Ya Plastics Corp., 174 F.3d 411, 422 (4th Cir. 1999); ELAINE W. SHOBEN & WILLIAM MURRAY TABB, CASES AND PROBLEMS ON REMEDIES 160 (2d ed. 1995).

249. *See supra* note 174 and accompanying text.

Under this analysis, courts currently have the authority to impose an Ice Cube Bond, whether as a literal bond or as a reserve or holdback of proceeds. No further statutory authorization is necessary.

B. Operationalizing the Ice Cube Bond

The Ice Cube Bond allows a quick sale to go forward but preserves the legal status quo by providing for compensation in the event that the sale causes harm or distorts distributional entitlements. As our analysis in Part II illustrated, there are two types of harm to consider: (1) Quick Sale Cost that exceeds the Speed Premium, and (2) distortions to the bankruptcy priority scheme. To address both harms, the funds would be considered unencumbered property of the bankruptcy estate to be distributed pursuant to a confirmed Chapter 11 plan, unless a sale proponent met its burden of establishing that (a) the purchase price was not reduced by the expedited nature of the sale; and (b) the claimant is entitled to the funds as proceeds of its collateral, or pursuant to a specified priority entitlement.[250] The Ice Cube Bond thus preserves the legal and economic status quo, without undercutting the finality of the sale. The sale proponent gets the expedited all-asset sale. The purchaser gets clear title to the assets. This approach makes it possible to approve a sale while postponing the discussion of proceeds allocation and possible valuation error.

1. How Much?

Just as Federal Rule of Civil Procedure 65 provides a blueprint for the Ice Cube Bond, it also articulates a principle that can be used to establish its size: "an amount that the court considers proper to pay the costs and damages sustained by any party found to have been wrongfully enjoined or restrained."[251] In Part II, we detailed the possible harms: (1) erroneous approval of the sale because it was not in the best interest of the estate (Kaldor-Hicks efficiency); and (2) opportunistic use of leverage to alter the distribution of sale proceeds (Pareto Optimality).

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250. The confirmed plan could also provide for a different negotiated disposition of the funds, so long as the disposition was negotiated after the sale was completed.

251. FED. R. CIV. P. 65(c). As previously noted, Federal Rule of Bankruptcy Procedure 7065, which extends Rule 65(c) to adversary proceedings in bankruptcy cases, does not require injunction bonds in bankruptcy cases, but also does not prohibit them. *See* FED. R. BANKR. P. 7065.

The portion of the Ice Cube Bond attributable to valuation error likely would depend on the type of property. Where the principal assets are tangible and easily priced – restaurant fixtures, for example – the bond might be quite small. By contrast, a promising startup company with significant upside might be quite difficult to value. In between, a business with a predictable cost structure and cash flow might be capable of valuation but only with well-presented data. The Ice Cube Bond serves an information-forcing role: the better the information provided by the sale proponent, the smaller the reserve. The Ice Cube Bond thus encourages sale proponents to reduce the information asymmetry associated with the sale – one of the problems that precipitated our proposal in the first place.

The same information-forcing effect operates with regard to allocation of sale proceeds. Allocation error can arise in a number of situations. It can arise when incumbent management seeks a sweetheart deal to ensure itself a place in the company going forward. This form of allocation error merges with valuation error. More often, though, allocation error may arise due to overcompensation of a secured creditor arising from (1) a gap in perfection of prepetition liens, and the presence of unencumbered assets; or (2) an increment of going-concern value or the Speed Premium that cannot properly be classified as proceeds of the secured creditor's collateral. In this context, to the extent that the sale proponent can provide information that establishes the secured creditor's entitlement to sale proceeds, the necessary reserve may be smaller.

The informational limits that make it difficult to evaluate expedited sales also make it costly to craft the optimal bond on a case-by-case basis. Precision is not essential here, however, as the funds will not disappear and the amount can be adjusted later. Indeed, implementation of the Ice Cube Bond might benefit from a presumptive amount, such as ten percent of the purchase price.[252] It need not, and probably should not, be set by statute, but rather by case law, local rule of procedure, or standing order.[253] A presumptive amount

252. The easiest scenario in which to implement the proposal involves an all-cash sale. As is well-known, non-cash sales and part-cash sales reduce the ability to easily compare bids. *See* Landers, *supra* note 66, at 111-12 (describing the common non-cash features in current 363 bidding). Some sales involve no exchange of cash because the secured creditor credit bids. 11 U.S.C. § 363(k). We return briefly to that issue *infra* note 255.

253. Bankruptcy courts have adopted guidelines for 363 sales, financing, and related matters through general orders or local rules, so implementation through this approach would be within the mainstream. *See, e.g.*, *In re* Adoption of Amended Guidelines for the Conduct of Asset Sales, General Order Amending M-331, M-383 (Bankr. S.D.N.Y. Nov. 18, 2009),

would alleviate concerns that disputes over the amount of the bond would bog down the sale process. As we envision it, the court could deviate even from a presumptive amount if the existing evidence showed the range of valuation errors or allocation errors was particularly large or small.

Whereas the melting ice cube argument may be a valid reason for accelerating the sale, any attempt by management or others to use melting ice cube leverage to seek a total waiver of the Ice Cube Bond should raise a red flag. Even with respect to Rule 65(c), which by its terms requires a preliminary injunction bond, courts have split over whether the district judge has the discretion to set the bond at $0 or a nominal amount.[254] We think the court and creditors should be able to resist in this context. First, melting ice cube leverage is greatest in cases where the valuation is most uncertain. Such situations counsel in favor of a greater bond, not a smaller one. Second, the Ice Cube Bond should not affect the value of the assets received by the buyer and thus should not affect the purchase price. As such, buyer interference in the reserve-setting process should backfire, signifying potential collusion with another party in interest. The only permissible basis for reducing the amount of the Ice Cube Bond should be certainty as to value, and this reduction should only be done by the court. It should not be the subject of pre-sale bargaining.

The Ice Cube Bond will make some claimants less certain of their ultimate distribution. However, this uncertainty is likely to improve rather than hinder governance. The Ice Cube Bond would place some, or all, claimants behind a veil of partial ignorance as to their distribution. This encourages such claimants to seek the highest value. More importantly, though, the Ice Cube Bond could be avoided by conducting the sale through a Chapter 11 plan. This would refocus questions about timing on the existence or non-existence of a Speed Premium. After all, when making the decision whether to hold an expedited sale, the question should not be whether the outcome is optimal for a

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http://www.nysb.uscourts.gov/sites/default/files/m383.pdf; LOCAL RULES FOR THE UNITED STATES BANKRUPTCY COURT: DISTRICT OF DELAWARE Rule 6004-1, at 67 (Feb. 1, 2013), http://www.deb.uscourts.gov/sites/default/files/local_rules/Local_Rules_2013.pdf (addressing "Sale and Sale Procedures Motions"); LOCAL BANKRUPTCY RULES OF THE UNITED STATES BANKRUPTCY COURT FOR THE NORTHERN DISTRICT OF TEXAS app. G (Apr. 1, 2012), http://www.txnb.uscourts.gov/sites/default/files/local_rules/TXNB_Local_Rules.pdf (providing guidelines for the early disposition of assets in Chapter 11 cases, the sale of substantially all assets under § 363, and overbid and topping fees); UNITED STATES BANKRUPTCY COURT, NORTHERN DISTRICT OF ILLINOIS: LOCAL RULES Rule 4001-2 (Jan. 1, 2012), http://www.ilnb.uscourts.gov/sites/default/files/local_rules/Local_Rules_2012.pdf (providing rules for cash collateral and financing orders, not for sales).

254. *See supra* note 236 and accompanying text.

particular claimant but whether holding the sale outside a plan is good for the bankruptcy estate.

2. *Who Pays?*

Up until this point we have stated that the Ice Cube Bond, whether a true bond or a reserve from proceeds, would protect against valuation and allocation errors. We have not specified who will pay. Sometimes the proponent of the sale may be obvious. In some cases, an undersecured creditor (or syndicate of investors in a credit facility) asserting a blanket lien will push for a sale and try to claim all of the proceeds.[255] In principle, that undersecured creditor should bear the entire cost. It is also axiomatic that claimants would not be required to post a bond if they are not going to receive a distribution in any event. However, cases are not always this straightforward.[256] There may be a fully secured first lien claimant and an undersecured second lien claimant. Or there may be enough to pay all senior claimants, and a significant pro rata distribution to unsecured creditors, but no distribution to equity. There may be an indisputably undersecured senior creditor as well as unencumbered assets of the debtor. The principal beneficiary of the sale may not be obvious.

We do not want the costs of administering the Ice Cube Bond to eat substantially into its potential benefits. If a case-by-case approach is seen as unworkable, another approach would be to deduct pro rata from each claimant that stands to receive a portion of the sale proceeds, possibly adjusted based on any more specific information about the sale proponents. Everybody receiving a distribution would be involved proportionally. This would have the virtue of encouraging objections to the sale from claimants that doubt the existence of a Speed Premium.

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255. How the participants in a credit facility consortium or syndicate might allocate the cost amongst themselves is beyond the scope of this Article. We do not see the Ice Cube Bond working differently depending on the number of investors in a credit facility who would appoint an agent to speak on their behalf. Coordination problems may arise in this context, just like they could in any other. Douglas G. Baird & Anthony J. Casey, *Bankruptcy Step Zero* 6 (Chi. Pub. Law & Legal Theory, Working Paper No. 419, 2013). Disagreements among syndicate members arise in a variety of contexts in bankruptcy, and resolution often involves fact-intensive questions of contract interpretation and negotiation. *See, e.g.*, *In re* WestPoint Stevens, Inc., 600 F.3d 231 (2d Cir. 2010). But reducing those risks and resolving those questions is not an Ice Cube Bond problem; those disagreements must be dealt with within the syndicate itself.

256. *See supra* notes 156-161 and accompanying text.

The Ice Cube Bond should not harm the bankruptcy estate by reducing the sale price. The requirement affects the distribution of the sale proceeds, at least temporarily, but it does not directly affect the value received by the purchaser and should not affect the price they are willing to pay.[257]

3. *When to Release?*

In other judicial contexts, an injunction bond is released if the party that sought the injunction succeeds at trial. In other words, the bond remains in place until the proponent establishes that the injunction was properly issued. Bankruptcy sales are usually not reversible even if later found to be improvident.[258] Indeed, the finality and clean title associated with bankruptcy sales contribute to bankruptcy-created value, as discussed in Parts I and II. The Ice Cube Bond is meant to preserve the finality of court-approved 363 sales. The legal questions relevant to releasing the Ice Cube Bond are whether expediting the sale reduced the value of the estate, and who is entitled to the sale proceeds.

With regard to sale price, Article 9 of the U.C.C., like bankruptcy, values transactional finality. Article 9 sales generally cannot be unwound even if the sale was noncompliant.[259] The buyer can take its newly purchased property and go home, leaving any disputes about noncompliance to others.[260] As stated at the outset of Part III, all-asset 363 sales in bankruptcy cases can similarly be characterized as noncompliant because the Chapter 11 plan process was designed to accommodate sales, not just traditional reorganizations.[261]

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257. As with Polaroid's sale in 2002 (but unlike with Chrysler's sale), the identity of the investors in the purchasers may not be transparent at the time of the transaction, and some holders of claims or interests in the debtors may also be investors in the purchasing party. In this scenario, parties in interest may have an incentive to use melting ice cube leverage opportunistically, as we discussed in Part I. We cannot detail all the ways in which these patterns may affect or distort the size of the bids. Our proposal should help in at least three ways. First, it will make such conflicts more expensive for the conflicted party (by reducing their distribution). Second, the conflicts may be more apparent when the conflicted party seeks to recover the reserve. Third, the Ice Cube Bond encourages a sale through a plan when there is no Speed Premium. This would again make the conflicts more transparent.

258. 11 U.S.C. § 363(m) (2012).

259. *See, e.g.*, U.C.C. § 9-617 (2010) (defining the scope of a good faith transferee's right to clear title in cases where the secured party failed to comply with Article 9).

260. *Id.*

261. *See supra* note 39; *see also* 11 U.S.C. § 1123(a)(5)(D) (providing that a Chapter 11 plan shall provide adequate means for the plan's implementation, such as sale of property); *id.* §

Consistent with this analogy, the reserve should be distributed as unencumbered assets on the effective date of the Chapter 11 plan, unless the sale proponent can establish that the 363 Sale Value was positive.[262]

With regard to distribution, as we discussed above, there are considerable reasons to doubt that even a secured lender with a blanket lien is entitled to all of the sale proceeds.[263] As a result, a party seeking to recover withheld funds must do more than show lack of harm, but also that it is entitled to those sale proceeds—that, in the instance of a secured lender, they are proceeds of *its collateral*. Here we would place the burden of establishing entitlement on the claimant seeking preferred treatment.

C. *Potential Concerns*

1. *Priority Rules*

Some may argue that withholding sale proceeds from a secured creditor while making a distribution to unsecured creditors subverts priority. To the contrary, our proposed bonding procedure takes legal priorities seriously—perhaps more seriously than current practice. A security interest is not a straight distributional priority. It is an interest in particular property of the debtor.[264] As previously discussed, we neither assume the enforceability of blanket liens, nor expand the concept of proceeds to include reorganization (or other enterprise) value.[265] We seek to carefully define what constitutes the collateral of the senior lenders. Under our interpretation, a senior lien claimant is entitled to the value of its collateral. Its collateral consists of the assets

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1129(a)(11) (providing that the plan shall be confirmed only if confirmation is not likely to be followed by liquidation or the need for further reorganization unless liquidation is proposed in the plan).

262. Some Chapter 11 cases convert to Chapter 7 after a sale. *See* Klee & Levin, *supra* note 46. Claims to the reserve could be handled in the Chapter 7 case by a trustee. Other cases might be subject to a structured dismissal, producing a different process through which the reserve would be managed. *See* Norman L. Pernick & G. David Dean, *Structured Chapter 11 Dismissals: A Viable and Growing Alternative After Asset Sales*, 29 AM. BANKR. INST. J. 1, 57-58 (2010) (describing the most frequently granted types of relief in structured dismissal orders, but noting that there are very few reported or unreported decisions approving them).

263. *See supra* Subsection II.C.2.b.

264. *E.g.*, U.C.C. § 1-201(b)(35) (2010) (defining a security interest as "an interest in personal property or fixtures which secures payment or performance of an obligation").

265. *See supra* Subsection II.C.2.

encumbered on the bankruptcy petition date, plus traceable proceeds subject to the limitations of § 552(b). Thus, for example, the senior creditor's entitlement would exclude sale proceeds traceable to postpetition work by the debtor's at-will employees as well as proceeds attributable to value that would not be realized had the assets been sold piecemeal, unless the senior creditor can show they are traceable proceeds of its collateral. Our approach does not deprive secured creditors of their property rights.[266] It merely requires them to establish their entitlement. Preventing senior creditors from receiving *more* than they bargained for ex ante reflects the fact that priority has limits.[267] An important point here is that, while our approach may increase the likelihood that junior interests will participate in a distribution, and gives them a voice, it does not allow the junior creditors to play for time by blocking a sale pending resolution of a priority dispute. The bond allows the sale to go forward and preserves the dispute for later.

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266. A procedural nuance arises when a senior secured creditor seeks to acquire the property with a credit bid, meaning that it credits the sales price against the amount owed by to it by the debtor in the nature of a setoff. 11 U.S.C. § 363(k). The Supreme Court recently made clear that the right to credit bid is an incident of the secured creditor's property right. RadLAX Gateway Hotel v. Amalgamated Bank, 132 S. Ct. 2065 (2012). In *RadLAX*, the debtor sought to confirm a non-consensual Chapter 11 plan featuring a sale that would prohibit credit bidding. Although § 1129(b)(2)(A)(ii) expressly incorporates the § 363(k) credit bid right into non-consensual plans, the debtor argued that the proposal satisfied another route to cramdown. However, § 363(k) gives the court the power to disallow credit bidding for cause, and the debtor in *RadLAX* did not challenge on appeal the bankruptcy court's rejection of its request. Thus, the Supreme Court did not reach that doctrinal issue. Our proposal does not depend on banning credit bidding; it simply does not excuse the bonding requirement per se. We leave to courts the issue of how to handle situations in which the federal government is a secured creditor and seeks to credit bid in an expedited sale fitting the parameters of our proposal. Federal Rule of Civil Procedure 65(c) exempts the U.S. government from posting a bond. Generally, the U.S. government is blocked by anti-deficiency laws from laying out more cash. *RadLAX*, 132 S. Ct. at 2070 n.2; *see* Brief for the United States as Amicus Curiae Supporting Respondent at 28-30, *RadLAX*, 132 S. Ct. 2065 (No. 11-166), 2012 WL 765217. However, commentators have noted other reasons why the bankruptcy estate may benefit if credit bidding is disallowed, such as unusually chilled bidding if third parties doubt the estate will have the cash to pay a breakup fee. COMPARISON SHOPPING GUIDE, *supra* note 48, § 5.7.

267. *Cf.* N. Pac. Ry. v. Boyd, 228 U.S. 482 (1913) (criticizing an attempt by senior creditors to freeze out their junior counterparts); Michael T. Roberts, *The Bankruptcy Discount: Profiting at the Expense of Others in Chapter 11*, 21 AM. BANKR. INST. L. REV. 157 (2013) (describing how artificially low equity valuations for bankrupt firms can mask inappropriate transfers of value from junior to senior creditors).

2. *Institutional Competence*

Our proposal relies on a court to adjust the size and source of the bond or reserve on the front end (either setting it outright or establishing deviations from a presumptive amount), and preserves the ability of the court to determine release on the back end if necessary. Given that the role of the judge in Chapter 11 has been a perennial (albeit undertheorized) concern in the academic literature, the Ice Cube Bond will likely provoke questions about the judicial role in matters of valuation and distribution. When speaking of a market for distressed businesses and assets, advantages of a (generally thin) marketplace can be overstated. But whatever one's views on this debate, the Ice Cube Bond should improve the quality of decisionmaking with less time pressure.

Scholars have long declared that judicial valuations are inferior to market measures.[268] To say that a litigation process will better determine a company's worth than would a price paid by a willing buyer will strike some readers as extremely problematic; this concern has prevented some judges from permitting other kinds of evidence to be entered about asset value in the context of a sale.[269] For many observers, therefore, it is hard to imagine a situation in which an ex post presentation by experts could or should be undercut or be substituted for an actual market price.

On the other hand, the assumption that judicial valuations are inherently inferior deserves more critical examination. For example, in their study comparing 363 sales to traditional reorganizations, LoPucki and Doherty found that the all-asset 363-sale market underperformed the judicial valuations in traditional Chapter 11 plan confirmations. "The judicially-based valuations in reorganization cases were surprisingly accurate predictions of post-reorganization trading values. The market valuations in sale cases appeared to average less than half of what the companies were actually worth."[270] As one

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268. *E.g.*, Baird, *supra* note 111; Fortgang & Mayer, *supra* note 179; *see also* David Gray Carlson, *Secured Creditors and the Eely Character of Bankruptcy Valuations*, 41 AM. U. L. REV. 63 (1991).

269. Indeed, the Delaware court voiced this concern in the first Polaroid case when objectors to the proposed sale wanted to present evidence about the firm's value. *See* LOPUCKI, *supra* note 54, at 176 (quoting the hearing transcript); LoPucki & Doherty, *supra* note 5, at 13-14.

270. LoPucki & Doherty, *supra* note 5, at 10. Earlier studies of aircraft sales found fire sale discounts based on firm identity and financial distress and concluded that these findings cast doubt on the earlier assumption of law and economics scholars that sales were inherently better than judicially supervised reorganizations. Todd C. Pulvino, *Do Asset Fire Sales Exist? An Empirical Investigation of Commercial Aircraft Transactions*, 53 J. FIN. 939, 941

would expect, LoPucki and Doherty's explanations have attracted some criticism,[271] but their findings reinforce the basic concerns about markets for distressed assets. They examine the segment of Chapter 11 cases in which one would expect the most transparency and information: large, publicly held firms. Research on smaller firm outcomes in Chapter 11 has suggested reason for optimism about judicial decisionmaking—even among scholars who were once skeptical.[272]

(1998) (discussing the implications for the debate over the desirability of Chapter 11 reorganization); Todd C. Pulvino, *Effects of Bankruptcy Court Protection on Asset Sales*, 52 J. FIN. ECON. 151, 153-54 (1999) (discussing the possibility that bankruptcy attracts low-ball bids from opportunistic buyers and that the structure of bankruptcy incentivizes managers to accept them). Fire sale prices, and buyer windfalls at the expense of creditors and equity holders, are essentially what LoPucki and William Whitford predicted based on their earlier studies of large public companies in Chapter 11. Lynn M. LoPucki & William C. Whitford, *Corporate Governance in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 141 U. PA. L. REV. 669, 753-67 (1993); *see* Lynn M. LoPucki, *The Trouble with Chapter 11*, 1993 WIS. L. REV. 729, 758. Whether the sales achieve full value may be a function of the sale procedures. For example, Eckbo and Thorburn, *supra* note 119, found that prices and rate of business continuation were high for small- to medium-sized corporations where statutory sale procedures were followed.

271. The most pointed response, James J. White, *Bankruptcy Noir*, 106 MICH. L. REV. 691 (2008), did not, in our view, impair the essential insights of *Bankruptcy Fire Sales*. *See* Lynn M. LoPucki & Joseph W. Doherty, *Bankruptcy Vérité*, 106 MICH. L. REV. 721 (2008) (offering a systematic response to issues raised by White). Perhaps the strongest empirical counter to *Bankruptcy Fire Sales* that we have seen so far comes from an unpublished working paper that raises questions about selection effects. Branko LJ. Radulović, The Effect of §363 Sales on Recovery Rates: Allowing for Self-Selection Bias (Sept. 18, 2008) (unpublished manuscript), http://ssrn.com/abstract=1360383; *see also* Jared A. Wilkerson, *Defending the Current State of Section 363 Sales*, 86 AM. BANKR. L.J. 591, 605 (2012) (challenging explanations offered by LoPucki and Doherty for *Bankruptcy Fire Sale* findings, and also raising selection effects arguments, but noting that "it can simultaneously be true that debtors are getting the highest price available and the winning bidder is getting a great deal on the assets"). Baird and LoPucki also debated the selection effect question in an online exchange. *See H2H: LoPucki v. Baird*, U. CHI.: FACULTY BLOG, http://uchicagolaw.typepad.com/faculty/h2h_lopucki_v_baird_/index.html (last visited Sept. 3, 2013).

272. *See* Baird & Casey, *supra* note 29, at 8 n.29 (citing Morrison, *supra* note 40, at 411, for the proposition that courts "shut down firms in the same fashion as a rational decisionmaker" contrary to earlier conventional wisdom, and Elizabeth Warren & Jay Lawrence Westbrook, *The Success of Chapter 11: A Challenge to the Critics*, 107 MICH. L. REV. 603, 627-30 (2009), for further empirical support of this finding). Morrison's work suggests that bankruptcy judges can play an important role in tempering the overreaching of parties with an expected bias too far in favor of premature liquidation or protracted reorganization. Morrison, *supra* note 40, at 394.

In addition, the basic courts-versus-markets dichotomy as a matter of theory has long been over-emphasized. First, as Susan Block-Lieb has discussed, most proponents of contract corporate bankruptcy have not adequately explained how or whether those market alternatives would avoid the problems of decision costs and market imperfection when applied to real world settings.[273] Second, market proponents have regularly characterized the role of courts in Chapter 11 as far more exceptional than is accurate in the federal court system.[274]

We accept that the potential for an ex post hearing is a second-best solution when compared to a thick and liquid market. But, as previously noted, this is not the situation in bankruptcy.[275] When compared to the markets that actually exist for distressed assets, the comparative disadvantage of courts may not be as great as generally assumed. Another asserted disadvantage of judicial determination of value is cost. However, this too is likely a red herring because parties are likely to bargain post-sale rather than litigate over allocation of the holdback. The Ice Cube Bond ensures that questions about the existence of a Speed Premium and related matters of distribution will be scrutinized and negotiated after the sale has closed, in a circumstance of reduced time pressure free of melting ice cube leverage. The reduced time pressure should increase the quality of decisionmaking.

The Ice Cube Bond comes into play with respect to 363 sales that are best understood as procedurally noncompliant,[276] and that produce specific valuation and allocation risks.[277] Procedurally compliant foreclosure sales are entitled to deference, while procedurally noncompliant foreclosure sales are not.[278] It is precisely because the valuations in hurry-up sales are suspect that

273. Block-Lieb, *supra* note 111, at 555-58.

274. *See* Melissa B. Jacoby, *Fast, Cheap, and Creditor-Controlled: Is Corporate Reorganization Failing?*, 54 BUFF. L. REV. 401, 422-37 (2006) (using broader judicial behavior literature and models of judging from class action scholarship to evaluate bankruptcy courts' handling of Chapter 11 cases); Edward J. Janger, *Crystals and Mud in Bankruptcy Law: Judicial Competence and Statutory Design*, 43 ARIZ. L. REV. 559, 579-81 (2001) (illustrating how critiques of bankruptcy judges focused on an overly narrow conception of judging, ignoring the roles played by judges in public law and structural reform cases).

275. *See, e.g.*, Samuel L. Bufford, *What Is Right About Bankruptcy Law and Wrong About Its Critics*, 72 WASH. U. L.Q. 829, 846 (1994).

276. *See supra* notes 231-235 and accompanying text.

277. *See supra* Section II.C.

278. It is axiomatic that prices obtained at procedurally compliant foreclosure sales are entitled to deference. *See* BFP v. Resolution Trust Corp., 511 U.S. 531, 542 (1994). This was true even

we want to preserve the opportunity to reexamine them afterwards. Similarly, the sale price may be viewed with more confidence where there is no evidence of attempts to use leverage to distort the distributional scheme. In such cases it may be quite straightforward for the court to release the bond, essentially ratifying the sale price, but only *after* the sale has been completed.

When considering *entitlement* to the sale proceeds (to be distinguished from valuation), the market does not have the same degree of comparative advantage over courts. The market is good at valuing enterprises, not determining who has properly perfected a lien or is entitled to a particular priority. Nor is there as much need to resolve distributional questions before the sale. While questions of legal status, such as perfection, entitlement to priority, or preference liability, can be settled through negotiation, these negotiations are not time sensitive. The existence of a preferential transfer,[279] or lack of perfection of a lien on the petition date,[280] should not affect the viability of the business, and the legal arguments are not likely to change over time. As noted earlier, secured lenders do sometimes try to resolve such issues quickly through waivers in association with a sale or with financing.[281] But these efforts may themselves be evidence of melting ice cube opportunism.

The complexities and variations in Chapter 11 cases also give us a greater appreciation for the role of the judge overseeing these sales and cases. Although the largest public bankruptcies receive the most attention in the press, and have been the most systematically studied in the academic literature, the dynamics we have explored affect business bankruptcy cases of many sizes and structures. Many commentators assume the existence of a senior undersecured creditor (or syndicate) with a blanket lien on all assets, and that has been common in recent years. But that was not always the case historically and is not

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under the earlier rule on fraudulent transfers and foreclosure sales espoused in *Durrett v. Washington National Insurance Co.*, 621 F.2d 201 (5th Cir. 1980), so long as the sale price was greater than seventy percent of the appraised value, *id.* at 203.

279. *See* 11 U.S.C. § 547 (2012) (authorizing under certain conditions the avoidance of transfers of property of the debtor prior to bankruptcy that made the creditor better off).

280. *See id.* § 544(a) (authorizing the avoidance of liens that are not properly perfected under applicable non-bankruptcy law).

281. *See, e.g., In re* Gulf Coast Oil Corp., 404 B.R. 407, 412 (Bankr. S.D. Tex. 2009) (reporting on an unobjected-to cash-collateral order that "stipulates to the validity, priority, perfection, extent, and 'non-avoidability' of [the lender's] liens"); DEBTOR-IN-POSSESSION FINANCING, *supra* note 193, at 290-96 (identifying various clauses from proposed financing orders that debtor-in-possession lenders seek to reduce or eliminate the potential for litigation over the status of their prepetition claims); *see also supra* note 193 (providing examples of financing and cash collateral orders).

universally the case today. We anticipate a wider constellation of arrangements, including cases in which lenders intend a blanket lien but do not achieve it. A court can adjust to the variation, ensuring that the Quick Sale Costs and Speed Premium benefits are properly allocated.

3. Incentives

Law and economics scholars also worry that the possibility of ex post revision of transactions can distort ex ante incentives. In our view, this distortion is likely to be salutary rather than problematic. Ex post review should reduce the likelihood of proposed sales that substantially overreach. This dynamic exists whether or not a judge ultimately is called upon to make a determination (or, as might happen more regularly, the allocation of the reserve is worked out through post-sale bargaining). By deterring overreaching, the availability of ex post review may improve market behavior ex ante, where, as here, there is considerable concern about opportunistic behavior. We are not concerned about hurry-up sales, per se. We are concerned about the impact of the opportunistic use of the melting ice cube argument on valuation and distribution.

Given that it does not actually prevent a quick sale from going forward, the Ice Cube Bond can be distinguished from proposals that would affirmatively limit the use of 363 sales.[282] But, if properly administered, the Ice Cube Bond should deter quick sales for which the Speed Premium, if any, is outweighed by the Quick Sale Costs, and channel them towards a sale under a plan. It should also reduce the routine use of the melting ice cube argument when it is not warranted. Sale proponents have options. They can propose a quick 363 sale and either accept the fact of the bonding requirement, or be prepared to establish entitlement to the funds. This will be worthwhile only if the debtor really is a melting ice cube. Or they can conduct the sale as part of the full Chapter 11 plan process.[283] This may occasion some delay, but no Ice Cube Bond would be necessary. If the debtor is not a melting ice cube, the proponent

282. *See* Bussel & Klee, *supra* note 35, at 732 (favoring limiting all-asset sales under § 363 to instances of "true emergency").

283. 11 U.S.C. § 1123(b)(4) (providing that a Chapter 11 plan may provide "for the sale of all or substantially all of the property of the estate . . . and the distribution of the proceeds").

will be encouraged to comply with the normal plan process rather than take a shortcut.[284]

4. *Bargaining*

As previously noted, some readers may worry that the buyer will use its leverage to specify that, as a condition of sale, the estate will forgo the Ice Cube Bond. The concern here is that the same pre-sale leverage that is used to bargain for other favorable conditions also will be used by the buyer to obtain a waiver of the Ice Cube Bond. As we said before, this should be a red flag. A key benefit of the Ice Cube Bond is that it allows the buyer to take clear title to the assets without being embroiled in disputes about the distribution of the proceeds. We see no legitimate reason for the buyer to care how the proceeds are distributed, unless it has struck a side deal with a party in the case. In short, such a stipulation is not about the purchase, but about distribution, and a sign that a particular creditor constituency has agreed to support the sale in return for an enhanced distribution. The court, the creditors' committee, or individual parties should call this bluff.

It is important to recognize that if the sale proceeds holdback is to be distributed pursuant to a Chapter 11 plan, it will be subject to negotiation and potentially allocated pursuant to a consensual arrangement. A full judicial hearing need not happen. This raises another question: if the proceeds are going to be the subject of bargaining ex post, why is this preferable to allowing them to be the subject of bargaining prior to the sale? The difference lies in the absence of transactional leverage. The type of bargaining that happens ex post over distribution of the Bond is likely to be quite different from the hothouse bargaining that occurs ex ante prior to the sale.

Pre-sale bargaining would likely be based on transactional leverage—"my way or the highway" arguments.[285] The potential buyer is in the driver's seat, and it can exact concessions for its allies, in the form of deviations from the bankruptcy distributional scheme or price concessions. This form of brute-force bargaining does violence to legal entitlements that, outside of bankruptcy, might give rise to an economic duress defense against contract

284. Note, too, that the Chapter 11 plan process itself can move quite quickly, as evidenced by the use of prepackaged and pre-negotiated Chapter 11 plans. *See supra* note 130.

285. *See supra* Part I.

enforcement.[286] The *Humboldt Creamery* case discussed earlier shows that transactional leverage risks strong-arming the court as well, and insulates deals that might otherwise be unenforceable under contract law.[287]

By contrast, bargaining after the sale is positional. Instead of arguing about leverage, the conversation is about entitlement. Bargaining about the distribution of the Ice Cube Bond proceeds can and should be part of the Chapter 11 plan process. At that point, the conversation unfolds in the shadow of a judicial determination of value and entitlement rather than a game of transactional chicken. The fact that positional bargaining or judicial decision will occur ex post alters the nature of the bargaining ex ante. The bonding requirement thereby limits the extent to which transactional leverage can be used to distort legal entitlements.

5. *Comparison with Other Lock-up Related Proposals*

The melting ice cube argument is a member of the family of tools that business purchasers utilize to lock up a favored deal in various transactional contexts. In the corporate law literature on lock-ups, a number of alternative proposals reflect the concern that a sale deprives dissenting stakeholders of option value. Daines and Hanson propose that the dissenters be given bonds that would pay off if the original sale price for the company turned out to be inadequate.[288] Adler and Ayres, along with Lucian Bebchuk, propose various mechanisms through which junior interests could purchase the option value from the senior interest to protect their positions.[289] Flipping this idea on its head, Anthony Casey suggests that the senior creditor be required to purchase the option value from the junior creditors.[290]

When thinking about the melting ice cube problem in 363 sales, we have concerns about each of these approaches. The topping off bond eliminates the finality and clean title that is the hallmark of bankruptcy sales, as we explored earlier. Given the choice, purchasers prefer to have all price risk resolved at closing, and may seek to make it a condition of the sale. Unlike the topping off

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286. *See, e.g.*, Totem Marine Tug & Barge, Inc. v. Alyeska Pipeline Serv. Co., 584 P.2d 15 (Alaska 1978).

287. *See supra* notes 96-102 and accompanying text.

288. Daines & Hanson, *supra* note 14.

289. Adler & Ayres, *supra* note 114; Lucian Arye Bebchuk, *A New Approach to Corporate Reorganizations*, 101 HARV. L. REV. 775, 785-86 (1988).

290. Casey, *supra* note 16, at 791.

bond, our Ice Cube Bond proposal does not alter the finality of the outcome.[291] The Daines and Hanson proposal, by contrast, would leave the purchase price open for the duration of the proposed bond, which would undercut finality and reduce the asset's value to the buyer. Our Ice Cube Bond proposal does not erode this finality; it merely reserves the questions of value and allocation errors for another, later day. These questions of allocation do not concern the buyer and should not affect the sale price.

The other proposals noted above would require the junior creditors to set the value of their interests at the very time when their information is at its weakest. Bebchuk would require the junior interests to buy out the senior interest. Adler and Ayres would auction off the equity. Casey would have the senior interest buy out the junior interest's optionality. While these proposals, to varying degrees, have information-forcing attributes that might reduce the information asymmetry, none addresses the underlying problem of information shortage and time constraint associated with an early sale. They seek a market-based solution at a time when markets are thin, and, as Baird and Morrison point out in the Chapter 11 context, information is in short supply.[292] This makes us wary of a solution that seeks to definitively allocate option value at the time of sale.[293]

In addition, each of these proposals assumes a senior undersecured creditor with a valid blanket lien. But what happens if priority becomes non-hierarchical or uncertain, as often can be the case? The bargaining games become too complex under real-world conditions, particularly in a time-sensitive negotiation, for these proposals to operate. Where there are issues of entitlement, priority, and leverage, held by multiple parties, coordination problems may make consensual solutions impossible to achieve. Authoritative determinations based on legal entitlements may be unavoidable.

Moreover, the Adler and Ayres type auction might be difficult to accomplish within the time constraints associated with a true melting ice cube sale. Casey's priority may be even more problematic. By giving the junior creditors a veto, Casey takes a contractual right to repayment (protected with a

291. *See* 11 U.S.C. § 363(m) (2012) (limiting the impact of reversal or modification of a sale order on appeal).

292. *See supra* notes 134-136 and accompanying text.

293. This concern also makes us wary of the preemptive cramdown proposals. *See* LoPucki & Whitford, *supra* note 157, at 186-90; Lynn M. LoPucki & William C. Whitford, *Preemptive Cram Down*, 65 AM. BANKR. L.J. 625 (1991).

liability rule) and enforces it with a property rule.[294] The sale could not go forward unless junior creditors agreed to a price at which they might sell their option. He does not attempt to value the priority and does not suggest a judicial mechanism for doing so. As such, there is no set strike price that would allow the sale to go forward. This right to block a quick sale, like any functional property right, creates a unilateral veto and a bilateral monopoly.[295] Moreover, Casey assumes that junior creditors will be able to bargain as a group. But unsecured creditors are often diffuse and, at least in larger cases, numerous, and may find it difficult to coordinate.[296] Individually, they will have insufficient incentive (and limited capacity) to gather the necessary information.

While negotiation about the price of the option value may force out information and thus limit the information asymmetry, Casey's proposal does not remedy the problem that the melting ice cube argument forces negotiation to occur at a time when information is generally in short supply. As a result, Casey's proposal could *overdeter* quick sales.

CONCLUSION

Although the particular confluence of events that led to the Chrysler bankruptcy and sale may be a rarity, the case put the melting ice cube problem before the public in a concrete way. When a debtor and purchaser pursue a sale prior to a Chapter 11 plan and assert that the debtor is a quickly wasting asset, they initiate a game of chicken with other parties and a court that are at serious informational disadvantages.

If delay will destroy the value of the debtor, then bankruptcy law should facilitate a quick sale. Here, we have dissected the problem in a way that has led to a tailored solution: the Ice Cube Bond, reserved at the time of sale to insure

294. While calling the entitlement a priority, Casey effectively gives the junior creditors a property right to insist on a sale of the debtor pursuant to a plan.

295. Bilateral monopolies tend to produce expensive negotiations and may miss Coasean bargains. *Cf.* Ian Ayres & Eric Talley, *Solomonic Bargaining: Dividing a Legal Entitlement to Facilitate Coasean Trade*, 104 YALE L.J. 1027, 1051 (1995) (noting a cause of friction in bilateral bargaining).

296. Even if a creditors' committee has been appointed, its positions do not bind individual creditors, and thus the existence of a committee does not overcome this concern. *Cf.* Landers, *supra* note 66, at 106-08 (discussing how a creditors' committee can become "marginalized" by swiftly moving cases, particularly when debtor-in-possession lenders seek to limit the funding and investigatory scope of the committee).

against valuation errors and distortion of the bankruptcy priority scheme. The proposal should limit the leverage created using a melting ice cube bluff. We neither glorify nor vilify sales as a general matter, but seek to limit the use of transactional leverage by sale proponents, and facilitate the re-internalization of risks associated with expedited all-asset sales.