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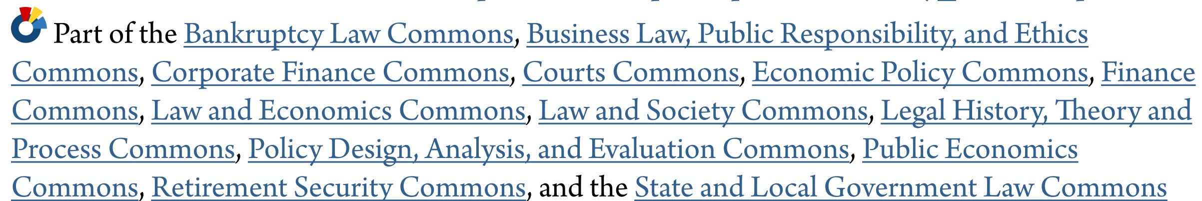
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FROM CHRYSLER AND GENERAL MOTORS TO DETROIT

David A. Skeel, Jr.[†]

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I. INTRODUCTION

In the past six years, three of the most remarkable bankruptcy cases in American history have come out of Detroit. In 2009, the U.S. government arranged for Chrysler and General Motors, two of the three major automakers, to file for bankruptcy and shed a substantial portion of their liabilities through a process that lasted a little more than a month in each case.[1] In 2013, Detroit became the first major American city to file for bankruptcy.[2] Its bankruptcy proved more time consuming, but Detroit too has restructured its obligations remarkably quickly.

Prior to Chrysler and General Motors, bailouts and bankruptcy were non-overlapping alternatives. The government sometimes

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[1] *See* A. Joseph Warburton, *Understanding the Bankruptcies of Chrysler and General Motors: A Primer*, 60 SYRACUSE L. REV. 531, 532-33 (2010) (describing the unique bankruptcy process used with Chrysler and General Motors intended to "make it easier . . . to clear away old liabilities").

[2] Christopher J. Tyson, *Municipal Identity as Property*, 118 PENN ST. L. REV. 647, 695 (2014).

bailed out a major corporation—as it did with Chrysler in 1979[3]—and it sometimes allowed major corporations to file for bankruptcy, as with Delta,[4] United,[5] and the other airlines.[6] But it historically did not combine the two.[7] Chrysler and GM broke the mold, as the federal government pumped roughly $15 billion into Chrysler[8] and $50 billion into GM,[9] and the government dictated the bankruptcy process as well. Detroit's bankruptcy was surprising for somewhat similar reasons: no state had previously permitted a major municipality to file for bankruptcy.[10] When New York City fell into serious financial distress in 1974-75, the state intervened by providing more than $2 billion in rescue financing, but it actively discouraged the bankruptcy option.[11] Michigan, by

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[3] Marcel Kahan & Edward B. Rock, *When the Government is the Controlling Shareholder*, 89 TEX. L. REV. 1293, 1349-51 (2011) (explaining the features of the 1979 Chrysler bailout).

[4] Kristina McQuaid, *Delta & Northwest File for Bankruptcy: Is it Time to Ground a Major Airline?*, 29 HOUS. J. INT'L L. 663, 665-66 (2007).

[5] Terry G. Sanders, *The Runway to Settlement: Rejection of Collective Bargaining Agreements in Airline Bankruptcies*, 72 BROOK. L. REV. 1401, 1401 n.1 (2007) (noting United Airlines filed for bankruptcy in 2002).

[6] *See* McQuaid, *supra* note 4, at 665-66 (stating that Northwest Airlines Corp. is another airline to file for bankruptcy); Sanders, *supra* note 5, at 1401 (listing multiple airlines that have filed for bankruptcy).

[7] The government did establish a liquidity fund for the airlines in the wake of 9/11, but access to the fund was severely limited after it was set up. *See* Margaret M. Blair, *The Economics of Post-September 11 Financial Aid to Airlines*, 36 IND. L. REV. 367, 367, 382-83 (2003) (noting that in order to qualify to receive funds, five requirements must be met).

[8] David Goldman, *CNNMoney.com's Bailout Tracker*, CNN, http://money.cnn.com/news/storysupplement/economy/bailouttracker/ (last visited Sept. 22, 2014).

[9] *Id.*

[10] *See* Juliet M. Moringiello, *Goals and Governance in Municipal Bankruptcy*, 71 WASH. & LEE L. REV. 403, 407 (2014) (noting that prior to the Detroit filing, Stockton, California, was the largest city by population ever to file for bankruptcy).

[11] Among the best accounts of the New York City crisis are: ROBERT W. BAILEY, THE CRISIS REGIME: THE MAC, THE EFCB, AND THE POLITICAL IMPACT OF THE NEW YORK CITY FINANCIAL CRISIS 1 (1984); SEYMOUR P. LACHMAN & ROBERT POLNER, THE MAN WHO SAVED NEW YORK: HUGH CAREY AND THE GREAT FISCAL CRISIS OF 1975 at 156-57 (2010); MARTIN SHEFTER, POLITICAL CRISIS / FISCAL CRISIS: THE COLLAPSE AND REVIVAL OF NEW YORK CITY xi (1985); *see also* Jesse Nankin & Krista Kjellman Schmidt,

contrast, authorized Detroit's bankruptcy filing after putting Emergency Manager Kevyn Orr in place to run the city;[12] and Michigan did not provide rescue funding until after Detroit had first filed for bankruptcy, as part of the elaborate "Grand Bargain" transaction[13] at the heart of the restructuring.

Detroit's and the automakers' bankruptcies share a second key feature as well. Chrysler, General Motors, and the City of Detroit all were staggered by the legacy costs of their obligations to unionized retirees.[14] Many of these promises came during the heyday of Detroit and the Big Three automakers, and the costs became increasingly unsustainable as the fortunes of each declined. To have any hope for a brighter future, the carmakers and Detroit needed to restructure their employee and retiree obligations.[15] Yet, the political and humanitarian costs of

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History of U.S. Gov't Bailouts, PROPUBLICA (Apr. 15, 2009), http://www.propublica.org/special/government-bailouts (noting that New York City was given $2.3 billion in loans).

[12] *See* Matt Helms, Nancy Kaffer, & Stephen Henderson, *Detroit Files for Bankruptcy, Setting Off Battles with Creditors, Pensions, Unions,* DETROIT FREE PRESS (July 19, 2013), http://www.freep.com/article/20130718/news01/307180107/Detroit-bankruptcy-filing-Kevyn-Orr-emergency-manager (explaining Orr's Chapter 9 filing after failed attempts to reach other settlements).

[13] Nicholas O'Donnell, *Detroit Institute of Arts Grand Bargain Not Done Yet, Creditors Claim to Have Purchaser Willing to Pay Nearly $2 Billion for Entire Collection*, ART LAW REPORT (Apr. 23, 2014), http://www.artlawreport.com/2014/04/23/detroit-institute-of-arts-grand-bargain-not-done-yet-creditors-claim-purchaser-willing-to-pay-nearly-2-billion-for-entire-collection/ (detailing the importance of this transaction within Detroit's plan of adjustment).

[14] *See* Mark J. Roe & David Skeel, *Assessing the Chrysler Bankruptcy*, 108 MICH. L. REV. 727, 733 (2010) (noting Chrysler's debt to retiree benefit plans); Joseph H. Smolinsky, *Retooling General Motors: Defending an Innovative Use of the Bankruptcy Code to Save America's Auto Industry*, 6 BROOK. J. CORP. FIN. & COM. L. 103, 106 (2011) (noting the increased legacy costs as a driving force of GM's need to restructure); Christine Sgarlata Chung, *Zombieland / The Detroit Bankruptcy: Why Debts Associated With Pensions, Benefits, and Municipal Securities Never Die . . . And How They Are Killing Cities Like Detroit*, 41 FORDHAM URB. L.J. 771, 782-86 (2014) (discussing the city of Detroit's legacy costs for retired workers).

[15] *See* Richard A. Epstein, *Political Bankruptcies: How Chrysler and GM Have Changed the Rules of the Game*, FEE (Nov. 18, 2009), http://fee.org/the_freeman/detail/political-bankruptcies-how-chrysler-and-gm-

redefining the union contracts—which once offered a middle class life to tens of thousands of blue-collar workers[16]—made restructuring extremely difficult.

This is where bankruptcy came into play. Bankruptcy made rescue funding more palatable to Republican lawmakers who would have resisted a bailout outside of bankruptcy.[17] But it also exposed employees and retirees to the prospect of a severe restructuring, since both are treated as general creditors in bankruptcy.[18] Chrysler, GM, and Detroit have each used carefully structured bankruptcy sale transactions to cushion the blow for retirees in particular. Although sales are, in form, the most market-oriented of transactions, the sales in these cases were designed to insulate a favored arrangement from market interference. Chrysler and General Motors sold their assets to newly created entities dubbed New Chrysler and New GM, while Detroit transferred the art in its world-class art museum—as well as the museum itself—

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have-changed-the-rules-of-the-game (highlighting the dire need of the auto companies to restructure debts accrued from retirement plans).

[16] *See, e.g,*, Thomas Sugrue, *The Rise and Fall of Detroit's Middle Class*, NEWYORKER.COM (July 22, 2013), http://www.newyorker.com/news/news-desk/the-rise-and-fall-of-detroits-middle-class (noting that the "traditional avenue to a life of at least modest comfort for black Detroiters . . . was the [unionized] auto industry").

[17] The administration of President George W. Bush did provide substantial rescue funding to Chrysler and General Motors before they filed for bankruptcy, but it used Troubled Asset Recovery Program funds that were designed to protect the banking industry to do so. Although Treasury Secretary Henry Paulson had previously promised not to use TARP for carmaker bailouts, he changed his mind, knowing that Congress was highly unlikely to approve a bailout. *See, e.g.*, Wendy Jones, *Paulson, Bernanke Testify, Get Grilled*, NBC NEWS (Nov. 18, 2008), http://firstread.nbcnews.com/_news/2008/11/18/4425489-paulson-bernanke-testify-get-grilled (quoting Paulson testimony that "TARP is aimed at the financial system" and that "in terms of autos, I have said it would not be a good thing").

[18] *See* George W. Kuney, *Hijacking Chapter 11*, 21 EMORY BANKR. DEV. J. 19, 74-75 (2004) (stating that employees are creditors); *see also* Mary Williams Walsh, *Bond Insurer Syncora Claims Mediator Favors Detroit's Retirees*, N.Y. TIMES (Aug. 12, 2014), http://dealbook.nytimes.com/2014/08/12/big-bond-insurer-syncora-files-objection-to-detroits-bankruptcy-plan/?_php=true&_type=blogs&_r=0 (noting that Detroit retirees, as one group of creditors, faced cuts to their pensions).

to a new nonprofit organization that is committed to keep the art in Detroit.[19]

The first and most important of this Article's two objectives is to show that the Grand Bargain at the heart of the Detroit bankruptcy is the direct offspring of the bankruptcy sale transactions that were used to restructure Chrysler and GM. The proponents of Detroit's Grand Bargain never would have dreamed up the transaction were it not for the federal government-engineered carmaker bankruptcies. Perhaps not coincidentally, the same law firm represented both Chrysler and Detroit,[20] although the *Chrysler* precedent was probably as important an inspiration as the continuity in law firms.

Although the carmaker sales made the Grand Bargain possible, the road did not begin with the Auto Task Force. After the current bankruptcy laws were enacted in 1978, debtors nearly always were restructured through a traditional reorganization process, not by sales.[21] While substantial bankruptcy sales were not unprecedented, they were quite uncommon for well over a decade after the bankruptcy laws were put in place. By the mid-1990s, however, sales became an increasingly routine strategy for resolving financial distress.[22] Prior to the rise of the bankruptcy sale, the Chrysler and General Motors strategies would not have been conceivable; after it, they were.

From this perspective, the Chrysler, GM and Detroit sales were extreme versions of a very common trend. In part because they are extreme, the sales have highlighted inadequacies of the largely ad hoc regulatory framework bankruptcy courts have used

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[19] *See* Warburton, *supra* note 1, at 534-35, 537-38 (explaining the distinction between "Old Chrysler" and "New Chrysler," and between "Old GM" and "New GM"); Sherri Welch, *Nonprofit to Manage 'Grand Bargain' Pension Donations*, CRAIN'S DETROIT BUSINESS (July 6, 2014), http://www.crainsdetroit.com/article/20140706/news/307069980/nonprofit-to-manage-grand-bargain-pension-donations# (noting the transfer of the art museum "to the nonprofit that runs it").

[20] *See infra* note 94 and accompanying text.

[21] *See* David A. Skeel, Jr., *The Past, Present and Future of Debtor-In-Possession Financing*, 25 CARDOZO L. REV. 1905, 1920 (2004) (noting the shift).

[22] Melissa B. Jacoby & Edward J. Janger, *Ice Cube Bonds: Allocating the Price of Process in Chapter 11 Bankruptcy*, 123 YALE L. J. 862, 901 (2014).

to decide whether and when to approve a proposed sale.[23] This Article's second objective is to highlight the need to fine-tune the treatment of bankruptcy sales, and briefly to suggest—as I and others have done in other work—possible adjustments.

Part II of the Article surveys the increased use of bankruptcy sales and related shifts in Chapter 11 practice over the past several decades. Part III describes the Chrysler and General Motors bankruptcies, which built on, but radically expanded the scope of a bankruptcy sale. Part IV turns to the Detroit bankruptcy, focusing primarily on the "Grand Bargain," while also exploring the city's use of another recent bankruptcy strategy, known as "gifting." The Article concludes, in a brief final part, that the Detroit cases have pushed recent bankruptcy innovations to their logical extremes—and beyond—exposing the need to update the oversight of bankruptcy sales.

II. THE NEW ERA OF BANKRUPTCY SALES

The basic trajectory of Chapter 11 reorganization practice in the past several decades is by now quite well-known. Responding to the agenda control that the debtor enjoys in Chapter 11, creditors began using contractual provisions such as the covenants in debtor-in-possession financing agreements and performance-based compensation bonuses to encourage a more timely reorganization process.[24]

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[23] *See, e.g.*, *In re* Lionel Corp., 722 F.2d 1063, 1070-71 (2d Cir. 1983) (illustrating the conflict courts face in determining whether and when to approve a sale); *In re* Chrysler LLC, 405 B.R. 84, 95 (Bankr. S.D.N.Y. 2009) (using the *Lionel* framework of business necessity to justify a sale); *see also In re* General Motors Corp., 407 B.R. 463, 493-94 (Bankr. S.D.N.Y. 2009) (using the "business judgment rule" as framework for approval of a sale).

[24] *See, e.g.,* Douglas G. Baird & Robert K. Rasmussen, *The End of Bankruptcy*, 55 STAN. L. REV. 751, 781-85 (2002) (identifying and explaining creditors' use of contractual provisions "to ensure that control rights lie in the appropriate hands"); David A. Skeel, Jr., *Creditor's Ball: The "New" New Corporate Governance in Chapter 11*, 152 U. PENN. L. REV. 917, 918-19 (2003) (describing how the "new Chapter 11 governance is contractual in nature," using both debtor-in-possession (DIP) financing and performance-based compensation packages as "important governance levers").

The most important of these developments for my purposes was an increased use of bankruptcy sales as an alternative to the traditional reorganization process.[25] Rather than negotiating the terms of a reorganization with their creditors and then submitting the proposed plan to a vote—a process that takes months at best—many debtors arrange to sell most or all of their assets to a buyer through an auction process early in the bankruptcy case.[26] Often, the debtor's lender insists on the sale as a prerequisite to making a loan, and in a large minority of cases the lender itself is the expected buyer.[27]

In this part, I very briefly chronicle the structure and treatment of bankruptcy sales. I then describe a related development that will also prove relevant later in the Article: gifting transactions.

A. Reorganization by Bankruptcy Sale

The statutory basis for a bankruptcy sale is section 363(b), which does little more than state that the debtor, "after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate."[28] This section requires the debtor to obtain court approval if it wishes to enter into transactions that are outside the ordinary course of business.[29] The drafters of the Bankruptcy Code assumed that debtors might use this provision to sell a few of their assets—say, a piece of equipment the debtor no longer needs. They do not seem to have imagined that a debtor

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[25] Baird and Rasmussen were the first scholars to draw sustained attention to the increased use of bankruptcy sales. *See, e.g.*, Baird & Rasmussen, *supra* note 24, at 751-52 (2002); Douglas G. Baird & Robert K. Rasmussen, Reply, *Chapter 11 at Twilight*, 56 STAN. L. REV. 673, 685-89 (2003) [hereinafter Baird & Rasmussen, *Chapter 11 at Twilight*].

[26] Vincent S. J. Buccola & Ashley C. Keller, *Credit Bidding and the Design of Bankruptcy Auctions*, 18 GEO. MASON L. REV. 99, 99 (2010).

[27] For concerns about sales in which the same party serves as both lender and buyer, see Kenneth Ayotte & David A. Skeel, Jr., *An Efficiency-Based Explanation for Current Corporate Reorganization Practice*, 73 U. CHI. L. REV. 425, 465-67 (2006).

[28] 11 U.S.C. § 363(b) (2012). Section 363(b) refers to the "trustee," but trustees are rarely appointed in a Chapter 11 case. In Chapter 11, the debtor (as "debtor in possession") usually continues to run the business and is given the same powers that a trustee would have. *Id*. § 1107(a).

[29] *Id*. § 363(b) (setting forth basic requirements for sales of property).

might use section 363 to sell *all* of its assets. But section 363 proved quite attractive because the process was fast and required only the bankruptcy judge's approval. Selling assets in connection with a reorganization plan, by contrast, is much more cumbersome and necessitates an elaborate voting process.[30]

As the popularity of section 363 sales increased, bankruptcy judges developed an increasingly standardized process for handling them. Although section 363 does not say anything about an auction, most judges require that a proposed sale take the form of an auction that gives potential bidders at least thirty days to submit a bid.[31] The debtor generally secures an initial bid from a "stalking horse" before proposing the sale.[32] Sometimes other bidders emerge, but often they do not. To increase the likelihood it will prevail, the initial bidder may ask for protections, such as "qualified bid requirements" that impose restrictions on the terms of potential bids.[33]

In addition to buying the debtor's assets, buyers also often agree to assume some of the debtor's ongoing contracts with

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[30] 11 U.S.C. § 1122 sets the parameters for dividing the holders of claims and interests into classes, and 11 U.S.C. § 1126 sets forth the voting rules. *Id*. §§ 1122, 1126. If each class votes yes, and the plan satisfies fifteen other requirements, it can be confirmed under 11 U.S.C. § 1129(a). *Id*. § 1129(a). If one or more classes vote no, the plan can only be confirmed if it meets the requirements for "cramdown" under 11 U.S.C. § 1129(b). *Id*. § 1129(b).

[31] In 2006, the U.S Bankruptcy Court for the Southern District of New York released a set of guidelines for bankruptcy sales. *In re* Adoption of Guidelines for the Conduct of Asset Sales, General Order M-331 (Bankr. S.D.N.Y. Sept. 5, 2006), *available at* http://www.nysb.uscourts.gov/court-info/local-rules-and-orders/general-orders. Other courts have similar guidelines. *See* Hower v. Molding Sys. Eng'g Corp., 445 F.3d 935, 937 (7th Cir. 2006) (describing judge's allotment of thirty days for bids to be taken).

[32] *See generally* Gary W. Marsh & B. Summer Chandler, *The Pros and Cons of Being a Stalking Horse Bidder for Assets in Bankruptcy*, NATIONAL REAL ESTATE INVESTOR (Feb. 18, 2010), http://nreionline.com/print/distress/pros-and-cons-being-stalking-horse-bidder-assets-bankruptcy (analyzing the pros and cons of being a stalking horse).

[33] One common restriction only permits bids that exceed the initial bid by a specified amount. For an overview of qualified bid requirements, see N. Lynn Hiestand, Jeffery Steinle, & Alexa Paliwal, *Distressed Asset Sales: Selling and Acquiring from the Debtor Estate*, *reprinted in* 26TH ANNUAL CURRENT DEVELOPMENTS IN BANKRUPTCY & REORGANIZATION, vol. 1, at 935, 954 (2004).

suppliers or other creditors.[34] In most cases, however, the portion of the overall price paid by the buyer that consists of the assumption of debt is comparatively small.[35]

The surge in bankruptcy sales has generated intense debate in the bankruptcy literature. One prominent study suggested that creditors recover considerably less if the debtor's financial distress is resolved through a sale than if the debtor used the traditional reorganization process.[36]

B. Gifting

In recent years, the assets that a corporate debtor seeks to sell through a section 363 sale have often been fully encumbered—that is, they are collateral for a secured creditor that is owed as much or more than the assets are likely to sell for.[37] Often, the secured creditor itself intends to acquire the assets either by credit bidding or by making a cash bid.[38] In other cases, a third party will buy the assets, with the proceeds going to the secured creditors.[39] If the assets are fully encumbered, the debtor's unsecured creditors are the odd ones out. If they stand idly by, the case will, in effect, inure entirely to the benefit of the secured creditors and the buyer, with nothing left over for other creditors.[40] Unsecured creditors can be expected to protest loudly if they expect to be left empty-handed, and this is precisely what they do. They invariably object to the sale or threaten to do so if all the proceeds will go to others.

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[34] *See* Mark J. Roe & Joo-Hee Chung, *How the Chrysler Reorganization Differed from Prior Practice*, J. LEGAL ANALYSIS 1, 4-5, 19 n.14 (2013).

[35] *See id.* at 19 n.14 (indicating that Chrysler was different because "the debts assumed were huge obligations to Chrysler's labor suppliers").

[36] Lynn M. LoPucki & Joseph W. Doherty, *Bankruptcy Fire Sales*, 106 MICH. L. REV. 1, 3-4 (2007). For a more sanguine assessment, arguing that junior creditors do not seem to be harmed, see Jared A. Wilkerson, *Defending the Current State of Section 363 Sales*, 86 AM. BANKR. L.J. 591, 593 (2012).

[37] The question whether the secured creditor should be entitled to all of the proceeds, including intangible assets such as goodwill, has become a much-debated issue. *See, e.g.*, Jacoby & Janger, *supra* note 22, at 923; *see also In re* Residential Capital, LLC, 501 B.R. 549, 610-11 (Bankr. S.D.N.Y 2013) (ruling that lienholders were not entitled to lien on postpetition goodwill).

[38] Jacoby & Janger, *supra* note 22, at 937 n.266.

[39] *Id.* at 889-90.

[40] *Id.* at 890 n.113.

To quiet the unrest, the parties often agree to give at least a small portion of the proceeds to the debtor's unsecured creditors.[41] In many cases, this arrangement works out nicely for all of the parties involved. But the payments are problematic if other, higher priority creditors have not been paid in full. The payments appear to violate the absolute priority rule, which requires that higher priority creditors be paid first.[42]

A similar difficulty can arise in traditional reorganization cases. In some cases, particularly complex cases with a variety of different classes of creditors, the debtor may wish to give one group of creditors something extra—perhaps because they are particularly sympathetic creditors—such as asbestos victims in a case involving asbestos liability. If the debtor offers this class of creditors a special payout, but is unwilling or unable to pay a higher priority class of creditors in full, the proposal may violate the absolute priority rule.[43] If the class of creditors that is left out has the same priority as the favored class, rather than a higher priority, the proposal may violate another rule, bankruptcy's prohibition against "unfair discrimination."[44]

To sidestep these difficulties, debtors and their favored creditors have employed a strategy known as "gifting" in a number of recent cases. In a gifting transaction, a senior creditor gives some of its own recovery to another class of creditors.[45] A senior creditor that is entitled to $100, for instance, may accept a payout of $90 and gift the other $10 to a junior creditor. Although the $10

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[41] *See* Roe & Chung, *supra* note 34, at 8.

[42] The absolute priority rule, which is set forth in 11 U.S.C. § 1129(b) (2012), precludes a lower priority class from receiving any payment if a non-consenting, higher priority class will not be paid in full.

[43] *See id.* (establishing priority requirements for different classes of claims and interests).

[44] Like absolute priority, the unfair discrimination requirement appears in 11 U.S.C. § 1129(b)(1). *See supra* note 43. It too can be waived if a class that is being discriminated against agrees to the treatment. *See* Brad B. Erens & Timothy W. Hoffman, *The Triumph of the Trade Creditor in Chapter 11 Reorganization*, 9 PRATT'S J. BANKR. L. 26 (2013) (discussing various applications of such waivers).

[45] *See, e.g.*, Leah M. Eisenberg, *Gifting and Asset Reallocation in Chapter 11 Proceedings: A Synthesized Approach*, 29 AM. BANKR. INST. J. 50, 50 (2010) (defending gifting as facilitating an efficient reorganization process).

payment to the junior creditor appears to violate the absolute priority rule if an intermediate priority creditor receives nothing, advocates of the transaction insist that nothing is amiss.[46] Since the entire $100 belongs to the senior creditor, the intermediate creditor is not entitled to anything, and the senior creditor's decision to transfer a portion of its recovery to the junior creditor does not change that.[47]

If the value of the secured creditor's collateral could be determined with precision in every case—if we could be certain it is worth $100—gifting might not be especially problematic. But valuation is a messy business, which suggests that gifting could easily be subject to abuse.[48] A century ago, in one of the most important bankruptcy cases ever, the U.S. Supreme Court rejected an analogous transaction on precisely these grounds.[49]

In keeping with each of these concerns, courts have been increasingly skeptical of gifting arrangements. After one circuit court upheld a gifting transaction, two others have struck them down.[50] But gifting has not disappeared, and it was a key feature of the Detroit restructuring, as we shall see.

III. THE CHRYSLER AND GENERAL MOTORS BANKRUPTCIES

As the Auto Task Force deliberated over the fate of Chrysler and General Motors in early 2009, it became increasingly clear that

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[46] *See, e.g.*, *id*. (stating that such transactions "should pass legal muster" if done properly).

[47] *See id.* (explaining that senior creditors often make such a gift to discourage or settle litigation attacking the senior creditor's security interest).

[48] As Douglas Baird puts it, the essential "problem with gifting is not the skipping over of a class per se, but the possibility that the gift is being used to buy cooperation." Douglas G. Baird, *Lessons from the Automobile Reorganizations,* 4 J. LEGAL ANALYSIS 291-92 (2012).

[49] N. Pac. Ry. Co. v. Boyd, 228 U.S. 482, 504-05 (1913).

[50] *Compare In re* SPM Mfg. Corp., 984 F.2d 1305, 1307, 1313-14 (1st Cir. 1993) (upholding gifting), *with In re* Armstrong World Indus., Inc., 432 F.3d 507, 509, 513-15, 517 (3d Cir. 2005) (striking down a gifting transaction), *and In re* DBSD N. Am., 634 F.3d 79, 85 (2d Cir. 2011) (striking down a gifting transaction).

there was no realistic alternative other than bankruptcy.[51] But a bankruptcy filing would create several very serious problems. First, a lengthy bankruptcy case could be devastating to the carmakers, as confidence in their future waned and car buyers looked elsewhere for their cars.[52] Yet bankruptcies involving large corporations historically have taken several years to complete, sometimes longer. Second, the administration wanted to protect the carmakers' unionized employees, who had recently renegotiated their collective bargaining agreements, from any additional hardship.[53] Historically, however, union contracts and benefits had been significantly restructured in other bankruptcy cases, such as the bankruptcies of United, U.S. Air, and Delta.[54]

Until very recently, no one would have dreamed that there might be a way to put Chrysler and General Motors through "quick rinse" bankruptcies that lasted only thirty or forty days, and which protected some general creditors while radically restructuring the carmakers' obligations to others. Indeed, when rumors first surfaced that the Auto Task Force expected to complete the Chrysler and General Motors bankruptcies in one or two months, many experts were skeptical.[55] Yet the dramatic shifts in corporate bankruptcy practice made an unusually quick bankruptcy case less

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[51] Steven Rattner, a member of the Auto Task Force, has recounted the process that led to conclusion that bankruptcy would be necessary. *See, e.g.*, STEVEN RATTNER, OVERHAUL: AN INSIDER'S ACCOUNT OF THE OBAMA ADMINISTRATION'S EMERGENCY RESCUE OF THE AUTO INDUSTRY 67 (2010).

[52] The potential effect on consumers' willingness to buy cars was the excuse GM's chief executive gave for refusing to seriously consider the bankruptcy option. *See, e.g.*, Bob Sechler, *Wagoner Says GM Won't File for Bankruptcy or Reduce Brands*, WALL ST. J. (July 11, 2008), http://online.wsj.com/articles/SB121573308128544183.

[53] *See generally* RATTNER, *supra* note 51, at 37-38 (discussing the concessions made by the unions).

[54] *See* Babette A. Ceccotti, *Lost in Transformation: The Disappearance of Labor Policies in Applying Section 1113 of the Bankruptcy Code*, 15 AM. BANKR. INST. L. REV. 415, 434 n.125, 435 n.127 (2007) (noting that the cuts to union benefits in the airline bankruptcies are a common trend in restructuring).

[55] Including this one. *See* Joann Muller, *Can America's Carmakers Inspire Confidence?*, FORBES.COM (Mar. 31, 2009), http://www.forbes.com/2009/03/31/gm-chrysler-consumer-confidence-business-autos-confidence.html (quoting David Skeel as saying " 'I don't think it is a few week thing' " and " 'GM is not a classic in-and-out type of company' ").

unthinkable. No debtor as large and complex as Chrysler or GM had resolved its financial distress nearly this fast, but the combination of lender control and section 363 sales had made short cases almost routine for smaller corporate debtors. The Auto Task Force and its bankruptcy lawyers used these features of current cases as their template and extended them to radically new extremes.

In each case, the basic transaction was a section 363 sale of all of the car companies' good assets to newly created entities known as New Chrysler and New GM, with the U.S. government serving both as debtor-in-possession (DIP) financer and as lender to the new entity.[56] New Chrysler paid $2 billion to acquire Chrysler's assets, but also agreed to assume $5.3 billion in trade debt and to give 55% of New Chrysler's stock and a $4.6 billion note to Chrysler retirees for their healthcare benefits.[57] The GM transaction was similar, except that New GM actually did not pay anything for the assets it received.[58] (As it turned out, the GM transaction was less problematic because GM's creditors were not harmed by the fictitious sale: GM paid the senior creditors in full and GM's junior creditors probably received more than they would have in an ordinary Chapter 11 reorganization.)[59]

Three features of the Chrysler and GM transactions, each inspired by developments in recent Chapter 11 practice, are of particular note. The first is the dominant role of the DIP financer.[60] The carmaker bankruptcies most closely resemble a bankruptcy case in which the same entity serves both as lender and as buyer.

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[56] For a description of the Chrysler transaction in detail and the GM transaction more briefly, see Roe & Skeel, *supra* note 14, at 733-34, 765.

[57] *Id.* at 733 (describing the Chrysler transaction).

[58] *Id.* at 750; *see also* Todd L. Friedman, *The Unjustified Business Justification Rule: A Reexamination of the* Lionel *Canon in Light of the Bankruptcies of Lehman, Chrysler, and General Motors*, 11 U.C. DAVIS BUS. L.J. 181, 218 (2010) (stating that New GM took on debt of Old GM in exchange for the assets it received).

[59] *See, e.g.*, Roe & Skeel, *supra* note 14, at 765. For a more critical assessment of the GM case, see Ralph Brubaker & Charles Jordan Tabb, *Bankruptcy Reorganizations and the Troubling Legacy of* Chrysler *and* GM, 2010 U. ILL. L. REV. 1375, 1377.

[60] *See, e.g.*, Baird & Rasmussen, *supra* note 24, at 784-85; Skeel, *supra* note 24, at 919.

Sales to a DIP financer—often called loan-to-own transactions—are the most worrisome form of sales, due to information asymmetries between the lender-buyer and other potential bidders.[61] Thanks to its privileged access to the debtor's books and records, a financing buyer is likely to have better information than other potential bidders. The information disparity chills bidding, creating the risk that the financing buyer will acquire the debtor's assets for much less than they are worth. Although loan-to-own transactions can be entirely legitimate, they warrant careful scrutiny to discourage abuse.

The government did enjoy extensive access to information about Chrysler and General Motors, but a more significant chilling effect probably came from potential bidders' knowledge that the government's motives were not economic. The government was anxious to control the restructuring process and might therefore have been willing to pay more than the companies' assets were worth, if necessary.[62] None of this was illegitimate by itself—and nothing in the bankruptcy laws precludes the government from serving as financer or buyer—but it underscored the difficulty of creating an effective auction and the need for unusual vigilance.

The second distinctive feature was the nature of the sales. As already noted, buyers often assume a few of the debtor's obligations when they purchase a company's assets in a bankruptcy sale.[63] With Chrysler and GM, by contrast, the proportions were reversed, with small purchase prices and very large commitments to assume liabilities to favored creditors. The price paid for Chrysler was $2 billion, and the liabilities assumed were roughly $10 billion.[64] In the GM bankruptcy, there was no purchase price at all.[65]

The car bailouts looked less like genuine sales and much more like reorganizations, in which some creditors were favored

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[61] *See, e.g.*, Ayotte & Skeel, *supra* note 27, at 465; *see* Michelle M. Harner, *Activist Distressed Debtholders: The New Barbarians at the Gate?*, 89 WASH. U. L. REV. 157, 169-70 (2011) (reviewing the potential issues of loan-to-own investments).

[62] *See, e.g.*, Roe & Skeel, *supra* note 14, at 748.

[63] *See supra* note 35 and accompanying text.

[64] *See supra* note 57 and accompanying text.

[65] *See supra* note 58 and accompanying text.

(retirees, trade creditors) and others cut off (general unsecured creditors, terminated dealerships). Bankruptcy judges are aware of the risk that bankruptcy sales can be used to achieve a disguised reorganization that evades the procedural protections Chapter 11 provides for an ordinary reorganization. Proposed sales that actually are "*sub rosa*" plans of reorganization come in for condemnation in the case law.[66] In upholding the sales, the *Chrysler* and *GM* courts seemed to stretch the *sub rosa* plan doctrine beyond recognition.[67]

The final key feature was the terms of the Chrysler and GM auctions. The stalking horse bidder in a proposed bankruptcy sale often asks for bid protections, such as a requirement that bids must exceed the current bid by a specified minimum amount or that only bids for the entire company will be considered.[68] In the auto bankruptcies, the government asked for qualified bidder requirements that went far beyond any that a previous court had ever approved.[69] The government proposed that no bid be allowed unless the bidder promised to protect precisely the same favored creditors as were protected by the government's bid.[70] In *Chrysler*, for instance, bidders would be required to assume the approximately $5.3 billion of trade claims and offer stock and a nearly $4.6 billion note to retirees.[71] A bidder could not simply bid, say, $2.5 billion, for Jeep, even though such a bid would provide more proceeds than the government's $2 billion bid.[72]

If the bankruptcy judge had rejected the government's highly restrictive bidding rule altogether, the prospect of a legitimate

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[66] *In re* Braniff Airways, Inc., 700 F.2d 935, 940 (5th Cir. 1983).

[67] *See* Roe & Skeel, *supra* note 14, at 753-56 (characterizing the Chrysler sale as a "de facto reorganization, not an arm's-length transaction").

[68] *Id*. at 747; *see also supra* notes 32-33 and accompanying text.

[69] The closest prior analogue to *Chrysler* was the sale of Trans World Airlines, Inc.'s (TWA) assets to American Airlines, but the TWA sale explicitly invited alternative bids and bids for any part of the company. *See In re* Trans World Airlines, Inc., No. 01-00056 (PJW), 2001 WL 1820326, at *6 (Bankr. D. Del. 2001).

[70] *In re* Chrysler LLC, 405 B.R. 84, 108-09 (Bankr. S.D.N.Y. 2009).

[71] *Id.* at 90-92.

[72] *See* Motion of Debtors and Debtors in Possession ¶ 56, *In re* Chrysler LLC, No. 09-50002, (Bankr. S.D.N.Y. May 4, 2009) (stating that the qualified bidding procedures as modified by the court must be followed).

auction would have cured, at least in part, some of the other problems with the transactions. To his credit, the bankruptcy judge in *Chrysler* did insist on a slight modification of the bidding rules.[73] But the final rule fell far short of creating a meaningful auction. It required only that the debtor take a look at any non-qualifying bid, and then decide—after consultation with the U.S. Treasury and Chrysler's unions (as well as the creditors' committee), precisely the parties most interested in the government's arrangement—whether the non-qualifying bid should be considered.[74]

The Chrysler and GM transactions extended the domain of section 363 far beyond anything that had ever previously been attempted. In effect, they validated the use of sales to effect transactions that were not really sales at all, and which had the effect of favoring certain groups of creditors while leaving out others.[75]

IV. DETROIT'S GRAND BARGAIN

The centerpiece of the Detroit bankruptcy case was a transaction that participants in the case call the "Grand Bargain." Under the terms of the Grand Bargain, Detroit transferred the Detroit Institute of Arts (DIA) and its art in return for $816 million to a nonprofit foundation that is legally obligated to keep the art in Detroit.[76] Of this amount, $366 million will come from Kresge and other foundations,[77] $350 million from the state of Michigan,[78]

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[73] *In re Chrysler LLC*, 504 B.R. at 93.

[74] *Id.* at 108-09 & n.25.

[75] The carmaker bailouts were remarkably similar in form to the equity receivership transactions used before large scale reorganization was codified in the 1930s, which one prominent New Deal progressive derided as "a mockery and a sham." Jerome N. Frank, *Some Realistic Reflections on Some Aspects of Corporate Reorganization*, 19 VA. L. REV. 541, 555-56 (1933).

[76] For a description of the Grand Bargain, see Fourth Amended Disclosure Statement With Respect to Fourth Amended Plan for the Adjustment of Debts of the City of Detroit at 65-66, *In re* City of Detroit, No. 13-53846 (Bankr. E.D. Mich. May 5, 2014) [hereinafter Fourth Amended Disclosure Statement] (describing the transaction as the "DIA Settlement").

[77] *Id.* at 65.

[78] *Id.* at 66.

and $100 million from funds raised by the DIA itself.[79] The proceeds will be used to increase the payout to Detroit's pension beneficiaries.[80]

When a bankruptcy lawyer and I described the transaction to a table of bankruptcy experts at a bankruptcy conference several weeks after the Grand Bargain was first announced, several literally started shouting. "That's a fraudulent transfer!" one of them insisted; another said: "You can't do that!" They questioned both the purchase price, which seemed considerably lower than the museum's art is worth, and the use of the proceeds to pay one group of general creditors—the pension recipients—but not others.

Yet, the Detroit bankruptcy judge approved it. The Grand Bargain was the culmination of his and the chief mediator's handling of the Detroit bankruptcy.[81]

To understand the contrasting perspectives, it will be helpful to begin with the role of the bankruptcy judge and mediator in the Detroit case. I will then show how the Chrysler and GM bankruptcies made the Grand Bargain possible, and also how they seem to have inspired other features of the Detroit plan.

A. The Role of Detroit's Bankruptcy Judge and Mediator

As the U.S. government was deciding where to file the Chrysler and GM cases, the logical location would have been the Eastern District of Michigan, which is centered in Detroit. After all, the carmakers have been synonymous with Detroit for nearly a century. Yet, the government instructed Chrysler and GM to file their bankruptcy cases in New York. Although neither the government nor other insiders have publicly explained the choice of filing location,[82] rumors circulated at the time that the

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[79] *Id.* at 65.

[80] *Id.*

[81] *See, e.g.*, Matt Helms, *Orr: Duggan, City Council are Ready to Run Detroit*, DETROIT FREE PRESS, http://archive.freep.com/article/20140713/NEWS01/307130093/ (quoting praise by Professor Laura Bartell after the Grand Bargain was announced: "The one-two punch of Judge Rhodes and Judge Rosen on his team has been brilliant . . . .What they have achieved so far has been remarkable.").

[82] *See generally* Tom Hals, *Detroit Bankruptcy Judge Finally Gets His Big Case*, CHI. TRIB. (July 23, 2013), http://articles.chicagotribune.com/2013-07-

government was concerned about the lack of experience in the Eastern District of Michigan with major bankruptcy cases and about the court's administrative capacity to handle the huge number of claims and proceedings in such a large case.

Despite being happy with the government bailout, prominent Michigan officials, such as Representative John Conyers, complained bitterly about the decision to file the carmaker bankruptcies in New York.[83] The most prominent of the local bankruptcy judges, Steven Rhodes, was also critical, questioning the choice of filing location at several bankruptcy conferences.

Detroit's bankruptcy filing was thus a second chance for the local bankruptcy community, and it led to a flurry of behind-the-scenes maneuvering. With an ordinary corporate or consumer bankruptcy case, the judge who will oversee the case is assigned randomly.[84] In a municipal bankruptcy case, by contrast, there is nothing random about the assignment. The chief judge of the court of appeals overseeing the district in which the case is filed picks the judge who will handle the case.[85] When Detroit filed for bankruptcy, the Chief Judge of the district court, Judge Gerald Rosen, sent a letter to Judge Alice Batchelder, Chief Judge of the Eighth Circuit, strongly encouraging her to select Judge Rhodes.[86] Shortly after Judge Batchelder did indeed assign the Detroit bankruptcy to him, Judge Rhodes asked Judge Rosen to serve as

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23/news/sns-rt-us-usa-detroit-judge-20130719_1_bankruptcy-judge-chief-judge-eastern-district (describing without explaining the decisions of GM and Chrysler to file for bankruptcy in New York).

[83] *Id.*

[84] LEI LEI WANG EKVALL & EVAN D. SMILEY, BANKRUPTCY FOR BUSINESSES: THE BENEFITS, PITFALLS, AND ALTERNATIVES 30 (Jere Calmes ed., 2007).

[85] 11 U.S.C. § 921(b) (2012). Congress apparently was concerned to make sure that municipal bankruptcies would be overseen by judges who had sufficient expertise and experience. For discussion of Judge Steven Rhodes' expertise and experience, see Tresa Baldas & Brent Snavely, *Judge Steven Rhodes Selected to Oversee Detroit Bankruptcy,* DETROIT FREE PRESS (July 19, 2013, 11:07 PM), http://www.freep.com/article/20130719/NEWS01/307190070/Detroit-bankruptcy-judge-financial-crisis.

[86] *See* Nathan Bomey, *Detroit Bankruptcy to Get a Mediator: Federal Judge Gerald Rosen is Apparent Pick*, USA TODAY (July 24, 2013, 7:39 AM), *available at* http://www.usatoday.com/story/news/nation/2013/07/24/detroit-bankruptcy-mediator/2582003/; Baldas & Snavely, *supra* note 85.

the chief mediator in the case.[87] In that role, Judge Rosen oversaw mediation on nearly every major issue in the case.

Although the precise threads are not clear, the Grand Bargain appears to have been inspired by Judge Rosen. Early in the case, Judge Rosen hinted to a reporter that major national foundations could be expected to donate money to protect Detroit's art, which suggests that he was thinking about a major transaction from the beginning.[88] Rosen himself is a former Republican candidate for Congress[89] and has significant ties in Michigan political circles, as well as with the Detroit Institute of Art. As the framework for the Grand Bargain emerged, Judge Rosen actively lobbied for contributions from a variety of art world foundations.[90] He also circulated among Michigan Republican politicians to raise support for the legislation that would authorize Michigan to contribute.[91] Several weeks before the start of the confirmation trial in September 2014, a major creditor complained that Judge Rosen was biased,[92] which prompted a remarkable ruling by Judge Rosen striking the creditor's objections from the record.[93]

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[87] *See* Bomey, *supra* note 86.

[88] The statement in the text is based on a phone conversation on June 21, 2014, with a reporter who closely followed the case. Rosen himself has described the original inspiration as having come from a chance encounter with a local foundation president. *See* Helms, *supra* note 81 ("Rosen bumped into Mariam Noland, president of the Community Foundation for Southeast Michigan, at a Detroit deli last fall. As Rosen tells the story, Noland asked casually whether there was anything she could do to help."); *see also* Matthew Dolan, *The Doodle That Drove Detroit Deal*, WALL ST. J., Nov. 8-9, 2014, at A5 (describing the Grand Bargain as originating when Rosen "wrote the word 'art' on [a] pad and drew a box around it," and then "drew an arrow from the box to where he had written the word 'pensions' ").

[89] *See* Bomey, *supra* note 86.

[90] *See* Mark Stryker & John Gallagher, *DIA Joins Deal in Works With Mediators That Would Protect Art, Pensions in Detroit Bankruptcy,* DETROIT FREE PRESS (Dec. 11, 2013, 10:22 PM), http://www.freep.com/article/20131211/NEWS01/312110114/DIA-joins-deal-works-mediators-would-protect-art-pensions-Detroit-bankruptcy.

[91] *See* Helms, *supra* note 81; *see also Detroit's "Grand Bargain" Sweeps Ahead*, MICHIGAN NEWS, http://newsinmi.com/detroits-grand-bargain-sweeps-ahead-2/ (quoting lawmaker as saying Rosen was not lobbying, just explaining the details) (last visited Feb. 2, 2015).

[92] Syncora Guaranty Inc. and Syncora Capital Assurance Inc.'s Second Supplemental Objection to the Debtor's Plan of Adjustment at 2, 20-21, *In re*

It is possible that, in addition to lobbying for the Grand Bargain, Judge Rosen also devised it. But it seems equally likely that Detroit's bankruptcy lawyers worked out the details, or that both played a role. As it turns out, Detroit's emergency manager and its bankruptcy lawyers all come from precisely the same law firm that handled the Chrysler bankruptcy.[94]

B. Assessing the Grand Bargain

The Grand Bargain was a remarkable solution to several of the most vexing problems in the Detroit bankruptcy. The first was the perceived risk that Detroit's world-class art collection might need to be sold and the proceeds used to pay creditors.[95] This concern was quite real to those who love art, and the insistence that a great art museum is important to Detroit's future had a significant element of truth.[96] But as they campaigned to protect the art, art advocates risked being perceived as more concerned about the interests of wealthy art patrons than about the plight of struggling Detroiters. The second problem was the desire to minimize the hardship of the case on Detroit's pension beneficiaries,[97] many of whom depend on the relatively limited pensions, despite the general bankruptcy principle that one class of general creditors

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City of Detroit, No. 13-53846 (Bankr E.D. Mich. Aug. 28, 2014) [hereinafter Syncora Second Supplemental Objection].

[93] Order Granting in Part Motion to Strike and Order to Show Cause Why Sanctions Should Not Be Imposed Under Bankruptcy Rule 9011 and 28 U.S.C. § 1927, *In re* City of Detroit, No. 13-53846 (Bankr. E.D. Mich. Aug. 28, 2014) [hereinafter Order Granting in Part Motion to Strike].

[94] Jones Day was debtor's council for Chrysler and is now council for Detroit. Kevyn D. Orr, the emergency manager, was one of the main Jones Day partners involved in the Chrysler bankruptcy. *In re* City of Detroit, 504 B.R. 97, 125, 157-58, 181, 183 (Bankr. E.D. Mich. 2013).

[95] *See, e.g.*, *Art for Sale? Bankruptcy and the Detroit Institute of Arts*: *Q&A*, 14 IFAR J. 49, 49 (2014) (describing petition of support being circulated by Harvard professor Jeffrey Hamburger).

[96] "I would like to maintain that a dead DIA runs counter to what, ultimately, [the emergency manager's] charge is," the museum's president said at a panel discussion in New York, "which is to put the city back on the road to prosperity and success." *Id.*

[97] *See* Alexander Volokh, *Pension Protection and the Detroit Bankruptcy*, REASON FOUNDATION (Apr. 2, 2014), http://reason.org/news/show/volokh-detroit-pension-protection (examining the pension issue in Detroit's bankruptcy).

should not be treated differently than others. The Grand Bargain cleverly addressed both problems. It protected the art by requiring that it permanently remain in Detroit.[98] It boosted the payout to Detroit's pension beneficiaries by $816 million and directed the proceeds to the pensions,[99] thus preempting complaints that only the elite benefit.[100]

The only concern with the Grand Bargain was that it did not appear to be legal.[101] The transaction was remarkably similar to the Chrysler and GM transactions, relying as they did on a fictitious sale that was designed to favor some groups of creditors over others.[102] Indeed, it seems unlikely that the Grand Bargain would ever have been tried if it were not for the carmaker bailout precedent. With both of its key features, the fictitious sale and the favoring of one group of creditors, the Grand Bargain was in some respects even more audacious than Chrysler or GM.

Start with the fictional sale. The Chrysler and GM transactions each at least purported to leave open the possibility that another buyer could acquire the assets if it made an alternative bid. Detroit made clear that it would not be considering alternative transactions. When creditors announced that they had found four additional buyers, each of which had expressed interest in making a bid in excess of $816 million, Detroit refused to schedule talks

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[98] *See* Fourth Amended Disclosure Statement, *supra* note 76, at 65.

[99] *Id.*

[100] *See, e.g.*, Helms, *supra* note 81 (reporting strong support for the plan by retirees).

[101] Nathan Bomey, *Detroit's Bankruptcy Battle Begins*, USA TODAY (Sept. 2, 2014, 3:28 PM), http://www.usatoday.com/story/news/nation/2014/08/31/detroit-bankruptcy-trial-begins/14899547/ (highlighting two bond insurers' assertions that the Grand Bargain was illegal and unfairly favored pensioners).

[102] *See, e.g.*, Syncora Capital Assurance Inc. and Syncora Guarantee Inc.'s Objection to the Debtor's Plan of Adjustment at 31, *In re* City of Detroit, No. 13-53846 (Bankr. E.D. Mich. May 12, 2014) [hereinafter Syncora Objection to Debtor's Plan of Adjustment] (describing Detroit as "diverting over a billion dollars of value from multiple sources, including the DIA and Foundations on account of the art, State Contribution Agreement, UTGO Settlement, and the DWSD, solely for the benefit of Pension Claims").

with any of the bidders.[103] The city insisted that it had no obligation to consider other bids.[104]

As remarkable as this may sound to those who are not familiar with the peculiarities of Chapter 9, Detroit had plausible legal grounds for taking this position. Due to concerns about interfering with state sovereignty, Chapter 9 does not require even the bankruptcy judge's approval if Detroit wishes to sell some of its assets.[105] Detroit therefore could not be forced to sell the art, and when Detroit did decide to sell the art, it could not be forced to consider other possible buyers.[106]

The fictional sale could, however, be challenged indirectly. To confirm a debt adjustment plan, Detroit needed to show that the plan was in the "best interest of the creditors."[107] Precisely what this means is unclear. In Chapter 11, the debtor must pay each creditor at least as much as it would receive in a liquidation,[108] but

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[103] *See* Steven Church, Katya Kazakina, & Chris Christoff*, Detroit's Orr Shoots Down Creditors' $2 Billion Art Offer*, BLOOMBERG (Apr. 10, 2014), http://www.bloomberg.com/news/2014-04-09/detroit-bond-insurers-say-city-could-get-2-billion-for-art.html (describing the bids and noting that at least one of the four bidders also agreed to keep the art within Detroit).

[104] *See id.* ("Just like New York didn't have to build co-ops in Central Park when it was going through its troubles, Detroit should not have to denude itself," stated Emergency Manager, Kevyn Orr, in refusing to consider other bids.).

[105] 11 U.S.C. § 904 (2012) (prohibiting the bankruptcy court from interfering with a municipality's governmental functions). Consistent with this concern, section 901 does not incorporate section 363(b), which requires court approval of sales in consumer and corporate bankruptcy cases. *Id*. § 901.

[106] Syncora argued that the sale was a fraudulent transfer under Michigan law because Detroit would not receive reasonably equivalent value for its art and Detroit was insolvent. Syncora Objection to Debtor's Plan of Adjustment, *supra* note 92, at 58 n.59. Although the art does seem to have been worth more than $816 million, even taking into account questions concerning what Detroit actually owned, Detroit is probably solvent as a result of the restructuring of its debt. A legal opinion by Michigan's attorney general, arguing the art cannot be sold, emphasized the uncertainty about the nature of Detroit's ownership interest in the art. *See generally* BILL SCHUETTE, MICH. ATT'Y GEN., Opinion No. 7272, CONVEYANCE OR TRANSFER OF DETROIT INSTITUTE OF ARTS COLLECTION 13-14, 18-22 (Jun. 13, 2013) [hereinafter Opinion No. 7272], *available at* http://media.mlive.com/news/detroit_impact/other/AGO%207272.pdf. (arguing that the museum was a charitable trust).

[107] 11 U.S.C. § 943(b)(7) (2012).

[108] *Id*. § 1129(a)(7).

liquidation is not an option for a municipal debtor.[109] Courts have interpreted the test to require a showing that the debtor's plan is the best available alternative, usually as compared to what the creditors would have received if the debtor had never filed for bankruptcy.[110] Under this test, creditors could object (and did object) that a sale of the art for an inadequate price squandered proceeds that would otherwise have been available for creditors.[111]

The question then was whether the $816 million price tag was too great a bargain. The estimates that were released during the case suggest that it probably was, but the valuation questions are debatable.[112]

As with the fictional sale, the Grand Bargain's mechanism for favoring one class of creditors over others was even more remarkable than the sleight of hand used by Chrysler and GM. Unlike the car companies, Detroit made no pretense of treating its creditors evenhandedly under the Grand Bargain. It funneled the

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[109] Michael W. McConnell & Randal C. Picker, *When Cities Go Broke: A Conceptual Introduction to Municipal Bankruptcy*, 60 U. CHI. L. REV. 425, 430-31 (1993).

[110] *See, e.g.*, *In re* Mount Carbon Metro. Dist., 242 B.R. 18, 33-34 (Bankr. D. Colo. 1999) (the best interests test "require[s] that a proposed plan provide a better alternative for creditors than what they already have"); *see also In re* County of Orange, 191 B.R. 1005, 1020 (Bankr. C.D. Cal. 1996) (same standard); COLLIER ON BANKRUPTCY 943-26, ¶ 943.03[7][a] (16th ed. 2014) ("The concept should be interpreted to mean that the plan must be better than the alternative that creditors have . . . . However, . . . one must not be so carried away with the potentially adverse consequences of the alternative to a chapter 9 plan that one reaches the conclusion that any plan is better than the alternative.") (emphasis omitted).

[111] *See* Steven Church, *Detroit Consultant Defends Art Value Creditors Call Low*, BLOOMBERG (Sept. 16, 2014), http://www.bloomberg.com/news/print/2014-09-16/detroit-expert-defends-867-million-art-value-in-federal-trial.html (detailing creditors' objections over the loss they would be required to absorb).

[112] A valuation by Christies of a portion of the art estimated that these paintings would sell for between $454 million and $867 million. *See, e.g.*, Robert H. Frank, *Costs, Benefits and Masterpieces in Detroit*, N.Y. TIMES (Mar. 29, 2014), http://www.nytimes.com/2014/03/30/business/economy/costs-benefits-and-masterpieces-in-detroit.html?_r=0. In July, 2014, another art appraiser, Art Capital, concluded that the entire collection is worth more than $8 billion. *See* Mary Williams Walsh, *Detroit Mum on Proposal to Use its Art as Collateral*, N.Y. TIMES (Aug. 26, 2014, 8:53 PM), http://dealbook.nytimes.com/2014/08/26/detroit-mum-on-proposal-to-use-its-art-as-collateral/.

proceeds of the transaction directly to pension beneficiaries and did not give any proceeds to other creditors.[113] As a result of the Grand Bargain, pension beneficiaries will receive a much higher percentage recovery than several other classes of creditors.

The Chapter 9 provision that calls this kind of favoritism into question is the prohibition against "unfair discrimination."[114] As with the best interest of creditors test,[115] the precise contours of unfair discrimination are unsettled. Some courts have suggested that the requirement is violated if there is any significant difference in the recovery of one class as compared to another class that has not agreed to accept a lesser recovery. Others have adopted more nuanced approaches that permit some separate treatment if there is a legitimate basis for the differentiation.[116]

Although there are good reasons to give pension beneficiaries a somewhat higher recovery than other general creditors, the stark difference between their proposed payout and the recovery for several groups of bondholders is difficult to reconcile with the unfair discrimination rule.[117] But unfair discrimination claims can

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[113] Chad Livengood, *Detroit Bankruptcy Creditor Blasts Mediators Over Grand Bargain*, THE DETROIT NEWS (Aug. 12, 2014), http://www.detroitnews .com/article/20140812/METRO01/308120063.

[114] 11 U.S.C. § 1129(b)(1) (2012) (incorporated into Chapter 9 by 11 U.S.C. § 901(a) (2012)).

[115] *See supra* notes 107-12 and accompanying text.

[116] Two different tests have been used in the Eastern District of Michigan. The principal test comes from Bruce A. Markell, *A New Perspective on Unfair Discrimination in Chapter 11*, 72 AM. BANKR. L. J. 227, 254 (1998), which was adopted in *In re Dow Corning Corp.*, 244 B.R. 696, 701 (Bankr. E.D. Mich. 1999) (citing *In re* Aztec, 107 B.R. 585, 590 (Bankr. M.D. Tenn. 1989). Under the Markell test, a rebuttable presumption of unfair discrimination arises if one class will receive a materially lower recovery than another class, or a class's recovery is significantly riskier. Under an earlier test, the court considered four factors: "[a] whether the discriminating treatment is reasonable . . . . [b] whether the debtor could carry out a plan that does not so discriminate . . . . [c] whether the plan containing the discriminating treatment is proposed in good faith . . . . [and][d] the actual treatment of the discriminated class." *In re* Graphic Commc'ns, Inc., 200 B.R. 143, 148 (Bankr. E.D. Mich. 1996).

[117] *See, e.g.*, DAVID A. SKEEL, JR., CAN PENSIONS BE RESTRUCTURED IN (DETROIT'S) MUNICIPAL BANKRUPTCY, FEDERALIST SOC'Y WHITE PAPER 25 (analyzing Detroit's pension and bond holders' interests and suggesting the "no unfair discrimination" requirement is based on the principal that "sacrifice will be shared, rather than visited disproportionately on one or two classes of

only be invoked by classes of creditors that have objected to the reorganization plan.[118] By the time Judge Rhodes ruled on Detroit's proposed plan of adjustment in late 2014, the major objecting creditors had settled their disputes with the city. Although the objection did not disappear altogether—it was raised by two other classes of creditors—the most vigorous critics were gone. Judge Rhodes rejected the challenge, as expected.[119] The special treatment of pensions was justified, he concluded, because they were central to Detroit's mission, whereas the disfavored creditors, in his view, were not.[120]

C. The Gifting Transaction

In addition to the $816 million from the Grand Bargain, the pension recipients' payout was further enhanced by an unusual gifting transaction. Holders of a class of Detroit bonds known as Unlimited Tax General Obligations insisted that they were fully collateralized by Detroit's commitment to raise its *ad valorem* taxes to ensure payment of the bonds.[123] Countering this claim, Detroit insisted that the bonds were simply general obligation bonds.[124] After negotiating under the direction of Judge Rosen, the mediator and the parties agreed that Detroit would pay the full amount of the bonds, but that 74% would go to the bondholders and 26% to pensions.[125]

The bond settlement is a classic illustration of the dangers of gifting. If the bondholders were clearly entitled to full payment and opted to give a portion of their recovery to a lower priority

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creditors"), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2360302.

[118] *See* 11 U.S.C. § 1129(b) (applying the unfair discrimination requirement to "each class of claims or interests that is impaired under, and has not accepted, the plan").

[119] Oral Opinion on the Record at 29-31, *In re* City of Detroit, No. 13-53846 (Bankr. E.D. Mich. Nov. 7, 2014).

[120] *Id.* at 30-31. Judge Rhodes prefaced his analysis by suggesting that the touchstone is a court's "conscience," a standard that seems equally problematic.

[123] David A. Skeel, Jr., *What is a Lien? Lessons from Municipal Bankruptcy*, UNIV. OF PA. LAW SCH., PENN LAW: LEGAL SCHOLARSHIP REPOSITORY 13 (2014).

[124] *Id.*

[125] *Id.* at 13 n.57.

class such as the pensions, the gift might be defensible. But the bondholders' secured status was in doubt, which would imply something less than a 100% recovery. This raises serious questions about the legitimacy of the gift—questions that are in a sense subsumed into the unfair discrimination analysis, since the effect is to increase the payout to pension recipients.

V. THE FUTURE OF BANKRUPTCY SALES

It is often remarked that a tendency, when pushed to extremes, can begin to look a great deal like its opposite. Far right-wing politics may have more in common with socialism, for instance, than with moderate right-wing politics; left-wing socialism can begin to look like totalitarianism. The car bailouts and Detroit restructuring have brought this phenomenon to bankruptcy. The most distinctive feature of bankruptcy practice over the past twenty years has been the increasing role of the market transactions.[126] The expanded use of bankruptcy sales as an alternative to the traditional reorganization process is the culmination of this trend. In one sense, the car bailouts extended this trajectory to its furthest extremes, effecting a sale of companies much larger and more complex than any previous bankruptcy sale. In another sense, however, they inverted the trend. The carmaker sales were almost completely insulated from the markets and did not look like real sales at all. The Detroit Grand Bargain built on this pattern, removing all possibility of competing offers for a sale of Detroit's art.

The most obvious lesson from the cases is the need for more meaningful oversight of bankruptcy sales, at least in the Chapter 11 context.[127] Bankruptcy judges have devised ad hoc protections

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[126] *See, e.g.*, Robert K. Rasmussen & David A. Skeel, Jr., *The Economic Analysis of Corporate Bankruptcy Law*, 3 AM. BANKR. INST. L. REV. 85, 93-94 (1995) (emphasizing the use of market transactions).

[127] As discussed earlier, courts have less control in Chapter 9 because municipal debtors are not required to comply with section 363. *See supra* note 105 and accompanying text. As a result, the principal check on Chapter 9 asset sales is Chapter 9's confirmation requirements, such as the "best interest of creditors" and "unfair discrimination" tests. 11 U.S.C. §§ 1112(b)(1), 1129(b)(1) (2012).

such as the requirement that proposed sales be subject to a market test.[128] But these protections are notably incomplete, especially in unusual cases like the Chrysler and General Motors bankruptcies. Scholars have proposed a variety of additional correctives, a few of which may warrant more serious consideration than scholarly proposals usually receive.

The current proposals fall into three general categories. Some would impose procedural safeguards such as eschewing qualified bid requirements that dictate how the business will be run after the sale or what obligations would be assumed,[129] or counting only the cash portion of a bid in comparing bids.[130] A second general approach focuses on bankruptcy court scrutiny of a particular sale. The enhanced scrutiny might take the form of a strengthened and clarified prohibition against *sub rosa* plans of reorganization[131] or a more general invitation for the bankruptcy court to "make an independent assessment of whether the proposed sale is the course that maximizes the value of whatever is being sold for the benefit of the estate."[132] Third, to counter concerns that sales may give secured creditors value that actually should go to other creditors, two other commentators propose that part of the sales proceeds be set aside as a bond.[133] I personally am partial to additional procedural protections, together with a strengthened prohibition against *sub rosa* reorganizations. But each of the proposals I have described might improve both the efficacy and perceived fairness of the sales process.

The car bailouts were often described as one-off cases, with few implications for bankruptcy practice. Detroit's Grand Bargain has made clear that the innovations used in the car bailouts have

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[128] *See supra* notes 23-27 and accompanying text.

[129] Baird, *supra* note 48, at 297-98.

[130] Richard Squire, *Better Bankruptcy Sales Through Debt Bidding* (unpublished manuscript) (on file with author).

[131] Roe & Skeel, *supra* note 14, at 767 (advocating that major sales be permitted only if validated in an open auction that does not materially determine the parties' recoveries); *see supra* notes 66-67 and accompanying text.

[132] Baird, *supra* note 48, at 296. Barry Adler proposes that courts apply the standards that govern mergers and acquisitions under state law. Barry E. Adler, *A Reassessment of Bankruptcy Reorganization After Chrysler and General Motors*, AM. BANKR. L. REV. 305, 318 (2010)

[133] Jacoby & Janger, *supra* note 22, at 926.

not disappeared. Each of these cases achieved an essential restructuring of the debtors' finances. But they also have underscored the need to update the bankruptcy sale provision, and perhaps to simplify the requirements of traditional reorganizations, to reflect the new landscape of bankruptcy.