SECTION 363(B) RESTRUCTURING MEETS THE SOUND BUSINESS PURPOSE TEST WITH BITE:
AN OPPORTUNITY TO REBALANCE THE COMPETING INTERESTS OF BANKRUPTCY LAW

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INTRODUCTION

Since the economic cataclysm of the Great Depression, the rehabilitative principle underlying Chapter 11 business reorganizations has focused on the efficiency of preserving valuable assets by sustaining a business as a going concern rather than liquidation. Despite this traditional model of reorganization, Chapter 11 of the Bankruptcy Code provides distressed companies with two means of selling all or substantially all of their assets: a debtor in possession may undertake an asset sale (1) pursuant to § 363(b)(1) of the Code or (2) within a reorganization plan under § 1123.

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pursued, maximization of asset value remains the ultimate goal.\footnote{See \textit{In re} Gulf Coast Oil Corp., 404 B.R. 407, 420 (Bankr. S.D. Tex. 2009) ("[A] § 363 sale can often yield the highest price for the assets because of the buyer’s ability to select liabilities . . . and to purchase a going-concern business.").}

From an efficiency standpoint, there are several reasons why § 363 sales have become more advantageous vehicles than § 1123 reorganization plans for financially distressed companies. After the requisite notice and hearing,\footnote{Notification must be provided to creditors at least twenty-one days prior to the hearing. \textsc{Fed. R. Bankr. P.} 2002(a)(2). \textit{Cf.} \textit{Rose, supra} note 3, at 259-60 (noting that notification pursuant to § 363 sales is less informative due to the lack of "Chapter 11’s plan summary and disclosure").} these out-of-plan sales provide a more streamlined process because purchase agreements face only court approval, rather than the more time-consuming confirmation by several classes of creditors.\footnote{See \textit{In re Gulf Coast Oil}, 404 B.R. at 420 (recognizing the beneficial speed of the process under § 363, under which sales are typically completed within two to three months (quoting Robert E. Steinberg, \textit{The Seven Deadly Sins in § 363 Sales}, \textsc{Am. Bankr. Inst. J.}, June 2005, at 221)); \textit{Jackson, supra} note 2, at 461-62 (discussing the time efficiency of avoiding creditor confirmation of a reorganization plan, a process that may span several years); Micheline Maynard, \textit{Automakers’ Swift Cases in Bankruptcy Shock Experts}, \textsc{N.Y. Times}, July 7, 2009, at B1 (describing the expeditious forty-five day process of the General Motors and Chrysler asset sales).} Thus, corporations in need of fast cash undoubtedly prefer the more expeditious § 363 sale. In addition to the ease of bypassing the rather burdensome creditor voting rights, § 363 sales are more appealing because assets are typically sold free of liabilities,\footnote{See \textsc{11 U.S.C.} § 363(f) (stating circumstances when property may be sold “free and clear” of any interest in the property); \textit{In re Gulf Coast Oil}, 404 B.R. at 420 (“The assets are cleansed in that they are sold, with certain limited exceptions, free and clear of liens, claims and liabilities.” (quoting Steinberg, \textit{supra} note 6, at 22)).} and legally these transactions are final unless marred by bad faith.\footnote{See \textsc{11 U.S.C.} § 363(m) (mandating that the “reversal or modification on appeal” of a sale does not affect its validity if it was carried out in good faith).}

Debtors may find § 363 sales increasingly beneficial in the midst of recessions as a prompt means of generating “the capital needed to fund the company’s reorganization and future survival.”\footnote{See Pugatch et al., \textit{supra} note 1, at 41, 55 (explaining how the economy plays an integral role in compelling corporations to seek speedy liquidations in the face of financing shortages and overall declines in value).} As a result of the current financial crisis, Chapter 11 filings have inundated bankruptcy courts.\footnote{According to the American Bankruptcy Institute, declarations of bankruptcy by businesses nationwide spiked from 28,322 in 2007 to 43,456 in 2008 and 60,837 in 2009. \textit{Quarterly Business Bankruptcy Filings for 1994–2010}, \textsc{Am. Bankr. Inst.}, \url{http://www.abiworld.org/AM/Template.cfm?Section=Business_Bankruptcy_Filings1&Template=/TaggedPage/TaggedPageDisplay.cfm&TPLID=59&ContentID=36301}.} Insolvent corporations operating in various industries,
most notably the automobile industry, have used § 363 sales as the “preferred method of monetizing ... assets.” The recent use of § 363 sales as a substitute for the more traditional Chapter 11 restructuring of large global companies like General Motors, Chrysler, and Lehman Brothers reflects a dramatic shift in the bankruptcy arena. This trend has crystallized the idea that traditional restructurings through reorganization plans may have become a method of the past. Today, the scope of § 363 has even grown to include the sale of whole companies. The benefits of this tactic, however, do not come without significant costs.

Although this strategy is arguably more efficient than participating in an in-plan liquidation, § 363 sales have increasingly become more controversial and vulnerable to abuse. Under the current system, speed and ease beget inconsistency and a lack of transparency that jeopardize the soundness of these deals as well as the interests of creditors. Debtors companies pursuing the sale of assets under § 363(b)
obtain the advantage of circumventing the disclosure and equity requirements necessary for the approval of a reorganization plan. Significant differences in the mechanics of these sales—the lack of a disclosure statement describing the terms and conditions of the plan, the limited time and information provided to creditors to review the proposed sale, and an absence of the requirement that the plan be in the best interest of each creditor—create increasing opportunities for unfair dealing under § 363. Thus, prospective purchasers’ weak control over the terms of the transaction, as well as creditors’ lack of information and input, threatens creditor constituencies, endangering one of the fundamental aspects of bankruptcy law.

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16 See Jackson, supra note 2, at 459-65 (comparing the formal requirements of Chapter 11 plans with asset sales structured outside of such plans).
17 Cf. 11 U.S.C. § 1125(b) (2006) (“An acceptance or rejection of a plan may not be solicited after the commencement of the case under this title . . . unless, at the time of or before such solicitation, there is transmitted to such holder the plan or a summary of the plan, and a written disclosure statement approved, after notice and a hearing, by the court as containing adequate information.”). In comparison, the absence of this disclosure requirement is substituted with an obligatory notice and hearing under § 363, which are minimal at best. But see Rose, supra note 3, at 260-61 (arguing that “in traditional areas of increased scrutiny—good faith objections and insider dealing—notice should minimally include what chapter 11 requires”).
18 See 11 U.S.C. § 363(b)(1) (permitting the trustee to sell the property of the estate after notice and a hearing); FED. R. BANKR. P. 2002(a)(2) (requiring twenty-one days notice to all creditors of a proposed sale of property outside of the ordinary course of business). The decrease in information exchange between the debtor and creditors and the limited time to raise an objection to a proposed sale prior to a hearing may have the ultimate effect of stifling creditors’ opportunities to prevent a sale. See Rose, supra note 3, at 262 (explaining that “[p]lan confirmation depends on creditor approval but § 363 sale approval depends on the creditors’ failure” to carry the burden of proving harm within a relatively short period of time).
19 Cf. 11 U.S.C. § 1129(a)(7) (requiring that each creditor “receive or retain under the plan on account of such claim or interest property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under Chapter 7 of this title on such date” as a prerequisite to court approval of the sale); Jackson, supra note 2, at 459 (noting the “best interest of the creditors” rule for court approval of reorganization plans).
20 See infra note 72 and accompanying text (noting the disproportionately frequent occurrence of insider dealing with § 363 sales).
21 See Pugatch et al., supra note 1, at 57 (“Sales that occur via a confirmed plan not only allow the buyer to negotiate the terms of the acquisition, but also allow the buyer to concurrently assist in shaping the reorganization of the debt structure of the company that it is about to acquire.”).
22 See Rose, supra note 3, at 277 (“The diminution in information and time creates the potential for unfair dealing with § 363 sales.”). Instances of insider dealing and
The prominence of § 363 sales, the amplified speed of the process, and the use of this provision as an alternative to reorganization in unprecedented ways intensify these concerns over potential abuses. As a result of the shockingly speedy General Motors and Chrysler sales, where both companies exited from bankruptcy within forty-five days, critics are now duly alarmed that such hasty timelines will become more common, adversely affecting creditors’ ability to negotiate throughout the process. Furthermore, experts in the field criticize these recent § 363 sales as “sham sales,” setting the precedent that a debtor can design “pretend” sales of its key assets to a new entity set up by the debtor with the objective of avoiding interference by creditors and shareholders. Critics argue that such sales are “artificial” because they do not provide for the proper auction process that § 363 calls for—conferring power to one bidder rather than stimulating multi-party bargaining among other interested parties and creditors—and that they have the potential to violate the priority rules installed by the Code. Regardless of whether these innovative uses of asset sales are a product of government involvement or a reaction to the unique circumstances of the financial crisis, this precedent has other potential abuses will be discussed later. See supra notes 72-75 and accompanying text.

23 See Melissa Maleske, Fire Sale: The Chrysler and GM Bankruptcies Highlight the Dominance and Evolution of 363 Sales, INSIDE COUNSEL, Sept. 2009, at 18, 18 (comparing the speedy § 363 sales of GM and Chrysler, which lasted forty and forty-two days respectively, to the Chapter 11 reorganization of K-Mart, which lasted from January 2002 through May 2003).

24 See Ashby Jones & Mike Spector, Creditors Cry Foul at Chrysler Precedent, WALL ST. J., June 13-14, 2009, at B1 (recognizing that the speed of the Chrysler § 363 sale met with objections by creditors who felt that their lack of participation in the process resulted in “an end run around creditors”); Maynard, supra note 6 (predicting that for creditors, if debtors follow GM’s and Chrysler’s footsteps, it may “mean less time to reach a deal”).


26 See id. (describing how the sale of Chrysler to an entity owned by the company’s employees and Fiat avoids priority rules, by which secured lenders receive less than lower priority employees and have little power to object to the sale).

27 See Jones & Spector, supra note 24 (noting that use of § 363 sales to the detriment of creditors may be a concern that “likely will dissipate when the financial crisis ends”); Skeel, supra note 25 (“The government seems to have concluded—as with the bailouts of Bear Stearns and the American International Group . . .—that the end justifies the means in the current crisis.”).
now opened the door for smaller, private businesses to use § 363 sales to restructure their entire business.\footnote{28 See, e.g., Jones & Spector, supra note 24 (discussing the use of the Chrysler precedent to restructure the National Hockey League’s Phoenix Coyotes through a § 363 sale).}

No matter the cause, the exploitation of § 363 has jeopardized the soundness of these transactions. That creditors will likely fail to find sanctuary in bankruptcy courts’ treatment of § 363 sales augments such concerns. The prevalent standard for court approval of § 363 asset sales, articulated by the Second Circuit in \textit{In re Lionel Corp.}, requires only a motion, a hearing, and a court’s determination that the debtor has a sound business purpose for selling its assets.\footnote{722 F.2d 1063, 1070-71 (2d Cir. 1983).} This test is designed to strike a balance between judicial discretion and creditor protection.\footnote{See id. at 1069 (“To further the purposes of Chapter 11 reorganization, a bankruptcy judge must have substantial freedom to tailor his orders to meet differing circumstances.”). At the same time, the Second Circuit recognized that § 363 does not grant “the bankruptcy judge \textit{carte blanche} to permit the sale, which would be inconsistent with bankruptcy’s goal of protecting the rights of creditors and equity interests, specifically those of public investors with little bargaining power.” \textit{Id.} at 1069-70.}

As this Comment demonstrates, the “sound business purpose” test is applied inconsistently throughout the nation. Courts approach these cases using a variety of factors, which produces a large degree of variance in the weight given to each of these considerations.\footnote{See \textit{In re Gulf Coast Oil Corp.}, 404 B.R. 407, 418-19 (Bankr. S.D. Tex. 2009) (recognizing that “venue selection based on a court’s perceived propensity to approve § 363(b) sales . . . ha[s] altered the landscape of Chapter 11 in large cases”). The court likened forum shopping based on treatment of critical-vendor programs to judicial approval of § 363(b) sales. \textit{See id.} at 419 n.30 (“Choice of venue based on perception of judicial predisposition has been the subject of discussion in any number of fora including the popular press. The \textit{Wall Street Journal} ‘Bankruptcy Blog’ had the following comment . . . ‘New York judges are . . . willing to go along with critical-vendor programs, while courts elsewhere, specifically in Chicago, take a different and dimmer view of them.’” (quoting \textit{Creditors Won’t Let Motor Coach Roll Over Them}, WALL ST. J. BANKR. BEAT BLOG (Feb. 3, 2009, 2:08 PM), http://blogs.wsj.com/bankruptcy/2009/02/03/creditors-won-t-let-motor-coach-roll-over-them/)).} Perhaps a more troubling observation, in light of the escalating and evolving criticism of § 363 sales, is that despite underlying congressional intent\footnote{11 U.S.C. § 363(m) (2006) (indicating that good faith is a factor to consider in assessing the validity of a sale authorized under § 363).} and frequent judicial language indicating that good faith is one such salient factor to be considered, bankruptcy courts typically ex-
amine good faith only as a faint afterthought. 35 With the growing likelihood of abuse of § 363 sales to the detriment of creditors, it is disconcerting that an analysis of good faith in these transactions has been subordinated to a very liberal application of the business purpose test.

In reaction to the current criticism of large companies’ abuses of § 363 sales, the change in the bankruptcy “landscape,” and inconsistent treatment by bankruptcy courts, the Bankruptcy Court for the Southern District of Texas in *In re Gulf Coast Oil Corp.* enumerated thirteen factors to be weighed in determining whether to approve such a transaction. 34 This Comment argues that bankruptcy judges should follow the *Gulf Coast Oil* factors as a model. This test, which modifies previously recognized considerations and adds several new elements, strikes a sound balance between judicial discretion and adherence to the goals of bankruptcy law while also giving the sound business purpose test teeth to address recent concerns of abuse. By providing a more focused legal analysis, which pointedly implies a good faith requirement within its enumerated factors, this approach ensures an analysis of good faith as a potential remedy to ameliorate misuse of the Bankruptcy Code.

Part I of this Comment provides a brief overview and evaluation of the sound business purpose test that courts employ in approving § 363 sales. Part II examines the significance of good faith in the bankruptcy context by analyzing the differences between the meaning of good faith in Chapter 11 reorganizations and in the § 363 approval process. Additionally, this examination will illustrate the ramifications of ignoring whether a transaction is pursued in good faith. Finally, Part III analyzes *Gulf Coast Oil* and the framework that the court articulated. For the reasons outlined above, this Comment argues that this framework provides a preferable model for evaluating § 363 proposals. Because § 363 sales are so prominent across the nation, courts should reevaluate the broad discretion that the Bankruptcy Code confers upon them in order to guarantee that these sales promote creditor protection, an underlying principle of bankruptcy law, 35 by ensuring that parties enter into these deals in good faith.

33 See Rose, *supra* note 3, at 250 (warning that “vague good faith standards” weaken the judicial scrutiny necessary to combat the potential for abuse under § 363).
34 404 B.R. at 422-27.
35 The principles and goals of Chapter 11 include efficiency, maximizing value, preserving jobs, rehabilitating the business, and providing “[b]enefit [to] other parties affected by business failure.” Rose, *supra* note 3, at 254 (citing NAT’L BANKR. REVIEW COMM’N, BANKRUPTCY: THE NEXT TWENTY YEARS (1997)).
I. THE WORLD OF § 363 SALES: BUSINESS JUDGMENT, SUB ROSA, AND SWEETHEARTING

The increasing popularity of § 363 sales as a substitute for true reorganizations reflects a growing conflict between the underlying themes of corporate reorganization under Chapter 11 and the cursory obligations of debtors under § 363 sales. While the use of these asset sales promotes efficiency and maximization of value, this strategy also has the potential to deviate from several goals of bankruptcy law, namely securing equal distribution among creditors of the same class and rehabilitating the business. As such, the law must somehow reconcile this tension. In hopes of protecting equity and creditor interests, courts have fashioned flexible evaluations to balance the authority to sell all or substantially all of a debtor’s assets against the potential for abuse when parties evade Chapter 11’s safeguards. This Part will provide a brief summary of judicial scrutiny of § 363 sales and the failures of these methods in detecting abuse.

A. The Sound Business Purpose Test

In Lionel, which is presently recognized as the seminal case for the authorization of asset sales outside of a plan of reorganization, the Second Circuit addressed this tension through a comprehensive survey of the history behind asset sales in relation to the legislative scheme for corporate reorganizations. In response to the passage of the Bankruptcy Reform Act of 1978, the court defined the role of the bankruptcy judge in authorizing § 363 sales and the subsequent standard the debtor must satisfy to achieve court approval.

36 Gerald F. Munitz, The Bankruptcy Power and Structure of the Bankruptcy Code (describing the several “pillars” of bankruptcy law, including equal distribution amongst creditors and rehabilitation that maintains a going concern business rather than liquidation), in NUTS AND BOLTS OF CORPORATE BANKRUPTCY 2009, at 105, 112-13 (PLI COMMERCIAL LAW & PRACTICE, COURSE HANDBOOK SER. No. A-918).

37 See Jackson, supra note 2, at 474 (“Although the standards of review vary among the bankruptcy courts, the approaches are characteristically vague and therefore flexible enough to respond to the diverse needs of particular debtors.”).

38 Comm. of Equity Sec. Holders v. Lionel Corp. (In re Lionel Corp.), 722 F.2d 1063, 1066-70 (2d Cir. 1983).

39 The approach the Second Circuit took in resolving these questions is a significant indication of both a legislative and a judicial intent to open access to these sales to a wide range of debtors. However, the current controversies surrounding asset sales shed light on the continued expansion of § 363 that allows its use as an alternative to reorganization for distressed companies, a strategy that the Second Circuit most likely did not contemplate when deciding Lionel.
1. Unfettered Discretion

In *Lionel*, the Second Circuit noted that on its face, the Bankruptcy Reform Act of 1978, unlike earlier bankruptcy laws, does not constrain courts in approving the sale of assets. Thus, the Act provides courts broad discretion to authorize such transactions. Accordingly, the statutory language of the 1978 Act reflects a legislative intent to craft a more efficient system of judicial involvement. The statute confers upon bankruptcy courts “the authority to intercede, either to prohibit or impose conditions on sales, thereby protecting the interests in the debtor estate or to facilitating [sic] the efforts of the trustee in consummating a sale.” This break from previous bankruptcy law, which clearly favors a more flexible authorization of asset sales pursuant to § 363 with the purpose of maximizing the value of the estate, reduced judicial constraint.

The Second Circuit took account of certain policy considerations in interpreting § 363 to grant bankruptcy judges a discretionary role in the authorization of these transactions. The court acknowledged that with the best interests of the estate as the ultimate consideration, the decisionmaker would have to bear in mind that each debtor’s situation was unique. Each distressed company has obligations to different creditors with varying interests, and thus, the likelihood of maximizing value for one debtor may necessitate a different method or

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41 See *In re Lionel*, 722 F.2d at 1067-69 (concluding that strict limitations upon a court’s authorization of a sale of a debtor’s property under previous statutes, like the “upon cause shown” standard pursuant to the Chandler Act of 1938, were not present in the statutory language of the 1978 Act).
42 See id. at 1069 (“Section 363(b) of the Code seems on its face to confer upon the bankruptcy judge virtually unfettered discretion to authorize the use, sale or lease, other than in the ordinary course of business, of property of the estate.”).
43 Jackson, supra note 2, at 473 (footnotes omitted). Section 363(e) indicates a more limited judicial role in approving asset sales since an interested party must first request the court’s intervention. See 11 U.S.C. § 363(e) (2006).
44 See Jackson, supra note 2, at 473 n.112 (noting that § 363 was a “significant change from [existing] law, which require[d] the affirmative approval of the bankruptcy judge for almost every action” (alterations in original) (quoting H.R. Rep. 95-595, at 315 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6272)).
45 See id. (observing that § 363 affords judges more freedom either to “facilitate or frustrate” sales).
46 See *In re Lionel*, 722 F.2d at 1069 (“[T]he bankruptcy machinery should not straightjacket the bankruptcy judge so as to prevent him from doing what is best for the estate.”).
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2011 timeline than for another. Therefore, the court affirmed that “[t]o further the purposes of Chapter 11 reorganization, a bankruptcy judge must have substantial freedom to tailor his order to meet differing circumstances.”

At the same time, however, the court refused to interpret the statute to permit judicial approval of these asset sales without some form of scrutiny. Granting bankruptcy judges “carte blanche” was not an option since that would render the notice and hearing requirements superfluous; interested parties would know nothing about the rationale underlying the court’s decision to authorize a sale. Furthermore, some standard for granting approval was necessary to assuage the fear that authorization of these sales would put certain creditors and stockholders with little bargaining power, even with the Chapter 11 safeguards, at even more of a disadvantage. In effectuating the goals of Chapter 11, including the maximization of enterprise value and efficiency, a § 363 sale must not impede the rights of creditors and equity holders by completely circumventing Chapter 11’s safeguards. The Second Circuit therefore concluded that it was the bankruptcy judge’s duty to scrutinize these proposals in order to protect these parties. The sound business purpose test emanated out of this balance between avoiding a judicial “straightjacket” and providing adequate scrutiny in order to protect the interests of all parties.

2. Business Justification and the Relevant Factors

In Lionel, the Second Circuit reviewed a bankruptcy judge’s authorization of Lionel Corporation’s plan to sell its most valuable asset, an
eighty-two percent interest in Dale, a profitable manufacturer of electronic components.53 The bankruptcy judge affirmed the sale based on the Creditors’ Committee’s support for the auction of this stock despite that there was no potential for a decrease in the asset’s value if the sale occurred in the future as part of the reorganization plan.54 Thus, the Second Circuit, in determining whether to affirm the sale’s authorization, had to resolve the basic conflict between maximizing the value of Lionel’s asset to fund its plan of reorganization and permitting the debtor to sell its most profitable asset at the expense of the safeguards provided by Chapter 11.

With this conflict in mind, the court concluded that a judge may authorize the sale of an asset prior to a plan of reorganization that is out of the ordinary course of business under § 363 if the debtor has articulated “a good business reason to grant such an application.”55 This test has been equated to state corporate law’s “business judgment rule,” under which “great deference is given to a business in determining its own best interests.”56 However, in determining that the “appeasement of major creditors” alone does not constitute a good business reason for judicial approval of a § 363 sale, the Second Circuit implied that the business justification in the bankruptcy context must take into account equity and creditor interests, in addition to the business’s interests.57

The sound business purpose test that the Second Circuit pronounced, supplemented by the sub rosa doctrine,58 has become the

53 Id. at 1065-66.
54 Id.
55 Id. at 1070-71.
57 See In re Lionel, 722 F.2d at 1071 (asserting that support by the Creditors’ Committee was “insufficient as a matter of law because it ignores the equity interests required to be weighed and considered under Chapter 11”).
58 As articulated by the Fifth Circuit, the sub rosa doctrine provides that a proposed § 363 sale cannot “gut the bankruptcy estate before reorganization or . . . change the fundamental nature of the estate’s assets in such a way that limits a future reorganization plan.” Bergemann v. Babcock & Wilcox Co. (In re Babcock & Wilcox Co.), 250 F.3d 955, 960 (5th Cir. 2001). In theory, the sub rosa doctrine provides an additional method of objecting to a § 363 sale by claiming that the plan side-steps the protections of Chapter 11 by dictating any future plan of reorganization. See Pension Benefit Guar. Corp. v. Braniff Airways, Inc. (In re Braniff Airways, Inc.), 700 F.2d 935, 939-40 (5th Cir. 1983) (holding that a plan to sell assets was sub rosa because the transaction materially interfered with the scheme of creditor enfranchisement that would normally proceed under Chapter 11 and, similarly, would control distributions allocated in a future plan). Opponents of sales still advance this doctrine and assert that the transaction in question, though masked as a § 363 sale, is truly a reorganiza-
generally accepted standard by which debtors proposing § 363 sales are required to establish “a good, sound business justification for conducting the sale before confirmation . . . , that there has been adequate and reasonable notice of the sale, that the sale has been proposed in good faith, and that the purchase price is fair and reasonable.” In finding that pacification of certain creditors was not a good business justification for approving the sale of Lionel’s most valuable asset, the court set out relevant factors to consider, including (1) “the proportionate value of the asset to the estate as a whole,” (2) “the amount of elapsed time since the filing,” (3) “the likelihood that a plan of reorganization will be proposed and confirmed in the near future,” (4) “the effect of the proposed disposition on future plans of reorganization,” (5) “proceeds to be obtained from the disposition vis-à-vis any appraisals of the property,” (6) “which of the alternatives of use, sale or lease the proposal envisions,” and (7) “whether the asset is increasing or decreasing in value.”

These factors directly address the conflict between enabling creditors to vote on the confirmation of a reorganization plan, providing them with the leverage necessary to negotiate and protect their own interests, and granting the use of § 363 to liquidate a debtor’s assets. Moreover, the court designed this standard to guide judges in the use of their discretion, rather than to provide a stringent list of considerations to be analyzed. Whether the proposed sale constitutes a sub rosa plan depends on “the likelihood that a plan of reorganization will
be proposed and confirmed in the near future” and “the effect of the proposed disposition on future plans of reorganization.” These factors evaluate whether the § 363 sale “has potential to lead toward confirmation of a plan and is not to evade the plan confirmation process” and thus aid in determining whether the proponent of the transaction has advanced a proper business justification.

The last factor, namely the fluctuation of the asset in question’s value, has been characterized as the most salient consideration because the history of bankruptcy law indicates that a sale is appropriate to prevent a depreciating asset from jeopardizing the goal of maximizing the value of the estate. Analysis of this factor in *Lionel*—notably the only factor the Second Circuit’s majority opinion examined besides the inadequacy of the proceeds of the sale—was determinative in establishing that there was no good business justification for the sale because the common stock to be sold was not deteriorating in value. In contrast, the court in *In re Baldwin United Corp.* found that the debtor articulated a sound business justification for selling a partnership interest constituting forty percent of its assets where the nature of such interest would, if not sold promptly, only impede reorganization and would lose value as an asset in the long term. Thus, without the urgent need to sell an asset that is quickly decreasing in value, courts may conclude that it is in the best interest of the estate to delay the sale until the confirmation of a reorganization plan in order to maximize the proceeds to be distributed among creditors. Under this test, judges mold their decisions to the unique circumstances surrounding each debtor’s case, using the factors to determine how to satisfy the objectives of bankruptcy law.

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62 Id.


64 See *id.* at 94 (reviewing previous requirements that prior to the sale of estate assets, debtors had to establish that the assets were either “perishable” or would deteriorate in value in the absence of prompt action).

65 See *In re *Lionel*, 722 F.2d at 1071-72 (explaining objections to the sale, including that “the sale was premature because Dale is not a wasting asset . . . [and] there was no justifiable cause present since Dale, if anything, is improving”).

66 See *In re Baldwin United Corp.*, 43 B.R. 888, 905-06 (Bankr. S.D. Ohio 1984) (“[T]he fair value of the partnership interest can only be realized by selling it, and . . . the Ameritrust proposal provides the best opportunity presently available for realizing that fair value.”).
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B. Evaluating the Sound Business Purpose Test Against the Goals of Chapter 11

Due to the flexible nature of the sound business purpose test, judges give a range of considerations different weight in deciding whether to approve § 363 sales, despite a clear pattern of “reoccurring business justifications.” Scrutiny under this test tends to be cursory and superficial. Courts liberally defer to the debtor’s business judgment without undertaking a comprehensive discussion of the factors enumerated in *Lionel*. Deference to management serving as debtor-in-possession is common because courts view management’s expertise and relationships within the industry as significant in maximizing the company’s value. Although such expertise is certainly persuasive, the process is vulnerable to abuse because of the acceleration of an asset sale under § 363, as well as the debtor’s disproportionate control over the sale due to the absence of creditor confirmation. The current system of judicial approval of § 363 sales, in particular the deferential and inconsistent standard applied throughout the nation, has engendered much criticism. In particular, critics charge that it allows unfair deals to slip through the cracks of the business justification scheme and, more recently, that it permits large companies to make unprecedented end runs around creditors who are already in disadvantaged bargaining positions.

In theory, the sound business purpose test and sub rosa doctrine have balanced the disclosure and confirmation requirements of Chapter 11 and the streamlined process under § 363. However, empirical

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67 See *Rose*, *supra* note 3, at 269 (averring that courts typically approve certain justifications including “[s]ales that allow the debtor to avoid unnecessary administrative costs, sales where time is of the essence, and sales that preserve the going concern value of the business”).

68 See id. at 268 (“[C]ourts have continued to evaluate plans inconsistently and often rely on *Braniff, Lionel*, and *Continental* as a basis for mere factual comparison.”). As a result of judges’ discretion in authorizing § 363 sales, written opinions often fail to flesh out all of the relevant factors in relation to the particular circumstances of the case. See, e.g., *In re Lionel*, 722 F.2d at 1071-72 (objecting to the sale on the basis of two of the relevant factors without addressing others that may have been pertinent to the decision).

69 See *Rose*, *supra* note 3, at 271 (“A consistent theme in the courts’ assessment of business justification is the debtor’s superior position in liquidation efforts. . . . Deference to the debtor’s expertise and connections is especially common with complex business structures and specialized industries.”).

70 See id. at 263 (“[D]isproportionate leverage in an accelerated sale . . . gives the debtor the opportunity for unfair dealing.”).

71 See id. at 272 (“The lax standards used to evaluate these sales have contributed to some of the most corrupt and egregious acts by mega-companies in our country’s history.”).
evidence indicates that “§ 363 insider dealing occurs with disproportionate frequency when compared to chapter 11 confirmed plans.”72

The participation of the debtor’s management in negotiating asset sales with prospective purchasers, along with the speed and lack of transparency in this process,73 leaves room for potential self-dealing that may go undetected without cautious judicial consideration of which groups are benefitting from these sales. Such potential for abuse calls for increased scrutiny at the bankruptcy court level, rather than later in the appellate process, because § 363(m) requires an appellant either to obtain a stay on the closing of a sale pending appeal or to allege that the purchaser has undertaken the transaction in bad faith.74

The limited ability to appeal once a sale has been authorized therefore increases the potential for abuse, a danger exacerbated where parties typically close sales immediately after receiving court approval.75

Despite certain cases in which potential self-dealers have been caught red-handed by bankruptcy courts,76 classes of creditors and public investors alike have been held at the mercy of debtors and bidders who have utilized the sound business purpose test to their own

72 Rose, supra note 3, at 277 (citing LYNN M. LOPUCKI, COURTING FAILURE 175 (2005)).

73 See Rose, supra note 3, at 280 (“The debtor’s ability to manipulate the value of the business is more of a vulnerability in § 363(b) sales because of the lack of transparency and the accelerated speed of the process.”).

74 11 U.S.C. § 363(m) (2006) (“The reversal or modification on appeal of an authorization . . . of a sale or lease of property does not affect the validity of a sale or lease . . . to an entity that purchased or leased such property in good faith . . . unless such authorization and such sale or lease were stayed pending appeal.”).

75 See Josef S. Athanas, Section 363 Bankruptcy Sales Attached by Judges and Commentators Just as Economic Conditions Make Them More Important Than Ever (“Once Section 363 sales were approved by the bankruptcy court, parties would quickly close the sale. Upon closing, appeal of the order approving the sale was virtually impossible.”), in BANKRUPTCY AND RESTRUCTURING CHAPTER 11 STRATEGIES 2009, at 39, 43 (2009); see also Lindsey Freeman, Comment, BAPCPA and Bankruptcy Direct Appeals: The Impact of Procedural Uncertainty on Predictable Precedent, 159 U. PA. L. REV. 543, 571-72 (2011) (noting that the doctrine of equitable mootness may prevent Article III review of bankruptcy court orders if the bankruptcy court does not grant a stay pending appeal).

76 In In re Biderman Indus. U.S.A., Inc., the court was faced with whether to approve a letter agreement authorizing a leveraged buyout of the debtor by two companies. 203 B.R. 547, 549 (Bankr. S.D.N.Y. 1997). The CEO of the debtor-in-possession was to be employed by one of the purchasers. Id. at 549. As a result of this conflict of interest, the court would not authorize the sale without an assessment of the fairness of the transaction. Id. at 554. Notably, the court did not analyze this potential sale under the sound business purpose test after there was evidence of potential self-dealing. Some courts will analyze § 363 sales under several of the relevant factors without taking note of any potential for self-dealing or manipulation, which, as demonstrated below, can lead to inconsistency. See infra Section II.B.
personal advantage. In Mission Iowa Wind Co. v. Enron Corp., Enron Wind Corporation and its domestic subsidiaries filed for bankruptcy in relation to its parent corporation’s bankruptcy and proceeded to seek approval of a proposed sale agreement in which General Electric Co. would purchase substantially all of the corporation’s assets as well as assets of several solvent European subsidiaries. Although conflict arose over the allocation of cash payment for these assets between the U.S. and European subsidiaries, the bankruptcy court, without reaching the merits of the case, deferred to Enron Wind’s business judgment.

Review of the preplan sale by the district court illustrates the potential for abuse that results from complete deference to a debtor’s business judgment. The potential for self-dealing was apparent in this case, yet the bankruptcy court overlooked it. In finding that Enron Wind was receiving a fair price for its assets, the court superficially took account of just one of the factors pronounced in Lionel. The bankruptcy court failed to scrutinize whether the allocation of the proceeds was fair and reasonable, and thus in the best interests of the creditors. If the bankruptcy court had undertaken a more comprehensive scrutiny of the deal, it would have discovered that because Enron Corp., the parent corporation, had been the sole entity negotiating the transaction with General Electric Co., Enron may have possessed a special interest in apportioning more of the proceeds to its European subsidiaries in an effort to redirect the flow of this money, which was now free of claims, to itself. Although the district court identified the importance of addressing “the possibility that the allo-

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77 See Rose, supra note 3, at 277-78 (describing the authorization of an asset sale by Polaroid that caused controversy because several members of Polaroid’s management and other parties involved in the deal personally benefitted by retaining an equity interest in the purchaser’s business while the asset sold was severely underpriced).
79 Id. at 41. Under the proposal, Enron Wind would receive approximately thirty-seven percent of the $325 million cash payment while sixty-three percent would be allotted to its solvent European subsidiaries despite creditor objection to this allocation. Id. According to this allocation, “monies paid to the European Asset Sellers would then flow back to Enron Wind—free . . . of further claims by the creditors of its subsidiaries . . . —from whence such funds could flow to the parent Enron Corp. and its creditors.” Id. at 43.
80 Id. at 43.
81 See id. (“[A]lthough the Bankruptcy Court did find that the total compensation paid . . . was fair and reasonable, it explicitly avoided any analysis of the allocation itself, believing that this was a matter of deference to the parties’ business judgment.” (citations omitted)).
82 See id. (explaining the need for “meaningful scrutiny” of the allocation of proceeds to address the possibility of self-dealing).
cation may have been infected by self-dealing on the part of Enron Corp.” in time to resolve the issue partially in favor of the creditors, this deference to a debtor’s business judgment in “conclusory fashion” is disconcertingly widespread. With such great interests at stake, these accelerated sales, characterized by less disclosure and fewer expenses, must not come at the expense of circumventing the goals of Chapter 11, including those of equal distribution and creditor protection. Recognizing that a sound business judgment must take account of all interests, not just those of the debtor’s business, broad deference to the party holding the most control over the transaction under § 363 certainly increases the likelihood of unfair dealing.

Moreover, recent criticism of the approval of Chrysler’s § 363 sale has shed light on yet another way in which the sound business purpose test may sidestep creditor protection. In April 2009, Chrysler LLC and 24 of its subsidiaries (Chrysler) filed for bankruptcy under Chapter 11 after recording a net loss of $16.8 billion in 2008. As required by Chrysler’s acceptance of $4 billion in TARP financing, Chrysler pursued a Viability Plan that involved: (1) Chrysler transferring substantially all of its operating assets to New CarCo (New Chrysler), a limited liability company set up by Fiat as an alliance entity, and (2) assumption of certain liabilities and $2 billion in cash to be paid to Chrysler in exchange for those assets. According to this prenegotiated deal, first-priority secured creditors holding approximately $6.9 billion in claims would receive twenty-nine cents on the dollar in exchange for the transfer of their collateral to New Chrysler. Secured creditors, including certain Indiana funds, advanced one of the major objections to the proposed preplan sale: that the sale benefited cer-

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83 See id. at 42-43 (noting that although the exchange had already been consummated, the cash proceeds could potentially be redistributed to the extent that the funds had returned to the debtors).
84 Id. at 43.
85 See Comm. of Equity Sec. Holders v. Lionel Corp. (In re Lionel Corp.), 722 F.2d 1063, 1070-71 (2d Cir. 1983) (indicating the importance of considering interests of public investors in addition to the debtor’s own interests).
87 Id. at 90.
88 Id. at 92.
89 Id. at 93.
tain unsecured creditors more than those with collateral. As such, these creditors argued that the sale would incorrectly prioritize those claims in violation of the Code.

Bankruptcy Judge Arthur Gonzalez applied the sound business purpose test and concluded that Chrysler had asserted a sound business justification for the sale of its assets outside of a reorganization plan. The basis for this determination emanated from the Lionel factors. First, the court found that the sale of substantially all of Chrysler’s assets to Fiat, who had an interest in New Chrysler, was the only currently viable option because immediate liquidation would result in less value to be distributed amongst creditors. Thus, maximization of value called for the sale of the whole enterprise, as opposed to piecemeal fire sales of its assets. Second, Judge Gonzalez determined that prompt action was required to prevent substantial costs from accruing due to the loss of skilled workers and erosion of consumer confidence. Finally, immediate action was necessary to preserve, at minimum, part of the going concern value of the business since governmental financing of the transaction would be cut off if the sale did not close quickly and Fiat’s offer would expire if the sale did not close by a certain date. Furthermore, the court rejected one secured creditor’s argument that the sale constituted a bad faith transaction.

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90 See id. (asserting that certain secured lenders would receive less value for their collateral than what such collateral would be worth when later sold to New Chrysler, while unsecured creditors, like the UAW, would receive more value).
91 See Richard A. Epstein, The Deadly Sins of the Chrysler Bankruptcy, FORBES.COM (May 12, 2009, 12:00 AM), http://www.forbes.com/2009/05/11/chrysler-bankruptcy-mortgage-opinions-columnists-epstein.html (“[T]he established priorities of creditor claims outside bankruptcy have been cast aside in this bankruptcy case as the unsecured claims of the union health pension plan have received a better deal than the secured claims of various bond holders, some of which may represent pension plans of their own.”).
92 See In re Chrysler LLC, 405 B.R. at 96 (asserting that the Fiat transaction was the only viable option at the time).
93 Id.
94 See id. (“[T]he terms of the Fiat Transaction present an opportunity that the marketplace alone could not offer, and that certainly exceeds the liquidation value.”).
95 See id. (listing various costs resulting from any “material delay” in resuming production).
96 See id. at 96 (indicating that delay may have “vitiate[d] several vital agreements” and that various constituents and creditors required and relied on prompt action).
97 See id. at 106-08 (rejecting the assertion that the U.S. Treasury improperly acted as an “insider” by controlling both debtors and New Chrysler without possessing the authority to enter into these transactions). Significantly, the Second Circuit affirmed the conclusion of the lower court and rejected the bad faith argument. See In re Chrysler LLC, 576 F.3d 108, 120 (2d Cir. 2009) (concluding that the record did not support
The court found that the debtors acted in accordance with their fiduciary duty in choosing "the only option available other than piecemeal liquidation" and no evidence of "fraud, collusion or attempts ‘to take grossly unfair advantage of other bidders’ [were] present." Furthermore, the court found the allegation that the U.S. Treasury acted as an “insider” of the debtors unfounded because Chrysler’s assets were extensively marketed for two years, the government did not act to preclude other entities from participating or negotiating in the sale, and the Treasury did not control the debtors.

The Second Circuit upheld the Bankruptcy Court’s decision, affirming that an analysis of the Lionel factors provided a good business reason for the § 363 sale of Chrysler. The court noted that the sale would in no way offend the priority rules of bankruptcy because “[t]he lien holders’ security interests would attach to all proceeds of the Sale” and, significantly, any new value arising from the operation of New Chrysler would be derived from new assets, such as new management, that were not previously attached to the secured creditors’ collateral. The Second Circuit also emphasized the clear presence of the deterioration of the going concern value of Chrysler and the consequent need for a prompt sale of the business.

Although the courts engaged in a thorough analysis of Chrysler’s business judgment, commentators criticize the courts involved in authorizing this transaction for allowing § 363 sales as substitutes for reorganization and for denying creditors the right to actively negotiate to enhance their own interests. The courts made it clear that a finding that majority lenders were coerced into the sale), vacated as moot sub nom. Ind. State Police Pension Trust v. Chrysler LLC, 130 S. Ct. 1015 (2009).

98 In re Chrysler, 405 B.R. at 97.
99 Id. at 106 (quoting Licensing by Paolo, Inc. v. Sinatra (In re Gucci), 126 F.3d 380, 390 (2d Cir. 1997)). However, on petition for writ of certiorari, the Supreme Court vacated this judgment and remanded the case to the Second Circuit “with instructions to dismiss the appeal as moot.” Chrysler, 130 S. Ct. at 1015.
100 Id. at 107-108.
101 See In re Chrysler, 576 F.3d at 118-19 (agreeing with the “linchpin” of the bankruptcy court’s analysis).
102 Id. at 118.
103 Id. at 119.
104 See id. (“With its revenues sinking, its factories dark, and its massive debts growing, Chrysler fit the paradigm of the melting ice cube.”). In fact, the court pointed to expert testimony asserting that Chrysler’s going concern value was declining by nearly $100 million each day. Id.
105 See Skeel, supra note 25 (criticizing the use of § 363 in the Chrysler bankruptcy as a “sham sale”); cf. Jones & Spector, supra note 24 (“The Obama administration’s plan
the asset sale was necessary to preserve the going concern value of Chrysler and that delay of the confirmation process would likely destroy value in the form of both assets and jobs. Lenders, hedge funds, and other investors, however, may rightfully be concerned that recent cases similar to Chrysler have established precedent jeopardizing their interests. Although the use of § 363 as a vehicle to salvage the value of a going concern is arguably an economically efficient alternative that, in certain cases, ultimately benefits creditors through larger distributions, efficiency should not take precedence over the law. The Bankruptcy Code calls for measures of creditor protection, as exemplified by the disclosure and creditor approval requirements of reorganization plans, and for this reason, safeguards against self-dealing and abuse should be incorporated within the Lionel framework. Drastic increases in the use of § 363 sales as a method of reorganization, changes in the economy that are sure to continue in the aftermath of the financial crisis, and the potential for abuse under this provision demand a reevaluation of Lionel’s sound business purpose test. A more stringent good faith analysis within the sound business purpose test is a strong step in the direction of ameliorating these concerns. The next Part will examine the various approaches and the significance of scrutinizing good faith within bankruptcy law.

II. GOOD FAITH IN THE BANKRUPTCY CONTEXT: IS BUSINESS JUDGMENT SUFFICIENT?

After gaining an understanding of the fundamental objectives and policies underlying the authorization of § 363 sales and corporate reorganizations more generally, it becomes apparent that in the face of the tensions inherent in these transactions, good faith may be the cement that holds the bankruptcy structure together. Despite the fact that courts frequently and troublingly gloss over the issue of good faith when approving § 363 sales, “[e]very bankruptcy statute since 1898 has incorporated literally, or by judicial interpretation, a standard of good faith for the commencement, prosecution, and confirmation of bankruptcy proceedings.” As courts of equity, with the...
authority to use tools such as the turnover of assets, bankruptcy courts employ the good faith standard to ensure that the benefits of filing for bankruptcy are afforded only to parties with “clean hands.” Furthermore, the good faith requirement balances the competing interests of debtors, creditors, and equity holders. By placing the debtor’s motives in the spotlight, courts attempt to balance the bargaining positions of the parties and undertake the responsibility of preventing the manipulation of bankruptcy law. For these reasons, a survey of courts’ definitions of good faith within the bankruptcy context is essential to understanding how a good faith requirement can serve to reconcile the tension between Chapter 11 reorganizations and § 363 sales in an effort to thwart abuse.

A. Good Faith in Corporate Reorganizations

Although Chapter 11 of the Bankruptcy Code does not expressly require that petitioners file for bankruptcy in good faith, the courts have interpreted the statute to include a good faith requirement to further the central policies of debtor rehabilitation and creditor protection. Good faith in this context focuses on whether a debtor seeks to achieve a purpose “outside the legitimate scope of the bankruptcy laws.” Courts, however, are split over whether subjective bad faith is sufficient to establish bad faith or whether the good faith stan-

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109 In re Little Creek Dev. Co., 779 F.2d at 1072; see also In re SGL Carbon Corp., 200 F.3d 154, 161 (3d Cir. 1999) (“The ‘good faith’ requirement for Chapter 11 petitioners has strong roots in equity.”).
110 See In re Little Creek Dev. Co., 779 F.2d at 1072 (noting that the good faith requirement “legitimize[s] delays and costs imposed upon parties to a bankruptcy,” “prevents abuse of the bankruptcy process by debtors,” and “protects the jurisdictional integrity of the bankruptcy courts”).
111 Much of the discussion of what constitutes a bad faith filing under Chapter 11 revolves around § 1112(b). This provision requires a court to “convert a case under this chapter to a case under Chapter 7 or dismiss a case under this chapter, whichever is in the best interests of creditors and the estate, if the movant establishes cause.” 11 U.S.C. § 1112(b)(1) (2006).
112 See Carlos J. Cuevas, Good Faith and Chapter 11: Standard that Should Be Employed to Dismiss Bad Faith Chapter 11 Cases, 60 TENN. L. REV. 525, 525-26 (1993) (discussing how the tension within the case law between debtor rehabilitation and creditor protection has shaped courts’ interpretations of what constitutes good faith in corporate reorganizations).
113 Marsch v. Marsh (In re Marsh), 36 F.3d 825, 828 (9th Cir. 1994); see also Connell v. Coastal Cable T.V., Inc. (In re Coastal Cable T.V., Inc.), 709 F.2d 762, 764 (1st Cir. 1983) (“[T]here must be some relation . . . between the Chapter 11 plan and the reorganization-related purposes that the chapter was designed to serve.”).
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dard includes both subjective and objective considerations. In light of the tension between “the need for permitting a debtor sufficient latitude to reorganize and the need for creditor protection,” the courts have leaned toward a flexible standard of good faith, which coincides with the heavily factual, case-specific inquiries bankruptcy judges typically employ.

Several courts have held that subjective bad faith—a finding that the debtor endeavored to abuse the bankruptcy system by filing for Chapter 11 protection—is a sufficient reason for dismissal. Under this narrow approach, a court will focus on a debtor’s motives for filing and will find bad faith where there is “a pattern of concealment, evasion and direct violations of the Code or court order which clearly establishes an improper motive.” In such cases, debtor behavior such as acting evasively, manipulating assets, or filing primarily to frustrate a secured creditor will be enough to establish bad faith, even where there is a likelihood of successful reorganization.

While this interpretation of good faith acts as a strong means of creditor protection, this approach ignores another fundamental policy behind Chapter 11. By dismissing cases where reorganization is possible, this tactic fails to give financially distressed companies the opportunity to continue operations and emerge from bankruptcy as a going concern. To balance these two policies, other courts have employed a less rigid standard that takes into account both the debtor’s subjective intentions and “all of the facts and circumstances of

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114 See Cuevas, supra note 112, at 528-29 (identifying courts that apply an “objective-subjective test” and those that apply a “subjective good faith test”).
115 Cuevas, supra note 112, at 531.
116 See Rose, supra note 3, at 273-75 (describing the trend away from the narrow, intent-to-reorganize standard toward a more flexible interpretation that requires a case-specific inquiry).
117 See Cuevas, supra note 112, at 532-33 (detailing cases in which courts have dismissed Chapter 11 cases on the sole basis of the debtor’s intent to frustrate creditors and the bankruptcy process in general).
119 See id. (determining that violating court orders, commingling assets, and filing frivolous motions constituted bad faith and grounds to dismiss the debtor’s petition).
120 See Phoenix Piccadilly, Ltd. v. Life Ins. Co. of Va. (In re Phoenix Piccadilly, Ltd.), 849 F.2d 1393, 1394-95 (11th Cir. 1988) (“The possibility of a successful reorganization cannot transform a bad faith filing into one undertaken in good faith.”).
121 See Cuevas, supra note 112, at 533-34 (“[U]nder the subjective test, once subjective bad faith is established then the prospect of a successful reorganization is irrelevant. Dismissal, under these circumstances, is contrary to the policies of open access and financial rehabilitation of distressed companies.” (footnote omitted)).
the case.\textsuperscript{122} Courts will evaluate various objective factors to determine whether a debtor possesses a rehabilitative purpose because, if not, the “statutory provisions designed to accomplish the reorganization objective become destructive of the legitimate rights and interests of creditors.”\textsuperscript{125} Thus, an analysis of the debtor’s financial condition and plan to reorganize is considered a significant indication of the debtor’s subjective intent and whether the filing falls within the legitimate scope of bankruptcy law.

In \textit{In re SGL Carbon Corp.}, a manufacturer and seller of graphite electrodes facing potential civil antitrust liability filed for protection under Chapter 11 and made it explicitly known that its primary purpose for filing was protection against the plaintiffs’ demands.\textsuperscript{124} In response to the unsecured creditor committee’s motion to dismiss the petition on grounds of bad faith, the Third Circuit concluded that SGL Carbon’s filing lacked “a valid reorganizational purpose” and therefore dismissed the case.\textsuperscript{125} Despite noting that debtors may possess a valid reorganizational purpose based on the concern that pending litigation may severely jeopardize business operations, the Court held that SGL Carbon had filed prematurely because the company was still financially viable.\textsuperscript{126} After examining the objective conditions surrounding the filing—the realities of the debtor’s financial situation and the stated purpose for the petition—the court determined that SGL Carbon improperly intended to use bankruptcy law as a litigation strategy.\textsuperscript{127} Accordingly, a debtor’s “intended use of chapter 11 pro-

\textsuperscript{122} \textit{In re Adler}, 329 B.R. 406, 410 (Bankr. S.D.N.Y. 2005); \textit{see also In re SGL Carbon Corp.}, 200 F.3d 154, 162 (3d Cir. 1999) (examining “the totality of facts and circumstances to determine whether they support a finding of good faith”); Little Creek Dev. Co. v. Commonwealth Mortg. Corp. (\textit{In re Little Creek Dev. Co.}), 779 F.2d 1068, 1074 (5th Cir. 1986) (recognizing that a good faith examination requires judges to investigate “all the particular facts and circumstances in each case,” including the debtor’s financial condition (quoting Meadowbrook Investors’ Grp. v. Thirtieth Place, Inc. (\textit{In re Thirtieth Place, Inc.}), 30 B.R. 503, 505 (B.A.P. 9th Cir. 1983))). Cuevas refers to this standard as the “totality of the circumstances test.” Cuevas, \textit{supra} note 112, at 534-35.

\textsuperscript{124} \textit{In re SGL Carbon}, 200 F.3d at 156-58.

\textsuperscript{125} \textit{Id.} at 160.

\textsuperscript{126} \textit{Id.} at 164.

\textsuperscript{127} \textit{See id.} at 163, 165 (“SGL Carbon has offered no evidence it could not effectively use [Chapter 11] protections as the prospect of . . . a judgment becomes imminent.”); \textit{see also Marsch v. Marsch (\textit{In re Marsch})}, 36 F.3d 825, 828-29 (9th Cir. 1994) (holding
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Section 363(b) Restructuring is a significant element of the good faith requirement, since it can demonstrate whether “the debtor objectively ha[d] no reasonable prospect of reorganizing” and whether the debtor subjectively intended the Chapter 11 petition as a means of “harming creditors or abusing the integrity of the bankruptcy system.”

It is important to realize, however, that filing for Chapter 11 in good faith means more than having a “valid reorganizational purpose.” In In re Laguna Associates, the Sixth Circuit set forth several relevant factors to aid the courts in determining whether the debtor has filed in bad faith, including when “the debtor has one asset; . . . the pre-petition conduct of the debtor has been improper; . . . the debtor has no ongoing business or employees; and . . . the lack of possibility of reorganization.” This examination of both subjective and objective factors, in addition to the ability to reorganize, suggests that Chapter 11’s good faith requirement is designed to address the underlying goals of the Bankruptcy Code in a comprehensive manner. Bad faith is not limited to frustration of creditors and other interested parties; it is also concerned with the broader issue of honoring the objectives of bankruptcy law as voiced by Congress. The concept of good faith within Chapter 11 strikes a balance between the protection of creditors and debtors alike and, in doing so, aims to protect the integrity of Chapter 11’s scope from manipulation.

B. Good Faith Under § 363

Courts have extended the flexible, case-by-case analysis of good faith adopted in the corporate reorganization arena to preplan liquidation of assets under § 363. More specifically, one element that the

that a debtor who had financial means to pay restitution judgment to her ex-husband used the Chapter 11 petition as a litigation tactic in bad faith).

128 Rose, supra note 3, at 273.
129 Cuevas, supra note 112, at 529.
131 See Cuevas, supra note 112, at 536 (noting how totality-of-the-circumstances good faith examinations ensure that the bankruptcy process benefits all parties, including the debtor and creditors, and take into account “the impact of the corporate reorganization case on society”).
132 See, e.g., NMSBPCSLDHB, L.P. v. Integrated Telecom Express, Inc. (In re Integrated Telecom Express, Inc.), 384 F.3d 108, 120 n.4 (3d Cir. 2004) (“Yet liquidation plans, no less than reorganization plans, must serve a valid bankruptcy purpose. . . . [T]hey must either preserve some going concern value . . . or . . . maximiz[e] the value of the debtor’s estate.”).
proponents of a § 363 sale are expected to establish is “that the sale has been proposed in good faith.” The statutory authority for this good faith requirement stems from provision § 363(m) of the Code, which states:

The reversal or modification on appeal of an authorization under subsection (b) or (c) of this section of a sale or lease of property does not affect the validity of a sale or lease under such authorization to an entity that purchased or leased such property in good faith, whether or not such entity knew of the pendency of the appeal, unless such authorization and such sale or lease were stayed pending appeal.

Consequently, good faith remains significant under § 363 since an opponent of a sale will retain the ability to appeal an approval of an asset sale only if the opponent raises an objection to the good faith of the purchaser involved in the transaction or if the sale is stayed, a seemingly difficult pursuit when closings typically occur immediately after judicial approval.

Section 363 sales’ expedited process and lesser disclosure requirements make investigation of the purchaser’s behavior vital in order to protect creditors, equity holders, and debtors from exploitation. Increased potential for abuse threatens creditors’ interests as well as the debtor’s ability to maximize the value of the estate. Therefore, in theory, efforts to prevent fraud and inequitable deals should escalate to a new level of import for court approval of § 363 sales.

Where courts have undertaken a specific analysis of good faith in the context of approving § 363 sales, they focus more on the detection of collusion and unfair dealing rather than the more general determination of whether a debtor’s purpose for filing bankruptcy comports with the goals of the Bankruptcy Code. An analysis of a party’s status as a good faith purchaser turns on whether the purchaser has engaged in any fraudulent or collusive conduct including “fraud, col-

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135 See supra note 75 and accompanying text.
136 See Cumberland Farms Dairy, Inc. v. Nat’l Farmers’ Org., Inc. (In re Abbotts Dairies of Pa., Inc.), 788 F.2d 143, 147 (3d Cir. 1986) (“The requirement that a purchaser act in good faith . . . speaks to the integrity of his conduct in the course of the sale proceedings.” (alteration in original) (quoting In re Rock Indus. Mach. Corp. 572 F.2d 1195, 1198 (7th Cir. 1978))). With the objective of encouraging bidders to participate in these auctions, courts seem to be reluctant to set aside sale orders where no inequitable conduct has occurred. Cf. Taylor v. Lake (In re Cada Invs., Inc.), 664 F.2d 1138, 1162 (9th Cir. 1981) (recognizing that despite a strong interest in finality of sale orders, “[c]ourts have generally appeared willing to set aside confirmed sales that were ‘tinged with fraud, error or similar defects which would in equity affect the validity of any private transaction’” (quoting In re Gen. Insecticide Co., 403 F.2d 629, 631 (2d Cir. 1968))).
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The scope of this investigation into the purchaser’s conduct encompasses the purchaser’s actions throughout the bankruptcy process up through the performance of the sale. Moreover, a court will look both to the conduct of the purchaser and to the purchaser’s relationship with the debtor, treating arm’s-length negotiations and a fair and reasonable price for the assets involved as indicia of a good faith purchase.

Despite the articulation of these good faith standards, the potential for unfair dealing and abuse within asset sales consummated under § 363 increases when courts fail to take a comprehensive look at the parties involved and the underlying transaction. Although an inquiry into whether the sale in question was proposed in good faith is often cited as a component of the sound business purpose test, such inquiries are often vague and negligible at best, and therefore fail to protect creditors and investors from exposure to collusive behavior.

In re Abbotts Dairies of Pennsylvania, Inc. serves as an example. In that case, the debtor proposed a sale of its businesses to ADC in order to transfer the debtor’s business operations to the purchaser. Notice of the motion for approval of the purchase agreement did not indicate that Mr. Gwinn, the debtor’s chairman and CEO, was retained as a consultant of the purchaser, nor that he would be employed by ADC upon the sale’s closing. Despite numerous attempts on the

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137 In re Abbotts Dairies, 788 F.2d at 147 (internal quotation marks omitted) (quoting In re Rock Indus. Mach. Corp., 572 F.2d at 1198).
138 See Charles R. Sterbach & Keriann M. Atencio, Why Johnny Can’t Get Paid on His General Unsecured Claims: A Potpourri of Lingering Abuses in Chapter 11 Cases, 14 J. BANKR. L. & PRAC. 111, 127 (2005) (noting that a good faith analysis examines the purchaser’s conduct during “the course of the bankruptcy proceedings, including its conduct leading up to and during the sale itself”).
139 See In re W.A. Mallory Co., 214 B.R. 834, 837 (E.D. Va. 1997) (“Good faith requires the Court to scrutinize the sales to insure that they are arm’s length transactions and absolutely fair under the circumstances.”).
140 See Rose, supra note 5, at 275 (“Whether it is the inconsistent scrutiny afforded § 363 sales or the more aggressive use by debtors, the current standards are not sufficient to shield the bankruptcy system from unfair dealing and abuse.”). An analysis of the purchase and the underlying relationship between the parties involved may fall short of an extensive inquiry when bankruptcy judges defer to disingenuous business justifications. See, e.g., Mission Iowa Wind Co. v. Enron Corp. (In re Enron Corp.), 291 B.R. 39, 43 (S.D.N.Y. 2003) (asserting that when there was a reasonable basis to believe that the asset sale had been subject to self-dealing by Enron, the bankruptcy judge should have engaged in an analysis of the asset allocation rather than simply deferring to the debtor’s business judgment).
141 In re Abbotts Dairies, 788 F.2d at 144-45.
142 Id. at 145-46.
part of unsecured creditors and bidders to object to the purchase agreement on grounds of bad faith—specifically, that no appraisal of the debtor’s assets had been performed, competitive bidding had been chilled, and ADC had agreed to pay an inadequate value—the bankruptcy court approved the purchase agreement and the district court dismissed the opponent’s appeals as moot.\footnote{Id. at 146-48.}

Upon appellate review and after the sale had already closed, the Third Circuit ruled that the lower courts erred by failing to recognize that “the situation was ripe for collusion and interested dealing.”\footnote{Id. at 149.} The courts would have had reason to question the debtor’s and purchaser’s good faith if the lower courts had taken account of the CEO’s conflict of interest, the timing of the debtor’s petition, and the absence of any valuation of the assets being sold.\footnote{Id.} The Third Circuit reversed the district court’s judgment and remanded the proceeding to the bankruptcy court for several determinations, including whether any such collusion between ADC and Abbotts would constitute bad faith and, if so, whether ADC had paid “value” for the assets it purchased.\footnote{Id. at 151.} The bankruptcy court would then have to decide whether it could equitably undo the sale of the assets to ADC.\footnote{Id. at 151.} Thus, the circumstances of \textit{Abbotts Dairies} demonstrate the need for bankruptcy courts to engage in an earnest analysis of good faith prior to the closing of the sale. Without such an investigation, authorizations of sales made in bad faith may be consummated to the detriment of creditors and other opponents who then must appeal their objections, an expensive and legally problematic undertaking with no predictable outcome.\footnote{Id. at 149-50.}

For this reason, the Third Circuit clarified that findings of good faith are not to be implied in a bankruptcy court’s approval of a sale pursuant to § 363, but rather that a bankruptcy court, when authorizing such sales, is “required to make a finding with respect to the ‘good faith’ of the purchaser.”\footnote{Id. at 149.} Good faith examinations must be per-
formed at the bankruptcy court level because the bankruptcy court is best equipped to inquire into the good faith of a sale, and the district court is permitted to make such findings only “in certain very limited circumstances.”

Such prominent instances of bankruptcy courts failing to address whether a sale has been proposed in good faith reflect the significant need for more extensive scrutiny of good faith at the bankruptcy level. Without an explicit investigation into the underlying transaction and the relationship between the debtor and purchaser, misuse of § 363 sales will become more likely, to the detriment of the estate, creditors, and other interested parties. The good faith requirement remains essential to the integrity and spirit of the Bankruptcy Code and thus should not be reduced to investigation at the appellate level after assets have already been sold and transferred to bad faith purchasers.

III. In re Gulf Coast Oil Corp.: A Comprehensive Framework for the Analysis of Preplan Asset Sales

Financially distressed companies are increasingly looking to § 363 for a faster, less burdensome, and cheaper resolution to their financial ailments. A procedure once customarily used “to shed failing plants or unneeded equipment” as a means of augmenting a successful reorganization plan has been transformed into a one-stop liquidation of large, publicly traded companies like GM and Chrysler. The last decade has seen “quantum leaps” in the approval of sales under § 363(b) in corporate bankruptcy cases of varying sizes as a consequence of factors including “active participation in bankruptcy cases by hedge funds and other non-bank lending entities, and venue selection based on a court’s perceived propensity to approve § 363(b) sales.”

150 See id. ("First, the bankruptcy court, given its greater familiarity with the parties and proceedings, represents the forum best able to make such a determination in the first instance.").

151 Id. at 150. The Third Circuit noted that the purpose of requiring bankruptcy courts to engage in this scrutiny of asset sales for good faith paralleled the need to do so in examining a debtor’s reorganization plan. An inquiry into the good faith of the debtor and, in the § 363 context, the purchaser, is necessary to ensure that the plan or sale will comply with the principles of the Code, including creditor protection. See id. at 150 n.5 ("The purpose of requiring such a finding in each situation, however, is quite similar: it prevents a debtor-in-possession or trustee from effectively abrogating the creditor protections of Chapter 11.").

152 See Rose, supra note 3, at 272-73 (discussing the need for meaningful scrutiny of good faith in the face of an easily manipulated business justification test).

153 Maynard, supra note 6.

However, the advantages of this tactic do not come without controversy. The prominent cases of abuse, as well as the evolving application of § 363 as a tool to carry out complete restructurings, raise questions concerning the courts’ inconsistent role and whether these developments call for corresponding reform of the applicable legal standards governing these sales. Examining the sound business purpose test and the rather lax good faith requirement, it appears that the process under this provision has become too easy to maneuver at the expense of the interests at stake in bankruptcy. The Lionel court, and all courts following that decisive opinion, rejected a literal reading of § 363(b) that would provide debtors with boundless opportunities to sell their assets outside of a reorganization plan.\textsuperscript{155} In recognition that the statutory language of the Code and decades of case law require some form of constraint to be imposed upon debtors and purchasers entering into these sales,\textsuperscript{156} the standard applied must afford creditors and other parties safeguards that will maintain the underlying principles of corporate reorganization. Accordingly, the shift in the use of § 363 sales must be accompanied by a modification of the applicable legal standard of court approvals to rebalance the competing interests of debtor rehabilitation and maximization of value with the fair treatment and protection of creditors and equity holders. As this Part discusses, the framework the court presented in Gulf Coast Oil fulfills this need—and does so well within the confines of the Code—by maintaining judicial discretion and including an analysis of good faith as interpreted by courts nationwide.

A. A Revised Outlook on Approval of § 363 Sales

1. Background

The Bankruptcy Court for the Southern District of Texas recently reassessed the Fifth Circuit’s position on the judicial role in approving preplan asset sales. The court was confronted with the issue of whether to authorize an asset sale proposed by a debtor (Gulf Coast Oil) that encompassed several affiliated companies involved in oil and gas

\textsuperscript{155} See Comm. of Equity Sec. Holders v. Lionel Corp. (\textit{In re Lionel Corp.}), 722 F.2d 1063, 1066 (2d Cir. 1983).

\textsuperscript{156} See id. (“[A]nalysis of the statute’s history and over seven decades of case law convinces us that such a literal reading of section 363(b) would unnecessarily violate the congressional scheme for corporate reorganizations.”).
exploration and production in southern Texas.\textsuperscript{157} As of 2005, per an agreement the debtors entered into with Laurus Master Fund, Ltd. (Laurus), Laurus was the debtors’ sole secured creditor.\textsuperscript{158} Due to falling oil and gas prices, inadequate cash flow to support a plan of reorganization, and Laurus’s refusal to accept the reorganization plan, the debtors filed a motion to sell all of Gulf Coast Oil’s assets.\textsuperscript{159}

The court recognized that over an eight-month period, the debtors had received little interest from purchasers other than Laurus, and thus, there was “little potential for a meaningful auction.”\textsuperscript{160} If Laurus, as the only viable purchaser, bought all of the debtors’ assets, then between $200,000 and $300,000 of unsecured claims would not be paid.\textsuperscript{161} Although the debtors claimed that members of the class of creditors that possessed lien rights would be protected under the sale, since these encumbrances would be transferred to the proceeds of the sale, the court rejected this assertion as meaningless. After the sale, there would be no proceeds to which the liens could attach.\textsuperscript{162} Consequently, because the debtors would retain no assets upon consummation of the sale, the case would either have to be dismissed or converted to a Chapter 7 “no-asset case,” rather than move forward as a reorganization in Chapter 11.\textsuperscript{163}

2. A Modified Approach to Authorization of § 363 Sales

On the issue of whether to authorize the proposed sale of all of the debtors’ assets to its sole secured creditor, the court found it useful to evaluate the boundaries of the sound business purpose test and the sub rosa doctrine.\textsuperscript{164} After examining the legal standards applied

\textsuperscript{157} In re Gulf Coast Oil, 404 B.R. at 410. The companies that filed voluntary petitions for Chapter 11 protection on July 28, 2008, included Gulf Coast Oil Corp., Century Resources, Inc., and New Century Energy Corp. Id. at 410.
\textsuperscript{158} Id. at 411.
\textsuperscript{159} See id. at 412-13. The debtors’ reorganization plan was infeasible because their assets had so dramatically declined in value that Laurus’s secured claim exceeded the value of the assets. Id. The debtors sought authorization “to sell all of the property of the estate, including all cash, oil and gas properties, fixtures, equipment, inventory, and office equipment, free and clear of all liens, claims, and encumbrances.” Id. at 413.
\textsuperscript{160} Id. at 412-13. More specifically, in the eight months in which the debtors marketed their assets, they failed to receive any firm offers, and the only expressions of interest were inadequate since the prices contemplated were much smaller than the claim Laurus held. Id. at 411-13.
\textsuperscript{161} Id. at 412.
\textsuperscript{162} Id. at 413.
\textsuperscript{163} Id. at 414.
\textsuperscript{164} Id. at 415-18.
by courts in determining motions to approve § 363 sales, the court shed light on recent developments in bankruptcy and expressed concern that “[t]he concept of debtor reorganization and rehabilitation is in peril.”

Although the court identified the advantages of these sales, it further recognized that businesses’ growing use of “Chapter 11 merely to sell their assets and divide up the proceeds” has had a significant impact on the potential for improper use of the Code. Putting aside the growing debate between efficiency and protection of parties’ interests, the court explained that the continued expansion of § 363 sales necessitated legal guidelines that would address these new developments.

In the face of these concerns, the court adopted a framework that incorporated the sound business purpose test and followed the flexible structure of weighing all the facts and circumstances of a case as implemented by the Lionel court. However, the court modified its inquiry to include a determination of “whether safeguards are necessary to protect rights that could be exercised in the context of plan confirmation.” To guide this analysis, the court enumerated thirteen factors “that a court can consider in determining whether to approve a § 363(b) sale prior to confirmation of a chapter 11 plan”:  

1. “Is there evidence of a need for speed?”  
2. “What is the business justification?”  
3. “Is the case sufficiently mature to assure due process?”  
4. “Is the proposed [asset purchase agreement] sufficiently straightforward to facilitate competitive bids or [i]s the purchaser the only potential interested party?”  
5. “Have the assets been aggressively marketed in an active market?”  
6. “Are the fiduciaries that control the debtor truly disinterested?”  
7. “Does the proposed sale include all of a debtor’s assets and does it include the ‘crown jewel?’”

165 Id. at 419 (quoting Harvey R. Miller & Shai Y. Waisman, Is Chapter 11 Bankrupt?, 47 B.C.L. REV. 129, 129 (2005)).  
166 Id. at 419 (quoting Douglas G. Baird & Robert K. Rasmussen, The End of Bankruptcy, 55 STAN. L. REV. 751, 751 (2002)).  
167 Id. at 419.  
168 See id. at 422 (“It would be very helpful if the Fifth Circuit were to take another look at the boundaries of § 363(b) sales to provide more guidance to the bankruptcy courts in the circuit.”).  
169 Id. at 423.  
170 Id.
8. “What extraordinary protections does the purchaser want?”

9. “How burdensome would it be to propose the sale as part of confirmation of a Chapter 11 plan?”

10. “Who will benefit from the sale?”

11. “Are Special Adequate Protection Measures Necessary and Possible?”

12. “Was the hearing a true adversary presentation? Is the integrity of the bankruptcy process protected?”

13. “Other factors that apply to the case at hand.”

After weighing these considerations, a court “must determine whether safeguards are necessary to protect rights that could be exercised in the context of plan confirmation” and, if so, may implement such safeguards accordingly. Thus, the inquiry the court adopted focuses judicial deliberation on securing both maximization of value for the debtor’s estate and minimization of creditors’ exposure to vulnerabilities that the reorganization confirmation process would otherwise protect. For the purpose of demonstrating how, in light of the evolution of § 363 sales, the test the Bankruptcy Court of the Southern District of Texas advocated builds upon the Lionel framework, this Comment groups the factors into the following categories: efficiency and the maximization of value, creditor protection and the good faith requirement, and preservation of the integrity of the bankruptcy process.

a. Factors Aimed at Efficiency and the Maximization of Value

The first factor—the “need for speed”—seeks to ascertain whether an immediate sale is necessary to prevent the asset from deteriorating in value. This question, like the Lionel court’s assessment of whether “the asset is increasing or decreasing in value,” is aimed at ensuring the maximization of value of the debtor’s estate. Although “[d]isposition of perishable assets is the archetype justification for a § 363(b) sale,” the Gulf Coast Oil court advanced the caveat that judges must take a deeper look into the need to act quickly in the name of value preservation because not all asset sales justify immediate action. Accordingly,
courts should be more hesitant to approve § 363 sales since efficiency should trump the Chapter 11 safeguards only when a decline in the asset’s value threatens a company’s ability to emerge from bankruptcy successfully. For instance, the Second Circuit in *In re Chrysler* reasoned that Chrysler exemplified this “melting ice cube” archetype because “its revenues [were] sinking, its factories [were] dark, and its massive debts [were] growing.”

The second factor—the business justification—embodies Lionel’s sound business purpose test in that a debtor’s pursuit of the sale of all or substantially all of its assets must establish a valid business justification for entering into the transaction outside of a reorganization plan. The ninth factor, which considers how burdensome it would be to effectuate the proposed sale as an element of confirmation of a Chapter 11 plan, serves as a filter, allowing debtors to use § 363 sales only where they will be most efficient. The court distinguished between cases involving mega-companies, in which the cost and scope of the provision of disclosure statements and confirmation of a plan would be quite sizeable, and smaller businesses that would face much lower reorganization costs. In cases where the delay resulting from confirmation of a plan is similar to the delay resulting from court approval of a § 363 sale, “there is no apparent reason why it is more appropriate to apply equitable powers aggressively to facilitate a § 363(b) sale than it is appropriate to apply equitable powers aggressively to let creditors vote on that proposal.” Thus, the *Gulf Coast Oil* court prioritizes safeguards provided under Chapter 11 unless the debtor establishes that a § 363 sale will indeed prove to be the quicker and less costly option.

b. *Creditor Protection and the Good Faith Requirement*

The following factors are aimed at reconciling the tension between the efficiency of § 363 sales and the lack of safeguards, including disclosure and confirmation, in the § 363 sale process. The third

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176 *In re Gulf Coast Oil*, 404 B.R. at 423.

177 See *id.* at 424-25 (comparing the “burdensome and expensive” process for cases such as Enron and Lehman Brothers to other “smaller and simpler” cases).

178 *Id.* at 425.

179 *Id.* at 426 (“The party proposing a § 363(b) sale . . . should be prepared to prove, not merely recite, that a § 363(b) sale is quicker and less expensive.”).
factor incorporates a creditor-protection requirement into the court’s analysis by framing the issue not only in terms of “the amount of elapsed time since the filing,” but also as a means of detecting whether adequate notice has been provided to all interested parties. As previously discussed, under § 363, creditors and investors lose leverage in negotiating the terms of in-plan liquidations as debtors circumvent the disclosure statements required in the reorganization process. As a matter of due process, the Gulf Coast Oil court found it critical to provide these parties with enough time to receive notice, organize their claims and, if desired, participate in defending their interests in the face of these proposals. For this reason, judges are encouraged to confirm that all parties, not just those who benefit from the purchase of the assets, are informed and have time to understand how the sale, if approved, would affect their rights. Assurance that the parties possessed the time to receive information regarding the sale may assuage concerns of unfair dealing by giving parties the opportunity to object to the good faith of the debtor and purchaser prior to the closing of the deal.

The fourth, fifth, and sixth factors directly address the issue of good faith in the bankruptcy context, directing the courts to engage in an inquiry specifically related to past instances of abuse. Considerations of whether the proposed purchase agreement facilitates competing bids or whether the assets in question have been actively marketed indicate whether these sales are arm’s-length transactions. According to the court’s reasoning, the existence of only one interested purchaser may be a sign of collusion or insider dealing. In noting that “the proponents of § 363 sales argue that competitive markets

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180 In re Lionel, 722 F.2d at 1071.
181 See In re Gulf Coast Oil, 404 B.R. at 423 (noting that “when assets are sold immediately after the case is filed,” the court may worry whether “all parties in interest have adequately organized” and “received adequate notice”).
182 See supra notes 16-19 and accompanying text (discussing differences and advantages gained by circumventing disclosure and equity requirements for reorganization plans).
183 See In re Gulf Coast Oil, 404 B.R. at 423 (“It takes time for . . . creditors and equity interests to organize and to engage counsel, . . . to hire financial or other experts . . . , for government regulatory agencies to mobilize . . . and for other creditors and parties in interest to determine whether (and how) to participate in the case.”).
184 See id. at 423-24 (“Proposals for quick sales, understood only by a few parties who would benefit from the sale, are inherently suspect.”).
185 See id. at 424 (“The principal justification for § 363(b) sales is that aggressive marketing in an active market assures that the estate will receive maximum benefit.”).
186 See id. (“The absence of any market is problematic.”).
are the assurance of *bona fide* sales for highest value,” the court determined that an analysis of the structure of the proposal in terms of bidding is a significant step toward obtaining maximum value for the estate.\textsuperscript{187} In addition, the sixth factor pointedly responds to and seeks to avoid examples of insider transactions and sweetheart deals exemplified in *Abbotts Dairies*.\textsuperscript{188} Through acknowledgement of management’s fiduciary duties, both as managers of a business and as debtors-in-possession, the court explicitly integrated the disinterest of these parties as an aspect to consider when assessing a debtor’s business judgment.\textsuperscript{189} The connection between the debtor and the purchaser is a significant consideration in protecting both the debtor’s estate and creditors from being taken advantage of by inadequate purchase prices.

Moreover, the eighth factor questions the extent to which purchasers of assets may benefit from protections against successor liability under Chapter 11. Although “[t]he Bankruptcy Code seems to treat negotiation and acceptance . . . of a chapter 11 plan as the *quid pro quo* for extraordinary bankruptcy benefits,” the court made it clear that purchasers do not necessarily have the same rights outside of plans that enfranchised creditors confirm.\textsuperscript{190} Again, the court was seemingly concerned with protecting creditors who do not possess the opportunity to play a significant role in negotiations or voting on plans.

The tenth factor evaluates which parties will benefit from a § 363 sale and ingrains the principle that “bankruptcy is, at its essence, a collective remedy intended to benefit all creditors, not just the secured lender.”\textsuperscript{191} The equal treatment of creditors should not be distorted by permitting one or a few select parties to profit from the purchase of the debtor’s assets to the detriment of other parties. Furthermore, judicial investigation into the entities that will benefit from these sales will deter purchasers who behave in bad faith. The eleventh factor gives judges the power to act in their discretion by adopting protective measures where necessary and supplements those safeguards available through the reorganization process.\textsuperscript{192}

\textsuperscript{187} Id.  
\textsuperscript{188} See text accompanying *supra* notes 141-48 (outlining the problematic deal present in *Abbotts Dairies*).  
\textsuperscript{189} See *In re Gulf Coast Oil*, 404 B.R. at 424 (“If entities that control the debtor will benefit, or will potentially benefit, from the sale the court must carefully consider whether it is also appropriate to defer to their business judgment.”).  
\textsuperscript{190} Id.  
\textsuperscript{191} Id. at 426.  
\textsuperscript{192} See *id.* at 427 (allowing the bankruptcy court to “consider fashioning appropriate” remedies).
c. Preservation of the Integrity of the Bankruptcy Process

Several factors the Gulf Coast Oil court considered are arguably intended to ensure that distressed companies and other interested parties do not manipulate the Code in ways that Congress did not anticipate. The seventh factor, which questions whether an asset sale will include all of a company’s assets or its most valuable assets, \(^{193}\) seeks to further the original purpose of § 363—to liquidate assets like equipment to fund a successful reorganization plan. Although the court did not prohibit sales of companies in their entirety or sales of a business’s most valuable asset, \(^{194}\) this factor is salient in discouraging sales that extend beyond the legitimate scope of corporate reorganizations and congressional intent.

The twelfth factor addresses the “integrity of the bankruptcy process” and urges judges to examine the interests at stake more extensively to avoid authorizing a sale that jeopardizes those interests or contravenes the statutory provisions or fundamental goals of bankruptcy law. \(^{195}\) The last factor ultimately grants judges the discretion to give different weight to these considerations or to take account of other aspects of a case in determining whether to authorize a sale pursuant to § 363. \(^{196}\)

3. Application of the Gulf Coast Oil Framework

After articulating these factors and expressing the notion that the circumstances surrounding each case are “unique,” the Gulf Coast Oil court proceeded to apply these considerations to Gulf Coast Oil’s proposal. \(^{197}\) The court denied the debtor’s motion to sell all of its assets to Laurus on the grounds that the debtors had failed to demonstrate a good business reason for the need to sell the company prior to a plan

\(^{193}\) See id. at 424 (“Does the proposed sale include all of a debtor’s assets and does it include the ‘crown jewel?’”).  
\(^{194}\) See id. (noting that neither kind of sale is “per se prohibited”).  
\(^{195}\) See id. at 427 (describing the judge’s interest in the result of the hearing as striving to “satisfy public expectations concerning the competence of ‘judicial supervision’ of the reorganization process”).  
\(^{196}\) See id. at 427-28 (“There may be other factors that tip the balance or that overweigh the evaluative factors set forth above.”). Notably, this factor indicates that this list of considerations is not exhaustive, similar to the list of relevant factors enumerated in Lionel. See Comm. of Equity Sec. Holders v. Lionel Corp. (In re Lionel Corp.), 722 F.2d 1063, 1071 (2d Cir. 1983) (listing factors that courts may consider but cautioning that “[t]his list is not intended to be exclusive”).  
\(^{197}\) In re Gulf Coast Oil, 404 B.R. at 427-28.
confirmation. Considering the “need for speed” and the question of “who will benefit from the sale,” the debtor’s proposal lacked evidence of deterioration of the affiliates’ assets or justification for using § 363 to pursue the sale of the debtor’s business to its single secured lender. Thus, no basis for approving a sale outside of a plan existed where the same benefits of using § 363 as a vehicle to preserve the going concern value of Gulf Coast Oil’s operations could be reached under § 1123 in compliance with the conditions of confirmation.

In essence, the court’s rationale in denying the debtors’ motion reflected its prior recognition that the procedural burdens of proposing the sale as part of a reorganization plan do not exist in all cases. As here, where § 363 provided no advantage, courts should hesitate to allow debtors to sidestep creditor safeguards such as negotiation and voting—procedural protections that are clearly important in promoting the equal treatment of creditors under the Code. Moreover, in light of its concern over whether the sale of all of a debtor’s assets outside of a confirmation plan falls within the scope of Chapter 11, the court was cautious in authorizing a sale of all of Gulf Coast Oil’s assets, especially where “there is not an active market that assures a fair price.” In effect, the conclusion not to authorize the sale of Gulf Coast Oil prior to a reorganization plan serves as a word of caution to all bankruptcy courts. Weighing these factors should encourage judges to examine the underlying transaction more extensively, above and beyond the proffered business justification, as a means of upholding the integrity of and purpose behind the Bankruptcy Code.

B. Sound Business Purpose Test with Bite

The evolving nature of § 363 deals and recent criticism of these preplan sales, which are perhaps more appropriately referred to as “sale restructurings,” call for a revision of the legal standard applied to

198 Id. at 427-28.
199 Id. at 426-28. The Gulf Coast Oil court found the debtors’ argument that use of § 363(b) or § 1123 would not affect the outcome of the disposition irrelevant and insufficient as a business justification. Id. at 428. The legal standard does not ask whether “an expedited plan process would . . . achieve the same result,” but rather whether a business justification exists for permitting court approval of an asset sale outside of the disclosure and confirmation requirements called for under Congress’s scheme of reorganization. Id. at 428.
200 Id.
201 See supra notes 176-78 and accompanying text (describing the court’s observation that promotion of a § 363 sale is not desirable or efficient in all cases).
202 In re Gulf Coast Oil, 404 B.R. at 428.
these cases. Many bankruptcy petitions, especially those involving plans filed by smaller businesses, do not invoke the potential for abuse and unfair dealing that has alarmed critics, but the key weaknesses of the current framework can be ameliorated by closer judicial scrutiny.\(^{203}\) Although the Bankruptcy Court of the Southern District of Texas did not engage in a complete overhaul of the Lionel standard and the sub rosa doctrine (courts must still consider factors like “the need for speed” and the value of the assets to be purchased), it did integrate several new factors into the analysis in order to direct judicial attention to the evident changes in the use of § 363 that have developed since the Second Circuit set forth its seminal decision in 1983. The Gulf Coast Oil court recognized the need to set limitations on the use of § 363 in an effort to ensure that financially distressed companies and judges do not stray too far from congressional intent. The comprehensive set of guidelines presented in Gulf Coast Oil accomplishes this closer scrutiny without altering the essence of the sound business purpose test, namely a broad authorization of judicial discretion to balance the competing interests that serve as the foundation for modern bankruptcy law. Furthermore, the main focus of the additional factors set forth by the court fall neatly within the margins of the Code and related case law. Most importantly, by incorporating a good faith requirement, this inquiry will be more effective in distinguishing permissible § 363 sales from those that open the bankruptcy process to potential abuse under the Lionel sound business purpose test.

The standard prescribed in Gulf Coast Oil maintains the basic balancing test structure employed under Lionel’s sound business purpose test, which was designed to confer on judges the flexibility to address the tension between efficiency and creditor protection in a variety of circumstances. The interplay of the advantages and drawbacks of exercising either alternative, whether it is a sale under § 363 or § 1123, is dependent upon the circumstances of the particular case. As previously discussed, the statutory language, legislative history, and policy underlying § 363 create the need for courts to find a balance between appropriate standards and giving judges free rein over what sales shall be authorized.\(^{204}\) Liberal standards and case-by-case assessments are common throughout a wide range of bankruptcy issues be-

\(^{203}\) Critics like Rose support the contention that “expanded good faith and a more involved business justification test would safeguard § 363 sales from abuse.” Rose, supra note 3, at 283.

\(^{204}\) See supra subsection I.A.1 (explaining the discretion Congress granted to judges to authorize or deny asset sales).
cause it is generally accepted that drawing “bright-line rules [will] constrain the equitable powers of bankruptcy judges to serve the best interests of the parties in any given proceeding.”

The court in Gulf Coast Oil acknowledged this need to maintain a balancing test by requiring bankruptcy judges to “weigh all of the facts and circumstances of the case.” Thus, this newly developed framework is no more narrow than the test established in Lionel. By providing a list of non-exhaustive factors as a means of updating considerations in light of current trends, critics may argue that application of the Gulf Coast Oil framework will result in the same “inconsistent treatment by the courts.” However, such a criticism distorts Congress’s intent to provide judges with the power to effectuate the goals of bankruptcy in a meaningful way. For instance, strict rules governing which assets may be sold and an enumeration of an exclusive set of business reasons that will justify these sales will result in the hindrance of some debtors from maximizing the value of their estates in contravention of the purpose of § 363. Furthermore, an examination of the court’s analysis reveals that judicial discretion in these cases may in fact serve as a powerful mechanism to counteract recent concerns. The Gulf Coast Oil framework confers upon judges the authority to fashion safeguards similar to those required by in-plan sales, demonstrating that discretion may be just the tool necessary to protect the interests at stake. As bright-line rules are generally not appropriate in the bankruptcy context, the model used by the Bankruptcy Court of the Southern District of Texas provides the best option for encouraging judges to exercise their discretionary power more effectively. This new model will encourage bankruptcy judges to address new considerations and inquire into the good faith of the sale as a

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205 Jackson, supra note 2, at 454, 497-98.
206 In re Gulf Coast Oil, 404 B.R. at 423.
207 See Eric English, Texas Bankruptcy Court Rejects Chapter 11 Debtors’ Request to Sell All of Their Assets and Calls for Fifth Circuit to Clarify Legal Standard, LEXISNEXIS EMERGING ISSUES ANALYSIS, May 14, 2009, available at LEXIS, 2009 EMERGING ISSUES 3629 (“[T]he opinion in In re Gulf Coast Oil Corp. demonstrates that some courts construe section 363 and the applicable Fifth Circuit precedent rather narrowly.”).
208 Rose, supra note 3, at 250.
209 In re Gulf Coast Oil, 404 B.R. at 423.
210 See, e.g., In re On-Site Sourcing, Inc., 412 B.R. 817, 824-26 (Bankr. E.D. Va. 2009) (utilizing the discretion afforded by the Gulf Coast Oil test to approve a proposed asset sale on the condition that certain terms of the agreement, such as the release of three key employees and a general unsecured creditors trust, were removed in order to avoid evasion of the Chapter 11 confirmation process).
means of shaping § 363 sales into transactions that balance debtor rehabilitation with creditor protection.

In conjunction with this affirmation of discretion, the Gulf Coast Oil standard encourages more stringent scrutiny of § 363 sales from yet another angle often overlooked by courts. In recent years, much attention has been drawn to cases such as Mission Iowa Wind Co. v. Enron Corp. and In re Abbotts Dairies, in which bankruptcy courts have failed to take notice of potential insider dealing—conduct clearly exemplifying bad faith under the relevant good faith paradigm.211 Despite the recognition that both § 363(m) and § 1112(b) impose a good faith obligation on both the debtor and purchaser, it is common for opinions involving approval of § 363 sales merely cite good faith as a component of the sound business purpose test without delving into any such inquiry. Critics often warn that because of vague “you know it when you see it” standards for good faith . . . and the ability of the dominant parties to create a business justification for a quick sale, the bankruptcy courts are being turned into the auction houses of choice for businesses with either financial trouble or the potential of liabilities that would otherwise follow their assets.212 For this reason, § 363 sales have become vehicles for abuse and, as such, courts must undertake a more stringent analysis of good faith before approving these transactions in order to comply fully with the Code.

The framework set out in Gulf Coast Oil resolves this issue by implying a good faith requirement within its enumerated factors. Although the case does not expressly use the term “good faith,” several factors of the test aim to detect bad faith as it has been interpreted within the context of § 363 sales. First, the consideration of the disinterest of the fiduciaries controlling the debtor serves to discern whether a transaction is tainted by inside dealing and collusion.213 Requiring the establishment of a good business reason for selling a debtor’s assets outside of a plan of reorganization was designed to provide a limitation on the use of § 363 sales, a constraint believed to be necessary to further the purpose of the bankruptcy process.214

211 See discussion supra Section I.B (highlighting the self-dealing present where bankruptcy courts do not adequately investigate asset sales).
213 In re Gulf Coast Oil, 404 B.R. at 424.
214 See Comm. of Equity Sec. Holders v. Lionel Corp. (In re Lionel Corp.), 722 F.2d 1063, 1071 (2d Cir. 1983) (“Every sale under § 363(b) does not automatically short-circuit or side-step Chapter 11; nor are these two statutory provisions to be read as mutually exclusive.”).
However, deference to a business judgment provided by interested members of management who seek to gain money, stock, or employment with the purchaser would render this limitation meaningless. For instance, had the bankruptcy court in In re Abbotts Dairies investigated the question of whether Mr. Gwinn, the Chairman and Chief Executive Officer of the debtor, was truly a disinterested fiduciary, the court would have had reason to doubt the proffered business reason for the sale of the assets to ADC.\(^{215}\) Surely Mr. Gwinn’s expected employment with the debtor’s prospective purchaser would have given the court a strong foundation to believe that collusion had occurred between the fiduciary and ADC and that the agreement reached between the parties did not maximize the debtor’s value. Thus the court intended this consideration to augment the vigor of the sound business purpose test.

Moreover, the questions related to the beneficiaries of the sale—whether there has been an active market for the assets involved and if the terms of the purchase agreement facilitate competitive bids—attempt to discern whether the transaction has been negotiated at arm’s length.\(^{216}\) A dissection of the court’s reasoning for characterizing these factors as significant indicates that an inquiry into the market and the potential purchaser is necessary in order to ensure both that the estate receives the maximum value for the assets and that a low purchase amount that benefits only the purchaser does not harm creditor’s rights or the debtor’s rehabilitation.\(^{217}\)

These factors provide courts with the guidelines necessary to address recent concerns head-on because the factors incorporate direct considerations of good faith, rather than implying that the superficial citations of the term satisfy the requirement. Some courts do undertake inquiries into the good faith of the debtor and purchaser,\(^{218}\) and in these cases, one can argue that the Gulf Coast Oil considerations reach the same outcome expressly that other courts arrive at implicit-

\(^{216}\) In re Gulf Coast Oil, 404 B.R. at 424-26.
\(^{217}\) See id. at 424 (“[A]ggressive marketing in an active market assures that the estate will receive maximum benefit.”).
\(^{218}\) See e.g., In re Chrysler LLC, 405 B.R. 84, 106-08 (Bankr. S.D.N.Y. 2009) (concluding that negotiations between Fiat and Chrysler were in good faith, that neither the terms of the agreement nor the involvement of the government precluded competitive bidding, and that the government did not constitute an “insider” of the debtors), aff’d, 576 F.3d 108 (2d Cir. 2009), vacated as moot sub nom. Ind. State Police Pension Trust v. Chrysler LLC, 130 S. Ct. 1015 (2009).
ly. However, as shown, all too often bad faith proposals are caught only at the appellate level. Consequently, there is a concern that unless a party objects to a sale with enough fervor, bad faith transactions that are not in the best interests of the parties and have the ability to tarnish the integrity of the bankruptcy process will slip through the growing loopholes of the sound business purpose test. Where appeals are often difficult to come by and such great interests are at stake, the standard set forth in Gulf Coast Oil reaches the appropriate solution to the current tendency of judges to bypass a good faith analysis and creditor safeguards in favor of the debtor’s business judgment.

Furthermore, even in cases where the court investigates the good faith of the purchaser, courts disregard the more general interpretation of good faith, that is, whether a debtor seeks to achieve a purpose “outside the legitimate scope of the bankruptcy laws.” Although the Lionel factors partially address this issue by contemplating the likelihood of the proposal or confirmation of a reorganization plan and the effect of the sale on any future plans, case law indicates that good faith extends beyond possession of a “valid reorganizational purpose.” Notably, the court in Gulf Coast Oil addressed the latest concerns stimulated by the GM and Chrysler bankruptcies: questions of good faith in the broader context of Chapter 11 and whether courts are authorizing sales that go beyond the purpose of § 363. Factors including whether “the proposed sale include[s] all of a debtor’s assets” and if the proposal is adverse to the integrity of the bankruptcy process have the purpose of uncovering whether this use of § 363 as a substitute for corporate restructurings is legitimately within the scope of bankruptcy law. Although the outcome of the Chrysler bankruptcy may not have been altered by an analysis of these factors, a further investigation into the legislative history and purpose behind § 363 may have provided debtors, creditors, investors, judges, and lawyers insight into the boundaries of this expanding tactic. In light of the relationship between the controversial aspects of § 363 sales and

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219 See supra notes 141-48 and accompanying text (discussing the Third Circuit’s review of Abbotts Dairies).
220 See supra notes 74-75 and accompanying text (describing the practical barriers to appeal in such instances).
221 Marsch v. Marsch (In re Marsch), 36 F.3d 825, 828 (9th Cir. 1994).
222 Comm. of Equity Sec. Holders v. Lionel Corp. (In re Lionel Corp.), 722 F.2d 1063, 1071 (2d Cir. 1983).
223 See supra note 130 and accompanying text (noting the factors set forth by the Sixth Circuit for aiding courts “in determining that the debtor has filed in bad faith”).
the factors set forth by the Gulf Coast Oil court, it is evident that this more comprehensive standard gives the sound business purpose test the bite necessary to encourage judges to take a more critical stance in authorizing these transactions.

CONCLUSION

While the advantages of a quick, less costly, and often more efficient sale of assets within the scope of a bankruptcy petition are manifestly undisputed, the generally accepted sound business purpose test has grown too malleable in the hands of powerful creditors and self-interested debtors. The need for a more stringent legal standard to assist courts in determining whether to authorize a sale under § 363 has surfaced with new urgency in this turbulent economy. The framework the Gulf Coast Oil court adopted provides an updated and balanced solution to the concerns arising from the expanded use of § 363 as a complete restructuring tactic by emphasizing both the benefits of this provision and the constraints that should be applied to bad faith debtors and purchasers.

The thirteen enumerated factors offer a basis on which judges may exercise their statutory “unfettered” discretion to mold these sales in the most efficient, yet creditor-friendly manner. Additionally, the factors’ analysis of good faith from several perspectives—namely an investigation into the underlying relationship between the debtor and the purchaser, as well as a discussion of whether the transaction falls within the legitimate scope of the bankruptcy laws—promotes principles significant throughout other aspects of the bankruptcy process. This foundation preserves the advantages of § 363 but at the same time recognizes the need to weigh the competing interests of debtor rehabilitation and creditor protection inherent in bankruptcy law. As a result, Gulf Coast Oil’s flexible, yet more focused approach allows courts to address concerns of abuse while tailoring § 363 sales to promote the underlying goals of bankruptcy. Therefore, as § 363 sales continue to evolve, this standard should serve as the model for future courts.