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Misinterpreting Bankruptcy Code Section 363(f) and Undermining the Chapter 11 Process

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Misinterpreting Bankruptcy Code Section 363(f) and Undermining the Chapter 11 Process

by

*George W. Kuney**

Seemingly slight misinterpretations can dramatically alter an entire statutory scheme. Like small cracks along a rock face, these slight imperfections provide toeholds for roots, ice, wind and water that will eventually erode the entire surface. Courts faced with interpretation of Bankruptcy Code[1] § 363(f) prove this to be all too true. Multiple misinterpretations of this subsection of the Code have been repeatedly committed. This Article focuses on a misinterpretation that has shifted Chapter 11 from a process originally focused on confirmation of a plan of reorganization into one making bankruptcy courts *the* forum of choice for sales of businesses, troubled or not.[2] This misinterpretation provides a shield from liability for purchasers and insiders—not debtors and their creditors—that is otherwise unavailable under applicable nonbankruptcy law. Coupled with a provision that largely squelches appellate review, this misinterpretation has changed the statutory scheme and bankruptcy practice from what Congress intended when enacting the Code. The massive increase in Chapter 11 cases and assets subject to Chapter 11 administration in the wake of the Dot.com meltdown, the eco-

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[1]Throughout this Article, reference is made to the "Bankruptcy Code" or the "Code." All such references are to Title 11 of the United States Code. Additionally, all citations to "section," "sections," "§," or "§§" are to the Bankruptcy Code and all references to "Rule" or "Rules" are citations to the Federal Rules of Bankruptcy Procedure unless otherwise noted.

[2]The effect of other misinterpretations of § 363(f) is discussed in another article. *See* George W. Kuney, *Further Misinterpretation of Bankruptcy Code § 363(f): Elevating In Rem Interests and Promoting the Use of Property Law to Bankruptcy-Proof Real Estate Developments Projects* (forthcoming 76 AM. BANKR. L.J. 2002).

nomic contraction following the World Trade Center attack, and the collapse of energy trading giant Enron makes this trend both interesting and disturbing.[3]

The Bankruptcy Code provides two separate and distinct sets of provisions under which a Chapter 11 debtor or trustee may sell property free and clear of claims or interests.[4] Sections 363(b) and 363(f) govern sales prior to plan approval and impose only the Bankruptcy Code's minimal requirements for notice and a hearing.[5] Sections 1123(a)(5)(D) and 1141(c) govern sales made as part of a plan of reorganization confirmed after extensive disclosure and a multiple hearing process.[6]

As would be expected given the more extensive process involved in plan confirmation, the literal language of §§ 1123 and 1141 gives the bankruptcy court broader authority to approve sales free and clear of claims and interests than does § 363(f), which requires little in the way of notice, disclosure, and an opportunity for objectors and alternate bidders to actually be heard. Section 1141(c) authorizes the post-sale vesting of property free and clear of all "claims and interests," whereas § 363(f) only authorizes the sale free of "any interests." Bankruptcy courts, however, have chosen not to follow the plain meaning of §363(f),[7] but instead to interpret that subsection's words "any interest" to mean "any claim or interest" so as to give the debtor or trustee the same power to sell prior to plan confirmation as that under a confirmed plan, and to strip off liens, claims and other interests in the process.[8] This is a

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[3]*See* Janet Kidd Stewart, *Behind the Bankruptcy Boom*, DETROIT FREE PRESS, Jan. 14, 2002, at 5 (detailing record high number of publicly traded businesses filing for bankruptcy protection in 2001 and citing problems inherent in protection for equity holders). As of this writing, Enron has proposed forming a subsidiary that will house its North American, Central American, and South American energy infrastructure business and then sell it to willing buyers on unspecified terms under § 363(f) in an effort to "remove viable operations out from under Chapter 11." *Enron Presents Process to Creditors' Committee for Separating Power, Pipeline Company from Bankruptcy* (May 3, 2002), *at* <http://www.enron.com/corp/pressroom/releases/2002>. *See generally* George W. Kuney, *Adding an Explicit Pre-Plan Sale Process as an Alternative Exit from Chapter 11* (forthcoming 2002) (working manuscript on file with author and available from the author by e-mailing Kuney@libra.law.utk.edu).

[4]1 WEIL, GOTSHAL & MANGES LLP, REORGANIZING FAILING BUSINESSES 11-2 (ABA 1998) (discussing the two methods of selling assets in Chapter 11: pursuant to a plan or a preplan sale).

[5]11 U.S.C. § 363(b), (f) (2000). *See* 11 U.S.C. § 102(1) (2000).

[6]11 U.S.C. §§ 1123(a)(5)(D), 1141(c) (2000); FED. R. BANKR. P. 2002, 3013, and 3016-3020.

[7]Plain meaning is the place to begin when interpreting a statute and, if the meaning is plain, it is also the end. *See* Caminetti v. United States, 242 U.S. 470, 485 (1917) ("It is elementary that the meaning of a statute must, in the first instance, be sought in the language in which the act is framed, and if that is plain, . . . the sole function of the courts is to enforce it according to its terms.") (citations omitted).

[8]This discussion may cause some to recall the alternatively criticized and praised decisions in *Dewsnup v. Timm*, 502 U.S. 410 (1992) (§ 506(d) does not authorize "strip down" of undersecured lien in Chapter 7), and *Nobelman v. Am. Sav. Bank*, 508 U.S. 324 (1993) (accord in Chapter 13), which some characterize as prohibiting all strip-downs, including the ultimate strip-down: the "strip-off." When accurately read, however, these decisions do not state that strip-down or strip-off is impermissible under Chapter 7, Chapter 13, or the Code itself. Rather, they stand for the more limited proposition that Chapter 7 and Chapter

drastic change from the original focus of Chapter 11: the plan process rather than quick sales.[9]

Part I of this Article explores the state of the law regarding sales free and clear of interests in the preplan context, concluding that the courts have incorrectly included unsecured claims as interests that can be stripped off preplan under § 363(f).[10] Part II examines the effect of the inclusion of "claims" within § 363's use of the word "interests," which creates a fast-track, safe-harbor procedure for asset disposition, conferring protection on purchasers that is unavailable elsewhere.[11] This, in turn, undermines the plan proposal and confirmation process that was an integral part of Chapter 11's intent and design, and the most negative ramifications of this development are reserved for those least able to afford or defend against them. The Article concludes by proposing reverting to a plain-meaning interpretation of the statute.[12] The conclusion contrasts the plain-meaning interpretation of the statutes involved with the misinterpretation of § 363(f) and warns that the dominant interpretation is unlikely to change absent considered, purposeful action by Congress or the appellate courts, chiefly because the Code itself contains provisions that effectively squelch much appellate review.

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13 debtors can not use § 506(d) to effect lien stripping. *See* Harmon v. United States, 101 F. 3d 574, 581-82 (8th Cir. 1996) (discussing this distinction as well as the accuracy of the adage that liens "ride through bankruptcy unaffected"). Section 363(f) is drafted specifically to allow for such stripping. The National Bankruptcy Review Commission recommended that Congress specifically examine the power of sale under § 363(f) and whether, *inter alia*, it was meant to include preplan sales free and clear of both claims and interests. *See infra* note 9.

[9]The National Bankruptcy Review Commission (the "NBRC") recognized this less-than-plain-meaning interpretation and recommended amendment of the statute to accommodate it:

> *Clarify § 363(f).* Congress should amend the Bankruptcy Code to make clear that the court can authorize the sale of property of the estate free of creditors' claims and interests, regardless of the relationship between the face amount of any liens and the value of the property to be sold.

NAT'L BANKR REVIEW COMM'N, BANKRUPTCY: THE NEXT TWENTY YEARS, Recommendation 2.4.12, at 527-34 (1997) [hereinafter the "NAT'L BANKR REVIEW COMM'N REP."]. To date, that recommendation has not been acted upon. *See also* Karen M. Gebbia, Reporter, *First Report of the Select Advisory Committee on Business Reorganization*, 57 BUS. LAW. 163, 168 (2001) (identifying uncertainty arising from statutory ambiguity, absence of clear standards, and variations in local legal practice and administration as factors contributing to the perceived high cost of Chapter 11 cases). The author is not certain that simply amending the statute to match a dominant misinterpretation is well advised or in keeping with notions of appropriate due process for such a sweeping power of sale. *See, e.g., infra* notes 42-44 and accompanying text. *But see* Kuney, *supra* note 3.

[10]*See infra* notes 13-141 and accompanying text.

[11]*See infra* notes 142-95 and accompanying text.

[12]*See infra* notes 196-200 and accompanying text.

I. THE LAW OF SALES FREE AND CLEAR WITH AND WITHOUT A PLAN OF REORGANIZATION

A. SECTIONS 363(F) AND 1141(C)

Bankruptcy Code § 363(f)[13] permits a trustee or debtor in possession[14] to sell property of the estate free and clear of *interests* in the property if any one of five conditions is met.[15] The section provides:

> The trustee may sell property under subsection (b) or (c) of this section free and clear of *any interest in such property* of an entity other than the estate, only if -
>
> (1) applicable nonbankruptcy law permits sale of such property free and clear of such interest;
>
> (2) such entity consents;

[13]The bankruptcy court may have the power to sell assets free and clear even without the existence of § 363(f) or the plan process. *See* MacArthur Co. v. Johns-Manville Corp. (*In re* Johns-Manville Corp.), 837 F.2d 89, 93 (2d Cir. 1988) (citing, *inter alia*, to Van Huffel v. Harkelrode, 284 U.S. 225 (1931)), for the proposition that "even absent express statutory authority, the Bankruptcy Court had the inherent equitable power to sell a debtor's property and to transfer third-party interests to the proceeds of the sale" and *see* Fierman v. Seward Nat'l Bank, 37 F.2d 11, 13 (2d Cir. 1930), for the proposition that "[w]hen the bankrupt's property was sold free of liens, the liens upon the property became rights against the substituted proceeds of sale, and claimants to this fund were obliged to assert their rights by applying to the court in whose custody it was"). Precedent from the *Johns-Manville* case, however, is suspect under the doctrine of "good facts make bad law," *see* State v. Anderson, 580 N.W.2d 329 (1998) (good facts form "a comfortable backdrop against which courts relax their vigilance"), and, at a minimum, should generally be confined to the facts of mass tort cases. *Cf.* Burke v. Deere & Co.,6 F.3d 497, 510 (8th Cir. 1993) (citing Chrysler Corp. v. Wolmer, 499 So. 2d 823, 826 (Fla. 1986)), regarding limiting jury instruction from *Johns-Manville* to asbestos cases. Further, more recent cases indicate little willingness to acknowledge free-standing equitable powers in the bankruptcy courts. *See, e.g.*, Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 206 (1988) ("whatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code"); Petro v. Mishler, 276 F.3d 375 (7th Cir. 2002) (Section 105(a) could not be used to supplement Chapter 13 confirmation standards as those were explicitly set by statute). This leads to the conclusion that the present Supreme Court would be more likely to find that § 363(f) has circumscribed the limits of whatever original, broad equitable power of sale free and clear may have existed in the bankruptcy courts and that even § 105 (the all writs provision) cannot be used to expand that power. *See* Celotex Corp. v. Edwards, 514 U.S. 300, 313-33 (1995) (Stevens, J., joined by Ginsburg, J., dissenting and observing problems with broad injunction issued under § 105 by non-Article III bankruptcy judge); United States v. Energy Res. Co., 495 U.S. 545, 549-50 (1990) (broad equitable powers of §§ 105 and 1123(b)(5) are limited if subject matter has been addressed by other provisions of the Code or other applicable law); § 363(f) (the sale-free-and-clear-sale power may be used "only if" one of five express conditions is met).

[14]11 U.S.C. § 902(5) (2000) ("trustee" generally means "debtor" in Chapter 9 cases); 11 U.S.C. § 1107(a) (2000) (granting a Chapter 11 debtor in possession the rights, powers, and duties otherwise provided for the trustee under the Bankruptcy Code); 11 U.S.C. § 1203 (2000) (accord for Chapter 12 debtor); 11 U.S.C. § 1303 (2000) (accord for Chapter 13 debtor) .

[15]§ 363(f). *See generally* Lee R. Bogdanoff, *The Purchase and Sale of Assets in Reorganization Cases - of Interest and Principal, of Principles and Interests*, 47 BUS. LAW. 1367, 1415-25 (1992) (discussing many of the issues involved in the sale of assets in bankruptcy cases that are beyond the scope of this Article, and noting, at 1371-72, that although the sale provisions of the Code present some of its most difficult issues of statutory construction and application, they have traditionally received little critical analysis).

> (3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;
> (4) such interest is in bona fide dispute; or
> (5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.[16]

Although § 363 can be used to implement a confirmed plan, it can also be used on a free-standing basis to authorize a preplan sale free and clear through a trustee's or debtor in possession's motion to sell.[17] The Code also contains provisions that can explicitly render assets free and clear of *claims and interests* through the process of plan confirmation, consummation, and postconfirmation vesting:[18]

> Except as provided in subsections (d)(2) and (d)(3) of this section and except as otherwise provided in the plan or in the order confirming the plan, after confirmation of a plan, the property dealt with by the plan is free and clear of all claims and interests of creditors, equity security holders, and of general partners in the debtor.[19]

The postconfirmation vesting power can only be invoked under a confirmed

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[16] 11 U.S.C. § 363(f) (2000) (emphasis added).

[17] FED. R. BANKR. P. 4001 (motion practice procedure for, *inter alia,* sales free and clear). Absent an objection, and assuming that the pleadings provide an evidentiary basis to support the sale, there is not even the need for a hearing. 11 U.S.C. § 102(1) (2000) ("after notice and a hearing" defined to authorize court action if notice is given properly and no hearing is requested or there is no time for a hearing); *see also* U.S. TRUSTEE MANUAL § 3-9.4.14 *available at* <http://www.usdoj.gov> (last visited June 4, 2002) (recognizing procedure of sale of substantially all of a debtor's assets by motion as an alternative to a sale through a plan and providing trustees with guidance as to issues that should be addressed in the scope of their duties). For an overview of the asserted benefits of the preplan sale process, visit the website of Insolvency Strategies, Inc., which touts asset sales of substantially all the assets of a business and includes a recording of a hearing at which such a sale was approved. *See* <http://www.isinconline.com> (last visited June 4, 2002).

[18] 11 U.S.C. § 1123(a)(5) (2000) (plan may provide for sale or transfer of property); 11 U.S.C. § 1123(b)(3) (2000) (plan may settle or adjust any claim or interest); 11 U.S.C. § 1123(b)(4) (2000) (plan may provide for sale of substantially all of the assets the estate); 11 U.S.C. § 1141(c) (2000) (allowing postconfirmation vesting of property free and clear of all claims and interests). When a bankruptcy case is commenced—upon the entry of the order for relief—an estate is created and all of the debtor's nonexempt property passes to the estate. 11 U.S.C. § 541 (2000). In a Chapter 11 case, upon consummation of the confirmed plan the property is transferred out of the estate and revests in the debtor or other entity designated by the plan under § 1141(c). A similar provision is found in Chapter 13 cases involving adjustment of the debts of an individual with regular income. *See* 11 U.S.C. § 1327(c) (2000).

[19] 11 U.S.C. § 1141(c). Section 1141(c) compliments or enables the portion of § 1123(b) that allows a plan to contain provisions "for the sale of all or substantially all of the property of the estate." 11 U.S.C. § 1123(b)(4).

plan.[20]

The sale-and-vesting free-and-clear powers contain a number of issues that have been resolved by the courts in ways that could not have been predicted when the statute was enacted in 1979. For example, the term "interest"—the group of things that an asset may be sold or vested free and clear of—is not defined in the Bankruptcy Code,[21] despite detailed definitions for many similar foundational terms.[22] Although one commentator has noted that courts seem to provide an interpretation of "interest" that is broader than mere ownership interests and lien rights,[23] another has noted that the courts are perhaps unduly restrictive in their interpretation of the term.[24] Yet at the same time, courts have largely ignored the absence of the word "claims" in § 363(f) and the contrast of that section's language with that of § 1141(c), which explicitly speaks of vesting free and clear of *claims and interests* under a confirmed plan.[25] Despite the absence of the word

[20]11 U.S.C. § 1141(c). This postconfirmation vesting free and clear is independent of the issue of whether a debtor receives a discharge from prepetition claims in the case. For example, when a debtor liquidates under a confirmed plan, or when the reorganized debtor is not an individual (i.e., is a noncorporeal entity such as a corporation), it does not receive a discharge. 11 U.S.C. § 1141(d)(3) (2000). There is no reason, however, that the debtor's property that is liquidated under the plan cannot vest with the purchaser free and clear of the claims and interests of the debtor's creditors, equity security holders and general partners. *See* § 1141(c) and 1141(d)(3) (Section 1141(c) does not specify with whom the property can vest; it leaves that open-ended. Section 1141(d)(3) specifies only that the debtor is not discharged from claims under certain circumstances; it does not deal with the debtor's or the estate's property or a purchaser of that property).

[21]*See* Folger Adam Sec., Inc. v. Dematteis/MacGregor, JV, 209 F.3d 252, 257 (3d Cir. 2000) ("The term 'any interest' as used in section 363(f), is not defined anywhere in the Bankruptcy Code."); Minstar, Inc. v. Plastech Research, Inc. (*In re* Arctic Enter., Inc.), 68 B.R. 71, 78-79 (D. Minn. 1986) (construing "interests" under § 1141(c) to include liens).

[22]*See, e.g.*, 11 U.S.C. §§ 101(5) (2000) (claim), (10) (creditor), (12) (debt), (15) (entity), (16) (equity security, which includes "interest of a limited partner in a limited partnership" or warrant or right to purchase, sell or subscribe, but not to convert, shares of a corporation or limited partnership interest), (17) (equity security holder), (28) (indenture), (36) (judicial lien), (37) (lien) ("a charge against or interest in property to secure payment or performance"), (41) (person), (43) (purchaser), (49) (security), (50) (security agreement), (51) (security interest), (54) (transfer). This definitional void may have been partially filled by *Butner v. United States*, 440 U.S. 48 (1979), in which the Court held that the nature and extent of property rights were to be determined by applicable nonbankruptcy law—primarily state law. This may suggest that "interest" is coextensive with "property rights recognized by applicable non-bankruptcy law." Such an interpretation is, however, somewhat broader than that applied by the courts.

[23]3 COLLIER ON BANKRUPTCY § 363.06[1] (15th ed., Rev. 1998).

[24]Basil H. Mattingly, *Sale of Property of the Estate Free and Clear of Restrictions and Covenants in Bankruptcy*, 4 AM. BANKR. INST. L. REV. 431 (1996) (hereinafter Mattingly). Although two recent commentators apparently believe that the term "interest" denotes a property right in all cases, Walter W. Miller, Jr. & Maureen A. O'Rourke, *Bankruptcy Law v. Privacy Rights: Which Holds the Trump Card?*, 38 HOUS. L. REV. 777, 813 (2001), the authority that they cite for this proposition can be construed to support a different interpretation. *See* 11 U.S.C. § 541(a) (2000) (property of the estate includes "all legal and equitable interests of the debtor in property"—inclusion of the phrase "in property" suggests a limitation on the phrase "all legal and equitable interests" just as does "of the debtor").

[25]The NBRC rather coyly noted that "[w]hether the term "interests" means only security interests

"claims" in § 363(f), preplan sales free and clear of claims are routine.[26] Finally, § 363(f)'s sale free-and-clear power has been interpreted expansively (except in the area of traditional *in rem* interests in real property),[27] while at the same time § 1141(c)'s vesting free-and-clear power, which is broader than § 363(f) on its face, has been largely ignored and misconstrued.[28]

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and liens, or whether it also includes unsecured claims, is an unresolved question." NAT'L BANKR. R. COMM'N REP., *supra* note 9, at 348.

[26]A treatise prepared by perhaps the preeminent corporate restructuring firm describes the practice, notes the lack of express language in § 363(f) to authorize sales free and clear of claims, and glosses over the matter in a footnote that draws upon historical equitable powers and policy arguments. *See* 1 WEIL, GOTSHAL & MANGES LLP, supra note 4, at 11-23 n.80. But equity and policy should not trump the plain language of a statute and should only be used where there is a gap in the statutory scheme. *Cf.* Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc. v. Anderson, 390 U.S. 414, 450 (1968) ("The need for expedition, however, is not a justification for abandoning proper standards."). *See also* Thomas E. Plank, *The Erie Doctrine in Bankruptcy*, (forthcoming 2002) (manuscript on file with author) (analyzing bankruptcy courts as *sui generis* and rejecting the oft-repeated assertion that they are courts of equity).

[27]*See* Kuney, *supra* note 2.

[28]This is not unusual. A Chapter 11 case that has a sale free and clear as its goal will generally proceed straight to a preplan sale before, if ever, engaging in the costly and time consuming process of proposing, confirming, and consummating a plan of reorganization. In fact, it is not uncommon for reorganization cases that began with a plan as their goal to end with a preplan sale. The plan process simply can consume too much time, generate too much expense, or fail to result in a feasible exit strategy for the debtor. *Cf. In re* APF, Co., No. 98-01596, Findings of Fact and Conclusions of Law and Order Confirming Modified Second Amended Joint Plan of Reorganization of FPA Medical Management Inc. and Certain of Its Subsidiaries and Affiliates, As Modified (Bankr. D. De. May 27, 1999) (unpublished decision) (on file with court, docket no. 2097) (confirmation of plan of reorganization long continued, finally plan confirmation process converted into § 363 sale with bare minimum of notice; liquidating plan followed).

Further, under § 363(m) and current best practice, a sale transaction will close shortly after court approval and any appeal will be rendered moot, assuming that requisite findings of good faith were made and no stay of the order is granted prior to the closing. *See* State v. Shenandoah Realty Partners, L.P. (*In re* Shenandoah Realty Partners, L.P.), 248 B.R. 505 (W.D Va. 2000) (discussing standards for stay pending appeal and denying motion for stay); *see, e.g.,* Official Comm. of Senior Unsecured Creditors of First RepublicBank Corp. v. First RepublicBank Corp., 106 B.R. 938, 940 (N.D. Tex. 1989) (appeal dismissed; sale order entered on December 16, stayed until noon December 19, sale closed on December 19 at noon, no stay pending appeal obtained: "the dog is dead and the appeal is moot"); *see generally* FED. R. BANKR. P. 8002 (orders are final and nonappealable ten days after entry). Section 363(m) of the Bankruptcy Code provides:

> The reversal or modification on appeal of an authorization under subsection (b) or (c) of this section [which are implicated in any 363(f) sale] 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.

11 U.S.C. § 363(m) (2000). *See also* Hoese Corp. v. Vetter Corp. (*In re* Vetter Corp.), 724 F.2d 52, 56 (7th Cir. 1983) ("good faith" for § 363(m) purposes requires a showing that there was not "fraud, collusion between the purchaser and other bidders or the trustee, or an attempt to take grossly unfair advantage of other bidders"). This provision creates a race to close a transaction as soon after entry of the sale order as possible to prevent any stay from issuing and to moot potential appeals. *See, e.g., In re* Sax, 796 F.2d 994, 997-98 (7th Cir. 1986) (sale closed without stay of appeal, appeal was automatically mooted). *See generally* 1 WEIL, GOTSHAL & MANGES LLP, *supra* note 4, at 11-29 to 11-31 (describing § 363(m) authorities and practice).

Although § 1141(c) has been largely ignored, it provides firm statutory support in the plan context for clearing title and blocking successor liability.[29] At the same time, § 363(f) has been used for this purpose almost exclusively since the erosion of the early prohibitions on preconfirmation reorganization-dispositive transactions.[30] This in turn has led to the rough-and-ready prac-

[29]Further support for sales free and clear of all claims in a plan setting exists when the debtor is entitled to a discharge under the plan. If the sale takes place concurrently with or after the discharge is granted, successor liability will be eliminated as well because the buying entity's liability is wholly derivative of the seller's liability. Once discharge is granted the source of successor liability is eliminated. *See infra* note 110 and accompanying text. Of course, this argument is not available in cases in which no discharge is available—such as corporate reorganization and liquidation cases. *See* 11 U.S.C. § 1141(d)(3) (2000) (no discharge if plan is a liquidating plan, if the debtor does not engage in business after consummation of the plan, or if the debtor would be denied a discharge in Chapter 7); 11 U.S.C. § 727(a)(1) (2000) (no discharge to nonindividuals such as corporations, partnerships, and limited liability companies).

[30]The legislative history is fairly clear that Chapter 11 cases were to produce plans of reorganization for confirmation, not preplan liquidations. *See* H.R. REP. NO. 95-595 (1977) ("The purpose of the reorganization . . . case is to formulate and have confirmed a plan of reorganization . . . ."); Lynn M. LoPucki, *The Debtor in Full Control-Systems Failure Under Chapter 11 of the Bankruptcy Code*, 57 AM. BANKR. L.J. 99, 106 (1983) ("From the viewpoint of the courts or policy makers, confirmation and consummation of a plan are probably both necessary elements of success."). Reflecting this purpose, early cases under the Bankruptcy Code expressed hostility to sales of substantially all the assets of a business through the § 363 motion process. *See, e.g.*, Institutional Creditors of Cont'l Air Lines, Inc. v. Cont'l Air Lines Inc. (*In re* Cont'l Air Lines, Inc.), 780 F.2d 1223, 1226 (5th Cir. 1986) (§ 363 "does not authorize a debtor and the bankruptcy court 'to short circuit the requirements of a reorganization plan by establishing the terms of the plan *sub rosa* in connection' with a proposed transaction," citing *In re* Braniff Airways, Inc., 700 F.2d 935, 940 (5th Cir. 1983)); Comm. of Equity Sec. Holders v. Lionel Corp. (*In re* Lionel Corp.), 722 F.2d 1063, 1069 (2d Cir. 1983) (introducing the "articulated business justification" for, *inter alia*, § 363(b) sales of assets outside of a plan of reorganization after reviewing the history of practice under the "perishability" standard of the Bankruptcy Act of 1867 and the "upon cause shown" standard of the Chandler Act of 1938); *In re* White Motor Credit Corp., 14 B.R. 584, 589-90 (Bankr. N.D. Ohio 1981) (§ 363(b)—use, sale or lease of estate property out of the ordinary course of business—does not authorize the preplan sale of substantially all estate assets in a Chapter 11 case). *See generally* John J. Hurley, *Chapter 11 Alternative: Section 363 Sale of All of the Debtor's Assets Outside of a Plan of Reorganization*, 58 AM. BANKR. L.J. 233 (1984) (collecting prior Bankruptcy Act and early Bankruptcy Code cases involving the preplan sale of substantially all the assets of a debtor). These early cases focused on the overall structure and description of the Chapter 11 process as one in which the debtor filed its petition, the automatic stay was invoked, a creditors' committee was appointed, plan negotiation ensued and, if successful, confirmation of a plan followed after the debtor and its supporters had "scal[ed] the hurdles erected in Chapter 11." Cont'l Air Lines, 780 F.2d at 1226.

As more debtors found themselves in the swamp that a Chapter 11 case can become rather than "scaling the hurdles" of Chapter 11, many in the insolvency community began to understand the usefulness of a quick sale of substantially all the assets of the bankruptcy estate followed by a simple plan distributing proceeds by strict priority or conversion to Chapter 7 as an exit strategy. Thus debtors' and purchasers' counsel fastened upon *Lionel*'s "articulated business justification" standard, and promoted sales of substantial portions or substantially all of the estate's assets. In time, in reaction to these repeated requests for preplan sales, the judicial bias against preplan sales of substantially all of a debtor's assets eroded. *See, e.g.*, Bergemann, Inc. v. Babcock & Wilcox Co. (*In re* Babcock & Wilcox Co.), 250 F.3d 955, 960 (5th Cir. 2001) (paying lip service to the *Braniff* prohibition on preplan transactions that amount to "*sub rosa*" plans of reorganization while affirming preplan substantive consolidation through DIP financing approval and coyly finding that the challenged order "neither changes the fundamental nature of the assets nor limits future reorganization options" despite the radical changes wrought by substantive consolidation); Official

tice of today: throwing companies into bankruptcy merely to effect an asset sale of a business or division.[31] Even though § 363's language does not support the breadth of interpretation that courts have imposed, this trend appears unlikely to reverse itself. Although appellate courts could exercise

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Comm. of Unsecured Creditors v. Cajun Elec. Power Coop., Inc. (*In re* Cajun Elec. Power Coop., Inc.), 119 F.3d 349 (5th Cir. 1997) (*accord*, approving sale of operating division including $107 million in cash and $20 million in transmission lines and substantial litigation claims); Richmond Leasing Co. v. Capital Bank, N.A., 762 F.2d 1303 (5th Cir. 1985) (*accord*, narrowly construing *Braniff* so as not to apply to broad renegotiation and assumption of major equipment lease); *In re* Brookfield Clothes, Inc., 31 B.R. 978 (S.D.N.Y. 1983) (discussing legislative history and case law under both the Bankruptcy Code and the prior Bankruptcy Act and finding that § 363(b) sales could dispose of substantially all of a debtor's property, preplan, assuming appropriate showing of exigency is made); *In re* Delaware & Hudson Ry. Co., 124 B.R. 169 (D. Del. 1991) (discussing history of standards for sales of substantially all assets out of the ordinary course of business under the prior Bankruptcy Act and the present Bankruptcy Code and the *Lionel*, and *Solar Mfg.Corp.*, 176 F. 2d 493, 495 (3d Cir. 1949), cases and standards for sale and recognizing that the delays inherent in the Chapter 11 plan process could themselves constitute the "emergency" to authorize such a sale. *See generally* Bogdanoff *supra* note 15, at 1392-1401 (discussing distinctions and standards under earlier cases for sales before and as part of plans of reorganization). Coupled with the acceptance of using § 363(f) to erect a firewall to block successor liability, *see infra* notes 91-104 and accompanying text, this evolution of judicial attitude has promoted the use of Chapter 11 as a liability-limiting "wrapper" for what would otherwise be rather vanilla asset purchase and sale transactions of substantially all of the assets of businesses that could otherwise be negotiated, documented, and consummated in or out of bankruptcy.

[31]*See, e.g.*, Nick Wingfield, *Napster Files for Chapter 11 Shelter*, WALL ST. J., June 4, 2002, at B6 ("Napster Inc., in an expected move, filed for Chapter 11 bankruptcy protection as a prelude to a proposed sale of the company's assets . . . ."). The evolution of Chapter 11 from cases focused on developing a plan to ones that feature use of the Code for a single preplan procedure or protection undermines attempts to quantify how many Chapter 11 cases are "successful." Early measurements of success focused on the percentage of successfully confirmed plans. *See* Hon. Samuel L. Bufford, *Chapter 11 Case Management and Delay Reduction: An Empirical Study*, 4 AM. BANKR. INST. L. REV. 85 (1996) (citing 1989 study by Ed Flynn of the Administrative Office of United States Courts showing plan confirmation rate of seventeen percent based on a nonrandom sample of 2395 cases drawn from across the nation over a ten-year period); Lisa Hill Fenning & Craig A. Hart, *Measuring Chapter 11: The Real World of 500 Cases*, 4 AM. BANKR. INST. L. REV. 119, 152 (1996) (noting difficulty of measuring success in Chapter 11 cases, that confirmation of a plan does not equal economic success, and that dismissal does not necessarily equal failure); Hon. Leif M. Clark et al., *What Constitutes Success in Chapter 11? A Roundtable Discussion*, 2 AM. BANKR. INST. L. REV. 229 (1994) (extensively discussing various types of success in Chapter 11); Lynn M. LoPucki & William C. Whitford, *Patterns in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 78 CORNELL L. REV. 597 (1993) (critically examining types of success in reorganization and classifying sale transactions as successful reorganizations only if the core businesses remain intact in a single entity). Even more recent measurements focus on confirmed plans and whether debtors must return to bankruptcy courts for a second or third attempt at reorganization. Lynn M. LoPucki & Sara D. Kalin, *The Failure of Public Company Bankruptcies in Delaware and New York: Empirical Evidence of a "Race to the Bottom,"* 54 VAND. L. REV. 231 (2001). These measures may easily miss successful reorganizations resulting from sales of substantially all of a debtor's assets to a purchaser that continues the debtor's business essentially intact or other transactions that lead to a favorable reorganization without a plan. Future studies of "success" in Chapter 11 must take these nonplan reorganizations into account to avoid substantial undercounting. *See generally* Elizabeth Warren & Jay L. Westbrook, *Financial Characteristics of Businesses in Bankruptcy*, 73 AM. BANKR. L.J. 499, 566 (1999) (explaining difficulties in using empirical measures like confirmation rates to measure success in Chapter 11 and finding that a high percentage of Chapter 11 cases were, at least eventually, liquidations).

independent statutory analysis and not blindly follow lower court decisions, § 363(m) makes this unlikely by mooting most appeals before they can be briefed and considered on even the first rung of the appellate ladder.[32]

The next subsections of Part I of this Article discuss the existing precedent regarding § 363(f) and identify the fundamental misinterpretation of the statute that is the subject of this Article: the interpretation of § 363(f)'s word "interest" to include "claims."

B. The Conditions for Sales Free and Clear

1. *Sections 363(f)(1), (2), (3) - Unsurprising Conditions Allowing Sale Free and Clear*

The first three alternative preconditions for preplan sales free and clear under § 363(f) are not surprising. Under § 363(f)(1), if applicable nonbankruptcy law permits the sale, the Code also permits the sale.[33] Essentially, this recognizes that there is no reason to limit preexisting rights and remedies in a liquidation or reorganization to benefit creditors and parties in interest.[34] There may be an advantage to selling the assets under § 363(f)(1) rather than the applicable nonbankruptcy law, since under § 363(f)(1) there is no need to follow the procedures of applicable nonbankruptcy law that one has used to justify the sale.[35] This may result in savings of time and money.

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[32]The appellate ladder for bankruptcy decisions has an extra rung over that of the garden-variety federal civil action. Bankruptcy court decisions are appealed to the district courts or to bankruptcy appellate panels, whose decisions are appealed to the circuit courts of appeals. Finally, resort may be had to the United States Supreme Court for a fourth, albeit discretionary, decision on the matter. The extra step involved, combined with the uncertain precedential value of bankruptcy appellate panel decisions, makes development of uniform standards and practices more difficult in bankruptcy than in those areas of law where the direct appeal is to the circuit court of appeals, whose decision is binding precedent upon all courts within the circuit. *See generally* Bank of Maui v. Estate Analysis, Inc., 904 F.2d 470, 472 (9th Cir. 1990) (bankruptcy appellate panel decisions rendered by Article I bankruptcy judges cannot bind Article III district courts). This odd system of appeals has a tendency to suppress the development of a dependable, consistent, uniform body of bankruptcy law. *See* Hon. Eugene R. Wedoff, *BAPS-Good, But Not Good Enough*, 19 AM. BANKR. INST. J. 32 (2000) (detailing the idiosyncracies of bankruptcy law and practice that retard development of a dependable, consistent body of bankruptcy law). U.S. TRUSTEE MANUAL § 3-9.4.14 (Feb. 25, 2002) *available at* <http://www.usdoj.gov> ("Many courts do not find a sale of most or all of a debtor's assets by motion to be objectionable . . . . The United States Trustee must become familiar with the prevailing case law in his/her district."). This tendency is enhanced in the case of § 363 because of parties using § 363(m) to moot most appeals even before they reach the district court or bankruptcy appellate panel. *See supra* note 28. The result is that, for there to be national uniformity of interpretation of § 363(f), legislative action is required. The protections of § 363(m) moot too many appeals for the normal process of appellate review and development of precedent to function effectively.

[33]11 U.S.C. § 363(f)(1) (2000).

[34]"Parties in interest" is a phrase used in no less than 106 sections of the Bankruptcy Code and 79 of the Federal Rules of Bankruptcy Procedure, yet it also is undefined in the Code or the Rules.

[35]Scherer v. Fed. Nat'l Mortgage Ass'n (*In re* Terrace Chalet Apartments, Ltd.), 159 B.R. 821, 824-25 (N.D. Ill. 1993) (specifying that the notice, manner, and timing of a sale free and clear are provided by Rules 2002(a)(2) and 6004(f)(1) and not by the state foreclosure law used to justify the sale).

Similarly, under § 363(f)(2), if the party asserting the interest consents to the sale free and clear of that interest, the Code permits the sale.[36] There is no reason to bar a consensual transaction that will benefit the estate.[37]

Finally, under § 363(f)(3), a sale free and clear of liens (a subset of interests) is authorized when it will result in proceeds which exceed the aggregate value of all liens on the property.[38] The liens exist to secure payment; if the payment is made, there is no need for the liens. A sale under § 363(f)(3) does, however, significantly change the rights of the parties, and may negatively affect a lienholder who is forced to receive an accelerated prepayment of a long-term obligation.[39]

The one controversial aspect of § 363(f)(3) concerns the amount of the payment that must be made to a purportedly secured creditor when the value of the collateral will not support full payment of the claim. In other words, if an undersecured creditor holds a one hundred dollar claim secured by property worth sixty dollars, does the sale have to produce proceeds of sixty or one hundred dollars to be authorized under § 363(f)(3)?[40] Even after the Bankruptcy Amendments and Federal Judgeship Act of 1984,[41] which at-

[36]11 U.S.C. § 363(f)(2) (2000). The statute requires actual consent, not "deemed consent" based upon a failure to object. *In re* Roberts, 249 B.R. 152 (Bankr. W.D. Mich. 2000) (when failure to object is the standard, the statute and rules use the phrase "after notice and a hearing," defined in § 102(1)(B)(i), which authorizes the no-hearing-without-objection-and-request-for-hearing procedure that is pervasive in bankruptcy practice and is colloquially known as "scream or die"). *But see* Citicorp Home Owner Serv., Inc. v. Elliot (*In re* Elliot), 94 B.R. 343, 345-46 (E.D. Penn. 1988) (failure to object is insufficient implied consent to satisfy § 363(f)(2)).

[37]A similar policy underlies § 363(b)'s authorization of postpetition ordinary course of business transactions. *See* Burlington N. R.R. Co. v. Dant & Russell, Inc. (*In re* Dant & Russell, Inc.), 853 F.2d 700 (9th Cir. 1988) (discussing policy in context of standard for judging which transactions are within the ordinary course of business and which are not).

[38]11 U.S.C. § 363(f)(3) (2000). Interestingly the § 363(f)(3) sale can even be a sale arranged after a secured creditor has seized the collateral. The trustee or debtor in possession need merely obtain turnover of the property at issue under § 542, and then seek to sell the property free and clear under § 363(f). Austein v. Schwartz (*In re* Gerwer), 898 F.2d 730, 734 (9th Cir. 1990) (Chapter 7 case; § 542 recovery and § 363(f)(4) sale), *see also* United States v. Whiting Pools, Inc., 462 U.S. 198 (1983) (Chapter 11 application of § 542 to allow debtor to recover property seized by the IRS prepetition). *But see* Thomas E. Plank, *The Creditor in Possession under the Bankruptcy Code: History, Text, and Policy*, 59 MD. L. REV. 253 (2000) (criticizing the *Whiting Pools* decision and, by implication, the *Gerwer* decision also).

[39]A prepayment risk like this is of interest to those involved in asset based lending, and securitization transactions. It is traditionally guarded against by including a prepayment fee in the note secured by the lien. These fees will be enforced and counted toward the total aggregate payoff amount unless found to be an unenforceable penalty. *See generally* David Grey Carlson, *Over Secured Creditors under Bankruptcy Code § 506(b): The Limits of Postpetition Interest, Attorneys' Fees, and Collection Expenses*, 7 BANKR. DEV. J. 381 (1990) (discussion of enforcement of prepayment charges and related matters).

[40]*See* 11 U.S.C. § 506(a) (2000) (a claim is a secured claim to the extent of value in collateral); 11 U.S.C. § 506(d) (2000) (liens in excess of value are void). Section 363(k) also provides a secured creditor with protection at the sale. That section allows the creditor to credit bid and acquire the property through offset of its claim against the purchase price and payment of any net balance due. 11 U.S.C. § 363(k) (2000).

[41]Pub. L. No. 98-353, 98 Stat. 372 (1984). Despite effective lobbying efforts, special interest groups

tempted to resolve this question by amending the statute, the courts are split as to whether the statute requires the payment of the economic value of the lien or the full amount of the obligation that the lien secured.[42] Despite an active secured creditors' lobby and a good description in the House and Senate Reports of the intent to affect the later interpretation, the statute was amended to read "if the proceeds exceed the value of all liens on the property"—again utilizing the confusing concept of "valuing a lien" rather than referring to the total amount of a debt secured, or purportedly secured, by the lien.[43]

While the first three of the five § 363(f) alternative conditions are fairly straightforward, the last two could not be more different. They address nonconsensual transfers of the highest order, and can lead to seemingly bizarre results if unchecked.

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that persuade Congress to amend the Bankruptcy Code to address their parochial interests may then fail to supply Congress with legislative "fixes" that actually achieve the desired result. *See, e.g.*, George W. Kuney & Jeffrey R. Patterson, *Single Asset Real Estate Under § 362(d)(3): A Narrower Construction Than You Might Expect (or, Why Every Hotel Should Have a Gift Shop and Troubled Golf Courses Should Keep Their Bars Open)*, 26 CAL. BANKR. J. 123 (2002) (discussing flawed amendments of §§ 101 and 362(d) to address concerns of lenders with single asset real estate collateral and the reaction of bankruptcy courts to the effort).

[42]*Compare In re* Beker Indus. Corp., 63 B.R. 474, 477 (Bankr. S.D.N.Y. 1986) (statutory "aggregate value of all liens" means the actual economic value of the lien, i.e., the sixty dollars in the example above) *with* Richardson v. Pitt County (*In re* Stroud Wholesale, Inc.), 47 B.R. 999, 1002 (E.D.N.C. 1985) (statutory "aggregate value of all liens" means the full amount of all debt secured by the liens, i.e., $100 in the example above), *aff'd* 983 F.2d 1057 (4th Cir. 1986).

[43]*See* H.R. REP. No. 95-595, at 344 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6301-02 ("trustee may sell free and clear if . . . the sale price of the property is greater than the amount secured by the lien"); *accord* S. REP. No. 95-989, at 56 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5842; Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 372. As stated in *In re Terrace Chalet Apts, Ltd.*, 159 B.R. 821, 826-27 (N.D. Ill. 1993):

> The Bankruptcy Amendments of 1984 further demonstrate that Section 363(f) does not protect merely the actual value of the lien. Previously, Section 363(f)(3) authorized a sale free and clear of liens if the sale proceeds exceeded the value of the "interests" of secured parties in the property. Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 372. In 1984, Congress amended Section 363(f)(3) to authorize a sale if the proceeds exceeded the value of "all liens on the property." *Id.* When Congress intends to denote the concept of "actual value" in the Bankruptcy Code, it consistently refers to the value of the secured party's interest. *E.g.*, 11 U.S.C. § 361 (using the phrase "the interest of an entity in property" to express the concept of actual value); 11 U.S.C. § 506(a) (using the phrase "value of such creditor's interest" to denote actual value); § 1129(a)(7)(B) (using the phrase "value of such holder's interest" to express actual value). Congress deleted the language of Section 363(f)(3) that courts have consistently interpreted as denoting actual value. This deletion suggests that Congress intended for Section 363(f)(3) to protect other than actual value.

2. *Section 363(f)(4) - Sale When the Interest is in Bona Fide Dispute*

Although far-reaching, this condition to the power of sale free and clear appears easily understood and applied. If the property interest is subject to bona fide dispute[44] by the interested parties, the property can be sold free and clear of that interest,[45] which will generally attach to the proceeds.[46] This provision allows productive assets subject to deadlocking disputes to be transferred to a third party so that they can remain economically productive, while the original parties may continue to litigate or otherwise proceed to resolve their dispute.[47]

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[44]The definition of "bona fide" in this context is also less than clear, *see* Cheslock-Bakker & Assocs. v. Kremer (*In re* Downtown Athletic Club), No. M-47-JSM, 2000 WL 744126, at *4 (S.D.N.Y. June 9, 2000) (*citing In re* Collins, 180 B.R. 447, 452 (Bankr. E.D. Va. 1995), for the proposition that "bona fide" dispute requires "an objective basis for either a factual or legal dispute"), although it is clearly the burden of the moving party, debtor in possession or trustee, to establish that it has been met. *In re* Octagon Roofing, 123 B.R. 583, 590 (Bankr. N.D. Ill. 1991). In the case of a secured-creditor-versus-debtor dispute it is unnecessary that either party have commenced an adversary proceeding challenging the priority, validity, and extent of the lien at issue. *In re* Oneida Lake Dev., Inc., 114 B.R. 352, 357-58 (Bankr. N.D.N.Y. 1990); *In re* Millerburg, 61 B.R. 125 (Bankr. E.D.N.C. 1986). The dispute need not even be between the estate and a third party. Disputes between third parties will satisfy the condition in the proper case. *In re* Gerwer, 898 F.2d at 733 (dispute between secured creditor and third party will justify sale under § 363(f)(4) if the outcome of the dispute could indirectly deplete or enhance the estate). It is probably a jurisdictional minimum that the court conclude that the property to be sold is actually property of the estate. *See* Missouri v. United States Bankr. Court, 647 F.2d 768, 778 (8th Cir. 1981) (requiring examination to determine that estate has a substantial ownership right). It appears likely that courts interpreting the "bona fide dispute" requirement for § 363(f)(4) would follow as persuasive the line of cases construing the term for purposes of § 363(b)(1) relating to qualified petitions filing an involuntary petition. These cases have generally held that a bona fide dispute is measured under an "objective test" as to whether there is a genuine issue of material fact or a meritorious contention regarding the application of law to fact. Liberty Tool & Mfg. v. Vortex Fishing Sys., Inc. (*In re* Vortex Fishing Sys., Inc.), 262 F.3d 985, 990 (9th Cir. 2001), *amended and superseded by* 277 F.3d 1057 (9th Cir. 2002) (citing as the originating case *In re* Lough, 57 B.R. 993, 996-97 (E.D. Mich. 1986), collecting other appellate courts adopting this standard, and noting that the "subjective" test of *In re* Johnston Hawks, Ltd., 49 B.R. 823 (Bankr. D. Haw. 1985) has been largely discarded).

[45]11 U.S.C. § 363(f)(4) (2000). Unlike sales under § 363(f)(2), failure to object to a sale of property under § 363(f)(4) can constitute implied consent to the sale. *In re* Elliot, 94 B.R. at 345-46; Pelican Homestead v. Wooten (*In re* Gabel), 61 B.R. 661, 667 (Bankr. W.D. La. 1985).

[46]Attachment to the proceeds is the most common form of adequate protection, although it is not the only option. *See* 11 U.S.C. § 363(e); *see also* Bankruptcy Law Revision: Report of the Committee on the Judiciary to Accompany H.R. 8200, H.R. REP. NO.95-595 (1977); H.R. 8200, 95th Cong. (1978) (indicating that sale free and clear in *bona fide* dispute circumstances and notions of adequate protection originated well before enactment of the Code). The mechanism of providing adequate protection is limited only by the imagination of the parties and the court. *Id.*; *see also* 11 U.S.C. § 363(d) (2000) (trustee may use, sell or lease property only to the extent not inconsistent with relief granted under § 363(c)-(f)).

[47]There is no reason that the transferee cannot be an entity owned or controlled by one of the original parties. *See, e.g.*, *supra* note 3 (discussing Enron's proposal to form a subsidiary to purchase its operating assets). For instance, there is no express restriction preventing one of two or more entities that assert an ownership interest in property from commencing a Chapter 11 case and forming a separate nondebtor entity to which the property would be sold. *Cf. In re* Apex Oil Co., 92 B.R. 847, 869 (Bankr. E.D. Mo. 1988) (affiliation of insider of debtor with purchaser is not sufficient to show lack of good faith for

a. Section 363(f)(4) in the Simple Case Makes Common Sense

Sales under § 363(f)(4) make straightforward good sense in the simple case involving economically productive assets. For example, productive agricultural land, a housing development, or an oil field might otherwise lie fallow until a multi-party dispute between co-owner, alleged co-owners, and secured creditors is finally resolved. In the bankruptcy case of an owner of these assets, a sale free and clear allows the asset to return to productivity, with attendant societal benefits, while the owners' and creditors' interests are adequately protected, generally by being transmuted into an interest in the proceeds of the sale.[48] Assuming something approaching a perfect market for the sale of the asset, the owners are not materially harmed and economic efficiency is served.[49]

Essentially, then, § 363(f)(4) can be used as an expeditious method to clear title to a disputed asset. The process also ensures that none of the parties claiming an interest in property subject to the bona fide dispute will directly[50] receive the property in question. Their dispute, which may be the precipitating event making resort to bankruptcy relief necessary, can be resolved in due course, but the asset will be transferred beyond the dispute and their reach. Owned by a third party, it can return to economic productivity.[51]

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§ 363(m) purposes; good faith is an absence of fraud, collusion with other bidders, or an attempt to take grossly unfair advantage of other bidders). Assuming such a transaction were approved, it effects a forced buyout of the nondebtor party's interest, whatever that may be, that will be satisfied with the proceeds of sale, if the interest is finally adjudicated valid. Further, the aggrieved party's opportunity for appellate review of the sale order will often be eliminated by an express finding in the order approving the sale that the purchaser has acted in good faith combined with a prompt closing of the transaction unless a stay pending appeal is quickly obtained. *See* Regions Bank v. Rivet, 224 F.3d 483, 492 (5th Cir. 2000), *cert. denied*, 531 U.S. 1126 (2001) (bankruptcy court sale free and clear orders are self-executing); 11 U.S.C. § 363(m) (2000); *see supra* note 28. For these reasons, it is common for bankruptcy purchase and sale agreements to feature a sale-order-remains-unstayed condition to closing (as opposed to a more traditional transactional order-is-final-and-nonappealable condition that one might expect), and for the sale to close as soon after the order is entered as is possible. This makes it physically impossible to obtain a stay of the order, effectively mooting the appeal. *See, e.g.*, Official Comm. of Senior Undersecured Creditors of First RepublicBank Corp. v. First RepublicBank Corp., 106 B.R. 938 (N.D. Tex.1989) (sale closed at same instant sale order was effective; appeal of order on grounds that the sale constituted a *sub rosa* plan of reorganization dismissed as moot).

[48]*See* 11 U.S.C. § 363(e) (2000).

[49]*See generally* John D. Ayer, *The Role of Finance Theory in Shaping Bankruptcy Policy*, 3 AM. BANKR. INST. L. REV. 53 (1995) (reviewing bankruptcy and finance theories including the efficient market hypothesis).

[50]There is no *per se* prohibition on the debtor regaining indirect ownership and control through sale to a debtor—or insider—controlled entity. *See supra* note 47.

[51]There is a striking similarity between the § 363(f)(4) solution and a common parental solution to children bickering over a new toy: "If the two of you can't agree on who plays with it, neither of you does. Instead, I'll return it to the store for a refund."

b. Bizarre Results May Arise Under § 363(f)(4)

Beyond the simple case, however, the § 363(f)(4) power to sell free and clear can lead to bizarre results. Consider the following example: A company closes a new round of financing by issuing publicly traded securities. It receives the proceeds of the transaction, twenty million dollars. A week later it releases disappointing information regarding operations, product development, and an inability to obtain a needed government approval. Immediately, a class action securities-fraud suit is filed seeking to rescind the financing and recover the proceeds for the investors. The company denies wrongdoing, stating that the negative news and results were unknown until after the transaction had closed.

The plaintiff seeks a preliminary injunction and temporary restraining order to enjoin the company from using the proceeds of the financing pending resolution of the securities-fraud action. Before the district court can even consider the request for a temporary restraining order, the company files a Chapter 11 petition in another district.[52] The original district court action is automatically stayed.[53]

The company continues to operate, using the proceeds of the financing, while seeking to sell substantially all of its assets, including the balance of the twenty million dollars in financing proceeds, to a "white knight" conglomerate, which will continue the company's operations in a separate subsidiary, transferring the twenty million dollars into its central cash concentration account where it will be used to fund activities of the entire corporate group. The conglomerate will pay for the acquisition with its own stock, which is not presently publicly traded.[54] The debtor will distribute this stock to its creditors and stockholders under its Chapter 11 plan after the stock has been

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[52]Strategically, filing the Chapter 11 case in a different district where venue is otherwise proper will maximize the disruptive effect of the bankruptcy filing on the class action and minimize the chances of smooth coordination between the district and bankruptcy courts, as well as the ease of withdrawing the reference to the bankruptcy court of the Chapter 11 case from the district court. *See* 28 U.S.C. § 1408 (1994) (venue of cases under title 11); 28 U.S.C. § 1452 (1994) (removal of claims related to bankruptcy cases). If the securities fraud suit and the Chapter 11 case are both filed in the same district, the district court could simply withdraw the reference of the bankruptcy case to the bankruptcy court and hear both the securities fraud action and the Chapter 11 proceeding, perhaps consolidating them. Of course, interdistrict transfer is possible, *see* 28 U.S.C. § 1412 (1994) (change of venue based on the interest of justice or convenience of the parties), but it is another level of complexity and delay for the plaintiffs as the debtor exercises its "second mover" advantage gained through the Chapter 11 filing.

[53]11 U.S.C. § 362(a)(1) (2000) (automatic stay of actions against the debtor).

[54]The transaction can fairly easily be structured as a reverse triangular merger with the result that the conglomerate becomes a publicly traded company without having to comply with the Securities Act of 1933, 48 Stat. 74, 15 U.S.C. §§ 77a-77aa (2000) (or the Securities Exchange Act of 1934, 48 Stat. 905, 908 (codified as amended at 15 U.S.C. §§ 77b (2000) *et seq.* and their related regulations (17 C.F.R. parts 230 and 240)). *See generally* George W. Kuney, *Going Public Via Chapter 11: 11 U.S.C. Sections 1125(e) and 1145*, 23 CAL. BANKR. J. 3 (1996).

valued by the bankruptcy court.[55] If the sale of the assets for stock is approved under § 363(f)(4),[56] the most the recent investors can ever hope to receive, whether they take their distribution on account of their fraud claims or their equity interests, is the stock of the conglomerate. This certainly is not the same thing as their money back or their prior equity interest in the stand-alone company, and it is far from a minor modification of their contract, securities law, and tort rights involved in the class action.

Boiled down, this means that a soon-to-be debtor may be able to obtain property of another by conversion or fraud and then reorganize, using the value of the wrongfully obtained property, paying the prior owner only if she later successfully proves her case. In any event, the prior equity participants will not get their property back, even if they prevail.[57] The most they can expect is payment of its value, or an approximation of that value as pronounced by a bankruptcy judge, assuming the debtor has sufficient assets to make such a payment once the adjudication of rights is complete.

The main limitations on this scenario are imposed by the requirements of a bona fide dispute, good faith,[58] and a jurisdictional finding that the debtor

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[55]The problem of valuation of the stock is very thorny and beyond the scope of this Article. Even if the stock is already publicly traded, market volatility and the likely effect of bulk sales by entities receiving stock under the plan make accurate valuation difficult if not impossible. *See* Lynn M. LoPucki, *Comment: Shareholder Interests and Bankruptcy*, 43 U. TORONTO L.J. 711, 712 (1993) (determination of reorganization value by the court for purposes of valuing securities is a "guess confounded by an estimate"); David G. Carlson, *Secured Creditors and the Eely Character of Bankruptcy Valuations*, 41 AM. U. L. REV. 63, 64 (1991) (positing that all bankruptcy court valuations are subjective, hypothetical, and inherently inaccurate); *see, e.g.*, Citibank v. Baer, 651 F.2d 1341, 1347 (10th Cir. 1980) (court notes the absurdity of its valuation of over $90 million of as yet undiscovered oil in the Canadian Arctic down to the nearest $50); *see also* George W. Kuney, *Financial Reporting by Chapter 11 Debtors: A Limited Critique of S.O.P. 90-7*, 5 J. BANKR. L. & PRAC. 311 (1996) (finding accounting guideline unworkable because "reorganization value" is generally never determined by the court as such and is imprecise in any event). There is no substitute for the market in this respect.

[56]Based upon the *bona fide* dispute that is the securities fraud action.

[57]This may be an overstatement. Courts recognize a distinction between whether or not the debtor acquires title to the property under applicable nonbankruptcy law. If title is obtained, even if subject to recission, the property will constitute property of the estate, and sale under § 363(f)(4) and the scenario discussed in the text can proceed. If good title is not obtained, such as when the debtor obtains the property by outright theft, it is not property of the estate and § 363 cannot be used to effect its sale. *See* Kitchen v. Boyd (*In re* Newpower), 233 F.3d 922 (6th Cir. 2000) (money misappropriated by debtor prepetition was not property of the estate but proceeds of that money were property of the estate).

[58]Good faith under § 363 is an absence of fraud, collusion with other bidders, or an attempt to take grossly unfair advantage of other bidders. Bleaufontaine, Inc. v. Roland, Int'l (*In re* Bleaufontaine, Inc.), 634 F.2d 1383, 1388 (5th Cir. 1981); *accord In re* Apex Oil Co., 92 B.R. 847, 869 (Bankr. E.D. Mo. 1988); *see also In re* Rock Indus. Mach. Corp., 572 F.2d 1195 (7th Cir. 1978) (good faith is founded solely upon integrity of conduct in sale process). This is analogous to the sometimes loosely stated good faith requirement for plan confirmation under § 1129(a)(3). *See* Connell v. Coastal Cable T.V., Inc., (*In re* Coastal Cable T.V., Inc.), 709 F.2d 762, 764 (1st Cir. 1983) ("[A] chapter 11 reorganization plan must be submitted in good faith .... That is to say, there must be some relation—at least an arguable relation—between the chapter 11 plan and the reorganization-related purposes that the chapter was designed to serve.") (citations omitted); Jorgensen v. Fed. Land Bank (*In re* Jorgensen), 66 B.R. 104, 109 (B.A.P. 9th Cir. 1986)

or estate has an interest in the property in question.[59] These are slight limitations indeed.

3. *Section 363(f)(5) - The Standard That Could Have Swallowed the Others*

The final alternative condition for a sale free and clear under § 363(f) is potentially the broadest of all: § 363(f)(5). It provides for sale free and clear of interests if the interest holder "could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest."[60] The requirement is phrased in the passive voice and does not identify who or what is instituting the hypothetical proceeding that compels the interest holder to accept a money judgment. This suggests that there are no limits on the identity of the hypothetical actor or legal or equitable proceeding. A plain reading of the statute is: If an entity can be forced to accept money for the property interest at law or in equity, its interest can be stripped off the asset in a § 363 sale.[61]

a. What Proceedings Qualify? Hypothetical NonBankruptcy Proceedings that are Broadly Accepted

Uniform Commercial Code ordinary-course-of-business sales[62] and fore-

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(a Chapter 11 plan is filed in good faith if the plan proponent has exhibited "a fundamental fairness in dealing with [the] creditors" and if the plan "will achieve a result consistent with the objectives and purposes of the Code") (citations omitted).

[59]ITNX v. Alpha Bus. Group, Inc. (*In re* Hurt), 9 Fed. Appx. 780, No. 00-15088, BAP No. AZ-98-01532-KPRy, 2001 WL 615282 (9th Cir. June 5, 2001); *see* Cont'l Nat'l Bank v. Sanchez (*In re* Toledo), 170 F.3d 1340, 1343 (11th Cir. 1999) ("It is questionable whether § 363(f) gives a bankruptcy court power to order or approve a sale of property that belongs only to an entity in which the estate holds an interest, and not the estate itself."); Missouri v. United States Bankr. Court, 647 F.2d 768, 778 (8th Cir. 1981) (requiring examination to determine that estate has a substantial ownership right).

[60]11 U.S.C. § 363(f)(5) (2000). The legal or equitable proceeding is referred to in this Article as the "hypothetical proceeding" from time to time. One commentator notes that this abbreviated terminology may obscure an important distinction. Rather than encompassing the entirety of judicial proceedings, Professor Plank suggests that law and equity are just two components of many types of proceedings. He contends that bankruptcy courts are not courts of equity but, rather, are *sui generis* in nature, and thus do not conduct legal or equitable proceedings. Plank, *supra* note 26 (finding bankruptcy to be outside of both law and equity and that confusing bankruptcy with equity jurisdiction is unwarranted). Under this analysis, then, use of a hypothetical admiralty proceeding in which the general maritime law would compel a party to accept monetary compensation in exchange for an interest in property—a salvage lien perhaps—can not satisfy § 363(f)(5)'s requirement for a sale free and clear in bankruptcy. Neither would a hypothetical bankruptcy proceeding.

[61]*See* Mattingly, *supra* note 24, at 431 (championing this interpretation and the use of eminent domain as the source of a § 363(f)(5) power of sale free and clear of all interests). Professor Plank's distinction between law and equity on the one hand and other proceedings on the other, *see supra* note 26, does not undermine Professor Mattingly's stance. Eminent domain, or, more precisely, a proceeding to recover for an uncompensated taking by the state under its eminent domain power, is a legal or equitable proceeding, depending upon the forum and the regime under which it is brought. *See infra* note 74.

[62]*See* U.C.C. §§ 9-320 (1999) (ordinary course of business sale is free and clear, even if proceeds are less than the full amount secured by a lien) and 9-322(c) (1999) (security interest in proceeds of sale).

closure sales[63] are commonly recognized hypothetical proceedings that can satisfy § 363(f)(5).[64] These nonesoteric nonbankruptcy proceedings give the courts little pause when interpreting § 363(f)(5). If the claimant, generally a lienholder, could be forced to accept a monetary satisfaction through the process of foreclosure, the condition is satisfied and the sale may take place. It is not even clear that a senior lien must actually exist, as foreclosure of a hypothetical priming tax lien may conceivably satisfy the condition.[65]

b. Do Bankruptcy Proceedings Themselves Count?

Some courts hold that a hypothetical cramdown confirmation proceeding[66] that would result in removal of the interest from the asset satisfies the § 363(f)(5) analysis, although generally they do not actually perform the analysis or take into account the § 1111(b) election and its ramifications.[67]

Collier notes that construing § 363(f)(5) to require full payment of all sums secured by a lien makes no sense when the sale is an ordinary course of business sale under § 363(c)—there is little chance that sale of an item of inventory will satisfy debt secured by the entire inventory. 2 COLLIER ON BANKRUPTCY ¶ 363.07 (15th ed. 1994), as cited by *In re* Grand Slam U.S.A., Inc., 178 B.R. 460, 461-64 (E.D. Mich. 1995). On the other hand, it is difficult to see why an ordinary course of business sale is a § 363(f)(5) matter—§ 363(f)(1) would appear more directly implicated. *See* 11 U.S.C. § 363(f)(1) (2000) (sale free and clear permitted if authorized by state law).

[63]*See* U.C.C. § 9-610 (1999).

[64]3 COLLIER ON BANKRUPTCY ¶ 363.06[6] (15th ed., Rev. 1998). Foreclosure sales resulting from judicial proceedings seem to fall directly within the words of the statute. More problematic is Collier's assertion that ordinary course of business sales constitute "proceedings" for purposes of § 363(f). Between these extremes lie trustee-conducted foreclosure sales under a deed of trust with no judicial involvement. The issue becomes one of whether a judicial proceeding is required for something to be a "legal or equitable proceeding"—like judicial foreclosure—or if it is enough that the proceeding be sanctioned or authorized by law—like ordinary-course-of-business and nonjudicial foreclosure sales. If any proceeding authorized by law or equity is sufficient, then Professor Plank's assertions that bankruptcy is *sui generis* and that a bankruptcy court is not a court of equity are irrelevant to the § 363(f)(5) analysis. *See* Plank, *supra* note 26.

[65]*Cf. In re* Grand Slam U.S.A., 178 B.R. at 461-64 (hypothetical administrative expense subordinating lien allowed sale without payment in full of subordinated debt).

[66]*See* 11 U.S.C. § 1129(b) (2000). "Cramdown" refers to confirmation of a plan of reorganization that has not been accepted by all classes of claims and interests as required by § 1129(a)(8). In such a circumstance, as long as the other requirements of § 1129(a) have been met, the plan can be confirmed if it does not discriminate unfairly and is fair and equitable with respect to each impaired class that has not accepted the plan. 11 U.S.C. § 1129(b) (2000). That seemingly simple description of cramdown, while accurate, does not illuminate the many complexities involved, which are beyond the scope of this Article. *See generally* Kenneth N. Klee, *All You Ever Wanted to Know About Cram Down Under the New Bankruptcy Code*, 53 AM. BANKR. L.J. 133 (1979); Kenneth N. Klee, *Cram Down II*, 64 AM. BANKR. L.J. 229 (1990). If bankruptcy proceedings are *sui generis* and do not constitute legal or equitable proceedings, *see* Plank *supra* note 26, then using any kind of hypothetical bankruptcy proceeding to satisfy the condition of § 363(f)(5) should not be permitted.

[67]*See, e.g., In re* Perroncello, 170 B.R. 189, 191 (Bankr. D. Mass. 1994) (the "tools" provided by the Code are valuation proceedings under § 506(a) and cramdown under § 1129(b)(2)—no mention of § 1111(b) or its ramifications); Hunt Energy Co. v. United States (*In re* Hunt Energy Co.), 48 B.R. 472, 485 (Bankr. N.D. Ohio 1985) ("The issue before this Court, therefore, is whether [a senior secured creditor and a junior nominally secured creditor] could be compelled in a legal or equitable proceeding to accept a money satisfaction of their interest. This Court finds they could be compelled, in the context of a cram-

Under this theory, if the entity could be forced to accept a money satisfaction for its interest in a cramdown, then sale free and clear is permitted.[68] To date, reported cases dealing with § 1129(b)(2) cramdown as the mechanism used to extinguish an interest under § 363(f)(5) have involved liens, not ownership claims or traditional *in rem* interests that run with the land. The problem with this argument as applied to liens is that it ignores the § 1111(b) election available to most[69] secured creditors.[70] Consider a creditor hypothetically making the § 1111(b) election in a hypothetical cramdown. Making the election means that the creditor would retain its lien on the property and be entitled to a payment stream equal to the face amount of its claim with a present value equal to the value of the lender's collateral, would have a credit-bid right at a sale of the property, or would be entitled to the indubitable equivalent of its claim—all of which either make stripping off the lien or the sale itself impossible or at least unlikely.

Although the cramdown analysis under § 363(f)(5) may fail because of § 1111(b) in the case of liens, it would not fail when used to address other sorts of interests. Those interests would be nonsecurity interests for which the § 1111(b) election is not an option, the credit-bid right of § 363(k) would have no application, the secured-creditor protections of § 1129(b)(2)(A)

down under Section 1129(b) . . . . [by receiving] 'the indubitable equivalent'" of their claims, which the court found to be equal to the sale price of the asset; § 1111(b) not mentioned); *accord* Mut. Life Ins. Co. of New York v. Red Oak Farms, Inc. (*In re* Red Oak Farms, Inc.), 36 B.R. 856, 858-59 (Bankr. W.D. Mo. 1984) (but finding that indubitable equivalent would not be realized and, thus, declining to approve sale).

[68] 3 COLLIER ON BANKRUPTCY, ¶ 363.06[6][a] (15th ed., Rev. 1998). The court in Scherer v. Federal National Mortgage Ass'n (*In re* Terrace Chalet Apts., Ltd.), 159 B.R. 821 (N.D. Ill. 1993), authorized the sale and extinguishment of a lien under § 363(f)(5) because the creditor involved could be crammed down and the creditor's lien extinguished pursuant to § 1129(b)(2). "[T]he decisions that require full satisfaction absent a showing of equitable consideration fail to capture the essence of Section 363(f)(5). . . . Section 363(f)(5) would repeat Section 363(f)(3) if it were interpreted merely to require a specific amount of money that the trustee could pay to sell the property free and clear of a lien." *Id.* at 829. "By its express terms, Section 363(f)(5) permits lien extinguishment if the trustee can demonstrate the existence of another legal mechanism by which a lien could be extinguished without full satisfaction of the secured debt. Section 1129(b)(2) cram down is such a provision." *Id.* Given that the statute does not exclude proceedings under the Bankruptcy Code from the hypothetical proceedings that may satisfy § 363(f)(5), this is a solid, plain-language interpretation. It would also support use of a hypothetical eminent domain proceeding as discussed in the next section.

[69] 11 U.S.C. § 1111(b)(1)(B) (2000) (prohibiting creditors with inconsequential interests or those with recourse against the debtor from making the election).

[70] Under § 1111(b), most secured creditors have the right to elect to avoid claim bifurcation into secured and unsecured claims and have their entire claim treated as an allowed secured claim. As a result, under the cramdown provisions of the Code, such an electing creditor is entitled either to (i) retain its lien on the property and receive a payment stream with a present value at least equal to the truly secured portion of its claim and a total face amount equal to at least the total claim, or (ii) credit bid up to 100% of its total claim amount at a sale of the collateral under a plan, or (iii) realize the indubitable equivalent of its claims. 11 U.S.C. § 1129(b)(2)(A)(i)-(iii) (2000). The first, and most commonly used, alternative prevents strip-off of the lien by its express terms. The effects of the second and third alternatives are not altogether clear.

would not be triggered, and the debtor's hypothetical plan would only need to satisfy the absolute priority rule or its new value exception.[71] It does not take a very clever bankruptcy attorney to envision a confirmable Chapter 11 plan that provides for interest stripping for one class if all other treatment and funding provisions of the plan can be hypothetical. The only restrictions are the ill-defined standards of unfair discrimination and lack of fair and equitable treatment.[72]

Similarly, some courts have considered and authorized sale free and clear of liens if those liens could be subordinated under § 724(b) and disallowed and stripped down under § 507(a)(1).[73]

c. Hypothetical Eminent Domain Proceedings

Given that any property or property interest can be taken by the state through the process of eminent domain, a legal proceeding in which the interest holder is compelled to accept a money satisfaction of its interest,[74] § 363(f)(5) would appear to obviate the need for the other subsections of § 363(f).[75] To date, no courts have mentioned this position in a published

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[71]11 U.S.C. § 1129(b)(2)(B)-(C) (2000) (absolute priority rule for unsecured claims and interests).

[72]*See* 11 U.S.C. § 1129(b)(1) (2000).

[73]*See, e.g., In re* Oglesby, 196 B.R. 938 (Bankr. E.D. Va. 1996); *In re* Grand Slam U.S.A., Inc., 178 B.R. 460, 464 (E.D. Mich. 1995) ("[T]he subordination provision within [§ 724(b)(2)] is as much 'a legal . . . proceeding [that forces the lien holder] to accept a money satisfaction of such interest' as is the 'cram down' provision of Section 1129(b)(2)(A).") (citing *In re* Healthco Int'l Inc., 174 B.R. 174 (Bankr. D. Mass. 1994)); King v. Bd. of Supervisors (*In re* A.G. Metre, Jr., Inc.), 155 B.R. 118 (Bankr. E.D. Va. 1994), *aff'd*, 16 F.3d 414 (4th Cir. 1994)). As with the use of hypothetical cramdown, not all courts agree that hypothetical subordination and strip down can be used to satisfy § 363(b)(5). *See In re* Grand Slam U.S.A., Inc., 178 B.R. at 463 (quoting bankruptcy court below's rejection of the use of § 724(b)(2) to satisfy § 363(f)(5)).

[74]Eminent domain is an extra-judicial legal procedure under which the condemning entity is authorized to take private property for public use. The proceedings may be reviewed by a court in an equitable proceeding, *see* Heller v. South Williamsport Borough, 74 Pa. D.& C.2d 795, 798 (Pa. Ct. Com. Pl. 1976); *accord* Lone Star Gas Co. v. Ft. Worth, 98 S.W.2d 799 (Tex. App. 1936), and actions to recover compensation for a taking are legal proceedings. *See* City of Monterey v. Del Monte Dunes at Monterey, Ltd., 526 U.S. 687, 709 (1999) (Section 1983 suit to recover for uncompenstated taking is an action at law). Eminent domain, thus, also raises the issue of whether or not § 363(f)'s use of the term "proceeding" is limited to proceedings involving a judge in the first instance. Hewing to the language of the statute would answer that question in the negative. The proceeding need only be legal or equitable. The branch—judicial, legislative, or executive—or the government actor that institutes or entertains the proceeding should be irrelevant. *See generally* 1 JULIUS L. STACKMAN & RUSSEL D. VAN BRUNT, NICHOLS ON EMINENT DOMAIN § 1.1-1.42 (3d ed. 1988) (tracing history of eminent domain from Roman to modern times, observing that the power is a reserved or inherent power of the state or sovereign, and at § 1.142[3], p. 1-58, explaining that, under one of many theories of the nature of eminent domain, exercise of the power by the state is an *in rem* action that strips the prior owner of title and leaves that owner with an *in personam* claim for compensation).

[75]Mattingly, *supra* note 24. This is exactly Professor Mattingly's point. It has not, however, been endorsed by any court. The plain language of the statute could be amended to avoid its current potential broad sweep by specifying a nongovernmental actor instigating the hypothetical proceeding: "could be compelled, in a legal or equitable proceeding *commenced by a hypothetical non-governmental party*, to accept a money satisfaction of *the* interest." Despite a massive rewrite of the Bankruptcy Code in the

decision, and neither has the leading treatise on bankruptcy law.[76] The rationale for adopting it, however, is clear. The power of eminent domain is used not just when the government wants to take property for its own use but when it seeks to redevelop a blighted area by taking the property, compensating the former owner, and then selling or giving the property to a private developer for a specific purpose.[77] This is constitutionally permissible, at least within limits.[78] Treating § 363(f)(5) as incorporating the power of eminent domain is no greater a stretch of the concept of taking private property for a "public" purpose. Substitute "reorganization" for "redevelopment" in the eminent domain case law to see how easily the approach can be supported.[79]

d. Case-By-Case Misinterpretation of § 363(f)(5)

Courts have reasoned that if § 363(f)(5) is read broadly,[80] then § 363(f) could be vastly simplified by retaining just the first twenty-two of its one hundred or so words, leaving it to read "The trustee may sell property under subsection (b) and (c) of this section free and clear of any interest in such

Bankruptcy Abuse Prevention and Consumer Protection Act of 2001, H.R. 333 (engrossed in House March 1, 2001), and the Bankruptcy Reform Act of 2001, S.R. 420 (engrossed in Senate March 15, 2001), Congress has not addressed the conflict between the statute's plain meaning and the courts' narrower interpretation. Neither § 363(e) nor (f) are amended by either the House or Senate versions.

[76] 3 COLLIER ON BANKRUPTCY ¶363.06 (15th ed., Rev. 1998).

[77] *See* Haw. Hous. Auth. v. Midkiff, 467 U.S. 229 (1984) (holding Hawaii Land Reform Act, which "redeveloped" leasehold estates into fee simple estates, constitutional under the Fifth Amendment); Berman v. Parker, 348 U.S. 26 (1954) (holding constitutional the D.C. Redevelopment Act of 1945, which provided for redevelopment of slum areas).

[78] *See Haw. Hous. Auth.*, 467 U.S. at 229. *See also* Palazzolo v. Rhode Island, 533 U.S. 606 (2001) (discussing takings clause and standards applicable to same).

[79] *See Berman*, 348 U.S. 26; *but see In re* Opinion of Justices, 126 N.E.2d 795, 803 (Mass. 1955) (noting that the principles of *Berman* do not apply where the area to be redeveloped is not a slum area); City and County of San Francisco v. Ross, 279 P.2d 529, 532 (Cal. 1955) (noting that *Berman* does not apply where stringent controls are not maintained over the properties that are taken and then sold or leased to private parties). *See generally* Julia Patterson Forrester, *Bankruptcy Takings*, 51 FLA. L. REV. 851 (1999) (challenging and rejecting Professor Rogers' long-standing view that the Fifth Amendment does not limit the bankruptcy clause and concluding that the takings clause is a vital consideration in determining the treatment of secured creditors in bankruptcy); James Steven Rogers, *The Impairment of Secured Creditors' Rights in Reorganization: A Study of the Relationship between the Fifth Amendment and the Bankruptcy Clause*, 96 HARV. L. REV. 973 (1983) (arguing that the bankruptcy clause itself and not the Fifth Amendment limits congressional bankruptcy power).

[80] The right case could present an appellate court with the chance to correct the interpretation of § 363(f) using a "plain language" approach. *See, e.g.*, United States v. Ron Pair Enters., Inc., 489 U.S. 235, 249 (1989) ("[W]here, as here, the statute's language is plain, 'the sole function of the courts is to enforce it according to its terms.'"). This could establish § 363's proper scope, applying to all types of interests, but not to claims, and using § 363(e)'s mandate of adequate protection as the principled limit on the use of § 363 to strip off interests. This would effectively force parties seeking to use the Bankruptcy Code to avoid successor liability to proceed with the plan process, utilizing postconfirmation vesting under § 1141 to block successor liability claims. Such an interpretation would put the genie back in the bottle, confine § 363 to its proper scope, and provide those whose interests the debtor or others sought to strip off through the free and clear process to the full panoply of procedural protections that surround proposal and confirmation of a plan of reorganization.

property."[81] But, since Congress did not enact merely the first twenty-two words of the statute, the reasoning goes, it must have meant something different from the no-limits plain language interpretation of § 363(f)(5) that could have been more succinctly drafted in twenty-two words.[82]

What the real meaning—rather than the plain one—is and was has been left to the courts to consider on a case-by-case basis.[83] Their conclusions become more clear if examined from the perspective of the particular interests in question—here claims that would otherwise be assertable against the purchaser of the debtor's assets under applicable state law—instead of further parsing the language of the statute in the abstract. One can then see how the courts have expanded the scope of the word "interests" to include successor liability claims, promoting use of the statute for a quick sale process that

[81]To alleviate the devastatingly broad sound of the pronouncement, the words "subject to the provisions of subsection (e) above" could be added. Although arguably surplus, this would ensure that concerns regarding the constitutionality of any "taking" under § 363(f) were addressed through the mechanism of adequate protection. *See* 11 U.S.C. § 363(e) (2000); *see also* 11 U.S.C. § 361 (2000) (defining adequate protection). *See generally* Ultimate Sports Bar, Inc. v. United States, 48 Fed. Cl. 540 (Fed. Cl. 2001) (citing Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555 (1935) ("The bankruptcy power, like the other great substantive powers of Congress, is subject to the Fifth Amendment.") and discussing the interplay between bankruptcy law and takings law, noting the adequate protection principle). The Supreme Court's view of how broadly or narrowly to interpret the takings clause in relation to the bankruptcy clause has vacillated over time. *See* Charles Jordan Tabb, *The History of The Bankruptcy Laws in the United States*, 3 AM. BANKR. INST. L. REV. 5, 48-50 (1995) (tracing history from *Louisville Joint Stock Land Bank* to *United States v. Security Industrial Bank*, 459 U.S. 70 (1982), regarding this issue).

[82]*See* Richardson v. Pitt County (*In re* Stroud Wholesale, Inc.), 47 B.R. 999 (E.D.N.C. 1985) ("If the trustee's interpretation was correct there would be no need for (f)(1)-(f)(4). This court can imagine very few situations where a lienholder could not be forced to accept monetary compensation for a lien on estate property. It is doubtful that Congress intended for (f)5 to be given such a broad reading. Therefore, this court does not believe that 'money satisfaction' means that estate property can be sold free and clear of all liens whenever those lien holders could be compelled to accept monetary compensation, however slight, for their liens.") (citation omitted), *aff'd*, 983 F.2d 1057 (4th Cir. 1986) (unpublished table decision). Even if § 363(f)(5) is read broadly, this does not necessarily mean that the other subsections are rendered a nullity. Rather, by specifying which subsection the sale is to be approved under, the trustee or debtor in possession may be selecting the adequate protection or treatment to be afforded to the interest holder whose interest is being stripped off the property. For example, if proceeding under state law authorizing the sale free and clear and terminating the interest with no compensation to the holder, no payment or other remedy would be ordered under § 363(e)'s mandate of adequate protection. In contrast, if an (f)(5) eminent domain justification for the same sale were used, then adequate protection would consist of payment of "just compensation" as developed under that body of law.

[83]The process of "judicial legislation" by interpretation of the Bankruptcy Code is nothing new. *See* Kenneth N. Klee & Frank A. Merola, *Ignoring Congressional Intent: Eight Years of Judicial Legislation*, 62 AM. BANKR. L.J. 1, 28 (1988) (discussing examples, including the Third Circuit's much criticized decision Avellino $ Bienes v. M. Frenville Co. (*In re* M. Frenville Co.), 744 F.2d 332 (3d Cir. 1984), which creatively interpreted the word "claim" with distorting ramifications); *see also* Hon. Leif M. Clark, *The Ripple Effect*, 20 AMER. BANKR. INST. J. 31 (July/Aug. 2001) ("[T]he reality of bankruptcy practice is that it is shaped as much by rulings and practices that are never set out in published opinions as it is by the cases printed in West's *Bankruptcy Reporter*. Those rulings and practices in turn grow out of choices that someone has made that have a ripple effect throughout the system, altering it in ways often more far-reaching than even a Supreme Court decision.").

erects a firewall between assets and creditors that is otherwise unavailable under applicable nonbankruptcy law.

C. Free and Clear of What?

1. *Liens*

"Liens"—which are closely related to "claims," at least secured ones—comprise at least a portion of "interests." Section 363(f) itself refers to liens as a subset of interests in subsection (3).[84] The Bankruptcy Code also provides a broad and seemingly clear definition of liens: any "charge against or *interest in* property to secure payment of a debt or performance of an obligation."[85] So, "lien" is a subset of "interest," an interest that secures payment or performance of a claim.[86] In any event, the definition of "lien" appears to give courts little difficulty,[87] and § 363(f) is commonly employed to sell property free and clear of liens securing payment obligations.[88]

2. *Unsecured Claims*

In a dramatic expansion of § 363(f)'s language into an interpretation that parallels the language of § 1141(c), some courts have concluded that unsecured[89] claims are a type of "interest" in property from which the property may be sold free and clear.[90] Although fundamentally flawed, this interpreta-

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[84]11 U.S.C. § 363(f)(3) (2000).

[85]11 U.S.C. § 101(37) (2000) (emphasis added). This definition of lien is broad enough to encompass liens in real, personal, tangible, and intangible property, and includes traditional liens by mortgage or deed of trust, Uniform Commercial Code security interests, and liens and security interests that arise otherwise by operation of law, such as tax and mechanics' liens.

[86]The definition of "claim" is:

> (A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or
> (B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured[.]

11 U.S.C. § 101(5) (2000).

[87]*See, e.g.*, 229 Main Street Ltd. P'ship v. Mass. Dep't of Envtl. Prot. (*In re* 229 Main Street Ltd. P'ship), 262 F.3d 1 (1st Cir 2001) (toxic clean up lien was an interest in property; noting that "interest in property" is not synonymous with lien insofar as it is a broader term); WBQ P'ship v. Commonwealth of Va. (*In re* WBQ P'ship), 189 B.R. 97 (Bankr. E.D. Va. 1995) (cogently discussing "lien" as a subset of "interest"); *see also* Minstar, Inc. v. Plastech Research, Inc. (*In re* Arctic Enters., Inc.), 68 B.R. 71 (D. Minn. 1986) (construing "interest" under § 1141(c) to include liens).

[88]Silverman v. Ankari (*In re* Oyster Bay Cove, Ltd.), 196 B.R. 251, 255 (E.D.N.Y. 1996) ("free and clear" applied to "interests *against the property*, such as liens or mortgages" which attach to the proceeds); *In re* A. Cardi Constr. Co., 154 B.R. 403, 405 (D.R.I. 1993) (free and clear applies to tax liens for "trust fund" taxes like any other lien).

[89]Secured claims are covered by the discussion of sales free and clear of liens at *supra* notes 84-88 and accompanying text.

[90]*See, e.g.*, United Mine Workers of Am. 1992 Benefit Plan v. Leckie Smokeless Coal Co. (*In re* Leckie

tion is pervasive and is loudly defended:

> State and federal decisions holding a bankruptcy purchaser liable as a successor of the debtor are directly at odds with Congressional intent to allow a debtor to sell its assets free and clear of all claims and interests therein. This conflict poses a constitutional dilemma that must be resolved in favor of the specific provisions of the Bankruptcy Code. Absent evidence of collusion or strong public policy concerns enunciated by Congress, a bankruptcy purchaser should not be held liable for a debtor's obligations. Any further extension of successor liability in the bankruptcy context is a policy decision best implemented by Congress pursuant to its exclusive jurisdiction over the subject of bankruptcy.[91]

This interpretation also has powerful consequences, primarily the use of a

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Smokeless Coal Co.), 99 F.3d 573, 582 (4th Cir. 1996) ("Yet while the plain meaning of the phrase 'interest in such property' suggests that not all general rights to payment are encompassed by the statute, Congress did not expressly indicate that, by employing such language, it intended to limit the scope of section 363(f) to *in rem* interests, strictly defined, and we decline to adopt such a restricted reading of the statute here."); P.K.R. Convalescent Ctrs., Inc. v. Commonwealth of Va. (*In re* P.K.R. Convalescent Ctrs., Inc.), 189 B.R. 90, 94 & n.3 (Bankr. E.D. Va. 1995) ("Under a § 363(f) sale, the purchaser acquires the property free and clear of all interests. Thus, the sale extinguishes [a general unsecured creditor's] interest in the property because [general unsecured creditor's] interest attaches to the proceeds of the sale. . . . [the creditor] possesses a contingent, unsecured, nonpriority claim."). Not all courts have embraced this argument, although at least one has found another route to the same result. *See infra* notes 108-12 and accompanying text (discussing the *Fairchild Aircraft* approach and rejecting it as equally unsupported in the majority of cases). Putting aside the thorny problem of future claims, i.e. those that have not yet arisen, such as a future wrongful death action arising out of a future use of a product manufactured defectively by a debtor prepetition, the cases are fairly consistent in holding that a preplan sale can be free and clear of existing claims held by creditors that receive notice. *See, e.g.*, Walker v. Lee (*In re* Rounds), 229 B.R. 758, 763 (Bankr. W.D. Ark. 1999) ("[E]ven notwithstanding the Code's concern for finality in bankruptcy sales, it 'will not . . . protect a [buyer] . . . where no notice [was] given to the lienholder[;] [s]uch a purchaser will be held to have purchased subject to the lien.'") (citation omitted); *In re* Burd, 202 B.R. 590, 593 (Bankr. N.D. Ohio 1996) ("[A] trustee, [or] the debtor-in-possession . . . may sell properties of the estate free and clear of liens by merely complying with the notice requirements of Bankruptcy Rule 2002(a)(2), (c)(1) and can effectively conclude the sale free and clear of any liens and encumbrances of all parties who were properly notified and given an opportunity to object.").

[91]Hon. William T. Bodoh & Michelle M. Morgan, *Inequality Among Creditors: The Unconstitutional Use of Successor Liability to Create a New Class of Priority Claimants*, 4 AM. BANKR. INST. L. REV. 325 (1996). Judge Bodoh and Ms. Morgan failed to note that § 363(f)'s "specific provisions" nowhere refer to "claims." Their point based upon notions of broad federal preemption is well taken in terms of free and clear sales accomplished using § 1141(c) and a confirmed plan to vest property free and clear of prior claims. The NBRC's final report stated that whether or not § 363(f) could be used to sell property free and clear of claims was unclear under the current statute, and proposed that the matter be addressed in upcoming amendments. NBRC Report, *supra* note 9, Recommendation 2.4.12, p. 23 (October 27, 1997). The currently pending House and Senate versions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2001, H.R. 333 (engrossed in House March 1, 2001) and The Bankruptcy Reform Act of 2001, S.R.420 (engrossed in Senate March 15, 2001), do not address the matter.

preplan sale using § 363(f) to purportedly cut off successor liability that, under applicable nonbankruptcy law, could lie against the purchaser after a sale of substantially all the assets of a business.[92] Successor liability may

[92]The general rule is that a purchaser of assets for fair consideration does not become liable for the seller's liabilities, even when the purchaser purchases substantially all of the assets of the seller. *See* Schwartz v. McGraw-Edison Co., 14 Cal. App. 3d 767, 780 (1971), *disapproved*, Ray v. Alad Corp., 560 P.2d 3, 11 (Cal. 1977); Husak v. Berkel, Inc., 341 A.2d 174, 176 (Pa. Super. Ct. 1975) ("Ordinarily when one company sells or transfers all its assets to another company, the latter is not liable for the debts and liabilities of the transferor simply by virtue of its succession to the transferor's property."); Schumacher v. Richards Shear Co., 451 N.E.2d 195, 198 (N.Y. 1983) ("It is the general rule that a corporation which acquires the assets of another is not liable for the torts of its predecessor."); Dana Corp. v. LTV Corp., 668 A.2d 752, 756 (Del. Ch.) (A successor "will be exposed to liability only if a court follows some exception to the traditional rule that a transfer of assets does not pass liabilities unless the transferee agrees to assume them."), *aff'd*, 670 A.2d 1337 (Del. Super. Ct. 1995) (unpublished table decision). Absent fraudulent transfers, acquisition of all or substantially all of a company's assets is a necessary but, by itself, insufficient element for a finding of successor liability. Acheson v. Falstaff Brewing Corp., 523 F.2d 1327, 1330 (9th Cir. 1975) (finding no successor liability as purchaser had not acquired accounts, customer lists, trade names or goodwill); *see also McGraw-Edison*, 14 Cal. App. 3d at 781 (purchaser who did not acquire substantially all of a business and who paid valuable and adequate consideration was not liable in tort for defective products manufactured by a seller that continued to exist as a separate corporate entity with substantial assets to meet its debts). Where exceptions to the general rule of no-successor-liability-for-asset-purchasers are accepted, they typically require an additional element over mere acquisition of substantially all the assets of an entity to impose successor liability. *See* RESTATEMENT (THIRD) OF TORTS § 12 (1998) (collecting and discussing authorities). The findings that can constitute the additional element needed to impose successor liability on an asset purchaser include:

> (1) An express or implied assumption of liabilities in the purchase agreement. *See, e.g.*, Kessinger v. Grefco, Inc., 875 F.2d 153 (7th Cir. 1989) (asset purchaser impliedly assumed a seller's unforeseen liability for certain tort claims where the purchaser agreed "'to pay, perform and discharge all debts, obligations, contracts and liabilities'" of the seller); Schwartz v. Pillsbury, Inc., 969 F.2d 840, 845 (9th Cir. 1992) (asset purchaser that acquired franchiser did not expressly or impliedly assume seller's tort liability when acquisition agreement expressly limited obligations assumed to certain specified contracts and agreements of seller); Carlos R. Leffler, Inc. v. Hutter, 696 A.2d 157 (Pa. Super. Ct. 1997) (asset purchaser impliedly assumed a liability where other liabilities were expressly assumed); or
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> (2) A transaction amounting to a consolidation or a "*de facto* merger." *See, e.g.*, Marks v. Minn. Mining & Mfg. Co., 187 Cal. App. 3d 1429, 1435-36 (1986) (*de facto* merger found where one corporation takes all of another's assets without providing any consideration to meet the claims of the seller's creditors; four factor test for *de facto* merger: (i) the purchaser continues the same enterprise after the sale; (ii) shareholders of the seller corporation become shareholders of the purchaser; (iii) the seller liquidates; and (iv) the buyer assumes the liabilities of the seller necessary to carry on the business); Sweatland v. Park Corp., 587 N.Y.S.2d 54, 56 (App. Div. 1992) (*de facto* merger factors include continuity of ownership, liquidation of predecessor, assumption of liabilities needed to carry on the business, and continuity of management, personnel, physical location, assets and general operations); Drug, Inc. v. Hunt, 168 A. 87 (Del. 1933) (where consideration for transfer of assets was stock in transferee and transferee assumed all debts and liabilities of the transferor, there was a *de facto* merger); or
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> (3) The purchasing corporation is "merely a continuation" of the seller. *See, e.g.*, Stanford Hotel Co. v. M. Schwind Co., 181 P. 780 (Cal. 1919) ("mere continuation" successor liability may lie when: (1) no adequate consideration was given for

appear on first blush to be an interest in property because the liability *appears* to follow the property to the purchaser. However, a review of the exceptions to the general rule of no-liability-for-asset-purchasers that, taken together, constitute successor liability, reveals this to be an incorrect charac-

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the acquired assets, and (2) where one or more persons were officers, directors, or stockholders of both corporations); Bostick v. Schall's Brakes & Repairs, Inc., 725 A.2d 1232 (Pa. Super. Ct. 1999) (reversing summary judgment and remanding for determination of whether successor was established to merely continue the former corporation's operations); Turner v. Bituminous Casualty Co., 244 N.W.2d 873 (Mich. 1976) ("Continuity is the purpose, continuity is the watchword, continuity is the fact."); or

(4) The transfer of assets to the purchaser is for the fraudulent purpose of escaping liability for the seller's debts. *See, e.g.*, Reddy v. Gonzalez, 8 Cal. App. 4th 118, 122 (1992) (under uniform fraudulent transfer act actual intent and inadequate consideration are alternative requirements for successor liability based upon fraudulent transfer); Schmoll v. ACandS, Inc., 703 F. Supp. 868 (D. Or. 1988) (finding corporate restructuring was undertaken to avoid liabilities from asbestos claimants and imposing liability on transferee), *aff'd*, 977 F.2d 499 (9th Cir. 1992); *see also Husak*, 341 A.2d at 176 (using inadequate consideration paid as alternative factor implying fraudulent purpose, much like constructive fraudulent conveyance theories of recovery); or

(5) In the seminal case of *Ray v. Alad Corp.*, 560 P.2d 3 (Cal. 1977), California's courts introduced the "product line" exception, imposing liability on an asset purchaser that continued production of the transferor's product line with the assets purchased. Since that time courts in New Jersey, Pennsylvania, Washington, Mississippi, New Mexico and New York have adopted the product line exception, and those of Ohio, Virginia, Massachusetts, Minnesota, Maine, Connecticut, New Hampshire, Iowa, Texas, Georgia, Kansas, Michigan, Missouri, Nebraska, Oklahoma, Wisconsin, North Dakota, South Dakota, Vermont, Florida, Colorado, Illinois, Oregon, and the District of Columbia have rejected it. *See* Harris v. T.I., Inc., 413 S.E.2d 605 (Va. 1992); Huff v. Shopsmith, Inc., 786 So.2d 383, 388 (Miss. 2001) (recognizing product line theory as a viable basis for recovery); Garcia v. Coe Mfg., Co., 933 P.2d 243 (N.M. 1997) (adopting product line theory from *Ray v. Alad*); Hart v. Bruno Mach. Corp., 679 N.Y.S.2d 740, 742-43 (App. Div. 1998) (applying product line theory); *accord* Dawejko v. Jorgenson Steel Co., 434 A.2d 106 (Pa. Super. Ct. 1981); *cf.* City of New York v. Charles Pfizer & Co., 688 N.Y.S.2d 23 (App. Div. 1999) (declining to adopt the product line theory of Ray v. Alad); *accord* Jordan v. Hawker Dayton Corp., 62 F.3d 29 (1st Cir. 1995) (Maine); Pesce v. Overhead Door Corp., No. 2-91-CV-00435, 1998 U.S. Dist. LEXIS 20665 (D. Conn. 1998); Griggs v. Capitol Mach. Works, Inc., 690 S.W.2d 287 (Tex. App. 1985); Bullington v. Union Tool Corp., 328 S.E.2d 726 (Ga. 1985); Stratton v. Garvey Int'l, Inc., 676 P.2d 1290 (Kan. Ct. App. 1984); Pelc v. Bendix Mach. Tool Corp., 314 N.W.2d 614 (Mich. Ct. App. 1981); Young v. Fulton Iron Works Co., 709 S.W.2d 927 (Mo. Ct. App. 1986); Jones v. Johnson Mach. and Press. Co. of Elkart, Ind., 320 N.W.2d 481 (Neb. 1982); Goucher v. Parmac, Inc., 694 P.2d 953 (Okla. Ct. App. 1984); Hamaker v. Kenwel-Jackson Mach., Inc., 387 N.W.2d 515 (S.D. 1986); *see also* Jeffrey Davis, *Cramming Down Future Claims in Bankruptcy: Fairness, Bankruptcy Policy, Due Process, and the Lessons of the Piper Reorganization*, 70 AM. BANKR. L.J. 329 (1996) (collecting cases).

terization.[93] Successor liability arises out of the *actions* of the purchaser, *not* the property itself. For example, the successor liability doctrine of express or implied assumption of liability[94] is rooted in the actions of the purchaser (agreeing or appearing to agree to assume liability). Similarly, when a de facto merger is found,[95] or mere continuation of an enterprise[96] justifies imposing successor liability, it is the purchaser's postsale conduct (in continuing the business in substantially the same form and manner) that gives rise to liability. The same is true for successor liability founded upon fraudulent transfer[97] and continued manufacture of a product line.[98] All these successor liability doctrines are grounded upon acts or implications from acts of the *purchaser*, not the property.

Further revealing the *in personam* nature of successor liability, if the assets are not sold as a unit but are nonfraudulently spread upon the wind to a variety of purchasers that put them to a variety of uses, successor liability will not lie.[99] An alternative to viewing the liability as arising out of the actions of the purchaser is to view it as arising out of the business that is conducted with the assets involved (by the purchaser). The focus of the inquiry is, again, not on the assets themselves, but on what is being done with them and by whom. Once the purchaser's conduct or the use of the assets to operate a business fits an applicable doctrine imposing successor liability, that liability is not capped at the value of the assets (unless, of course, those assets are the sole assets of the purchaser). As a result, successor liability claims are not properly viewed as *in rem* claims that can be included within the Code's term "interest" or "interest in property" or stripped off under § 363(f).[100]

Interpreting § 363(f) to allow preplan sales free and clear of claims also expands the number of cases in which such a sale can take place. Because Chapter 7 trustees operate in a nonplan environment,[101] if the power to sell free and clear of claims were confined to vesting of title under a confirmed plan and § 1141(c), trustees would not be able to conduct sales free and clear of claims.[102] Unlike most benefits created by the Code, this power to shield

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[93]*See supra* note 92 (collecting exceptions to general rule of no successor liability for purchasers of assets).

[94]*See supra* note 92 subparagraph (1).

[95]*See supra* note 92 subparagraph (2).

[96]*See supra* note 92 subparagraph (3).

[97]*See supra* note 92 subparagraph (4).

[98]*See supra* note 92 subparagraph (5).

[99]See *supra* note 92.

[100]*See* 11 U.S.C. § 363(f) (2000) (sale free and clear of "any interest"); 11 U.S.C. § 1141(c) (2000) (vesting "free and clear of all claims and interests"). *See also supra* notes 13-29 and accompanying text.

[101]11 U.S.C. §§ 701-766 (2000) (Chapter 7 is devoid of plan provisions).

[102]This, in turn, might depress the prices that trustees would realize from sales, arguably impacting negatively on unsecured creditors. This negative impact, however, is the product of correctly interpreting the statute as enacted and erasing a judicial gloss that has, perhaps, produced a windfall for unsecured

purchasers from successor liability only indirectly benefits debtors and their creditors, by arguably increasing the price that purchasers are willing to pay for the assets involved, and instead directly and substantially benefits the third-party purchaser, who may otherwise be a complete stranger to the case.[103] This expansive interpretation of § 363(f) may not just go beyond the plain language of the statute, it may be unconstitutional.[104]

a. Section 363 Only Refers to Interests and, Properly Viewed, a Claim is Not an Interest

Outside of bankruptcy, an unsecured claim, including a successor liability claim, has no relationship to any of the debtor's property unless it is sold fraudulently or as an enterprise. It is, therefore, merely an *in personam* claim against the debtor, unless, by virtue of being sold as a business unit, applicable nonbankruptcy law "tags" the purchaser with the liabilities of the seller, in which case it is an *in personam* claim against the purchaser as well.[105] It can be converted into an *in rem* secured claim by agreement or through the

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creditors. This windfall has largely been small to nonexistent as distributions to unsecured creditors in Chapter 7 cases are so small that it is questionable whether, from that perspective, the cost of the Chapter 7 system is worth it at all. *See* Marcy J. K. Tiffany, *Is Chapter 7 Cost Effective? An Analysis of Trustee Distribution Statistics in Region 16 for Calender Year 1996*, 25 CAL. BANKR. J. 33, 40-41 (1999) ("It thus follows that an enormously disproportionate percentage of governmental resources are being devoted to administering a huge number of cases that, overall, return relatively little to unsecured creditors. . . . In a very real sense, the administration of a large number of relatively small Chapter 7 asset cases results in little more than wealth redistribution, not from the debtors to their creditors, but from the unsecured creditors to the trustees, attorneys, and other professionals who administer the cases.").

[103]One reviewer of an earlier draft of this Article speculated that, based upon economic theory, a purchaser should be willing to pay more for the property free from liability than they would otherwise, and that the higher purchase price would benefit creditors. Theoretically, and assuming something approaching a perfect market, this is true. In the author's experience, however, outside of the mass tort case, this is not the case in practice. The ability to sell free and clear has the primary effect of enticing a purchaser to consider a transaction that might otherwise be ignored because it has too much "hair" on it. Once the purchaser entertains the transaction, little value is, at least expressly, attributed to the free and clear nature of the sale. Further, the bankruptcy sale process is not a perfect market in any sense. There is no perfect information, no multitude of willing buyers and sellers, and no absence of a compulsion to buy or sell. The process is often controlled by insiders and secured creditors who, in reality, have other things on their minds than increasing returns to unsecured creditors. This, combined with the use of blanket liens in prepetition secured financing means that whatever excess value the purchaser does attribute to the free and clear nature of the sale will generally not trickle down below the ranks of the secured creditors and administrative claimants. The one exception to this would be in precisely the area where it is fairly clear that the free and clear process cannot shield the purchaser: future claims. *See infra* notes 121 & 123 and accompanying text (discussing early view that future claims could be cut off and more recent and better reasoned view that they cannot be cut off consistent with due process under the current statute).

[104]Thomas E. Plank, *The Constitutional Limits of Bankruptcy*, 63 TENN. L. REV. 487, 565 (1996) ("Faced with ambiguous language, courts have also interpreted the Code to provide direct benefits to or impose harms on these third parties in the name of fostering the reorganization of an insolvent debtor. When Congress and the courts create these benefits or impose these harms in the name of the 'subject of Bankruptcies,' they exceed their constitutional authority.").

[105]Nathan F. Coco, Note, *An Examination of Successor Liability in the Post-Bankruptcy Context*, 22 J. CORP. L. 345, 353 (1997).

lawsuit-judgment-lien process of nonbankruptcy law. Until that is done, however, the claim is merely an unsecured claim, and should not properly be characterized as an interest.[106] The result should be no different inside bankruptcy absent an express statutory grant of the power to sell or vest assets free and clear of claims, like the one found in § 1141(c) that is absent in § 363(f). Because § 363(f) refers only to sales free and clear of *interests* in property, not *claims*, the preplan power of sale free and clear should not be construed to block claims of successor liability that would otherwise lie under applicable nonbankruptcy statutory and common law.[107]

b. In Practice, Sales are Free and Clear of Claims and Interests

Making the analytical leap to the conclusion that claims are a subset of interests[108] has conveniently allowed preplan sales free and clear of interests and claims under § 363(f). Alternatively, some have reasoned that, since successor liability claims are dependent upon the liability of the entity that is selling the assets, the bankruptcy court can discharge the underlying debtor liability, effectively cutting off the source of the successor's liability. As Bankruptcy Judge Clark states in his later self-vacated opinion in *In re Fairchild Aircraft Corporation*,

> . . . if the predecessor has a valid affirmative defense to the claim as of the [time of the] sale of the assets, then the suc-

[106]*Id.* at 356.

[107]*Id.* Mr. Coco notes, appropriately, the due process problems that arise when one allows § 363(f) sales to be free and clear of successor liability claims. He fails, however, to note the existence of § 1141(c) and the power to vest properly free and clear of claims under a confirmed plan. This omission leads him to the incorrect conclusion that the Bankruptcy Code can never be used to cleanse business assets of successor liability. *See id.* at 365-66. To address his valid due process concerns, however, sales free and clear of claims should properly be limited to those conducted under a confirmed plan, using § 1141's explicit grant of authority to vest free and clear of interests and claims. This would provide a better, and more due-process compliant, mechanism for addressing successor liability claims, including those of unknown claimants, than the contested-matter motion process applicable to § 363 sales. *See* Fairchild Aircraft Inc. v. Cambell (*In re* Fairchild Aircraft Corp.), 184 B.R. 910 (Bankr. W.D. Tex. 1995), *vacated by* 220 B.R. 909 (Bankr. W.D. Tex. 1998) (discussing future claim problems from a due process perspective); *see also* Frederick Tung, *Taking Future Claims Seriously: Future Claims and Successor Liability in Bankruptcy*, 49 CASE W. RES. L. REV. 435 (1999) (collecting authorities and addressing the problems posed by unknown future claims and claimants). The detailed and lengthy provisions of Bankruptcy Code §§ 1121-1129 coupled with Bankruptcy Rules 2002, 2019, 3013, and 3016-3020, provide a multi-step process that should be more than adequate to protect successor liability claimants, at least those that can be currently identified by the debtor or themselves. *See generally* Davis, *supra* note 92, ¶5 (discussing and analyzing due process concerns in confirmation process to address future claims and successor liability).

[108]The leap appears driven by the observation that successor liability rights follow the property—but this does not make it an *in rem* claim. Reviewing the development of successor liability under judge-made law, it is more a case of the claims following *the business*, not the property. *See In re* Fairchild Aircraft Corp., 184 B.R. at 920-21 ("[W]hile successor liability may give a party an alternative entity from whom to recover, the doctrine does not convert the claim to an *in rem* action running against the property being sold." Nor does the claim have an existence independent of the underlying liability of the entity that sold the assets.)

> cessor will be able to assert that same defense as a bar to liability. . . . Discharge in bankruptcy is but another affirmative defense, as would be a court-ordered sale of assets pursuant to section 363(b).[109]

Judge Clark's reasoning is persuasive, yet he too must make an unsupported analytical leap in order for a § 363(b) sale to cut off successor liability. Either the Code must provide for a discharge of the debtor upon sale of assets (it does not), or the sale process must take place under a confirmed plan in a case where the debtor is entitled to a discharge (which excludes, *inter alia*, artificial entity liquidation cases—the likely context of sales of substantially all of a business debtor's assets).[110] Whether one proceeds by the "interests-includes-claims" reasoning or this "affirmative-defense-at-time-of-sale" approach, one is making an analytical leap that is not supported by the Code's plain language to allow preplan sales free and clear of claims. Judge Clark's approach, however, does serve as additional support for effecting a sale of assets free and clear of successor liability and other claims under a confirmed plan in a case in which the debtor is entitled to a discharge. Interestingly, coupled with § 1141(c), this line of reasoning supports prosecution of reorganization cases under Chapter 11 as Congress originally intended: through the plan process, not through preplan sales.

Either approach—the inclusion of "claims" within "interests" in § 363(f) or providing the purchaser with the protection of the debtor's discharge[111]—allows purchasers to be protected from successor liability without having to navigate through the plan proposal and confirmation process that would allow use of § 1141(c)'s plain meaning to accomplish the same end.

In essence, and perhaps without intending to do so, the courts have concluded that the procedural due process that Congress determined was owed to creditors and other parties in interest faced with a sale free and clear of claims is too much.[112] The statute, as written, requires the plan confirmation process to activate the sale and vesting provisions of §§ 1123 and 1141. The

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[109]*See, e.g., id.* at 921 n.11.

[110]*See* 11 U.S.C. § 1141(d)(3) (2000).

[111]Whether application of Judge Clark's discharge-the-debtor-to-discharge-the-purchaser approach would survive a § 524(e) challenge is unknown. Section 524(e) provides that (with exceptions that are not pertinent here): "discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt." 11 U.S.C. § 524(e) (2000). No cases have been reported addressing the issue. Some courts interpret § 524 broadly, *see* Am. Hardwoods, Inc. v. Deutsche Credit Corp. (*In re* Am. Hardwoods, Inc.), 885 F.2d 621 (9th Cir. 1989); some narrowly. *See* Class Five Nevada Claimants v. Dow Corning Corp. (*In re* Dow Corning Corp.), 280 F.3d 648 (6th Cir. 2002), *pet. for cert. filed*, 70 U.S.L.W. 3726 (U.S. Apr. 29, 2002) (No. 01-1686).

[112]*See generally* Reid v. Covert, 354 U.S. 1, 75 (1957) ("[O]ne can say in fact, that the question of which specific safeguards of the Constitution are appropriately to be applied in a particular context . . . can be reduced to the issue of what process is 'due.'") (Harlan, J., concurring).

courts have accepted the mere motion practice process of Rule 4001 to effect sales free and clear of claims and interests under § 363(f). This is an interesting reversal of the traditional roles of these two bodies. Historically it has usually been Congress that has legislated inadequate process and the courts that have rejected this attempt under the rubric of lack of due process.[113]

Despite § 363(f)'s explicit reference to sales free and clear solely of "interests,"[114] these sales are commonly referred to as sales free and clear of "claims and interests."[115] Bankruptcy courts enter extensive findings of fact and conclusions of law supporting § 363(f) sale orders that commonly contain detailed provisions insulating the purchaser from liability.[116]

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[113]*See, e.g.*, McMillen v. Anderson, 95 U.S. 37, 39 (1877) (syllabus) ("Although taxes may be collected summarily and without the aid of the courts, there must be due process of some kind. It is not in the power of the legislature to make any process due process of law.").

[114]When the statute addresses claims and interests, it does so explicitly. *See, e.g.*, 11 U.S.C. § 1141(c) (2000) (property dealt with under confirmed plan of reorganization passes free and clear of "all claims and interests"); *see also* 11 U.S.C. § 1327(c) (2000) (accord). Interpreting "interest" to include "claims" makes the use of the phrase "claims and interests" two-thirds surplus, in terms of word count, both as used in the statute and as used in practice. *See infra* note 115 (containing titles of typical orders approving sale free and clear). The statute was carefully worded, and the use of specific terms should be honored. *Cf.* United States v. Ron Pair Enters., Inc., 489 U.S. 235, 242 n.5 (1989) ("When Congress wanted to restrict the application of a particular provision of the Code to [voluntary] liens, it used the term 'security interest.'").

[115]*See, e.g.*, Novon Int'l, Inc. v. Novamont S.P.A., Nos. 98-CV-0677E(F), 96-BK-15463B, 2000 W.L. 432848 (W.D.N.Y. Mar. 31, 2000) (quoting sale order referring to transfer property "free and clear of all liens, claims and encumbrances"); *In re* Einstein/Noah Bagel Corp., Nos. 00-04447-ECF-CGC and 00-04448-ECF-CGC, Order under §§ 105(a), 363(b), (f), (m), and (n), 365 and 1146(c), and Fed. R. Bankr. P. 2002, 6004, 6006, and 9014, Authorizing (A) Sale of Substantially All Assets of the Debtors Free and Clear of Liens, Claims, Encumbrances, and other Interests, (B) Assumption and Assignment of Certain Non-Residential Real Property Leases and Executory Contracts, (C) Assumption of Certain Debts, and (D) Related Relief (Bankr. D. Az. June 1, 2001) (unpublished decision) (on file with court and author) [hereinafter "Einstein/Noah Bagel Order"]; *In re* FPA Med. Mgmt., Inc., et al., No. 98-1596 (PJW) through 98-1685 (PJW), Order and Findings of Fact and Conclusions of Law, Under §§ 105, 363, 365, and 1146(c) and Fed. R. Bankr. P. 6004 and 9014, (A) Approving Asset Sale Agreement and Termination Fee In Connection Therewith, (B) Authorizing Sale of Orange Coast Assets Free and Clear of Liens, Claims, Encumbrances, and Interests, and Determining that Such Sale Is Exempt from Any Stamp, Transfer, Recording, or Similar Tax, (C) Authorizing Procedures to Reject or Assume and Assign Certain Executory Contracts and Unexpired Leases and (D) Granting Related Relief, at ¶ 5, pp. 11-12 (Bankr. D. Del. Sept. 23, 1998) (unpublished decision) (on file with court, docket n.740, and author) [hereinafter "FPA Order"]. The use of § 1146(c), which exempts transfers under a confirmed plan of reorganization from stamp and similar taxes, in preplan sale transactions is another interesting stretch—or blatant violation—of the statute, but is beyond the scope of this Article. *See In re* Automationsolutions Int'l, LLC, 274 B.R. 527 (Bankr. N.D. Cal. 2002) (striking provisions of proposed order approving sale that attempted to use § 1146(c) to avoid taxes).

[116]In practice these findings of fact and conclusions of law are drafted by the debtor's counsel and the purchaser's counsel, who insert detailed provisions to insulate their clients and themselves from liability. Consider the following finding of fact and conclusion of law from a § 363 sale order, which is typical:

> Pursuant to Bankruptcy Code sections 105(a) and 363(f), upon the closing under the Agreement, [the purchaser] shall acquire all title, right, and interest in the [purchased assets], subject only to the Assumed Liabilities (as defined in the Agreement). The [purchased assets] shall be free and clear of (a) all Encumbrances and Other Interests, and (b) all debts arising in any way in connection with any acts, or

Given the breadth of these findings and conclusions, it is preferable for the free and clear power to emanate from § 363 rather than merely relying upon § 105(a), the Bankruptcy Code's "all writs" provision[117] to protect the order and findings from vulnerability on appeal.[118] This practice is national

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> failures to act, of the Debtors or the Debtors predecessors or affiliates, claims (as that term is defined in the Bankruptcy Code), obligations, demands, guaranties, options, rights, contractual commitments, restrictions, interests, and matters of any kind and nature, whether arising prior to or subsequent to the commencement of these cases, and whether imposed by agreement, understanding, law, equity or otherwise (collectively, the "Claims"), with all such Encumbrances, Other Interests, and Claims to attach to the net proceeds of the sale of the [purchased assets] in the order of their priority, with the same validity, force, and effect which they now have as against the [purchased assets], subject to any claims and defenses the Debtors may possess with respect thereto.

FPA Order, *supra* note 115, at ¶ 5, pp. 11-12 (items in square brackets are generic references that replace specific names in the order). This free and clear language is far broader than the free and clear of interest language of Bankruptcy Code § 363(f) and the free and clear of claims and interest language of § 1141(c) even after discounting the lawyerly tendency to draft in a style of excess and repetition. *See also* Einstein/Noah Bagel Order, *supra* note 115 (substantially similar provision) accomplishing free and clear of claims result by defining "Interests" as "all liens, claims, encumbrances, and other interests," at p. 2, ln. 8-9; Precision Industries, Inc. v. Qualitech Steel SBQ, LLC, No. IPOO-0247-C-H/G, 2001 W.L. 699881, at *3 (S.D. Ind. Apr. 24, 2001) (quoting sale order provisions for sale "free and clear of all liens, claims, encumbrances and interests except [named exceptions]" and enjoining "all persons and entities holding or asserting liens, claims, encumbrances or interests" from asserting those items against, among others, the purchaser, its sucessors in interest or the assets sold). One court has recently examined the self-serving excesses of these kinds of sale comfort orders and found many of their provisions to be not only improper but unenforceable and not entitled to preclusive effect in later proceedings if they were not necessarily determined in the sale motion proceeding. *See In re* Automationsolutions Int'l, LLC, 274 B.R. 527 (Bankr. N.D. Cal. 2002). Such judicial scrutiny is both commendable and appropriate. A cynical but predictable reaction to *Automationsolutions* is that it will encourage development of a new comfort provision: a finding of fact that all findings and provisions of the order address matters that were necessarily determined in the sale motion proceeding (perhaps on the basis that, without the overreaching provisions of the comfort order and findings, the buyer would walk away from the transaction or only offer a lower price). One solution would be for bankruptcy judges to actively draft the terms of their orders, with the comment of the parties instead of the other way around.

[117]Section 105(a) provides:

> The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent abuse of process.

11 U.S.C. § 105(a) (2000).

[118]Section 105 is a fall-back equitable power provision used to plug what would otherwise be gaps in the statutory scheme, but § 105's grant of power is limited if other portions of title 11 address a subject scheme. *See* Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 206 (1988) (holding that § 105 should be used sparingly and it is not a wide-ranging grant of equitable powers); *see also* 11 U.S.C. § 524 (2000) (prohibition of discharge of debts of nondebtor entities, which would presumably include purchasers); *but see* Fairchild Aircraft Inc. v. Cambell (*In re* Fairchild Aircraft Corp.), 184 B.R. 910, 933 (Bankr. W.D. Tex. 1995) (noting that § 105 injunction can be used to block claims of successor liability but cannot bind future claimants who do not yet hold "claims" and are not part of the plan or sale process), *vacated by* 220

in scope.[119]

Thus, although there is no indication that § 363(f) was intended to be used to bar successor liability claims,[120] and it is equally clear that § 1141(c) provides a plan confirmation process to achieve this same end,[121] the dominant interpretation is that § 363(f) can be used to sell property free and clear of claims that could otherwise be assertable against the buyer of the assets under the common law doctrine of successor liability.[122] Courts have taken a similar position with regard to statutory successor liability claims[123] such as

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B.R. 909 (Bankr. W.D. Tex. 1998); *see generally* Davis, *supra* note 92, ¶ 5 (reviewing and analyzing successor liability, future claim problem, and evolution of case law in this regard).

[119]*See supra* notes 114 and 115 (discussing titles and terms of sale orders in four cases, one in Arizona, one in California, one in New York, and one in Delaware).

[120]H.R. Rep. No. 95-595 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963 (bill and Legislative history upon enactment are devoid of references to successor liability). While courts have expressed disbelief over a plain language reading of § 363(f) in terms of the scope of true property interests that can be stripped away and the hypothetical proceedings that can be used to satisfy § 363(f)(5), *see, e.g.*, Kuney, *supra* note 2, they have readily accepted a reading of the statute that includes the words "claims and" which nowhere appear in the statute. They only balk (sometimes) at the prospect of stripping off the claims of future, unidentifiable claimants on grounds of due process given the inability to give meaningful notice to those claimants. *See In re* Piper Aircraft Corp., 162 B.R. 619 (Bankr. S.D. Fla.), *aff'd* sub nom. Epstein v. Official Comm. of Undersecured Creditors (*In re* Piper Aircraft Corp.), 168 B.R. 434 (S.D. Fla. 1994), *aff'd as modified*, 58 F.3d 1573 (11th Cir. 1995); *In re Fairchild Aircraft Corp.*, 184 B.R. 910.

[121]11 U.S.C. § 1141(c) (2000); *see supra* notes 18-20 and accompanying text (use of 11 U.S.C. § 1129(b) or § 1141(c) to extinguish interests).

[122]The courts have long embraced the concept that "claims" are a subset of "interests," apparently without much thought or analysis. *See, e.g.*, Forde v. Kee-Lox Mfg. Co., 437 F. Supp. 631(W.D.N.Y. 1977) (sale free and clear bars civil rights suit based upon pre-sale conduct of business), *aff'd*, 584 F.2d 4 (2d Cir. 1978); *In re* Johns-Manville Corp., 57 B.R. 680 (Bankr. S.D.N.Y. 1986) (indemnification and contribution claims impliedly considered an interest); Am. Living Sys. v. Bonapfel (*In re* All Am. of Ashburn, Inc.), 56 B.R. 186 (Bankr. N.D. Ga. 1986) (assets had been sold free and clear of interests, including successor liability claims; collecting cases concluding that claims are a subset of interests), *aff'd*, 805 F.2d 1515 (11th Cir. 1986); Paris Mfg. Corp. v. Ace Hardware Corp. (*In re* Paris Indus. Corp.), 132 B.R. 504 (Bankr. D. Me. 1991) (remark in *dicta* that sale free and clear of future claims would be consistent with policies of the Bankruptcy Code); *but see* W. Auto Supply Co. v. Savage Arms, Inc. (*In re* Savage Indus., Inc.), 43 F.3d 714 (1st Cir. 1994) (denial of injunction to ban suit by holder of presale claim against purchaser of debtor's assets due to lack of notice to claimant and lack of showing that successor liability action posed a genuine threat to the legitimate operation of the Bankruptcy Code). The reaction of practitioners to *Savage Arms* has been predictable: increased attention to wide notice, including notice by publication, and inclusion of a self-serving finding in § 363(f) sale orders establishing the "necessity" of a bar to successor liability to consummate the sale. *See, e.g.*, 1 WEIL, GOTSHAL & MANGES LLP, REORGANIZING FAILING BUSINESSES 11-25 (ABA 1998). The one limit on sales free and clear of claims that appears to have arisen is that claimants whose claims first arise postsale will not be barred by the free and clear provisions of the sale order. *See In re* Piper Aircraft Corp., 58 F.3d 1573 (establishing "Piper Test" stating that, to be barred by sales free and clear order, claim must be based upon debtor's prepetition activities and "events occurring before confirmation [or preplan sale?] creating a relationship, such as contact, exposure, impact or privity between the claimant and the debtor's product"); *accord In re* Fairchild Aircraft Corp., 184 B.R. at 933.

[123]Significant areas of successor liability under state and federal law include sales and employment taxes, bulk sales without proper notice (U.C.C. article 6), CERCLA claims (42 U.S.C. §§ 96101 *et seq.*), and WARN Act claims (29 U.S.C. §§ 2101 *et seq.*).

employment benefit claims.[124] Section 363(f) has been used to bar tort claims that arise postsale from the use of a product manufactured presale or prepetition, although this use is questionable in light of more recent cases.[125] It was

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[124]Section 363(f) has been used successfully to avoid liability under federal labor law. *See* Steinbach v. Hubbard, 51 F.3d 843, 845 (9th Cir. 1995) (successor liability under federal labor laws generally arises when: (1) the purchaser continues operation of the business, (ii) the purchaser had notice of the potential liability, (iii) recovery from the seller is unavailable, and (iv) notions of equity and fairness support imposing liability); *but see* Chicago Truck Drivers Union (Independent) Pension Fund v. Tasemkin, Inc., 59 F.3d 48 (7th Cir. 1995) (bankruptcy proceeding was not an absolute bar to finding successor liability against new company that emerged from Chapter 7 bankruptcy with old company's assets).

In United Mine Workers of Am. 1992 Benefit Plan v. Leckie Smokeless Coal Co. (*In re* Leckie Smokeless Coal Co.), 99 F.3d 573 (4th Cir. 1996), the court held that Chapter 11 coal mine operators could sell their assets free and clear of the debtors' obligations to their workers' benefits plan, which would otherwise have passed on to the asset purchasers under the Coal Industry Retiree Health Benefit Act of 1992. In reaching that decision, the court rejected both a narrow interpretation that would "limit the scope of section 363(f) to *in rem* interests," as well as a broad interpretation recognizing an "interest" in the debtor's property "simply when one has a right to demand money from the debtor," i.e. an unsecured claim. *Id.* at 581-82. Apparently recognizing the thorny problem it was confronting and the lack of concrete guidance from the Code, legislative history or case law, the Seventh Circuit concluded by refusing to further define the words "interest in" leaving that task to future cases. *Id.* at 582. Rather than arising in the early life of the statute, where courts are likely to tread cautiously and allow categorical definitions to develop on a case-by-case basis, here the Fourth Circuit was confronting a fundamental definitional issue some seventeen years after the Bankruptcy Code was enacted. Viewing the question in the abstract, one would have expected those seventeen years to have led to a better understanding of the word "interest," to aid the court of appeals. *See also* Ninth Avenue Remedial Group v. Allis-Chalmers Corp., 195 B.R. 716 (N.D. Ind. 1996) (treating elimination of successor liability as a matter of discharging claims and concluding that all claims that could have been discharged may be stripped off in a sale free and clear); *In re* Creative Restaurant Mgmt., Inc., 141 B.R. 173 (Bankr. W.D. Mo.) (holding sale free and clear of NLRB claim was permitted), *vacated on other grounds*, 150 B.R. 232 (Bankr. W.D. Mo. 1992); Rubinstein v. Alaska Pac. Consortium (*In re* New England Fish Co.), 19 B.R. 323 (Bankr. W.D. Wash. 1982) (sale free and clear of employment discrimination and civil rights claims). The *Ninth Avenue* court's reasoning is suspect in light of the bar to discharge for liquidating noncorporeal entities such as corporations, partnerships, and limited liability companies. *See* 11 U.S.C. § 727 (2000); 11 U.S.C. § 1141(d)(3) (2000). These cases and others addressing different forms of successor liability show just how wrong or naive the court was in the *New England Fish Company* case when it stated:

> The apprehension that bankruptcy will become a convenient expedient for avoiding the successorship doctrine is not well founded. The adverse consequences of bankruptcies involving displacement of management, creditor control and liquidation hardly support the argument that employers will use bankruptcy to avoid their responsibilities . . . .

19 B.R. at 329.

[125]Cases supporting sale free and clear to bar future claims include *In re* Paris Indus. Corp., 132 B.R. 504 (D. Me. 1991) (tort claim based upon defective sled manufactured and sold by predecessor prepetition barred when asserted against purchaser of assets at 363(f) sale); *In re* All Am. of Ashburn, Inc., 56 B.R. 186; *but see In re* Savage Indus., Inc., 43 F.3d 714; Zerand-Bernal Group, Inc. v. Cox, 23 F.3d 159 (7th Cir. 1994); Chicago Truck Drivers Union (Independent) Pension Fund, 59 F.3d 48 (barring successor liability claims when the injury has not yet occurred and the claimant is not known, and thus has no opportunity to receive notice and be heard to object, is troubling and problematic). More recent decisions seemingly foreclose this application of the statute and limit the claims that can be banned on due process grounds. *See, e.g.*, Fogel v. Zell, 221 F.3d 955, 960 (7th Cir. 2000) (holding that, as to future tort claims such as product liability claims, no "claim" arises until the actual harm occurs; rejecting notion that a pedestrian

even used in the *Johns-Manville* case to support a mass tort debtor's settlement with its insurer featuring the establishment of a settlement fund by the insurer and the entry of a channeling injunction, forcing tort plaintiffs to assert their claims, if at all, against that fund.[126]

3. *Other Interests that Can Be Stripped Off in a Preplan Sale*

In cases examining more esoteric potential "interests," including those of taxing authorities, co-owners, optionees and the like, § 363(f)(5) is generally implicated in the process, because the interests are generally protected by nonbankruptcy law,[127] are not going to be consensually eliminated,[128] are not subject to satisfaction by the mere payment of money,[129] and are not subject to a good faith dispute.[130] As discussed above, § 363(f)(5) is the condition for a free and clear sale that eliminates the need for the other conditions, at least with regard to interests that can be satisfied through a money judgment over the objection of the interest-holder in a noneminent domain proceeding.[131] A state's right to recapture depreciation upon sale or change of use of

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has a contingent claim against every automobile that might hit him); *In re* Piper Aircraft Corp., 162 B.R. 619; *In re* Fairchild Aircraft Corp., 184 B.R. 910; Barbara J. Houser et al., *Mass Torts and Other Future Claims*, SB37 ALI/ABA 89 (May 1997) (collecting authorities and analyzing different approaches to the problem).

[126]MacArthur Co. v. Johns-Manville Corp. (*In re* Johns-Manville Corp.), 837 F.2d 89 (2d Cir. 1988) (§ 363(f) justifies approval of the settlement agreements between asbestos maker and its insurers that established a settlement fund, transferred or sold the insurance policies and the company's rights to indemnity and defense under those policies, and contained a channeling injunction forcing plaintiffs to assert their claims only against the settlement fund); Kane v. Johns-Manville Corp. (*In re* Johns-Manville Corp.), 843 F.2d 636 (2d Cir. 1988) (upholding confirmation of plan with similar provisions); *In re* A.H. Robins Co., 88 B.R. 742, 743 (E.D. Va. 1988) (confirming plan with channeling injunction), *aff'd sub nom.*, Menard-Sanford v. Mabey (*In re* A.H. Robins Co.), 880 F.2d 694 (4th Cir.), *cert. denied*, 493 U.S. 959 (1989). These cases and others like them dealing with channeling injunctions and nondebtor releases are beyond the scope of this Article, except to note their existence and their connection to the power to sell assets (such as insurance rights and proceeds) free and clear of claims and interests under § 363(f). Further, the problem of addressing future claims—claims arising from actions or products already taken or manufactured but which have not yet caused injury or other actionable damage—is beyond the scope of this Article, although recent courts considering that issue in reasoned, published decisions conclude that such claims cannot be addressed in a bankruptcy proceeding either in a preplan sale or one conducted under a plan of reorganization. *See generally In re* Fairchild Aircraft Corp., 184 B.R. 910.

[127]Eliminating § 363 (f)(1) as a source of sale free and clear power.

[128]Eliminating § 363(f)(2).

[129]Eliminating § 363(f)(3).

[130]Eliminating § 363(f)(4).

[131]*See* Mattingly, *supra* note 24 (arguing that exclusion of eminent domain from § 363(f) "legal or equitable proceedings" is unwarranted). Mattingly states that allowing bankruptcy courts to approve sales free and clear of any interest whatsoever could foster economic efficiency through the process of efficient breaches and restructuring of relationships based upon changed circumstances. *See id.* The wide ranging, potentially disruptive effects of such a reading that some might imagine could easily be mitigated by use of the court's § 363(e) power to adequately protect parties in interest and avoid an uncompensated and unconstitutional taking under the Fifth Amendment of the United States Constitution. *See* 11 U.S.C. § 363(e) (2000) (court "*shall*" impose adequate protection conditions on sales free and clear); Ultimate Sports Bar, Inc. v. United States, 48 Fed. Cl. 540, 549 (Fed. Cl. 2001) (denying tenant Fifth Amendment

property,[132] a debtor's homestead exemption,[133] a wife's tenancy-in-common interest,[134] a recorded right of first refusal,[135] and renters' rights to obtain

taking claim based upon debtor/landlord's rejection of lease in Chapter 11 case, stating that the "present decision is in no way intended to preclude such claims from being cognizable in this tribunal in the future. This is especially true when the judicial proceedings at issue involve bankruptcy—an area with a long-standing congressional policy to protect private property from uncompensated deprivations."); *see generally In re* Valuation Proceedings Under § 303(c) and § 306 of the Regional Rail Reorganization Act of 1973, 445 F. Supp. 994, 1001-03 (Reg'l Rail Reorg. Ct. 1977) (discussing interrelationship of bankruptcy and eminent domain powers); Midkiff v. Tom, 483 F. Supp. 62 (D. Haw. 1979) (government condemnation of land from owners that previously leased and refused to sell land to tenants upheld as part of governmental redevelopment and land reform program even though after the taking the land was immediately sold to former tenants for the condemnation price) (citing Berman v. Parker, 348 U.S. 26 (1954)) (upholding comprehensive use of eminent domain power to redevelop slums, even if this included resale of condemned land to private interests)), *rev'd*, 702 F. 2d 788 (9th Cir. 1983), *rev'd* sub nom. Haw. Housing Auth. v. Midkiff, 467 U.S. 229 (1984)). Of course, notice to interested parties would need to be adequate, a real issue in this context as those benefitted by an *in rem* interest may not otherwise appear as creditors in the debtor's schedules or records although they would seem to have sufficient presale relationships with the debtor to satisfy the *Piper* test for determining where to cut off the debtor's right to affect future claimants. *Cf. In re* Fairchild Aircraft Corp., 184 B.R. 910 (discussing notice problem in context of unknown claimants); *see generally* Reliable Elec. Co. v. Olson Constr. Co., 726 F.2d 620 (10th Cir. 1984) (due process requires adequate notice to those whose rights are to be affected in the bankruptcy proceeding). Further exacerbating the notice problem is the fast track process often used for § 363(f) sales. They are merely contested matters and approval of the sale is sought by simple motion, *see* Fed. R. Bankr. P. 4001, 6006, 9014, although in practice a two-step motion process is generally used: the first step is to preliminarily approve the opening bid and procedures, the second to approve the final buyer. *In re* The Plastic Surgery Co., No. ND 02-10980-RR through ND 02-10983-RR, Order (1) Establishing Sale Procedures for Sale of Substantially All of the Debtor's Assets, (2) Approving Termination Fee and Expense Reimbursement, (3) Setting Deadline to Object to Proposed Cure Amounts and (4) Approving Form and Manner of Notice of Cure Amounts (Bankr. C.D. Cal. May 3, 2002) (unpublished decision). Approval can be obtained in as little as twenty days, and often is granted in no more than sixty or ninety days, although this will vary with the size and complexity of the case and the degree of exigency of the "articulated business justification" for the preplan sale under § 363(b). *See* Fed. R. Bankr. P. 4003(d); *see also supra* note 30 (discussing the articulated business justification standard). If no objections are received, a hearing is not even necessary. FED. R. BANKR. P. 4003; see also 11 U.S.C. § 102(1) (2000) (defining "notice and a hearing" as including no hearing at all absent objection or if time does not permit). Unfortunately for plain-meaning academics that support a broad reading of the Bankruptcy Code and countless potential debtors yearning to be free of *in rem* interests, the courts have generally not allowed such interests to be stripped off under § 363(f). *See generally* Kuney, *supra* note 2.

[132]WBQ P'ship v. Commonwealth of Va. (*In re* WBQ P'ship), 189 B.R. 97, 99 (Bankr. E.D. Va. 1995) (free and clear sale authorized; state's right to recapture prior depreciation was an "interest" that could be reduced to a money judgement); *accord* P.K.R. Convalescent Ctrs., Inc. v. Commonwealth of Va. (*In re* P.K.R. Convalescent Centers, Inc.), 189 B.R. 90, 95 (Bankr. E.D. Va. 1995).

[133]*In re* Crabtree, 112 B.R. 420, 422 (Bankr. W.D. Okla. 1989).

[134]Gerdes v. Gerdes (*In re* Gerdes), 33 B.R. 860, 870-71 (Bankr. S.D. Ohio 1983); *but cf.* Community Nat'l Bank and Trust Co. of New York v. Persky (*In re* Persky), 134 B.R. 81 (Bankr. E.D.N.Y. 1991) (tenancy by the entireties interests are not amenable to sale under § 363(h) as such tenancy is not an undivided interest, such disposition would divest the spouse not only of an ownership interest but also a survivorship interest; and finding that § 363(h) is unconstitutional as it is beyond the scope of the Bankruptcy Clause of the United States Constitution, stating, at 103-04, "[w]e view section 363(h) as a mechanism for redistribution of wealth, infringing on the rights of third parties who are neither debtors nor creditors in favor of only creditors of the bankrupt's estate and feel that, under the Takings Clause, such an action does not meet the 'public use' requirement.").

leases under a rent stabilization law[136] have all been characterized as a sort of interest that can be stripped off as part of a sale free and clear under § 363(f).[137]

This is consistent with the overall spirit of § 363, which is one of promoting alienability of property of the estate right up to the constitutional limit of the Fifth Amendment "takings" clause, regardless of whoever else may have an interest in that property,[138] except as specifically addressed in its subsections.[139] Courts only seem to cry "foul" when they are faced with attempts to use § 363 to strip off traditional *in rem* interests that run with the land.[140] When faced with such an attempt, they constrain the definition

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[135]*In re* Fleishman, 138 B.R. 641 (Bankr. D. Mass. 1992).

[136]Cheslock-Bakker & Assocs, Inc. v. Kremer (*In re* Downtown Athletic Club of New York City), No. M-47 (JSM), 2000 WL 744126 (S.D.N.Y. June 9, 2000) (recognizing that the asserted right to obtain leases was not a "claim" under the Code's definition as it was merely a right to seek an equitable remedy, and as such the debtor's confirmation of a plan could not discharge this right, but finding that it was an "interest" and thus could be stripped off the property sold by using § 363(f) and citing, among others, *In re* Taylor, 198 B.R. 142, 162 (Bankr. D. S.C. 1996), for the proposition that "a leasehold interest is a type of 'interest' that fits within the plain text of the § 363(f)(4) statute.").

[137]There is a tension between § 363(f) and § 365(h) as applied to leases. Section 363(f), of course, provides for a sale free and clear of any interest, including a leasehold interest, if certain conditions are met. Under § 365(h), however, a tenant has the right to maintain occupancy of premises after a debtor/landlord has rejected a lease. There lies the tension. Can a debtor accomplish complete divestiture of a tenant's rights by selling free and clear when it could not achieve this same end through rejection of the lease? *Compare* Precision Indust., Inc. v. Qualitech Steel SBQ, LLC (*In re* Qualitech Steel Corp.), 2001 U.S. Dist. Lexis 8328, 2001 WL 699881 (S.D. Ind. 2001) (holding that the specific protection given lessees under § 365(h) controlled over the more general free and clear provisions of § 363(f)), *with In re* Downtown Athletic Club, 2001 WL 744126 (holding that § 365(h) applies only if the debtor retains the property and rejects the lease and § 363(f) applies to a sale free and clear). Resolution of this split of authority is beyond the scope of this Article. See also C.H.E.G., Inc. v. Millenium Bank, No. A094020, 2002 WL 1341140, 2002 Cal. App. Lexis 4307 (Cal. Ct. App. June 20, 2002) (construing sale free and clear of lease in prior bankruptcy case to have resulted in sale free and clear of broker's right to a commission when the leased property was later sold to the tenant under the lease, which contained the commission provision).

[138]Plank, *supra* note 104 at 571-72 (recognizing the expansive spirit of § 363 and concluding that the statute goes too far and is unconstitutional in that § 363(h) allows sales of nondebtor co-tenant interests in the absence of the protections of § 363(f)'s five alternative conditions).

[139]*See, e.g.,* 11 U.S.C. § 363(g) (2000) (authorizing sale free and clear of "vested right[s] in the nature of dower or courtesy [sic]"); 11 U.S.C. § 363(h) (2000) (authorizing sale free and clear of an interest as a "tenant in common, joint tenant, or tenant by the entirety" if certain conditions are met); *but see In re* Churchill Properties, III, Ltd. P'ship, 197 B.R. 283 (Bankr. N.D. Ill. 1996) (where attempted presale rejection of lease of real property was denied because of improper notice, but sale of real property proceeded, and lease was subsequently rejected, § 365(h)(1)(A)(ii) right of lessee to remain in possession trumped § 363(f) free and clear provision under rule of construction that specific and later enacted provisions—here § 365(h)—prevail over general, earlier enacted ones—here § 363(f)); *accord In re* Taylor, 198 B.R. 142, 165 (Bankr. D.S.C. 1996); *see also supra* note 137 concerning the § 363(f)/363(h) debate.

[140]*But see* Fairchild Aircraft Inc. v. Campbell (*In re* Fairchild Aircraft Corp.), 184 B.R. 910, 920 (Bankr. W.D. Tex. 1995) (grounding analysis of what can be sold free and clear of interests in property under § 363(f) in whether or not the interest is truly an *in rem* interest; if it is, the interest can be stripped off), *vacated by* 220 B.R. 909 (Bankr. W.D. Tex. 1998). This concern is properly addressed through the Code's "adequate protection" and "indubitable equivalent" requirements rather than by recharacterization of property rights as falling in or out of the definition of "interest." *See* 11 U.S.C. § 361 (2000) (adequate

of "interest" to block the sale free and clear of the *in rem* interest in contrast to their broad interpretation of "interests" to include "claims."[141]

II. THE EFFECTS OF INCLUDING "CLAIMS" WITHIN "INTERESTS" IN SECTION 363(f)

The courts' inclusion of "claims" within "interests" under § 363(f)[142] and the erosion of the bias against preplan sales of substantial groups of assets[143] has led to the use of Chapter 11 to achieve a prenegotiated sale of a business or group of assets and to protect the buyer from successor liability. Combined with the lack of any requirement of insolvency on the part of a debtor,[144] vague "you know it when you see it"[145] standards for good faith in commencing a bankruptcy case,[146] and the ability of the dominant parties to

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protection nonexclusively described); 11 U.S.C. § 363(e)(2000) (adequate protection for § 363 sales); 11 U.S.C. § 1129(b)(2)(A)(ii) (2000) (adequate protection through attachment to proceeds for sales free and clear under a plan); 11 U.S.C. § 1129(b)(2)(A)(iii) (2000) (indubitable equivalent alternative for cramdown).

[141] *See* Kuney, *supra* note 2.

[142] *See supra* notes 90-104 and accompanying text.

[143] *See supra* note 31.

[144] *In re* Johns-Manville Corp., 36 B.R. 727, 730 (Bankr. S.D.N.Y. 1984); *accord In re* Cohoes Indus. Terminal, Inc., 931 F.2d 222, 228 (2d Cir. 1991); *but see* Plank, *supra* note 104, at 545-56 (1996) (explaining that balance sheet or cash flow insolvency of the debtor is an inherent limitation on the Bankruptcy Clause); *see also* Thomas E. Plank, *Why Bankruptcy Judges Need Not and Should Not be Article III Judges*, 72 AM. BANKR. L.J. 567, 629-36 (1998) (arguing that bankruptcy judges need not be appointed for life under Article III of the U.S. Constitution so long as their activities are limited to the permissible scope of bankruptcy law, the adjustment of the insolvent debtor-creditor relationship). According to Professor Plank's research, this principle requires that a debtor may not be in bankruptcy unless he, she, or it is insolvent in either a balance sheet sense or a cash flow sense. He also notes that there was an explicit insolvency requirement under federal bankruptcy law for liquidations until 1939 and for reorganizations until 1979. The *Manville* rule—insolvency is not required—however, remains hornbook black letter law. In attempting to harmonize these two views it should be noted that in today's highly leveraged world of business, debtors can easily manipulate their balance sheets, operations and cash flow to produce the insolvency or looming insolvency that Professor Plank's view requires. *See generally* KEVIN J. DELANEY, STRATEGIC BANKRUPTCY 66-71 (Univ. Cal. Press 1988) (reviewing stream of events leading to *Johns-Manville*'s recognition, on the eve of its bankruptcy filing, of two billion dollars in contingent asbestos litigation claims that, without invoking the automatic stay by filing a bankruptcy petition, would have allowed its lenders to accelerate loans and other debts and render it balance sheet insolvent as well as unable to meet its debts as they came due).

[145] *Cf.* Jacobellis v. Ohio, 378 U.S. 184, 197 (1964) (Stewart, J., concurring, discussing difficulty of concrete definition of obscenity).

[146] The test for good faith is "whether a debtor is attempting to unreasonably deter and harass creditors or attempting to effect a speedy, efficient reorganization on a feasible basis." *In re* Marsch, 36 F.3d 825, 828 (9th Cir. 1994) (citing *In re* Arnold, 806 F.2d 937, 939 (9th Cir. 1986)). Good faith is lacking "only where the debtors' actions are a clear abuse of the bankruptcy process." *Arnold*, 806 F.2d at 939 (existence of good faith depends on amalgam of factors and not upon a specific fact); *In re* Thirtieth Place Inc., 30 B.R. 503, 505 (B.A.P. 9th Cir. 1983) (good faith cannot be denied where it is evident that Debtor is attempting to effect a speedy efficient reorganization on a feasible basis). The ovular case of *In re* Little Creek Dev. Co., 779 F.2d 1068, 1073 (5th Cir. 1986), identified ten common conditions indicating bad faith, generally aimed at single asset real estate cases, but which are, unfortunately, exhibited by most real

create a business justification for a quick sale,[147] 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.[148] Some counsel already generally advise purchasers[149] of those businesses that the preferred method of acquisition is through a quick Chapter 11 case featuring a prenegotiated asset purchase agreement and a preplan § 363(f) sale free and clear. Indeed, it may already be malpractice not to at least advise clients of the potential benefits of this process in many circumstances.

A. THE EFFECTS ON PRINCIPAL STAKEHOLDERS

Before embracing or condemning this trend, one must determine whose ox, if anyone's, is being gored by the practice.[150] The principle stakehold-

property owning entities at one time or another, whether financially strapped or not, whether commercial or not.

[147]*Cf.* Wolf v. Weinstein, 372 U.S. 633, 642 (1963) ("one who exercises control over a reorganization plan holds a post which might tempt him to affect or influence corporate policies—even the shaping of the very plan of reorganization—for the benefit of his own security holdings but to the detriment of the Debtor's interests and those of its creditors and other interested groups.").

[148]*See* John Shinal, *Dead Dot-Coms Can Still Cause Havoc*, BUS. WEEK, Mar. 12, 2001, at 50 (explaining that dot-com bankruptcy filings have led to the auctioning of computer equipment at "dirt-cheap prices"); Luis Salazar, *The Difficulties Practitioners Can Face When Dealing with Dot-Com Bankruptcies*, 18 No. 1 BANKR. STRATEGIST 1 (2000) (predicting the deluge of dot-com bankruptcies); Brian L. Davidoff, *Reorganizing the Internet Company*, 37 BCD NEWS & COMMENT 5 (2001) (discussing different methods for valuing internet companies in the bankruptcy process); *Dot-Coms Filing Bankruptcy Unconventionally*, (Oct. 15, 2001) *available at* <http://www.usatoday.com/life/cyber/invest/2001/10/15/dot-com-bankruptcies.htm>.

[149]The protections afforded by conducting the transaction within a bankruptcy case are not limited to purchasers. The officers, directors, and insiders of the debtor/seller can often benefit from having the sale approved by a bankruptcy court, which can and often does enter findings of fact and conclusions of law that accompany the sale order to the effect that, among other things, the sale was for fair value and reasonably equivalent consideration; the bankruptcy case and the sale were supported by the informed business judgment of the officers and directors of the debtor, formed after reasonable inquiry under the circumstances; and that the sale is in the best interests of stockholders, creditors, and all other stakeholders. *See* George W. Kuney, *The Hijacking of Chapter 11: Secured Creditors Have Climbed The Learning Curve* (publication pending; copy on file with author) [hereinafter Kuney, *Hijacking Chapter 11*]. Findings like this are, of course, drafted by the prevailing parties to serve their own interests in defending against later claims and lawsuits. They are often justified, if at all, as a condition of closing imposed by the purchaser, who claims to want insulation from claims that could support fraudulent transfer or similar claims that could result in recission, avoidance or unwinding of the sale, or litigation that could distract the insiders of the debtor from their postsale duties to the purchaser which will hire them immediately after closing. *See generally In re* Automationsolutions Int'l, LLC, 274 B.R. 527 (Bankr. N.D. Cal. 2002) (discussing and disparaging overbroad comfort order approving sale).

[150]*Cf.* Adarand Constructors, Inc. v. Pena, 515 U.S. 200, 241 (1995) (discussing classification of racial discrimination as "benign" or "malign" and finding the distinction depends on one's perspective: whose ox is being gored or whose "eye" is that of the "beholder"); *see also* C.R. Bowles & John Egan, *The Sale of the Century or a Fraud on Creditors?: The Fiduciary Duty of Trustees and Debtors in Possession Relating to the "Sale" of the Debtors' Assets in Bankruptcy*, 28 U. MEM. L. Rev. 781 (1998) (examining impacts of mechanics of § 363 sales upon debtors' fiduciary duties and urging limits on use of control incentives,

ers[151] involved are easily categorized. First are those with a legally cognizable direct claim against or interest in the debtor or its assets: secured creditors,[152] administrative priority creditors,[153] other priority creditors,[154] general unsecured creditors,[155] landlord creditors,[156] employees with long-term employment contracts or collective bargaining agreements,[157] and

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adoption of a benefit to the estate test for stalking horse protections, and giving *bona fide* bidders standing to object to and appeal § 363 motions and orders).

[151]*See* Susan Block-Lieb, *The Logic and Limits of Contract Bankruptcy*, 2001 U. ILL. L. REV. 503, 519 (it is not enough to examine bankruptcy law from a perspective of creditor welfare; all parties affected by the debtor's financial distress should be considered in the analysis); *see generally The Corporate Stakeholder Conference*, 43 TORONTO L.J. 297-798 (1993) (series of articles examining various stakeholder constituencies of artificial business entities).

[152]Secured creditors are those that hold a security interest or lien on the debtor's property. 11 U.S.C. § 506(a) (2000). They are oversecured if they hold a lien or security interest that, because of its priority or the value of the collateral, is sufficient to ensure payment through foreclosure of the full balance of their claim, in which case they may be entitled to postpetition interest, attorneys' fees, and other costs and charges. 11 U.S.C. § 506(b) (2000); United States v. Ron Pair Enter., Inc., 489 U.S. 235 (1989) (involuntary oversecured creditors entitled to interest; voluntary oversecured creditors entitled to interest and reasonable fees, costs, and expenses provided for in their agreements). Undersecured creditors are those whose lien or security interest, because of priority or the value of the collateral, is insufficient to ensure payment of their full claim; they hold two claims, one secured up to the value of their lien and the other an unsecured deficiency claim that, generally, is classified with those of the general unsecured creditors. 11 U.S.C. § 506(a), (d) (2000).

[153]Administrative priority creditors are those with claims for administrative expenses under § 503(b) and United States Trustee fees under Chapter 123 of title 28. 11 U.S.C. § 507(a)(1) (2000). Section 503(b) administrative expenses include the postpetition actual, necessary costs and expenses of preserving the estate, including allowed fees of professionals such as attorneys and accountants, certain taxes and fines, and certain creditor or indenture trustee expenses that result in a benefit to the estate. 11 U.S.C. § 503(b) (2000).

[154]Other priority unsecured creditors include limited claims for employee wages and commissions, contributions to employee benefit plans, amounts owing to grain producers and fishermen, customer deposits for goods or services, interspousal debts such as alimony and support, additional categories of tax claims, and FDIC claims. 11 U.S.C. § 507(a)(2)-(9) (2000).

[155]General unsecured creditors are a residual class. *See* 11 U.S.C. § 726(a)(2)-(5) (2000). They are not separately defined by the Code. They include all those that are not secured creditors, priority unsecured creditors or equity holders. They include landlord creditors and long term employment contract creditors, to the extent that they are unsecured, although in this discussion those subgroups are broken out separately because of statutory maximums imposed upon their claims.

[156]Landlord creditors are general unsecured creditors to the extent that they are not secured creditors by reason of a security deposit that they hold. *See generally* Michael St. James, *Landlord Beware: Will a Security Deposit Survive a Bankruptcy?*, 26 CAL. BANKR. J. 44 (2001) (exploring scope of appropriate application of security deposit and potential for refund of same to the estate under California law). Because landlord claims for breach of a long-term lease of real property may be massive in comparison to the claims of other unsecured creditors, and because of the potential for mitigation of their future damages through re-letting of the premises involved, the Code imposes a statutory maximum on these claims. 11 U.S.C. § 502(b)(6) (2000) (limiting claims for breach of lease to the greater of the rent for one year or fifteen percent of the remaining term of the lease, plus unpaid prepetition rent).

[157]Like landlords, employees with long-term employment contracts are subject to a statutory maximum on their claims because of the potential size of the claims, the potential for mitigation of future damages, and the equity holder-like relationship of those with truly long term employment contracts. 11

equity stakeholders.[158] Second are those members of society who lack such a direct legal claim or interest in the debtor or its property, but who are nevertheless also directly affected by the transaction: the debtor's employees, suppliers, and customers; the surrounding community; and the public at large and its confidence in the judicial system.[159]

1. *Secured Creditors*

Secured creditors are little harmed by the fast-track sale approach, arguably even benefitting from it.[160] Indeed, as a practical matter, large secured creditors are often instrumental in coordinating the sale, and often consent to and support it going forward with all possible speed.[161] Even smaller secured

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U.S.C. § 502(b)(7) (2000) (limiting such claims to one year's compensation plus unpaid prepetition compensation).

[158]Although the Code treats equity holders as being "interest holders," *see, e.g.*, § 1129(b)(2)(C) (using the term for the lowest rung on the priority ladder for absolute priority rule purposes), it nowhere defines "interest." *See also* 11 U.S.C. § 101(17) (2000) ("equity security holder" means one holding an "equity security"); 11 U.S.C. § 101(16) (2000) ("equity security" means corporate shares and similar securities, limited partnership interests, or warrants or rights to purchase these items). The Code has not quite caught up to limited liability company (LLC) practice and does not define or take into account LLCs, their members or membership interests. Yet LLCs are not excluded from being debtors. *See* 11 U.S.C. § 109 (2000). In all probability, courts faced with the issue will recognize membership interests as equity interests by analogy to the existing classifications of § 101(16).

[159]*See* William M. Evan & R. Edward Freeman, A STAKEHOLDER THEORY OF THE MODERN CORPORATION: KANTIAN CAPITALISM, ETHICAL THEORY & BUSINESS 97, 101-05 (Tom L. Beauchamp & Norman E. Bowie eds., 3d ed. 1988) (arguing that the typical focus on corporate duties to "shareholders" should be shared with other "stakeholders" such as employees, suppliers, local communities and perhaps many others). The shift in the focus from shareholder to stakeholder is demonstrated by passage of statutory "corporate constituency statutes" by over half of the states in the union. Timothy L. Fort, *The Corporation as Mediating Institution: An Efficacious Synthesis of Stakeholder Theory and Corporate Constituency Statutes*, 73 NOTRE DAME L. REV. 173, 174 (1997). These statutes generally allow, but do not require, managers to take into account nonshareholder constituencies in making corporate decisions. *Id.* *See also* Richard M. Cieri et al., *Breaking Up Is Hard To Do: Avoiding the Solvency-Related Pitfalls in Spinoff Transactions*, 54 BUS. LAW. 533 n.31 (1999) (discussing constituency statutes and collecting same).

[160]*See* Kuney, *Hijacking Chapter 11*, *supra* note 149.

[161]*See id.* Some would argue that the preplan and plan sale cases of large corporations in Delaware's accommodating bankruptcy courts is a demonstration of how the Code's sale provisions have allowed bankruptcy proceedings to be dominated by secured creditors, insiders, and their counsel. It is common in these cases for the debtor to lack any substantial equity in its assets, and for the case to be commenced or continued largely to facilitate DIP-lending assisted improvement of secured creditors' position and a sale of the secured creditors' collateral as a going concern to avoid the need for state law piecemeal foreclosure proceedings. In exchange for cooperation with this process, the secured lenders allow the corporate insiders to retain their positions and salaries presale, obtain self-serving findings designed to insulate them from creditor and shareholder liability apart from insurance coverage, receive releases of all liability connected to the debtor and the case, and the opportunity to seek continued employment with the eventual purchaser. Sometimes unsecured creditors receive a pittance distribution that they would not receive in a state law foreclosure context, after the creditors' committee and its counsel are paid in full. Despite the recognition in many districts that it is an unwise use of federal resources to administer a case and conduct a sales effort solely for the benefit of secured creditors, *c.f.* U.S. Trustee Manual § 3-2.8.3.3 (Feb. 25, 2002), *available at* <http://www.usdoj.gov.ust/ustp_manual/vol3ch02.htm#3-2.8> (last visited June 4,

creditors routinely consent to a sale after assuring that the value of their collateral is reflected in the purchase price and that they will be entitled to their fair share of the proceeds. Both large and small secured creditors save costs associated with foreclosing on their collateral by, instead, having it gathered, managed, and sold by those who are the most familiar with it: the personnel of the debtor in possession. Further, the going-concern value of the collateral is likely to be higher than its piecemeal liquidation value, and that value may be further enhanced by the protection from successor liability to be enjoyed by the purchaser.[162] The bankruptcy sale transaction also benefits secured creditors by reducing collateral and noncollateral to proceeds of collateral in which a secured party has a direct interest.[163] As a result, in a § 363 sale the secured creditor can, in some instances, effectively gain a security interest in noncollateral that is sold, something it could not gain through state-law foreclosure.[164] Finally, because secured creditors maintain their secured status either through possession of the collateral or a filing with the appropriate state or federal office, their interests are of record and they generally will receive prompt notice of the proposed sale so that they can easily and effectively appear and protect their interests.

2. *Administrative Priority Creditors*

Administrative priority creditors are probably also benefitted by the fast-track process. The dominant players in this category are the United States trustee and the postpetition professionals, including the debtor's lawyers and accountants, the unsecured creditors' committee's lawyers and accountants,

2002) (the United States Trustee should be principally concerned with preserving the rights of the unsecured creditor), the practice is widespread.

[162] *See supra* notes 90-119 and accompanying text.

[163] Under the newly revised Article 9 of the U.C.C., a secured party can perfect a security interest on proceeds of property on which it cannot hold perfected security interest. U.C.C. § 9-408 (1999).

[164] An example may make this clear. Assume a television and radio station with an FCC license is financially troubled. Its assets are all subject to a blanket security interest in favor of a bank—"all," that is, but the FCC license, in which the bank cannot take a security interest. *See* 47 U.S.C.A. § 310(d) (2000) (license ownership restrictions); *In re* Merkley, 94 F.C.C.2d 829, 830 (1983) ("The Commission has consistently held that a broadcast license, as distinguished from the station's plant or physical assets, is not an owned asset or vested property interest so as to be subject to mortgage, lien, pledge, attachment, seizure, or similar property right."); *In re* D.H. Overmyer Telecasting Co. Inc., 35 B.R. 400, 401 (Bankr. N.D. Ohio 1983) ("The FCC retains continuing jurisdiction over Telecasting's license, despite the Chapter 11 proceeding"). When the station defaults, the bank cannot foreclose on the license, arguably the station's most valuable asset, as it is not its collateral. Outside of bankruptcy, the bank forecloses on all other property, the license is unused for the prescribed time and it is canceled by the FCC, resulting in no value for the secured creditor. In bankruptcy, in contrast, the bank helps the trustee sell the license (with appropriate FCC consents) and obtains a security interest in the proceeds, essentially reaping a windfall diminished only by the need to provide the trustee and counsel with a carve-out to cover their fees to induce cooperation. *See* QUEENAN § 20.19 CHAPTER 11 THEORY AND PRACTICE, SALES OF REGULATED PROPERTY, LICENSES & PERMITS ("the debtor in possession [of FCC licenses] must receive FCC approval of a proposed assignee of a broadcast license").

and the investment bankers and other brokers engaged as part of the case.[165] First, all these groups are intimately involved in the case and can be sure to receive both formal and informal notice of any potential sale. That allows them to seek full disclosure of all aspects of the transaction, negotiate carve-outs or other provisions that will designate some of the proceeds to be applied to their allowed claims for fees and costs, and enjoy inexpensive access to knowledge about the inside details and dynamics of the proposed transaction.

Second, and quite important, serving as a professional in a preplan sale case limits exposure to loss over that which can be sustained in a Chapter 11 case in which the debtor is struggling to emerge from Chapter 11 under a confirmed plan of reorganization. Especially if the sale is negotiated and documented prepetition, the professionals should know within thirty to ninety days of the petition date whether or not the sale is likely to gain court approval and be consummated. This stands in marked contrast to the plan confirmation strategy where plan confirmation can take years to achieve. Both through securing a prepetition retainer large enough to cover fees for one calendar quarter, and by monitoring and assessing how likely consummation of the sale is progressing, the professionals can protect their interests. The one negative effect for administrative priority claimants is that they lose the right to veto a transaction unless it provides for payment in full of their allowed administrative claims, which they enjoy in the plan confirmation process.[166] On balance, though, the preplan sale process appears to benefit administrative claimants.

3. *Other Priority Creditors*

To the extent that other priority creditors are affected by the increase in preplan sales, it is hard to say whether that effect is positive or negative. On the positive side, they benefit from the speed of the case, which minimizes

[165] 11 U.S.C. §§ 327-331 (2000) (employment and compensation of professionals and officers).

[166] 11 U.S.C. § 1129(a)(9) (2000). This is a powerful protection and source of leverage for administrative priority creditors that is only available in the confirmation process. *See* QUEENAN § 22.01 CHAPTER 11 THEORY AND PRACTICE 22:3 ("In Chapter 11 cases, the very success of the reorganization may depend on the nature and amount of priority claims. This is especially true with respect to administrative expense claims (§ 507(a)(1)) and the claims of so-called gap creditors in an involuntary bankruptcy case (§ 507(a)(2)). 11 U.S.C. § 507(a) (2000). These claims must be paid in full as a condition of confirmation of a plan of reorganization. If administrative expense claims are too great, confirmation (and therefore reorganization) may not be possible."). For the debtors' and committees' attorneys, it may present an ethical dilemma: insisting upon full payment on the effective date of the plan may undermine or make impossible one's clients' reorganization or recovery. *See* MODEL RULES OF PROF'L CONDUCT R. 1.3 ("A lawyer shall act with reasonable diligence and promptness in representing a client."); *see also* MODEL CODE OF PROF'L RESPONSIBILITY DR 7-101(A)(1) ("A lawyer shall not intentionally fail to seek the lawful objectives of his client."); MODEL CODE OF PROF'L RESPONSIBILITY DR 7-101(A)(3) ("A lawyer shall not intentionally . . . [p]rejudice or damage his client during the course of the relationship"). In practice the issue is most often resolved by negotiation.

administrative priority claims that are senior to them, and they benefit from whatever price enhancement is generated from the free and clear nature of the sale.[167] On the negative side, like administrative claimants, priority creditors lose the veto power that they enjoy over a plan of reorganization if their claims are not provided for as specified in § 1129(a)(9).[168] Because these creditors are lower in priority than administrative priority creditors, the impact of this lost veto is greater because it further decreases their already meager negotiating power. In the end and on balance, due to low payouts on account of unsecured claims,[169] the increased use of preplan sales transactions is mostly neutral in the case of the less-than-administrative priority creditors.

4. *General Unsecured Creditors, Landlord Creditors, and Employees with Long-Term Employment Contracts or Collective Bargaining Agreements*

Below the level of priority creditors, it is harder to assess with any degree of accuracy the impact of preplan sale procedures on distributions. On balance, however, it is probably negative, although, as with priority creditors, the speed of the case should help control administrative claims, thus benefitting unsecured creditors. First, distributions to these lower priority creditors are often extremely low in Chapter 11 cases.[170] This is so because secured creditors often use blanket liens to capture the value of all assets at the incep-

[167]Mattingly, *supra* note 24 (asserting that stripping property free and clear of interests increases value).

[168]Section 1129(a)(9) provides in pertinent part that, as a requirement for confirmation:

> Except to the extent that the holder of a particular claim has agreed to a different treatment of such claim, the plan provides that-
>
> (A) with respect to a claim of a kind specified in section 507(a)(1) or 507(a)(2) of this title, on the effective date of the plan, the holder of such claim will receive on account of such claim cash equal to the allowed amount of such claim;
>
> (B) with respect to a class of claims of a kind specified in section 507(a)(3), 507(a)(4), 507(a)(5), 507(a)6), or 507(a)(7) of this title, each holder of a claim of such class will receive-
>
> (i) if such class has accepted the plan, deferred cash payments of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or
>
> (ii) if such class has not accepted the plan, cash on the effective date of the plan equal to the allowed amount of such claim; and
>
> (C) with respect to a claim of a kind specified in section 507(a)(8) of this title, the holder of such claim will receive on account of such claim deferred cash payments, over a period not exceeding six years after the date of assessment of such claim, of a value, as of the effective date of the plan, equal to the allowed amount of such claim.

11 U.S.C. § 1129(a) (2000).

[169]*Cf.* Tiffany, *supra* note 102 (statistical analysis of distributions to unsecured creditors in Chapter 7 cases).

[170]*Cf. id.*

tion of prepetition financing or the extension of debtor in possession financing, and business entities have many different judgment-proofing strategies to employ to channel profits and value to the equity holders and insiders.[171] Theoretically, any process that decreases higher priority claims and expenses would benefit these classes, but empirical evidence has yet to be gathered showing any significant benefit.

The increase in preplan sales would appear to negatively impact the ability of these low priority creditors to meaningfully participate in the proceedings and look after their interests, to the extent they are so inclined.[172] When a debtor's business is sold preplan, these creditors lose the specific protections of § 1129, including the best-interests-of-creditors test,[173] the requirement that there be at least one consenting impaired class,[174] and the absolute priority rule.[175] Employees with collective bargaining agreements lose the protections specifically enacted for them in general, and retirees lose the protections enacted for their benefit and specifically included in the plan confirmation process.[176] Although creditors' committees and their counsel

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[171]Lynn M. LoPucki, *The Essential Structure of Judgment Proofing*, 51 STAN. L. REV. 147 (1998) (describing judgment proofing techniques including leases, secured lending instruments, sale agreements, franchise agreements, licenses, and the formation of operating subsidiaries).

[172]Lynn M. LoPucki, *The Debtor in Full Control-Systems Failure Under Chapter 11 of the Bankruptcy Code?*, 57 AM. BANKR. L.J. 247 (1983) (creditors take little interest in bankruptcy proceedings only because bankruptcy legislation has failed to provide the means for them to exercise meaningful control or to make their participation profitable).

[173]11 U.S.C. § 1129(a)(7) (2000) (a confirmable plan must provide that every creditor either accepts the plan or will receive at least as much as he would in a hypothetical liquidation).

[174]11 U.S.C. § 1129(a)(10) (2000). Because this element is not present in the preplan sale process, theoretically the debtor could proceed to sale with no support from any class of creditors. Although unlikely in practice, this is a dramatic difference from the plan process.

[175]11 U.S.C. § 1129(b)(2) (2000).

[176]11 U.S.C. § 1129(a)(13) (2000) (confirmation requirement that retiree benefits be maintained at levels prescribed by § 1114). It is interesting that Congress has not chosen to specifically include compliance with § 1113, pertaining to the process for rejecting collective bargaining agreements, in § 1129(a)'s list of conditions to confirmation. The section may be incorporated by indirect reference through § 1129(a)(1)'s requirement that the plan comply with "applicable provisions of [title 11]")—although the existence of § 1129(a)(13) incorporating § 1114 into the confirmation process argues against that result. In a recent case involving construction of an already approved asset sale, the court determined that the purchaser was bound by the terms of certain collective bargaining agreements—but only because they were part of the group of contracts assumed by the purchaser under the terms of its own purchase agreement. Tenet HealthSystem Philadelphia, Inc. v. Nat'l Union of Hosp. & Health Care Employees (*In re* Allegheny Health Educ. & Research Found.), 265 B.R. 88 (Bankr. W.D. Penn. 2001). In the face of the plain assumption language, the court refused to allow a general reference in its order and in the purchase agreement to the effect that the assets were acquired free and clear of all encumbrances to defeat the principle that contracts are assumed *in toto* or not at all. *Id.* at 101-05; 11 U.S.C. § 1114 (2000) (payment of insurance benefits to retired employees). But this does not mean that sales of substantially all assets are, *per se*, subject to collective bargaining agreements; just the opposite is true. United Food & Comm. Workers Union v. Family Snacks, Inc. (*In re* Family Snacks, Inc.), 257 B.R. 884 (B.A.P. 8th Cir. 2001) (court upholds rejection of collective bargaining agreement on theory that it was no longer needed for an effective reorganization after sale of substantially all of the debtor's assets and when the debtor was no

ensure some protections, the speed at which preplan sales proceed certainly makes it less likely that individual creditors will be able to meaningfully participate. Further, special interest groups, such as landlords and employees with long-term employment contracts generally have no committee to address their special needs and interests.[177] On balance, it is hard to see how speeding up the reorganization case increases the negotiating leverage of these creditors or provides anything but a decrease in the flow and quality of information they receive and the ability to protect their particular interests. Absent a strong showing that the values received by the estate will be enhanced sufficiently to meaningfully increase dividends to general unsecured creditors, there is nothing to outweigh those negatives.

5. *Equity Stakeholders*

Equity holders can generally be divided into three categories: insiders,[178] majority interest-holders, and minority interest-holders. There may be overlaps between these categories. Preplan sales favor these groups in the order listed when compared to the full process for proposal, solicitation, and confirmation of a reorganization plan. Again, speeding up the case and minimizing the formal disclosure that must take place, the opportunities to challenge or test the information disclosed, and the time to negotiate the terms of the deal benefits those who are on the inside of the deal and those with large stakes and correspondingly large leverage at the expense of less knowledgeable, smaller interests.[179]

6. *Employees*

To the extent that they are not priority or general unsecured creditors or equity security holders, employee self-interest lies in the promise of future employment on similar or better terms. The sale free and clear does nothing

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longer a going concern). Debtors and purchasers will run afoul of §§ 1113 and 1114, if at all, only when they include conditions for modifications and waivers of those obligations in an asset purchase agreement that provides for their assumption. *See, e.g.*, Am. Flint Glass Workers Union v. Anchor Resolution Corp., 197 F.3d 76 (3d Cir. 1999). In any event, notwithstanding §§ 1113 and 1114, it would appear that employees and retirees may be stripped of their benefits under their collective bargaining agreements and retirement plans if the business is sold as a collection of assets under § 363(b) and (f), unless the affected parties and the court are vigilant. *See, e.g., In re* Condere Corp., 228 B.R. 615 (Bankr. S.D. Miss. 1998) (court states that any objections by a union to an asset sale can be satisfied by conditioning the sale on the assumption by the debtor of the collective bargaining agreement and assignment of that agreement to the purchaser).

[177]*But see* 11 U.S.C. § 1114(d) (2000) (upon motion bankruptcy court shall appoint a committee of retired employees if the debtor seeks to modify or cancel retiree benefits).

[178]11 U.S.C § 101(31) (2000) (definition of insider).

[179]This is not a new phenomenon. In 1940 the Securities and Exchange Commission, under the leadership of Justice-to-be William O. Douglas, finished three years of study and concluded that public investors need protection from insiders in reorganization cases. Tabb, *supra* note 81, at 30 n.216 (citing S.E.C., Report on the Study and Investigation of the Work, Activities, Personal Function of Protective and Reorganization Committees, pts. 1-8 (1937-1940)).

to advance these interests. Just the opposite, by allowing sales free and clear of employee successor-liability claims that would lie under applicable non-bankruptcy law as well as free and clear of collective bargaining agreements, the sale free and clear decreases the leverage that employees would otherwise enjoy by using successor-liability claims as a point of leverage.[180]

Although many Chapter 11 reorganization cases are heralded into court at their inception with carefully-worded professions of business revitalization and job preservation after working through whatever event precipitated the bankruptcy filing, in many sale cases these announcements are made to keep the employees at their jobs, thereby preserving the going-concern value pending approval of the sale. Many purchasers also desire that the employees stay on immediately after the closing to manage the transition to new ownership. Once new management is in place, especially when the purchaser is in the same business as the debtor/seller, the workforce is often "downsized" to eliminate duplicate positions.

7. *Suppliers and Customers*

Similarly, suppliers' and customers' interests are, at best, not advanced significantly by the preplan sale procedure. As with employees, after the case is commenced, suppliers and customers are to be mollified and kept satisfied so that the going-concern value of the business can be preserved. In the case of purchase by one of the debtor's prepetition competitors, postclosing, suppliers can expect to face increased competition and customers can expect to face decreased competition, neither of which is to their benefit. Further, to the extent that suppliers enjoy favorable contracts with the debtor/seller, the buyer will not be motivated to purchase or to take these contracts by assumption and assignment. The truncated preplan sale procedure minimizes the time in which the suppliers can enjoy the benefits of their preexisting contracts.

8. *The Surrounding Community and the Public*

Any process that increases the speed of change in the rights and duties of

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[180]*See supra* note 124 and accompanying text (citing cases regarding bar of employee successor liability claims); *see also In re* Lady H Coal Co., Inc., 193 B.R. 233 (Bankr. S.D. W.Va. 1996) (court does not approve rejection of collective bargaining agreement, but does approve sale of substantially all the debtor's assets free and clear of any interest imposed by that agreement); *accord* After Six, Inc. v. Philadelphia Joint Bd. (*In re* After Six, Inc.), 1993 WL 160385 (Bankr. E.D. Pa. 1993); *accord* New York Typographical Union No. 6 v. Maxwell Newspapers, Inc. (*In re* Maxwell Newspapers, Inc.), 981 F.2d 85 (2d Cir. 1992). The preplan sale free and clear process effectively guts whatever protection would otherwise be afforded by § 1114 and § 1129(a)(13). The only argument that can be made in support of this result is that it is the same result that would follow if the liquidation of the debtor's assets were to take place in a Chapter 7 case. *See In re* Ionosphere Clubs, Inc., 134 B.R. 515 (Bankr. S.D.N.Y. 1991) (recognizing that § 1114 does not apply to Chapter 7 cases and examining whether it should apply to liquidating Chapter 11 cases and concluding that, based on its plain language, it must, even though the legislative history suggests that Congress was not thinking that Chapter 11 included liquidating cases when it enacted the statute).

various parties has the potential to decrease the meaningful participation of slow-moving bureaucracies and smaller, unrepresented portions of the community. This being the case, the preplan sale procedure holds the potential for decreased input from these groups as compared to the plan confirmation process. With the exception of governmental actors, this difference is probably minimal, since members of the public usually do not have standing to appear and be heard in the bankruptcy case unless they are creditors or interest holders.[181] There is, however, a very real danger that slow-moving government agencies that might otherwise object to or weigh in on a transaction may be unable to meaningfully participate in the process.[182] Because the sale free and clear of claims and interests will bar whatever successor-liability claims would otherwise exist in favor of the agency,[183] the preplan sale procedure speeds the elimination of recourse to the assets involved unless it arises from a presale traditional *in rem* interest that the court will not strip off.

B. Setting the Stage for Backlash

All interest groups are affected differently by the choice of a § 363(f) preplan sale free and clear of claims and most interests rather than the plan confirmation process. Further, no two cases will present the same facts or the same effects. But the general pattern emerges: The rise of the preplan sale free and clear in place of the plan confirmation process magnifies the tendency for larger creditors and those with independent inside knowledge to benefit at the expense of smaller creditors and those lacking an independent source of information about the debtor and the transaction.[184] Any increased reliance upon an expedited preplan sale procedure enhances the interests of

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[181]*In re* O'Brien Envtl. Energy, Inc., 181 F.3d 527, 531 (3d Cir. 1999); G-K Dev. Co. v. Broadmoor Place Invs., L.P. (*In re* Broadmoor Place Invs., L.P.), 994 F.2d 744, 746 n.2 (10th Cir. 1993), *cert. denied*, 510 U.S. 1071 (1994); *but see In re* Colony Hill Assocs., 111 F.3d 269, 273 (2d Cir. 1997) (holding that an exception (and standing for an otherwise non-party-in-interest bidder) exists where the unsuccessful bidder alleges that the purchaser's actions destroyed the intrinsic fairness of the sale).

[182]Of course, the United States Trustee's Office monitors the case and, if appropriate, may alert or invite participation by other governmental agencies. *See* U.S. Trustee Manual §3-1.1 (U.S. Trustee's general case monitoring duties) (Feb. 25, 2002), *available at* <http://www.usdoj.gov> (last visited June 4, 2002); *id.* at §3-4.2.4.2 (discussing overlapping roles of U.S. Trustees and Creditors' Committees); *id.* at §3-4.4.1.6 (discussing whether governmental units like the Pension Benefit Guaranty Corporation are eligible and should be invited to serve on a creditors committee).

[183]*See supra* notes 90-98.

[184]Although courts make bold pronouncements about maintaining protections for all parties—"[u]ndertaking reorganization piecemeal pursuant to § 363(b) should not deny creditors the protection they would receive if the proposals were first raised in the reorganization plan," Institutional Creditors of Cont'l Air Lines v. Cont'l Air Lines, Inc. (*In re* Cont'l Air Lines), 780 F.2d 1223 (5th Cir. 1986)—the above analysis demonstrates that this is not the case. Realistically, there is no substitute for the plan confirmation procedure that Congress initially established. Allowing short-circuits of that procedure through § 363(b) and (f) sales of substantially all the assets of a business unavoidably alters the balance of power between constituencies in Chapter 11.

insiders, their professionals, secured creditors, and those who are intimately involved with the debtor. A relatively quick preplan sale instead of the plan process makes it more likely that smaller creditors and interest holders, as well as slower moving government agencies and the public at large, will be caught unaware and unrepresented.[185]

This development is contrary to many of the fundamental policies that underlie the bankruptcy process. Bankruptcy, under any chapter of the Code, is designed to be a collective proceeding in which the interests of the stakeholders in the debtor are weighed and balanced.[186] Debtors and their insiders face extensive disclosure requirements and are subject to special scrutiny regarding prepetition transfers and dealings with the debtor as well as postpetition compensation and other transfers.[187] In Chapter 11, through the confirmation process, extensive disclosure is required prior to voting on the merits of a plan.[188] Even after this disclosure, there are a set of confirmation standards, some absolute and some flexible, that constrain the plan's terms so

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[185]*Cf.* FED. R. CIV. P. 12(a) (providing nongovernmental parties with twenty days to file answer to complaint and sixty days for government parties).

[186]*See* S. REP. NO. 95-989 (1978), *reprinted in* U.S.C.C.A.N. 5787, 5800 (providing that the Code recognizes the "three-way tension" between the general creditor's interest in recouping their investment, the debtor's interest in a fresh start, and the tax collector's interest in raising revenue); H.R. REP. NO. 95-595 (1977), *reprinted in* U.S.C.C.A.N. (recognizing that one of the myriad policies in bankruptcy is the equality of treatment of all creditors); *see also* Rosemary Williams, Annotation, *Time and Method of Valuation under 11 U.S.C. § 506, of Security Held by Creditor of Bankruptcy*, 134 A.L.R. FED. 439 (1996) ("When the Bankruptcy Code was enacted in 1978, the drafters labored long to ensure that rights and remedies provided to creditors and debtors by the statute were balanced."); Thomas H. Jackson, *The Fresh-Start Policy in Bankruptcy Law*, 98 HARV. L. REV. 1393, 1395 (1985) ("most of bankruptcy law is concerned not with defining a debtor's right of discharge, but with providing a compulsory and collective system for satisfying the claims of creditors"); *In re* Chavarria, 117 B.R. 582, 584 (Bankr. D. Idaho 1990) ("The Bankruptcy Code, by its very nature, is an attempt to balance the interests of debtors and their creditors.").

[187]*See* 11 U.S.C. § 343 (2000) (the debtor shall appear and submit to examination under oath at § 341 meeting of creditors and equity holders); 11 U.S.C. § 521 (2000) (the debtor must file a schedule of financial data and if a trustee is serving in the case, surrender to the trustee all the property of the estate and any recorded information, including books, documents, records, and papers relating to property of the estate regardless of whether immunity is granted under § 344); 11 U.S.C. § 547 (b)(4)(B) (2000) (providing that a transfer of an interest of the debtor in property made to an insider is a voidable preference if the transfer is made within one year of the petition date); 11 U.S.C. § 101 (13) (2000) (defining an "insider"); 11 U.S.C. § 1106 (2000) (a)(2)-(4) (where a trustee has been appointed, the trustee shall file the § 521 disclosures, investigate relevant data about the debtor, file a statement of investigation including any irregularity in the management of the affairs of the debtor); 11 U.S.C. § 1107 (2000) (saddling debtor in possession with § 1106 duties); 11 U.S.C. § 1125 (2000) (a disclosure statement containing adequate information enabling a hypothetical reasonable investor to make an informed judgement about the plan); 11 U.S.C. § 1129 (a)(4) and (5) (2000) (requiring disclosure and court approval of certain payments made or to be made in connection with the plan or the case along with the disclosure of the identity of any director, officer, voting trustee, or insider that will be employed or retained by the reorganized debtor and the nature of any compensation for such insider).

[188]*See* 11 U.S.C. § 1125 (2000) (court finding that disclosure statement provides "adequate information" is prerequisite to soliciting acceptances and rejections of plan).

that minimum standards of treatment for all creditors and interest holders are met, no matter how small or unrepresented they are.[189] The use of § 363(f) sales free and clear to avoid these requirements and standards undermines the original balance of the Bankruptcy Code system, tilting the bankruptcy system toward debtors, insiders, and large secured creditors.

Overuse of preplan sales free and clear to aggressively strip claims and interests from assets sold may result in a backlash against the process and, perhaps, a resurgence of hostility to preplan, reorganization-dispositive transactions in Chapter 11 cases.[190] That result would be consistent with the history of United States bankruptcy laws, which is one of a cycle of expansion of debtor relief,[191] followed by perceptions of debtors abusing the system, followed by a contraction of debtor rights and an increase in creditors' rights or even abolishment of bankruptcy, followed in turn by perceptions of creditor abuse, a need for debtor relief, and a repetition of the cycle.[192]

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[189]*See* 11 U.S.C. § 1123 (2000) (what must and may be included in a plan); 11 U.S.C. § 1125 (2000) (prohibition on solicitation of acceptances and rejections of plan until court has approved disclosure statement as containing "adequate information"); 11 U.S.C. § 1129 (2000) (confirmation standards).

[190]The shift in treatment of future claimants from *Manville* and *Robbins* to *Piper* and *Fairchild Aircraft* may presage this backlash. In *Manville* and *Robbins* the courts embraced bars to successor liability based on § 363 and § 105. MacArthur Co. v. Johns-Manville Corp. (*In re* Johns-Manville Corp.), 837 F.2d 89 (2d Cir. 1988). *Piper* and *Fairchild Aircraft*, are not so gung-ho about this proposition. *See In re* Piper Aircraft Corp. 162 B.R. 619 (Bankr. S.D. Fla.1994); *In re* Fairchild Aircraft Corp., 184 B.R. 910 (Bankr. W.D. Tex. 1995). *Cf.* Pub. L. No. 98-353 (1984) (post-*Continental Airlines* amendments to Bankruptcy Code included addition of § 1114 to legislatively overrule *Bildisco* case after outrage and lobbying following *Continental's* rejection of its collective bargaining agreement in Chapter 11).

[191]For example, from the early 1980s to the mid-1990s the doctrine of bankruptcy *uber alis* seemed to prevail. This was the era of *Manville* involving the use of a channeling injunction and the "sale" of rights under insurance policies to a trust to limit the rights of present, known creditors and future, unknown, and unrepresented creditors alike to allow the debtor to shed these liabilities and continue in business, and *Continental Airlines*, in which the case was commenced specifically to break a union's collective bargain agreement. Essentially, during this period the Bankruptcy Code apparently preempted all other law if a "valid reorganization purpose" existed. *See, e.g.*, NLRB v. Bildisco & Bildisco, 465 U.S. 526 (1984) (conflict between federal labor and bankruptcy law resolved in favor of bankruptcy law); *see generally* KEVIN J. DELANEY, STRATEGIC BANKRUPTCY (Univ. Cal. Press 1988) (detailing strategies and outcome of *Manville* and *Continental* bankruptcy cases). More recent years have seen a contraction of this trend, although some would argue that overall the Bankruptcy Code is flexibly interpreted to solve problems that society's normal economic and political institutions and marketplaces are unable to process adequately. *See* DELANEY, *supra*. The Enron debacle appears to fit this mold, and the debtor in that case is also seeking to use § 363 as a way to solve its problems, or at least reduce the issues in its reorganization and speed up its bankruptcy case. *See Enron Presents Process to Creditors' Committee for Separating Power, Pipeline Company from Bankruptcy, available at* <http://www.enron.com/corp/pressroom/releases/2002/ene/23-0050302ReleaseLtr.html> (press release of May 3, 2002).

[192]Tabb, *supra* note 81, at 16-20 (1995) (tracing ebb and flow of bankruptcy law from prerevolutionary times to 1995, noting that various pro-debtor and pro-creditor changes are historically triggered by the then-recent state of the economy and shifting perceptions of debtor or creditor abuse). A similar cycle has occurred regarding extending the automatic stay to prevent suits against codebtors such as guarantors, partners, officers, and directors. Earlier requests for codebtor stays were almost routinely granted based upon vague assertions of how the distraction caused by such suits would threaten the debtors' prospects for reorganization. *See, e.g., In re* Old Orchard Inv. Co., 31 B.R. 599, 601 (D.C. Mich. 1983) (extending

The expansive construction given to § 363(f), that assets can be sold "free and clear" of "claims," appears unlikely to change.[193] More likely, the increase in the use of Chapter 7 and 11 proceedings to effect the sale and purchase of a business or its assets will continue, with counsel and business clients increasingly using the bankruptcy process to limit exposure to unknown liabilities, and with bankruptcy courts increasingly asked to provide a shield for purchasers from the claims of the debtor's creditors.[194] In some senses, the bankruptcy system is being used to solve the problem caused by purchasers' inability to take much comfort in the representations, warranties, and indemnities of the seller of a business, whether failing or not, or of its principals. A free-and-clear order that is final and nonappealable, backed up by the Bankruptcy and Supremacy Clauses of the United States Constitution, and entitled to full faith and credit in federal and state courts across the country is an effective tool indeed. By foreclosing the claims as a matter of law, there is no need for the parties to design an effective transactional mechanism to allocate

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stay to shield partner of debtor partnership); *accord In re* Otero Mills, Inc., 25 B.R. 1018 (D.N.M. 1982); *but see, e.g., In re* Aboussie Bros. Const. Co., 8 B.R. 302, 303 (D.C. Mo. 1981) (refusing to extend stay to partners in the debtor). As a result, more routine and aggressive use of the technique spawned calls for restraint or abolishment of the practice and adoption of the traditional four-part test for a preliminary injunction for the extension of the stay to nondebtor parties. *See In re* Kalispell Feed & Grain Supply, Inc., 55 B.R. 627, 629 (Bankr. D. Mont. 1985). The result is that today such requests, when granted, are often conditioned on specific progress in the Chapter 11 case or limited in scope and duration. The National Bankruptcy Review Commission's recommendations that Congress address whether § 363 allows sales free and clear of claims and how to deal with the problem of future claims indicates that at least the most knowledgeable circles of the insolvency community recognize the lack of uniformity and potential for abuse and waste inherent in the current state of the law. *See*, NAT'L BANKR REVIEW COMM'N REP., *supra* note 9; *see also* Ralph Brubaker, *Bankruptcy Injunctions and Complex Litigation: A Critical Reappraisal of Non-Debtor Releases in Chapter 11 Reorganizations*, 1997 U. ILL. L. REV. 959 (1997) (reviewing history of codebtor stays and nondebtor releases under current and prior law and finding nondebtor releases to be without jurisdictional, theoretical, or congressional justification). Things are not that different now than in Justice Douglas' days at the SEC, *see supra* note 179. Investors and the other disadvantaged constituencies discussed in this Article need protection from insiders, including large secured creditors. *See* 11 U.S.C. §§ 101(31)(B)(iii), 101(31)(C)(v) (2000) ("insiders" of corporations and partnerships to include those in control of those entities, in the reorganization process); *see* Kuney, *Hijacking Chapter 11*, *supra* note 149. The trend toward use of preplan sales free and clear does nothing to provide this needed protection. Reversing it would.

[193]Of course, the circuit courts of appeals and the United States Supreme Court could work a sea of change of this magnitude. However, the effectiveness of § 363(m) and current "speedy close" practice in mooting appeals makes it seldom that appeals get that far. *See supra* note 32. Declaratory relief actions brought by a debtor as a precondition to a sale might present the opportunity for meaningful judicial review. *See, e.g.*, Allstate Ins. Co. v. Mercier, 913 F.2d 273, 277 (6th Cir. 1990) (a declaratory judgment may be appropriate under the Declaratory Judgment Act of 1934, 28 U.S.C. § 2201 (2000), where it will serve a useful purpose in clarifying the legal relations in dispute and it will afford relief from the uncertainty, insecurity, and controversy giving rise to the proceedings). But this is *exactly* why they are not and will not be brought.

[194]*But see* Paul Traub, *Value and Cents: Strategic Disposition of Assets - Sometimes the Best Deal Isn't on the Courthouse Steps*, 17 AM. BANKR. INST. J. 26 (Nov. 1998) (detailing benefits of nonbankruptcy strategic asset dispositions).

risk between them—§ 363(f) as interpreted eliminates the risk. The losers under this scheme are successor-liability claimants, smaller, low priority creditors, and slow-moving entities and agencies.[195] To correct this trend under the existing statute, courts should hew to the plain meaning of the statute, recognize that when Congress wanted to speak of claims and interests it did so, and that postconfirmation vesting of property free and clear of claims and interests under a confirmed and consummated plan is the proper route to achieve this end.

CONCLUSION

Reverting to the plain meaning of the statute provides a principled way to avoid a further slide away from Chapter 11's plan-confirmation focus.[196] Courts should recognize the difference between the language of § 363 and § 1141(c). The inclusion of the word "claims" in the latter section demonstrates that the Code's use of the term "interest" in the first section does not include "claims."[197] The thorny and wide-ranging issues involved in sales free and clear of claims, including those future claims that may be contingent, unrealized or unknown at the time of sale, can best be addressed, if at all, through the plan proposal and confirmation process. That process provides the opportunity to carefully examine the circumstances, identify potential claimants, and allow a deliberate determination of what form of notice and opportunity to be heard is required to address due process concerns.

Adopting this plain meaning interpretation gives effect to the intent behind §§ 363 and 1141 as enacted, as well as the plan-focused scheme of Chapter 11. It also helps to ensure that the bankruptcy process does not run roughshod over the due process rights of potential successor-liability claim holders.[198] Although it may slow some sales of legitimately distressed businesses, and may even reduce the consideration received,[199] a shift to plain meaning will provide for proper consideration of competing claims and inter-

[195]This may be yet another example of the trend towards the elimination of any real liability of incorporeal entities beyond their insurance policies. *See* Lynn M. LoPucki, *The Death of Liability*, 106 YALE L.J. 1 (1996) (arguing that American businesses are rendering themselves judgment proof because of the ease with which a modern debtor can grant secured credit, the growth of asset securitization, the availability of foreign havens for hiding assets, and the traditional ways of avoiding legal liability, such as scattering assets among subsidiaries); *but see* James J. White, *Corporate Judgment Proofing: A Response to Lynn LoPucki's The Death of Liability*, 107 YALE L.J. 1363 (1998) (arguing that American businesses are not judgment proof and pointing to data showing that public companies grant much more modest levels of security than would be necessary to become judgment proof, that most companies have lien-free assets that greatly exceed their liabilities, and that most companies carry substantial amounts of liability insurance).

[196]Alternatively, Congress could amend § 363 to incorporate the dominant (mis)interpretations discussed in this Article. *See* Kuney, *supra* note 3.

[197]*See supra* note 26 and accompanying text.

[198]*See supra* notes 91-120 and accompanying text.

[199]The largest area of impact would be on Chapter 7 sales, in which sales free and clear of claims

ests, and allow a sale free and clear of claims under plans of reorganization only when the debtor meets the Code's disclosure and confirmation requirements and when such a transaction is in the best interests of creditors as well as fair and equitable to those who do not accept the plan.[200]

Although this proposed reversion to a plain language construction of the statute would reverse the effects of the prevalent misinterpretation, the weight of authority and the roadblocks to effective appellate review of preplan sale orders make a change unlikely. The result will be the continued and increased use of the bankruptcy courts for asset dispositions and acquisitions. That is, unless Congress or the courts act to either enforce the plain language of the statute or modify the statute to provide for preplan sales that close due process gaps and successor liability loopholes that Congress did not intend.

would be impossible. *See supra* note 102. This effect, however, is likely to be negligible in terms of economic impact. *See supra* note 103.

[200]For a proposal incorporating preplan sales as an explicit alternative exit from Chapter 11, *see* Kuney, *supra* note 3.