RESPONDING TO THREATS OF BANKRUPTCY ABUSE IN A POST-ENRON WORLD: TRUSTING THE BANKRUPTCY JUDGE AS THE GUARDIAN OF DEBTOR ESTATES

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I. INTRODUCTION

The recent bankruptcy boom reached its crescendo with a string of the largest Chapter 11 filings in history.[1] As a result, bankruptcy law has become the subject of increased scrutiny. Practitioners and academics alike have focused on a number of empirical trends as evidence of the abuse and potential demise of the bankruptcy process.[2] These include

[1] Lynn M. LoPucki, *The Nature of the Bankrupt Firm: A Response to Baird and Rasmussen's* The End of Bankruptcy, 56 STAN. L. REV. 645, 646-48 (2003) (citing his Bankruptcy Research Database to substantiate that seven out of thirteen of the largest Chapter 11 filings occurred in 2002); Anthony Baldo, *2001 Review: Busted*, DAILY DEAL, Jan. 31, 2003 (discussing Enron and other abnormally large Chapter 11 cases filed in 2001).

[2] *See* Lynn M. LoPucki & Sara D. Kalin, *The Failure of the Public Company Bankruptcies in Delaware and New York: Empirical Evidence of a "Race to the Bottom,"* 54 VAND. L. REV. 231, 264 (2001) (stating that "a part of Delaware's appeal was its willingness to confirm no-questions-asked reorganizations"); *Conference on Large Chapter 11 Cases: Report of the Subcomm. on Venue-Related Matters of the Judicial Conference Comm.*

the use of Chapter 11 to sell rather than reorganize companies;[3] the solicitation of filers among debtor-oriented jurisdictions producing a potential race-to-the-bottom;[4] the premature emergence of failing companies from bankruptcy at the insistence of vulture funds;[5] and the "double-dipping" problem in the Chapter 22 context.[6] Moreover,

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on the Administration of the Bankruptcy System, 108th Cong. (2004) (discussing potential legislative and judicial solutions for combating the venue-shopping problem raised by pro-debtor jurisdictions).

[3] Douglas G. Baird & Robert K. Rasmussen, *The End of Bankruptcy*, 55 STAN. L. REV. 751, 788 (2002) (arguing that because many modern firms lack going-concern value and a capital structure required for reorganization, most companies file with the intent to dispose of assets, rather than reorganize, and since the firms that do reorganize tend to be smaller companies, the cost of providing a reorganization option outweighs its utility). *But see* LoPucki, *supra* note 1, at 646, 666 (countering that reorganizations in Chapter 11 remain more prevalent than sales and that while many companies use Chapter 11 to sell a portion of their assets, they eventually reorganize and emerge from bankruptcy at a fraction of their previous size).

[4] *See* David A. Skeel, Jr., *Lockups and Delaware Venue in Corporate Law and Bankruptcy*, 68 U. CIN. L. REV.. 1243 (2002) (exploring whether the desire to use lockup agreements in bankruptcy sales leads to forum-shopping for judges supportive of protective sales devices); Jonathan Berke, *Texas Laws Help Bankrupt Companies*, DAILY DEAL, Apr. 17, 2001 (explaining how two new Texas bankruptcy laws that help speed up bankruptcy proceedings enabled SpectraCell Laboratories Inc. to emerge from bankruptcy in only 60 days). Berke noted that Texas, along with a number of other states, enact laws to entice local businesses to file in their home state, rather than such popular pro-debtor jurisdictions as Phoenix and Delaware. *Id.*

[5] See Harvey R. Miller & Shai Y. Waisman, *Does Chapter 11 Reorganization Remain a Viable Option for Distressed Businesses for the Twenty-First Century?*, 78 AM. BANKR. L.J. 153, 181-82, 188-89 (2004) (suggesting that "consensual" plans of reorganization are anything but consensual because the debtor is so constrained by covenants entered into with lenders and compelled by debt traders to emerge from bankruptcy as soon as possible so the traders "can monetize their claim and obtain a return on their speculation").

[6] Miller and Waisman, *supra* note 5, at 188-89 (stating that judges cannot independently review plan under duress of creditors, so debtors emerge without properly reorganizing and carrying more debt than resources can support); Michael P. Richman, *Chapter 22: Synonymous with Failure of Bankruptcy System?*, DAILY BANKR. REV., Sept. 15, 2004,

commentators censure bankruptcy judges for contributing to this flagrant bankruptcy abuse through their inconsistent rulings on the use of particular sales devices.[7] These critics argue that bankruptcy judges should create bright-line rules to protect both the integrity of bankruptcy sales and party expectations.[8]

Despite this recent criticism, imposing such formalism and rigidity onto bankruptcy sales would tie the hands of bankruptcy judges.[9] The powers of bankruptcy courts must remain adaptable to the needs of each debtor, and for this reason, crafting a one-size-fits-all approach is not amenable to the bankruptcy process. As a reflection of this reality, the current bankruptcy landscape reveals one clear focus: an effort to preserve the breadth and integrity of bankruptcy judges' equitable powers of discretion. In this way, bankruptcy judges can retain the flexibility to respond to the new challenges of conducting sales in bankruptcy by adhering to the fundamental principle of maximizing the value of the bankruptcy estate.[10]

To illustrate the need to preserve judicial discretion in bankruptcy proceedings, this Note will first provide an overview of the different methods and devices for conducting

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available at http://www.abiworld.org/Content/NavigationMenu/Online_Resources/Daily_Bankruptcy_Review_Dow_Jones_/ABI_Commentary/ABI_Commentary.htm; Matt Miller, *Enabling the Insolvents*, DAILY DEAL, Oct. 3, 2002.

[7] See discussion of recent critiques of the treatment of lockup agreements and break-up fees by bankruptcy courts *infra* at Part IV.A.

[8] *See, e.g.*, Robert J. Keach, *A Hole in the Glove: Why "Negotiation" Should Trump "Solicitation,"* 22-5 AM. BANKR. INST. J. 22, 47 (2003) (arguing that the Delaware bankruptcy court's opposition to lockup agreements does not further the interests of the Code, but "will only serve to chill the very kinds of negotiations that lead to consensual plans in the best interests of creditors and other interests of the estate").

[9] *See, e.g.*, Consumer News and Bus. Channel P'ship v. Fin. News Network Inc. (*In re* Fin. News Network Inc.), 980 F.2d 165, 169 (2d Cir. 1992) (stating that "in bankruptcy proceedings substance should not give way to form, and that a bankruptcy judge's broad discretionary power in conducting the sale of a debtor's assets should not be narrowed by technical rules mindlessly followed").

[10] *In re* S.N.A. Nut Co., 186 B.R. 98, 106 (Bankr. N.D. Ill. 1995).

sales in bankruptcy, as well as the relative advantages and detriments of such structures. Second, it will delineate the various sources of power of the bankruptcy courts and the principles of the United States Bankruptcy Code (the "Code") that guide their performance in conducting bankruptcy sales. Third, this Note will survey recent bankruptcy decisions that reject bright-line rules that would jeopardize the ability of bankruptcy courts to effectuate the goals of the Code.

II. AN OVERVIEW OF ASSET SALES IN BANKRUPTCY

Chapter 11 of the Code provides two main vehicles for selling assets in bankruptcy: liquidations within reorganization plans ("in-plan sales") and out-of-plan sales defined by 11 U.S.C. § 363 ("Section 363 sales").[11] Businesses pursue sales in bankruptcy primarily to transfer assets "free and clear" of liabilities.[12] Additionally, Chapter 11 facilitates the sale of assets by enabling parties to circumvent many of the inefficiencies and controls of state and federal laws.[13] Because federal bankruptcy laws supersede state laws, a court-approved bankruptcy sale will usually bar any state

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[11] 11 U.S.C. § 1129 (2000) (authorizing bankruptcy courts to approve bankruptcy plans that fulfill the statutory requirements); 11 U.S.C. § 363(b)(1) (2000) provides that "[t]he trustee, after notice and a hearing, may use, sell or lease, other than in the ordinary course of business, property of the estate." Section 363 may be employed under Chapters 7, 11, 12, and 13. 3 COLLIER ON BANKRUPTCY ¶ 363.01 n.4 (Alan N. Resnick et al. eds., 15th rev. ed. 2005) [hereinafter COLLIER ON BANKRUPTCY] (citing 11 U.S.C. § 103(a) (2000)). When a business files a Chapter 11 petition, the business becomes the debtor-in-possession and implements the Section 363 rights in lieu of a trustee. 11 U.S.C. § 1107(a) (2000).

[12] *See* 11 U.S.C. §§ 1123(a)(5)(D), 363(f) (providing for the sale of assets "free and clear" of liabilities upon plan confirmation). Outside of bankruptcy, businesses may purchase assets individually to strip them of attendant liabilities. However, a court may consider the sale a de facto merger and transfer the seller's liabilities to the purchaser as well. *See also* Baird & Rasmussen, *supra* note 3, at 786-87 (citing Philadelphia Elec. Co. v. Hercules, Inc., 762 F.2d 303 (3d Cir. 1985)); Neil Cummings, *A Time to Buy*, DAILY DEAL, May 16, 2002. This potential remains a valid concern for businesses for a court recently declared an asset sale a de facto merger.

[13] *See* Baird & Rasmussen, *supra* note 3, at 786.

fraudulent transfer or fraudulent conveyance claims.[14] Further, the Code trumps state anti-takeover laws and reduces the risk of successor liability.[15] Also, in the federal context, parties can avoid the holdout problems associated with the Trust Indenture Act by preparing pre-packaged[16] bankruptcy plans that bind minority creditors.[17]

Chapter 11 sales are typically more efficient than non-bankruptcy sales because they require neither shareholder approval nor the exhaustive disclosure mandated by state laws for the sale of "all or substantially all" of a corporation's assets.[18] Moreover, the bankruptcy court may, in certain cases, approve a sale in the absence or in derogation of

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[14] *See* Corinne Ball & John M. Kane, *A Practical Guide to Distress M&A*, THE M&A LAWYER Nos. 7-8, at 4 (2003), *available at* http://www.glasserlegalworks.com; *but see* 11 U.S.C. §§ 544(b), 548 (2000) (providing for the recoupment of assets "fraudulently transferred" if the transaction in question was fraudulent or constructively fraudulent).

[15] *See* Ball & Kane, *supra* note 14, at 1.

[16] Baird & Rasmussen, *supra* note 3, at 788 (stating that pre-packaged bankruptcies permit creditors holding over two-thirds of outstanding claims to bind the minority creditors).

[17] Baird & Rasmussen, *supra* note 3, at 787-88 (stating that the Trust Indenture Act proscribes the collective drafting of contracts by investors and therefore frustrates "out-of-court restructuring") (citing Trust Indenture Act of 1939 § 316(b) (codified at 15 U.S.C. § 77(b) (2000))). Sales in bankruptcy are also generally exempted from documentary stamp and other federal taxes. *See* Scott J. Cousins, *Chapter 11 Asset Sales*, 27 DEL. J. CORP. L. 835, 836-37 n.5 (2002) (citing 11 U.S.C. § 1146(c)).

[18] 11 U.S.C. § 1125 (2000) does not require the debtor to comply with the proxy rules pursuant to the Securities Exchange Act of 1934 or going private rules when soliciting approval of a reorganization plan. *See* Cummings, *supra* note 12, at 1-2. Delaware corporate law provides that shareholder or board approval is unnecessary if the sale is structured and approved within a plan of reorganization. 8 DEL. CODE ANN. 303(a) (2005) (stating that "corporate action may be taken, as may be directed by such decrees or orders [of the bankruptcy court], by the trustee or trustees of such corporation . . . with like effect as if exercised and taken by unanimous action of the directors and stockholders of the corporation"). The powers to "be dissolved, transfer all or part of its assets, merge or consolidate" are listed in Section 303(b) among the actions that the trustee or debtor in possession may execute without shareholder vote and appraisal right.

creditor dissent.[19] Furthermore, because a prospective purchaser may "cherry pick" which leases and contracts to maintain, buyers may secure a formidable bargaining advantage over third parties eager to perform executory contracts.[20] Because in-plan sales[21] and Section 363 sales have different requirements and provide distinct advantages, debtors select a particular sales vehicle based on their respective needs and motivations at the time of sale.[22]

A. Selling Assets within Reorganization Plans

Chapter 11 differs from other bankruptcy filings in that it enables the debtor's management, as the debtor-in-possession ("DIP"), to retain control of business operations while developing a plan to reorganize or liquidate the company.[23] Within a plan and subject to court approval, the DIP may assign or reject executory contracts and leases, adjust or settle any claims, sell "all or substantially all of the property of the estate," restructure payment of secured and

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[19] *See* 11 U.S.C. § 1129(b)(1) (2000); *see also* Ralph R. Mabey & Patrick S. Malone, *Chapter 11 Reorganization of Utility Companies*, 22 ENERGY L.J. 277, 282 (2001) (stating that "cram down" provisions must satisfy the "absolute priorities rule," which requires that shareholders cannot receive any compensation until the dissenting creditors are paid).

[20] Ball & Kane, *supra* note 14, at 4.

[21] Sales conducted within a Chapter 11 reorganization plan will be referred to as "in-plan" sales or "plan-sales."

[22] Recent examples of Section 363 sales approved outside of a plan include American Airlines' purchase of TWA, Time Warner's purchase of GST Telecom, IDT Corp.'s purchase of Winstar Co., the UBS purchase of Enron, and Comdisco's sale to various buyers. *See* Ball & Kane, *supra* note 14, at 2.

[23] *See* CFTC v. Weintraub, 471 U.S. 343, 352, 355 (1986) (stating that the "Bankruptcy Code gives the trustee [or debtor-in-possession] wide-ranging management authority over the debtor") (citing 11 U.S.C. §§ 1108, 721 (2000)). The debtor may elect to have either a debtor in possession or a trustee orchestrate the bankruptcy proceeding. However, creditors may appoint a trustee themselves if they can show that management committed fraud or gross negligence. *See* COLLIER ON BANKRUPTCY, *supra* note 11, ¶ 1107.2 n.4 (citing instances where bankruptcy courts have dismissed a debtor in possession for breach of fiduciary duties of care or loyalty).

unsecured claims, and include "any provisions not inconsistent with the Code," as authorized by the catch-all provision of Section 1123(b)(6).[24] A majority of courts have interpreted the Code to permit liquidations within Chapter 11 as well.[25] Some courts have even approved liquidation plans that only benefited the secured creditors or a single large creditor.[26]

Upon filing a Chapter 11 petition, the debtor entity becomes the DIP and the assets of the estate pass to the DIP.[27] As a result, the DIP assumes the duty to maximize the value of the estate.[28] Concurrently, an "automatic stay" temporarily suspends any efforts by creditors to collect on existing obligations.[29] The DIP utilizes this "breathing room" to arrange a Chapter 11 strategy and obtain court approval for a plan to govern the payment of creditors as the business emerges from bankruptcy.[30] The Code provides that the DIP has the exclusive right to propose a plan within the first 120 days of filing.[31] This period enables potential buyers to develop a sale agreement with the debtor before a rigorous market for the assets has developed.[32]

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[24] 11 U.S.C. §§ 1123(b)(1)-(6) (2000); 11 U.S.C. §§ 363(b), 365(a) (2000).

[25] *See* 11 U.S.C. §§ 1123(a)(5)(D), (b)(4); § 1129(a)(11) (2000). *See also, e.g.*, Toibb v. Radloff, 501 U.S. 157, 161 (1991) ("The Code contains no ongoing business requirement for reorganization under Chapter 11."); Bartel v. Bar Harbor Airways, 196 B.R. 268, 273 (Bankr. S.D.N.Y. 1996) (holding that Section 1123(b)(4) allows the sale of assets as part of a liquidation plan).

[26] *See In re* W. Pac. Airlines, Inc., 218 B.R. 590 (Bankr. D. Colo. 1998); *In re* Staff Inv., 146 B.R. 256 (Bankr. E.D. Cal. 1993).

[27] 11 U.S.C. §§ 323, 541 (2000).

[28] *See Weintraub*, 471 U.S. at 352 (citing 11 U.S.C. §§ 704(1), 1106(a)(1) (2000)).

[29] 11 U.S.C. § 362(a) (2000). The Chapter 11 petition also halts post-petition interest from accruing on most obligations outstanding at the moment of filing. *See* Mabey & Malone, *supra* note 19, at 280-81.

[30] Assuming all technical statutory requirements are met, a court may approve a plan as long as it was "proposed in good faith and not by any means forbidden by law." 11 U.S.C § 1129(a)(3) (2000).

[31] *See* 11 U.S.C § 1121(b) (2000).

[32] Ball & Kane, *supra* note 14, at 3.

The DIP must satisfy several formal requirements before submitting a Chapter 11 plan for bankruptcy court approval. Prior to soliciting a vote from the interested parties, the DIP must seek court approval of a disclosure statement, similar to a proxy statement, detailing the terms of the proposed plan.[33] The DIP must also provide notice to creditors so that they may attend a hearing on the court's review of the disclosure statement.[34] After obtaining court approval, the DIP submits the disclosure statement and summary of the plan to the creditors.[35] In addition, plans must satisfy the "best interest of the creditors" rule, which requires that "each creditor or interest holder will receive at least as much in reorganization as it would in liquidation."[36]

Creditors ratify the plan when either the holders of at least two-thirds of the value of total outstanding claims approve or holders of more than one-half of the total claims consent.[37] Additionally, the court may confirm a plan without the voting mandate if it finds that the terms of the plan are "fair and equitable" and the plan meets the requirements of the "cram-down" provision.[38] Because the DIP has fiduciary obligations to its creditors,[39] any plan proposed must benefit the equitable interests of the creditors.[40] Moreover, the DIP must ensure that the plan

[33] 11 U.S.C. § 1125(b) (2000).

[34] *Id.*

[35] 11 U.S.C. § 1125(c) (2000).

[36] 11 U.S.C. § 1129(a)(7) (2000).

[37] 11 U.S.C. § 1126 (2000).

[38] 11 U.S.C. § 1129(b)(1) (2000) provides that a court may confirm a reorganization plan as long as the "plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan."

[39] Pepper v. Linton, 308 U.S. 295 (1939) (stating that in bankruptcy the debtor has fiduciary duties to the creditors to maximize the value of the estate).

[40] Mabey & Malone, *supra* note 19, at 278 (stating that "[o]nce a company enters bankruptcy . . . the duty of the debtor-in-possession [is] . . . to maximize the value of the bankruptcy estate primarily for the benefit of the debtor's unsecured creditors").

comports with the "absolute priority rule."[41] Bankruptcy courts may withhold approval of a plan to ensure that the DIP properly discharges its fiduciary duties and maximizes the value of the debtor's assets.[42]

B. Section 363 Sales

Section 363 of the Code enables bankruptcy courts to authorize the sale of assets free from liabilities, a power that the Supreme Court had historically recognized by implication.[43] Section 363 provides that "[t]he trustee, after notice and a hearing, may use, sell, or lease other than in the ordinary course of business, property of the estate."[44] Unless the court specifies otherwise, "the trustee may enter into transactions . . . in the ordinary course of business, without notice or a hearing, and may use property of the estate in the ordinary course of business without notice or a hearing."[45] The court may approve a sale "free and clear" of liabilities under Section 363(f) as long as the statutory criteria are

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[41] The "absolute priorities rule" provides that shareholders cannot receive any compensation until the dissenting creditors are paid. *Id.* at 282.

[42] *See* Toibb v. Radloff, 501 U.S. 157, 163 (1991) (stating that Chapter 11 "embodies the general Code policy of maximizing the value of the bankruptcy estate"); *In re* Integrated Res., Inc., 135 B.R. 746, 750 (Bankr. S.D.N.Y. 1992) ("When a debtor desires to sell an asset, its main responsibility, and the primary concern of the bankruptcy court, is the maximization of the value of the asset sold."); *In re* S.N.A. Nut Co., 186 B.R. 98, 106 (Bankr. N.D. Ill. 1995) (stating that the "goal of the bankruptcy auction . . . is to maximize the return to the estate").

[43] 3 COLLIER ON BANKRUPTCY, *supra* note 11, ¶ 363.LH (citing Van Huffel v. Harkelrode, 284 U.S. 225, 227-28 (1938) (explaining courts' power to sell certain assets, the Court states that there is "no provision which in terms confers upon bankruptcy courts the power to sell property of the bankrupt free from encumbrances . . . [but this power] must be implied from the general equity powers of the court")).

[44] Section 363 was enacted pursuant to the Bankruptcy Reform Act of 1978. If the business has filed in Chapter 11, the debtor-in-possession exercises the powers of the trustee under Section 1107(a) of the Code.

[45] 11 U.S.C. § 363(c)(1) (2000).

satisfied.[46] On the other hand, if none of the interested parties registers any objections, the trustee may close a sale even without court approval.[47]

Section 363 sales provide several advantages over sales structured within reorganization plans.[48] First, Section 363 sales tend to be cheaper and more time efficient.[49] Unlike a plan sale, Section 363 sales neither entail the plan confirmation process, which may take months or even years to complete, nor require majority creditor approval, but may be approved over creditor dissent.[50] In fact, a sale may take

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[46] The sale of assets free and clear of liabilities may be approved only if

> (1) applicable non-bankruptcy law permits sale of such property free and clear of such interest; (2) such entity consents; (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.

11 U.S.C. § 363(f). *See* EEOC v. Knox-Schillinger (*In re* Trans World Airlines, Inc.), 322 F.3d 283, 289 (3d Cir. 2003) (holding that assets may be sold free and clear of liabilities under Section 363(f) as long as the claims are "connected to, or arise from, the property being sold").

[47] 3 COLLIER ON BANKRUPTCY, *supra* note 11, ¶ 363.LH (citing H.R. REP. NO. 95-595, at 315, 95th Cong. (1st Sess. 1977)).

[48] Section 363 sales also provide certain statutory benefits, such as reducing the waiting period under the Hart-Scott-Rodino Act to fifteen days, *see* 11 U.S.C. § 363(b)(2)(B), and granting a limited exception to the filing requirements of the Securities Act of 1933. *See* 11 U.S.C. § 1145 (2000).

[49] *See* George W. Kuney, *Let's Make It Official: Adding an Explicit Preplan Sale Process as an Alternative Exit from Bankruptcy*, 40 HOUS. L. REV. 1265, 1273 (2004). In light of the advantages of Section 363 sales over sales structured within reorganization plans, Professor Kuney proposes current amendments to the Code to facilitate uniformity of non-plan sales. *Id.* at 1266-70.

[50] In-plan sales may obtain court approval in spite of the objections of certain creditors if the DIP satisfies the requirements of the cram-down provision. 11 U.S.C. § 1129(b) (2000). Section 363 sales may be conducted without creditor approval as well because the debtor often needs only to demonstrate that it has received the highest value for the assets. Particularly for auction sales, creditors and other interested parties may

place within a single hearing after the DIP has provided the requisite twenty days notice to creditors.[51] In certain cases, the DIP may accept a bid without subsequent court approval if none of the parties objects.[52] Because the DIP is not required to negotiate with what could be multiple creditor classes, and given the relative brevity of the court approval process, Section 363 sales reduce the fees and costs associated with in-plan sales because the parties may settle matters more expeditiously amongst themselves. Further, Section 363 sales may afford purchasers greater security because sales are not generally reversible on appeal.[53]

As a result of the streamlined procedural requirements of Section 363 sales, in-plan sales offer options unavailable in Section 363 sales.[54] For instance, the amount of disclosure required for in-plan sales is more extensive, and therefore

only present objections at the hearing for bidding procedures. Thereafter, the bidders are constrained by these court-approved procedures. Even at the sale hearing to approve the winning bid, disgruntled bidders are generally denied standing. Moreover, such parties generally lack standing to challenge the approval of a sale because they lack a specified interest. *See* Calpine Corp. v. O'Brien Env. Energy, Inc. (*In re* O'Brien Env. Energy, Inc.), 181 F.3d 527, 531 (3d Cir. 1999).

[51] FED. R. BANKR. P. 2002(a)(2), 9034(a). In some cases, bankruptcy courts may waive the notice requirement if necessary under the circumstances.

[52] *See* 11 U.S.C. § 363(c)(1) (2000) ("If the business of the debtor is authorized to be operated under section 721, 1108, 1203, 1204, or 1304 of this title and *unless the court orders otherwise*, the trustee may enter into transactions, including the sale or lease of property of the estate, in the ordinary course of business, without notice or a hearing, and may use property of the estate in the ordinary course of business without notice or a hearing.") (emphasis added); FED. R. BANKR. P. 2002, 6004. In discussing Section 363, the legislature stated, "If there is no objection to the proposed action, the action may go ahead without court action." H.R. REP. NO. 95-595, at 315 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6272. Nevertheless, bankruptcy courts may restrict a DIP's ability to conduct sales without court approval by including a limiting instruction in the "order authorizing operation of the business." H.R. REP. NO. 95-595, at 344-46.

[53] 11 U.S.C. § 363(m) (2000).

[54] *See* Ball & Kane, *supra* note 14, at 3; 11 U.S.C. § 1123(b) (2000). Assets sold within a reorganization plan are also exempted from certain securities laws and recording taxes.

may afford purchasers greater protection from successor liability than simple 363 sales.[55] Additionally, pursuing an in-plan sale may be advantageous because it affords the seller greater flexibility in timing an asset sale.[56] Although a debtor may be inclined to sell the assets of the company, the market may not provide a buyer willing or able to purchase the assets at a price favorable to the seller.[57] Therefore, the

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[55] *Administration of Large Business Bankruptcy Reorganizations: Has Competition For Big Cases Corrupted The Bankruptcy System?: Hearing Before the Subcomm. on Commercial and Administrative Law of the House Comm. on the Judiciary*, 108th Cong. 6 (2004) (statement of Professor Lynn M. LoPucki, Security Bank Professor of Law, UCLA School of Law). LoPucki argues that Section 363 sales are "fraught with potential for abuse" because of the lack of adequate disclosure, ability to circumvent creditor approval, and potential conflicts of interest of managers and bankers pushing for sales in order to receive kick-backs. Citing the fact that Delaware has approved sales of seven large companies in under fifty days since 1997, LoPucki contends that debtors are pushed out of bankruptcy prematurely to the detriment of the creditors and, ultimately, the debtor company itself. *Id.*

[56] *See* Harvey R. Miller & Shai Y. Waisman, *Does Chapter 11 Reorganization Remain a Viable Option for Distressed Businesses for the Twenty-First Century?*, 78 AM. BANKR. L.J. 153 (2004). Miller and Waisman delineate the continuing benefits of the reorganization option under Chapter 11 as (1) permitting debtors to marshal claims and sell assets free & clear of liabilities, which may raise purchase price; (2) where the debtor does not intend to reorganize, filing Chapter 11 often creates a market for debtor's assets; (3) bringing all interested parties to the table marshals assets and liabilities of the debtor, effecting efficient resolution of all claims, and cleansing liabilities so as to provide market for the assets and maximize shareholder recovery; (4) staying of claims so "breathing room" to provide efficient resolution; (5) noting pre-petition contracts cannot address all complexities of numerous creditors' divergent goals as the reorganization process may provide; (6) granting protections to counteract the rising power of lenders by permitting the appointment of statutory committee of unsecured creditors, a basis for re-characterization or equitable subordination of secured claims, and court approval of debtor's decision to obtain DIP financing or sell assets; and lastly, providing a forum for judges to balance public policy concerns. *Id.* at 195-99. Furthermore, where a debtor sells "all or substantially all" of the assets and does not intend to continue its existing business operations, the plan confirmation does not discharge the debtor's debts. 11 U.S.C. § 1141(d)(3)(A) (2000).

[57] *See id.* at 193.

debtor may employ the reorganization alternative and postpone the sale until market conditions have improved.[58] Furthermore, courts may be more hesitant to approve the sale of an entire business outside a plan of reorganization and thus may apply additional constraints to such sales.[59]

While the plain language of Section 363(b) allows the sale of the total assets of a company without the procedural safeguards of Chapter 11, courts have added a gloss to the statute requiring the seller to demonstrate a "good business reason" for the sale.[60] Parties do not have unfettered discretion to sell the company *in toto* under Section 363(b), and bankruptcy courts do not have "carte blanche" to approve such sales.[61] Bankruptcy courts frequently refer to the factor test used in *In re Lionel* to evaluate the seller's justification for circumventing the protections of Chapter 11.[62] Courts also refuse to approve "sub rosa" sales that exceed the scope of the "use, sale, or lease" provision under

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[58] *Id.* at 184.

[59] *See, e.g.*, *In re* Lionel Corp., 722 F.2d 1063, 1071 (2d Cir. 1983) (requiring that Section 363 sales demonstrate a "good business reason" for the sale).

[60] *Id.* (holding that creditor's insistence on a sale does not constitute a "sound business reason"). The *Lionel* court emphasized that bankruptcy judges must have "substantial freedom to tailor [their] order to meet differing circumstances." *Id.* at 1069. Courts have almost uniformly rejected the notion that parties may only conduct 363 sales in an emergency. *See* John J. Hurley, *Chapter 11 Alternative: Section 363 Sale of All of the Debtor's Assets Outside the Plan of Reorganization*, 58 AM. BANKR. L.J. 233, 241-49 (1984) (discussing the decline of the emergency requirement for selling assets outside a reorganization plan).

[61] *Lionel*, 722 F.2d at 1069.

[62] *Id.* The court prescribed a list of salient factors for a bankruptcy judge's consideration including:

> the proportionate value of the asset to the estate as a whole, the amount of elapsed time since the filing, the likelihood that a plan of reorganization will be proposed and confirmed in the near future, the effect of the proposed disposition on future plans of reorganization . . . which of the alternatives of use, sale or lease the proposal envisions and, most importantly perhaps, whether the asset is increasing or decreasing in value.

Id. at 1071.

Section 363(b) or that try to impose restrictions on future reorganization plans.[63] As bankruptcy courts are primarily concerned with maximizing the value of the assets,[64] they have also withheld approval of sales where the parties did not adequately test the initial bid on the market or where another bidder has put forward a higher offering price.[65]

C. Tools of Bankruptcy Sales

1. Sales Protection Devices: Lockup Agreements and Break-up Fees

In light of the general principle that bankruptcy sales must maximize the value of the estate, prospective purchasers acknowledge that bankruptcy courts award sales to the highest bidder.[66] Where a business intends to dispose of its assets in a Section 363 sale, the seller will often negotiate an agreement with a prospective purchaser outlining the terms of the sale prior to filing a Chapter 11 petition.[67] Before deciding to purchase a seller's assets, a potential buyer will generally invest significant resources in researching the business operations of the seller, performing

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[63] Pension Benefit Guaranty Corp. v. Braniff Airways, Inc. (*In re* Braniff Airways, Inc.), 700 F.2d 935, 939-40 (5th Cir. 1983) (stating that parties "must scale the hurdles erected in Chapter 11" before trying to dictate the terms of a reorganization plan).

[64] *See* Toibb v. Radloff, 501 U.S. 157, 163 (1991); *In re* Integrated Res., Inc., 135 B.R. 746, 750 (Bankr. S.D.N.Y. 1992); *In re* S.N.A. Nut Co., 186 B.R. 98, 106 (Bankr. N.D. Ill. 1995).

[65] *See* 1-6 COLLIER BUSINESS WORKOUT GUIDE ¶ 6.05 (Alan N. Resnick et al. eds., 15th rev. ed. 2004) [hereinafter COLLIER BUSINESS WORKOUT GUIDE] (discussing the common methods for maximizing the value of the assets as "shopping of the assets" and conducting an auction). *See infra* Part IV.C for instances where bankruptcy courts have refrained from approving a winning auction bid.

[66] *See id.* ¶ 6.05 (citing *Integrated Res.*, 135 B.R. at 750); *In re* Atlanta Packaging Prods., Inc., 99 B.R. 124, 131 (Bankr. N.D. Ga. 1988) ("It is a well-established principle of bankruptcy law that the objective of bankruptcy sales and the trustee's duty with respect to such sales is to obtain the highest price or greatest overall benefit possible for the estate."); *Toibb*, 501 U.S. at 163; *S.N.A. Nut Co.*, 186 B.R. at 98.

[67] *See* COLLIER BUSINESS WORKOUT GUIDE, *supra* note 65, ¶ 6.05.

due diligence to investigate the financial health of the company, and negotiating the terms of the sale.[68] As Professor Markell has remarked, the prospect that the bankruptcy court may select the offer of a higher bidder "gives any bankruptcy sale—regardless of whether it is by formal auction procedures—auction-like qualities."[69] For that reason, prospective bidders often seek protection for their investments in the form of lockup agreements and break-up fees.[70]

By negotiating a sale agreement prior to a bankruptcy filing, the intended bidder effectively assumes the position of a "stalking horse," a prospective purchaser that furnishes the initial bid for a sale that is later "'shopped around' to attract higher offers."[71] Although the stalking horse assumes the risk of losing the sale to another bidder, it reaps substantial benefits, including the opportunity to investigate the seller more thoroughly, establish the initial bid, and negotiate bidding procedures with the seller.[72] To further subsidize its risk, the stalking horse will oftentimes negotiate a lockup agreement with the seller.[73] Frequently, the lockup

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[68] *Id.*

[69] Bruce A. Markell, *The Case Against Breakup Fees in Bankruptcy*, 66 AM. BANKR. L.J. 349, 351 (1992).

[70] Harold S. Novikoff & Beth M. Polebaum, Lockup Agreements in Chapter 11 Cases 2 (July 14, 2003) (unpublished ALI-ABA Course Materials, on file with the Columbia Business Law Review).

[71] *Integrated Res.*, 135 B.R. at 750.

[72] COLLIER BUSINESS WORKOUT GUIDE, *supra* note 65, ¶ 6.05. The ability to influence bidding procedures is of great importance because those procedures regulate who may enter the auction and how they may participate. *See infra* Part IV.C for further discussion of bidding procedures.

[73] Novikoff & Polebaum, *supra* note 70, at 1 (defining a lockup agreement as "a written agreement entered into by parties involved in a restructuring of a debtor, which may or may not then be the subject of a Chapter 11 case, in which such parties agree to vote in favor of and/or otherwise support a particular Chapter 11 plan in exchange for inclusion of certain terms and conditions in such plan"). Because the company may exit from bankruptcy more quickly, Novikoff states that lockup agreements reduce Chapter 11 associated expenses, prevent the departure

agreement will include a "break-up fee,"[74] along with other protections within the bidding procedures, payable in the event the sale goes to another bidder.[75] As well as ensuring that the seller receives the highest offer for its assets, the use of break-up fees also promotes the establishment of a high bid early on because these devices "discourage bidding strateg[ies] designed to hold back competitive bids until later in the process."[76]

Defensive tactics introduced from corporate law, such as lockup agreements and break-up fees, have recently been adopted in bankruptcy sales.[77] In corporate mergers and acquisitions, sellers commonly include such defenses in merger agreements to protect their transactions from hostile takeovers.[78] Because of their potential to discourage otherwise willing buyers and therefore "chill bidding," courts do not simply defer to a corporate board's business judgment in utilizing such protective devices.[79] Rather, courts examine

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of valuable employees and alleviate some of the worries of trade creditors and customers while the business continues operations. *Id.*

[74] A break-up fee is a "fee paid to a potential acquiror of a business, or certain assets, by the seller, in the event that the transaction contemplated fails to be consummated and certain criteria in the purchase agreement are met . . . [and] may take the form of paying out-of-pocket expenses incurred in arranging the deal, including due diligence expenses, . . . [or] a bidder's lost opportunity costs." *Integrated Res.*, 135 B.R. at 750. *See infra* Part IV.A for a discussion of break-up fees.

[75] COLLIER BUSINESS WORKOUT GUIDE, *supra* note 65, ¶ 6.05. Collier lists additional bidding protections the parties may include, such as the timing of the sale, criteria for eligible bidders and bids, and minimum overbids.

[76] *Integrated Res*, 135 B.R. at 750.

[77] *See* Markell, *supra* note 69, at 354; Skeel, *supra* note 4, at 1268 n.89.

[78] *See* Skeel, *supra* note 4, at 1245-46.

[79] *In re* 995 Fifth Ave. Assocs., L.P., 96 B.R. 24, 28 (Bankr. S.D.N.Y. 1989) (stating that "[a] break-up fee may discourage an auction process and preclude further bidding when the fee is so large as to make competing bids too expensive") (citing Revlon Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 185 (Del. Sup. 1985)); *Integrated Res.*, 135 B.R. at 750 (noting that large break-up fees "may discourage the auction process and preclude further bidding"). The "business judgment rule" describes the standard of review for which judges evaluate the

the seller's motives for using the lockup and evaluate the reasonableness of its use.[80]

The first case to address the use of these defensive tools in bankruptcy adopted the corporate law approach to evaluating such methods.[81] In *995 Fifth Avenue Associates*, the bankruptcy court did not address whether corporate law methods were amenable to the bankruptcy context, but merely asserted that "[t]hese principles have vitality by analogy."[82] Since then, a majority of bankruptcy courts outside of the Second Circuit have rejected the perfunctory application of the business judgment rule as applied in *995 Fifth Avenue Associates* in favor of more exacting standards.[83]

2. Methods of Conducting Section 363 Sales

A debtor commonly pursues one of three methods of conducting a bankruptcy sale: a private sale, an auction sale, or an auction initiated with a "stalking horse."[84] In a private sale, a party asks the court to endorse a sale to a specific buyer for a pre-determined price.[85] If another party offers a higher price, the court may conduct an informal auction or order a hearing with all creditors.[86] In an auction sale, the court approves procedures to govern the auction and provides an opportunity for interested parties to object to such

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conduct of corporate executives and board of directors while acting in the ordinary course of business. *See Revlon*, 506 A.2d at 173.

[80] *See, e.g.*, *Integrated Res.*, 135 B.R. at 750.

[81] *995 Fifth Ave. Assocs.*, 96 B.R. at 24; *see also* Markell, *supra* note 69, at 354.

[82] *995 Fifth Ave. Assocs.*, 96 B.R. at 28; *see also* Markell, *supra* note 69, at 354-55.

[83] *See* 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 a Debtor's Assets in Bankruptcy*, 28 U. MEM. L. REV. 781, 810-19 (1998).

[84] Thomas Waldrep, Sales of Businesses in Bankruptcy 9 (Feb. 1, 2003) (unpublished article, North Carolina Bar Association) (on file with the author).

[85] *See id.* at 2-3; Markell, *supra* note 69, at 350-51.

[86] Waldrep, *supra* note 84, at 2-3; Markell, *supra* note 69, at 350-51.

procedures.[87] If the parties do not raise any objections at the hearing, they generally cannot object to these procedures during the auction.[88] In addition, any bids entered must conform to these governing rules.[89] At the conclusion of the auction, the DIP is free to accept or reject the winning bid and may then submit its selection to the judge for approval.[90]

A "stalking horse" auction is virtually identical to a private sale except that it begins with an initial bid by the stalking horse. The DIP then tests the stalking horse bid on the market by seeking out additional bidders for the auction. The process of conducting an auction generally establishes that a successful bidder has paid the fair market value for the asset.[91] Therefore, considering the tremendous emphasis that bankruptcy courts place on maximizing the value of the estate, auction sales are advisable because judges do not tend to scrutinize closely such transactions before approving the final sale.[92] In addition, the security of an auction sale is

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[87] Waldrep, *supra* note 84, at 4. Bidding procedures may include stalking horse agreements, bidder qualifications, irrevocable bids, minimum bidding increments, break-up and topping fees, deposit requirements, and matching bids. Kimberly Osenbaugh et al., *Technology Business Asset Sales in Bankruptcy* 3 (June 17, 2004), *available at* http://www.prestongates.com/images/pubs/TechnologyBusinessAsset.pdf; *see also* COLLIER BUSINESS WORKOUT GUIDE, *supra* note 65, ¶ 6.05

[88] *See, e.g.*, Bartel v. Bar Harbor Airways, 196 B.R. 268, 271-72 (Bankr. S.D.N.Y. 1996).

[89] *See infra* Part IV.C (discussing the importance of bidding procedures).

[90] The debtor may submit the sale to the judge because judicial approval may provide protection against fraudulent conveyance and fraudulent transfer claims.

[91] *See* Kermit Roosevelt, *Understanding Lockups: Effects in Bankruptcy and the Market for Corporate Control*, 17 YALE J. ON REG. 93, 121 (2000) (stating that because Section 363 sales represent sales "outside the ordinary course of business" and therefore need judicial approval, even sales conducted outside of an auction nonetheless take on "auction-like qualities").

[92] *See In re* Integrated Res., Inc., 135 B.R. 746, 750 (Bankr. S.D.N.Y. 1992) (stating that "[w]hen a debtor desires to sell an asset, its main responsibility, and the primary concern of the Bankruptcy Court, is the maximization of the value of the asset sold . . . [which] appl[ies] to the

enhanced because appellate courts review bankruptcy court confirmations with considerable deference and, therefore, disgruntled bidders are rarely successful in challenging a court-approved sale.[93] Nevertheless, courts may approve a lower offer if it is better for the debtor under the circumstances.[94]

III. SOURCES OF POWER FOR BANKRUPTCY COURTS

A. Section 105

Section 105 of the Code defines the power of bankruptcy courts and provides that judges "may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Code]."[95] The Supreme Court and numerous lower courts have cited Section 105 as providing a foundation for the "broad authority" of bankruptcy courts to exercise their equitable powers.[96] Prior

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outright purchase of a debtor or its primary assets, as well as the effective acquisition of a debtor through the funding of a plan of reorganization").

[93] *See In re* Abbotts Dairies of Pa., Inc., 788 F.2d 143, 149 (3d Cir. 1986) (stating that an "auction may be sufficient to establish that one has paid 'value' for the assets of a bankrupt").

[94] *See* Consumer News and Bus. Channel P'ship v. Fin. News Network Inc. (*In re* Fin. News Network Inc.), 980 F.2d 165, 169-70 (2d Cir. 1992) (Bankruptcy courts have broad flexibility in determining which of the several bidders should be deemed the successful bidder at a Section 363(b) sale.); *In re* After Six, Inc., 154 B.R. 876, 882 (Bankr. E.D. Pa. 1993). *See also infra* Part IV.C for discussion on the finality of auction sales.

[95] 11 U.S.C. § 105(a) (2000). The Code was enacted pursuant to the Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 and resides in Title 11 of the United States Code. *See* Daniel B. Bogart, *Resisting the Expansion of Bankruptcy Court Power Under Section 105 of the Bankruptcy Code: The All Writs Act and an Admonition from Chief Justice Marshall*, 35 ARIZ. ST. L.J. 793 n.1 (2003).

[96] United States v. Energy Res. Co., 495 U.S. 545, 549 (1990). *See also* 1 COLLIER ON BANKRUPTCY, *supra* note 11, ¶ 105.01 (stating that Section 105 is an "omnibus provision" that serves as "the basis for a broad exercise of power in the administration of a bankruptcy case"). Some commentators dispute whether bankruptcy courts possess equitable powers at all. *See* Bogart, *supra* note 95, at 803-04; Marcia S. Krieger, *"The Bankruptcy Court is a Court of Equity": What Does That Mean?*, 50

to the enactment of the Code, the Bankruptcy Act of 1978 contained a provision similar to Section 105, which allowed bankruptcy courts "to make such orders . . . as may be *necessary* for the enforcement of the provisions of the Act."[97] When Congress enacted Section 105, it broadened the authority of bankruptcy courts to make such orders where "necessary or appropriate."[98] Since its enactment, Congress has continued to amend Section 105 to increase the power of bankruptcy courts to "control their dockets and manage cases pending before them."[99]

Courts and commentators are split on how to construe the authority Section 105 grants to bankruptcy courts.[100] Section 105 has been analogized to the All Writs Statute, which enables federal courts to issue orders to facilitate the purpose of a statute where no express provision authorizes such action.[101] Section 213 of the 1978 Code extended the power of

S.C. L. REV. 275, 297-301 (1999); Steve H. Nickles & David G. Epstein, Bankruptcy Symposium, *Another Way of Thinking About Section 105(a) and Other Sources of Supplemental Law Under the Bankruptcy Code*, 3 CHAP. L. REV. 7 (2000) (stating that if any equitable powers remain with the bankruptcy courts, such power is derivative as "units" of the district courts). Although Congress repealed the provision granting bankruptcy courts express equitable powers, the Supreme Court has continued to assert the equitable powers of bankruptcy courts. *See* Young v. United States, 535 U.S. 43, 50 (2002) (stating that bankruptcy courts are courts of equity); *Energy Res.*, 495 U.S. at 549 (citing Pepper v. Linton, 308 U.S. 295, 303-04 (1939)).

[97] 11 U.S.C. § 11(a)(15), *repealed by* Bankruptcy Reform Act of 1978, P.L. 95-598, § 402(a) (1978) (amended 1984, 1986 & 1994).

[98] 1 COLLIER ON BANKRUPTCY, *supra* note 11, ¶ 105.LH.

[99] *Id.* Congress amended Section 105 in 1986 to allow the court to raise issues sua sponte to "tak[e] any action or mak[e] any determination necessary or appropriate to enforce or implement court order or rules, or to prevent an abuse of process." *Id.* (citing Pub. L. No. 99-554 (1984)). In 1994, Congress added subsection (d) to Section 105 to empower bankruptcy judges to conduct status conferences, which broadened their power to manage cases. *Id.* (citing 140 CONG. REC. H10,764 (daily ed. Oct. 4, 1994) (rem. of Rep. Brooks)).

[100] 1 COLLIER ON BANKRUPTCY, *supra* note 11, ¶ 105.LH.

[101] *Id.* *See* 28 U.S.C. § 1651 (2000) (providing that federal courts may "issue all writs necessary or appropriate in aid of their respective jurisdictions and agreeable to the usages and principles of law").

the All Writs Statute to bankruptcy courts, but this provision was later deleted in 1984.[102] Congress did not provide any explanation for this deletion.[103] The omission may indicate that Sections 105 and 213 were duplicative and Congress deleted the reference merely to eliminate the redundancy.[104]

A majority of courts broadly construe Section 105 to permit bankruptcy courts to "fill the gaps" in the Code.[105] The minority approach contends that Section 105 should be narrowly construed.[106] Regardless, the fact that Section 105 authorizes bankruptcy courts to carry out "provisions" rather than general purposes of the Code is instructive and may imply that bankruptcy courts should exercise their Section 105 power only in relation to other sections of the Code.[107] The Supreme Court's interpretation of Section 105 provides further support for the proposition that Section 105 should be used in conjunction with another provision of the Code.[108] For although the Supreme Court has referenced Section 105 in discussing the "broad authority" of bankruptcy courts,[109] the Court has also recognized that this power is constrained by the limits of the Code.[110]

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[102] 1 COLLIER ON BANKRUPTCY, *supra* note 11, ¶ 105.LH.

[103] *Id.* (citing Pub. L. No. 98-353 (1984)).

[104] *Id.*

[105] *Id.* (citing Sears, Roebuck & Co. v. Spivey, 265 B.R. 357, 371 (E.D.N.Y. 2001) (stating that "[s]ection 105 of the Bankruptcy Code bestows on bankruptcy courts a specific equitable power to act in accordance with principles of justice and fairness. Bankruptcy courts have broad latitude in exercising this power")).

[106] *Id.*

[107] *Id.* (citing Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 206 (1988) (stating that "whatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code")); *see also* Bogart, *supra* note 95, at 803-04.

[108] United States v. Energy Res. Co., 495 U.S. 545, 549 (1990) (stating that "[Sections 105(a), 1123(b)(5), 1129] are consistent with the traditional understanding that bankruptcy courts, as courts of equity, have broad authority to modify creditor-debtor relationships").

[109] *Id.*

[110] *See* 1 COLLIER ON BANKRUPTCY, *supra* note 11, ¶ 105.LH.; GAF Corp. v. Johns-Manville Corp. (*In re* Johns-Manville Corp.) 26 B.R. 405, 409 (Bankr. S.D.N.Y. 1983) ("Section 105 is not without limits. It does not

B. Section 363

Congress enacted Section 363 to separate administrative duties from the judicial functions of the bankruptcy court and to make assets sales in bankruptcy more efficient.[111] Section 363 bestowed significant power in the trustee to conduct sales without court approval.[112] For instance, a trustee may conduct a sale without a hearing if no requests for such are made.[113] At the same time, Congress also granted bankruptcy courts the authority to intercede, either to prohibit or impose conditions on sales, thereby protecting the interests in the debtor estate[114] or to facilitating the efforts of the trustee in consummating a sale.[115] Where the DIP conducts a sale within an auction, courts have broad authority to select the successful bidder.[116] To expedite a

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permit the court to ignore, supersede, suspend or even misconstrue the statute itself or the rules."). Some commentators have criticized the use of Section 105 to create "supplemental law," by which bankruptcy courts exceed the scope or exercise authority inconsistent with the express provisions of the Code. *See* Bogart, *supra* note 95, at 803-04); Steve H Nickles & David G. Epstein, *Bankruptcy Symposium: Another Way of Thinking About Section 105(a) and Other Sources of Supplemental Law Under the Bankruptcy Code*, 3 CHAP. L. REV. 7 (2000). Because this note does not address the exercise of power beyond the limits of the Code, this issue will not be discussed further.

[111] *See* 3 COLLIER ON BANKRUPTCY, *supra* note 11, ¶ 363.02

[112] *Id.* ¶ 363.02 n.9 (citing H.R. REP. 95-595, at 315 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6272 (stating that Section 363 represented a "significant change from [existing] law, which require[d] the affirmative approval of the bankruptcy judge for almost every action")).

[113] *Id.* (citing H.R. REP. NO. 95-595, at 345 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6301; S. REP. NO. 989, at 55 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5841-42).

[114] "[A]t any time, on request of an entity that has an interest in property used, sold or leased, or proposed to be used, sold, or leased, by the trustee, the court, with or without a hearing, shall prohibit or condition such use, sale, or lease as is necessary to provide adequate protection of such interest." 11 U.S.C. § 363(e) (2000).

[115] *See* 3 COLLIER ON BANKRUPTCY, *supra* note 11, ¶ 363.02

[116] *See In re* Fin. Network, Inc., 980 F.2d 165, 169-70 (2d Cir. 1992). For a discussion of recent opinions addressing the finality of auction sales, *see infra* Part IV.C.

transaction, a bankruptcy court may authorize the trustee to consummate a sale without the requisite statutory notice if doing so will help to conserve the remaining assets of the depleted estate.[117]

The combined effect of these statutory provisions suggests that Congress empowered bankruptcy courts to enable the sale of assets wherever possible and when in the best interest of the estate.[118] The limited ability to appeal Section 363 sales provides additional evidence of a legislative desire to consummate sales.[119] For example, Section 363(m) provides that confirmed sales will not be overturned unless the sale is stayed pending appeal, and so long as the property was purchased in good faith.[120] Appeals may be further restricted because bankruptcy courts may deny motions for stay within their discretion.[121]

Where parties seek court approval of a sale, bankruptcy courts apply various standards to evaluate such transactions.[122] Although the standards of review vary among the bankruptcy courts, the approaches are characteristically vague and therefore flexible enough to respond to the diverse needs of particular debtors.[123] In *Lionel*, the Second Circuit addressed the ability of

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[117] *See* 3 COLLIER ON BANKRUPTCY, *supra* note 11, ¶ 363.02 (citing FED. R. BANK. P. 2002(i)).

[118] *See* 11 U.S.C. § 363(e) (providing that "the court, with or without a hearing, shall prohibit or condition such use, sale, or lease as is necessary to provide adequate protection of such interest").

[119] *See generally* COLLIER ON BANKRUPTCY, *supra* note 11, ¶ 363.11.

[120] 11 U.S.C. § 363(m) ("The reversal or modification on appeal of an authorization . . . 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*." (emphasis added)).

[121] *See* FED. R. BANKR. P. 6004(g). *See also, e.g., In re* Colony Hill Assocs., 111 F.3d 269, 271-72 (2d Cir. 1997). For further discussion on the finality of auction sales, *see infra* Part IV.C.

[122] *See* COLLIER ON BANKRUPTCY, *supra* note 11, ¶ 363.02. *See supra* Part II.B for further discussion of the current approaches to approving Section 363 sales.

[123] *See* COLLIER ON BANKRUPTCY, *supra* note 11, ¶ 363.02

bankruptcy courts to approve Section 363 sales outside of the ordinary course of business.[124] The court began by asserting "a bankruptcy judge must not be shackled with unnecessarily rigid rules when exercising the undoubtedly broad administrative power granted him under the Code."[125] The court rejected the "emergency" and "upon cause shown" requirements in favor of the more liberal "business purpose" test.[126] The Second Circuit reasoned that a more expansive reading of Section 363(b) affords bankruptcy judges the "substantial freedom" necessary "to tailor [their] orders to meet differing circumstances" and "further the purposes of Chapter 11."[127]

The expansive statutory language of Section 363, coupled with the "broad authority" Section 105 affords bankruptcy courts to issue orders "necessary or appropriate to carry out the provisions of [the Code]," cumulatively demonstrate that bankruptcy courts have considerable discretion to facilitate or frustrate sales under Section 363 depending on the circumstances at hand. Bankruptcy courts employ this discretion to secure the best interests of the estate,[128] which oftentimes necessitates "maximizing the value of the estate."[129]

[124] *In re* Lionel Corp., 722 F.2d 1063, 1066 (2d Cir. 1983).

[125] *Id.* at 1069-70.

[126] *Id.* (stating that Section 363 sales must have "some articulated business justification, other than appeasement of major creditors, for using, selling or leasing property out of the ordinary course of business before the bankruptcy judge may order disposition").

[127] *Id.* at 1069. Nonetheless, the court also noted that bankruptcy courts do not have "carte blanche" under the Code and therefore must not construe Section 363(b) to "swallo[w] up Chapter 11's safeguards." *Id.*

[128] 9B AM. JUR. 2D *Bankruptcy* § 1529 (2004) (stating that courts must apply the "best interests of the estate" standard to sales outside of the ordinary course of business) (citing *In re* American West Airlines, Inc., 166 B.R. 908 (Bankr. D. Ariz. 1994)).

[129] *See In re* S.N.A. Nut Co., 186 B.R. 98, 106 (Bankr. N.D. Ill. 1995) (stating that "[t]he goal of a bankruptcy auction . . . is to maximize the return to the estate").

C. Section 1129

Section 1129 of the Code enumerates the requirements for judicial confirmation of a Chapter 11 bankruptcy plan.[130] These provisions are necessarily undefined and generally stipulate that the plan or debtor should not contravene any provision of the Code, that the plan has been "proposed in good faith and not by any means forbidden by law," and that the court has found the plan to be reasonable.[131] Section 1129 does not prescribe any model plans.[132] As a result, it affords the bankruptcy court considerable latitude to accept or reject a proposed plan. Additionally, bankruptcy courts may facilitate the development of plans by approving "cram-down" provisions.[133] In this way, bankruptcy courts may ensure that hold outs among creditors do not frustrate plans essential to preserving the best interests of the estate.

Judges may approve the sale of assets either prior to or within a Chapter 11 plan.[134] Because the literal application

[130] 11 U.S.C. § 1129 (2000). The requirements for judicial approval of a plan differ if the confirmation is consensual or not. *See* COLLIER ON BANKRUPTCY, *supra* note 11, ¶ 1129.01 (citing §§ 1129(a)-(b)). Additionally, nonconsensual plans may not unfairly discriminate against dissenting creditors and must be fair and equitable. *Id.*

[131] 11 U.S.C. § 1129(a)(1)-(4) (2000). Additionally, Section 1123 provides that plans designate the treatment of impaired and non-impaired classes of creditors, provide equal treatment to each member of a respective class, and provide "adequate means for the plan's implementation," and "contain only provisions that are consistent with the interests of creditors and equity holders and with public policy." 11 U.S.C. § 1123(a)(1)-(7). Under Section 1129(d), the debtor may not pursue a plan whose principal purpose to avoid tax or securities laws.

[132] COLLIER ON BANKRUPTCY, *supra* note 11, ¶ 1129.01 (stating that within the constraints of § 1129, "plan proponents are free to create innovative solutions to an estate's problems").

[133] 11 U.S.C. § 1129(b) provides that a court may confirm a reorganization plan as long as the "plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan."

[134] *See* 11 U.S.C. § 363(b) (authorizing the sale of assets other than in the ordinary course of business); 11 U.S.C. § 1123(b)(4) (providing for the "sale of all or substantially all of the property of the estate"); COLLIER ON BANKRUPTCY, *supra* note 11, ¶ 1129.01.

of Section 363(b) would permit parties to circumvent the procedural protections of Chapter 11, courts tend to scrutinize the "sale of all or substantially all the assets" in this context.[135] Nevertheless, the Supreme Court has held that "[t]he Code contains no ongoing business requirement for reorganization under Chapter 11."[136] Moreover, the Court asserted, "Chapter 11 also embodies the general Code policy of maximizing the value of the bankruptcy estate."[137] Accordingly, bankruptcy courts employ their discretionary powers to approve sales consonant with the purpose of Chapter 11: maximizing estate value.

IV. BANKRUPTCY LAW ON THE GROUND

Review of the statutory language of the Code, its legislative history, and pertinent Supreme Court opinions reveals that bankruptcy courts hold considerable discretion to conduct bankruptcy sales. As the *Lionel* court observed, this authority is essential to enabling bankruptcy courts to tailor their approaches to the diverse needs of each debtor.[138] In light of this mandate, bankruptcy courts vigilantly conserve this discretion in rendering their decisions. As an examination of bankruptcy decisions over time demonstrates, bankruptcy courts generally eschew bright-line rules that would constrain their equitable powers. Further, to the extent that private ordering threatens this reserve of power and the court's ability to respond to the needs of the debtor estate, bankruptcy courts frequently invalidate such efforts.

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[135] *See* COLLIER ON BANKRUPTCY, *supra* note 11, ¶ 1129.01 (stating that courts differ as to the extent that they permit the sale of substantially all assets outside a bankruptcy plan). For further discussion on the current treatment of sales of the entire estate, *see infra* Part IV.B.

[136] Toibb v. Radloff, 501 U.S. 157, 161 (1991).

[137] *Id.* at 163 (citing CFTC v. Weintraub, 471 U.S. 343, 351-54 (1986)).

[138] *In re* Lionel Corp., 722 F.2d 1063, 1069 (2d Cir. 1983).

A. The Modern Approach to Lockup Agreements & Break-up Fees: Case-by-Case Assessment

As distressed debt M&A deals have become an increasingly popular method of sale, lockup agreements and break-up fees have arguably become more important to preserving negotiations and protecting debtor companies from hostile takeovers.[139] Without the added security of a lockup agreement, a prospective buyer may be unwilling to proffer its highest bid or expend resources performing due diligence and obtaining financing for a transaction.[140] If the sale proceeds through an auction, the "stalking horse" will often seek a lockup agreement binding creditors to ratifying certain bidding protections, like break-up fees, in the event that the court awards the sale to another bidder.[141] Where the parties engage in pre-petition negotiations, the debtor may use a lockup to bind the creditors to accept a proposed reorganization plan.

Imported from corporate law, lockup agreements and break-up fees have only recently been employed in bankruptcy sales.[142] As a result, bankruptcy courts have struggled with whether to review these defensive devices under corporate law principles[143] or to evaluate them differently in the bankruptcy context.[144] For instance, in *In re*

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[139] *See* Roosevelt, *supra* note 91, at 94-95.

[140] *See In re* Integrated Res., 135 B.R. 746, 750 (Bankr. S.D.N.Y. 1992); COLLIER BUSINESS WORKOUT GUIDE, *supra* note 65, at ¶ 6.05.

[141] *See In re* Integrated Res., 135 B.R. at 750; Bowles & Egan, *supra* note 83, at 804-07.

[142] Markell, *supra* note 69, at 354 (citing *In re* 995 Fifth Ave. Assocs., 96 B.R. 24 (Bankr. S.D.N.Y. 1989) as the first reported case to mention break-up fees).

[143] *See In re* 995 Fifth Ave. Assocs., 96 B.R. at 28 (borrowing principles from corporate law to assess an application for break-up fees); *In re* Integrated Res., Inc., 135 B.R. 746 (Bankr. S.D.N.Y. 1992).

[144] *See In re* Hupp Indus. Inc., 140 B.R. 191 (Bankr. N.D. Ohio 1992) (stating that break-up fees should "be highly scrutinized in view of the uncertainty of dividends, if any, to be received by claimants of the debtor's estate"); *In re* America West Airlines, Inc., 166 B.R. 908, 911 (Bankr. D. Ariz. 1994) (adopting Professor Markell's reasoning and rejecting the business judgment rule because such deferential review may be

995 Fifth Avenue Assocs., the bankruptcy court assessed a lockup agreement according to the business judgment rule.[145] Subsequently, many courts have rejected this deferential approach, finding it obscures the distinction between the disparate goals and constraints imposed by the separate legal regimes, notably the insolvent state of a business in bankruptcy where fiduciary duties run to the creditors rather than the shareholders, and the monitoring and advisory role of the bankruptcy judge.[146] In addition, where parties sell assets under Section 363(b), which prescribes sales conducted outside of the ordinary course of business, application of the business judgment rule is particularly inapposite because it only addresses transactions occurring within the ordinary course.[147]

Bankruptcy courts since have developed standards to evaluate economic incentives in light of bankruptcy

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inconsistent with the best interests of the estate); Bowles & Egan, *supra* note 83, at 813 (stating that a majority of the courts since *In re 995 Fifth Ave. Assocs.* have rejected the business judgment rule in favor of a stricter standard that asks whether "the proposed incentives benefit the bankruptcy estate"). Professor Markell suggests that corporate law standards for evaluating break-up fees are not applicable to bankruptcy sales because the standard is too deferential and therefore favors approving the fee. Markell, *supra* note 69, at 359. Rather, Markell argues that break-up fees should be restricted because they do not induce bidding and therefore represent an unnecessary cost to creditor. *Id.* at 372-73.

[145] 96 B.R. at 28-29.

[146] Markell, *supra* note 69, at 359. Professor Markell distinguished sales occurring outside of Chapter 11 by noting that no clear market exists to aid courts in "external valuation," hindsight bias prevents courts from differentiating good from bad break-up fees, search costs and due diligence expenses are reduced due to the relatively free access to information, and break-up fees are subject to very limited review on appeal. *See* Calpine Corp. v. O'Brien Envtl. Energy, Inc. *(In re* O'Brien Envtl. Energy, Inc.), 181 F.3d 527, 535 (3d Cir. 1999) (break-up fees are neither permissible nor necessary to the same extent in bankruptcy sales as in corporate transactions).

[147] *See In re* S.N.A. Nut Co., 186 B.R. at 105 (declaring the proper test to be whether the "breakup fee is in the best interests of the estate"). Moreover, the fact that Section 363(b) sales may be approved without creditor assent provides more reason for bankruptcy courts to subject break-up fees to more exacting review. *Id.* at 103.

principles, particularly to maximize the value of the debtor estate.[148] The following sections discuss the development of the modern approach for analyzing defensive devices, which recognizes the potential harm and benefits of these sales tools. In both contexts, courts have rejected a per se rule of invalidity in favor of a case-by-case analysis. By rejecting a bright-line rule, bankruptcy courts reserve the discretion to evaluate the propriety of these tools in light of the prevailing circumstances.

1. Lockup Agreements

Before drafting a lockup agreement, the parties must observe the Code's restrictions on private ordering. Section 1125 of the Code governs the solicitation of votes for a proposed reorganization plan and states that a DIP may not petition votes before submitting a summary of the plan and disclosure statement to the creditors.[149] In addition, bankruptcy courts will not approve such disclosures before notice and hearing to the creditors.[150] The foundational case allowing lockups in Chapter 11, *In re Texaco*, involved the settlement of Texaco's multi-billion dollar judgment to Pennzoil.[151] Texaco contended that Pennzoil's assent was essential to "effect[ing] a confirmable plan of reorganization."[152] Although Texaco had secured Pennzoil's support prior to obtaining court approval of a disclosure statement, the bankruptcy court held that this conduct did

[148] *Id.* at 104 (stating that the debtor or trustee "has an obligation to maximize revenues for the estate"); *In re* Integrated Res., Inc., 135 B.R. at 750 (stating that the primary responsibility of the debtor and the bankruptcy court is "maximization of the value of the asset sold"); Bowles & Egan, *supra* note 83, at 835 (stating that "a DIP has a fiduciary duty to maximize the value of the assets of a bankruptcy estate for the benefit of the estate's creditors").

[149] 11 U.S.C. § 1125 (2000).

[150] 11 U.S.C. § 104(1) (2000).

[151] Trans World Airlines, Inc. v. Texaco, Inc. (*In re* Texaco, Inc.), 81 B.R. 813 (Bankr. S.D.N.Y. 1988); *see also In re* 995 Fifth Ave. Assocs., 96 B.R. 24 (Bankr. S.D.N.Y. 1989) (first reported case to discuss the use lockup agreements in bankruptcy proceedings).

[152] *In re* Texaco, Inc., 81 B.R. at 815.

not violate Section 1125 because Pennzoil's stipulation "not to vote for, [or] consent to any other plans" was not equivalent to an affirmative vote.[153] As Texaco had not yet filed its plan, the court reasoned that there was no established need for a disclosure statement.[154]

More recently, courts have questioned the *Texaco* court's liberal approach to reviewing lockup agreements.[155] Where a debtor seeks to liquidate or conduct a Section 363 sale, many courts impose a "*Revlon*-like duty to maximize the value of the bankruptcy estate by selling the debtor's assets to the highest and best bidder."[156] Bankruptcy courts frequently invalidate lockup agreements that may "chill bidding" as incompatible with the debtor's fiduciary duties to its creditors.[157] In addition, critics of lockup agreements have argued that such measures are unnecessary to induce

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153 *Id.* at 815-16.

154 *Id.* at 816. The court suggested that Section 1126 was consistent with its reasoning because the remedy provided that any "improperly solicited acceptance or rejection [should be] disregarded for purposes of computing the vote on the plan." However, since Texaco had not sought any formal "solicitations," there was no statutory relief available for lack of disclosure when a plan had not yet been filed.

155 Markell, *supra* note 69; *see* Cinerama Inc. v. Technicolor Inc., 1991 WL 111134, at *16 (Del. Ch. June 24, 1994) (stating that a "lockup is suspect" because it restricts the debtor's access to information on other bidders potentially willing to pay more for the assets); *In re* S.N.A. Nut Co., 186 B.R. 98 (Bankr. N.D. Ill. 1995); *In re* 995 Fifth Ave. Assocs., 96 B.R. at 28; Novikoff & Polebaum, *supra* note 70, at 4 (citing *In re* NII Holdings, Inc., No. 02-11505 (Bankr. D. Del.) Docket No. 394, Transcript of Oct. 22, 2002; *In re* Stations Holding, No. 02-10882 (Bankr. D. Del.), Docket Nos. 190 & 196, Transcript of Sept. 25, 2002); Roosevelt, *supra* note 91, at 121. Despite the argument to the contrary, Professor Roosevelt advocates that lockup agreements should always be reviewed under the business judgment rule. *Id.* at 129.

156 Bowles & Egan, *supra* note 83, at 798. *See also* Toibb v. Radloff, 501 U.S. 157 (1991); *In re* S.N.A. Nut Co., 186 B.R. at 106.

157 Bowles & Egan, *supra* note 83, at 820-21 (describing lockup agreements as "control incentives" in that the party to the agreement seeks to prevent any other bids for the assets).

bidding, merely waste assets, and threaten the ability of the debtor to obtain the highest value for the debtor estate.[158]

On the other hand, some commentators contend that lockup agreements are beneficial to bankruptcy sales because they maximize revenue and efficiency.[159] By guaranteeing a fixed return, lockups may encourage large creditors to compromise on their claims, which may in turn induce smaller creditors to consent to a proposed plan.[160] Given the enhanced security of large creditor support, lockups may help to exact the maximum price for the assets and persuade debtors to settle substantial claims where the judgment creditor assents to the plan.[161]

As compelling arguments exist on both sides of the debate, bankruptcy courts have refrained from creating a bright-line rule on the use of lockup agreements. Generally, courts will withhold approval of lockup agreements in cases where bids are not adequately exposed to the market, the DIP fails to secure the highest value for the assets, or the bid is unnecessary to induce bidding or otherwise represents an unnecessary expense to the creditors.[162] Conversely, courts

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[158] *See id.* at 820-21; Markell, *supra* note 69, at 260-69, 374-77. Markell argues that applying the business judgment standard to such agreements ignores important distinctions between bankruptcy and non-bankruptcy sales, including the absence of a clear market value for the distressed assets, hindsight bias in discerning good from bad incentives, fiduciary duties that run to the creditors rather than the shareholders, greater accessibility of information in bankruptcy and thus reduced search costs, greater likelihood of getting a bargain, and certainty that attends the purchase of assets in bankruptcy.

[159] *See* Roosevelt, *supra* note 91, at 122-29; Skeel, *supra* note 4, at 1279 (arguing that courts should enforce lockup agreements, but restrict fees to bidder's reliance costs).

[160] *See* Novikoff & Polebaum, *supra* note 70, at 4; COLLIER BUSINESS WORKOUT GUIDE, *supra* note 65, ¶ 5.05.

[161] COLLIER BUSINESS WORKOUT GUIDE, *supra* note 65, ¶ 5.05; Novikoff & Polebaum, *supra* note 70, at 4.

[162] Bowles & Egan, *supra* note 83, at 820-27 (citing *In re* Biderman Indus. U.S.A., Inc., 203 B.R. 547 (Bankr. S.D.N.Y. 1997) (rejecting a "window shop" provision as mere window-dressing because the assets had not been sufficiently tested on the market)).

tend to approve lockups where the debtor would otherwise be unable to secure the same benefits for creditors.[163]

a. Invalidating Lockup Agreements Where Incompatible With Creditor Interests

Proponents of lockup agreements have criticized the Delaware bankruptcy court's recent resistance to defensive devices.[164] In *Stations Holding Co.*, Judge Walrath upheld the U.S. Trustee's decision to exclude from the voting confirmation process creditors that executed a post-petition lockup agreement prior to Section 1125 disclosure.[165] The bankruptcy court invalidated the agreement even though it contained a "fiduciary out"[166] and made the creditor's ultimate acceptance contingent on court approval of the disclosure statement.[167] In the court's view, the lockup agreement violated Section 1125(b) because the assenting parties did not have the ability to "change their vote" after reading the disclosure statement.[168] The court characterized the lockup agreement as an impermissible solicitation of a

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[163] *See, e.g.*, *In re* Bush Indus., Inc., 315 B.R. 292 (Bankr. W.D.N.Y. 2004).

[164] Novikoff & Polebaum, *supra* note 70, at 13. The Delaware Supreme Court has also recently challenged the use of lockup agreements in the corporate context as well. *See* Skeel, *supra* note 4, at 1279 (advocating that bankruptcy courts should generally limit lockup agreements to situations involving some cognizable reliance by the parties).

[165] Novikoff & Polebaum, *supra* note 70, at 4 (citing *In re* Stations Holding, No. 02-10882 (Bankr. D. Del.), Docket Nos. 190 & 196, Transcript of Sept. 25, 2002). *See* 11 U.S.C. § 1126(e) (2000) (providing that the court may "designate . . . any entity whose acceptance or rejection of such plan . . . was not solicited or procured in good faith or in accordance with the provisions of this title").

[166] *See Omnicare, Inc. v. NCS Healthcare, Inc.*, 818 A.2d at 914, 936 n.74 (Del. 2003) (citing RESTATEMENT OF CONTRACTS § 193 as support for the premise that lock up agreements will be unfavorable to the extent they contravene a corporation's fiduciary duties to its shareholders).

[167] Novikoff & Polebaum, *supra* note 70, at 4 (citing *In re* Stations Holding, No. 02-10882 (Bankr. D. Del), Docket Nos. 190 & 196, Transcript of Sept. 25, 2002, at 22-27).

[168] *See In re Stations Holding*, No. 02-10882, Docket Nos. 190 & 196, Transcript of Sept. 25, 2002, at 27.

vote, rather than mere negotiations, and withheld approval of the plan on the basis that it constituted a Section 1125(b) violation.[169]

Similarly, in *NII Holdings*,[170] the Delaware bankruptcy court disqualified creditors who had assented to a pre-petition lockup agreement structured within a pre-negotiated plan of reorganization. After filing its Chapter 11 petition, the debtor added minor changes to the plan without obtaining further creditor consent.[171] In addition, the debtor did not provide the creditors with a Section 1125 disclosure statement before recording their votes.[172] Although the agreement was not absolute and contained several "outs," the court found that merely signing a preliminary agreement suggested that it held some binding significance.[173] Nonetheless, the court explained that it lacked jurisdiction over pre-petition solicitations and would not interfere with such arrangements unless the parties sought to have them designated as a vote.[174] On the other hand, the court asserted that it would invalidate votes secured post-petition, even if parties did not move to enforce the lockup agreement, because Section 1125 "prohibits solicitation of a vote."[175]

Prior to *Stations Holding* and *NII Holdings*, the Delaware bankruptcy court had followed the majority approach for differentiating between conduct constituting a solicitation, which requires Section 1125 notice and disclosure, and mere negotiations, which do not raise Section 1125 duties.[176] The majority approach defines "solicitations" narrowly out of concern that a "broad reading of [Section] 1125 can seriously

[169] *Id.*

[170] Novikoff & Polebaum, *supra* note 70, at 4 (citing *In re NII Holdings*, No. 02-11505, Docket No. 394, Transcript of Oct. 22, 2002).

[171] *Id.*

[172] *Id.*

[173] *In re NII Holdings*, No. 02-11505, Docket No. 394, Transcript of Oct. 22, 2002, at 47 (stating that "[t]he fact that it was signed had some effect. Or it would not have been signed or the debtor would not have asked you to sign it.").

[174] *Id.* at 59.

[175] *Id.* at 25.

[176] *Keach*, *supra* note 8, at 22.

inhibit free creditor negotiations."[177] The bankruptcy courts in the Delaware cases excluded votes without explaining their departure from the majority position.[178]

While guided by precedent, bankruptcy courts generally resist bright-line rules to the extent they inhibit their ability to act in the best interests of the debtor estate.[179] In *Stations Holding*, the creditors did not review the disclosure statement before granting their consent.[180] Despite the agreement's contingencies, the bankruptcy court suggested that the creditors' ability to vote for another plan was illusory, as they could not change their votes after reading the disclosure statement. Because the lockup frustrated informed voting, the court rejected the agreement as counter to creditor interests. Similarly, in *NII Holdings* the court refused to enforce the lockup in order to protect the interests of a large creditor that had not assented to revisions in the agreement. Though it strictly construed the provisions of the

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[177] *Id.* at 45 (discussing that the lockup agreements in *NII Holdings* and *Stations Holding* were very similar to the agreements upheld in *Texaco*); *See also In re* Century Glove Inc., 860 F.2d 94, 101 (3d Cir. 1988) (stating that "no principled, predictable difference [exists] between negotiation and solicitation of future acceptances" [and thus] "reject[ing] any definition of solicitation which might cause creditors to limit their negotiations"); *In re* Texaco Inc., 81 B.R. 813, 816 (Bankr. S.D.N.Y. 1988) (stating that "an agreement not to support any other plans in the future does not amount to the solicitation of a rejection of a plan which must be accompanied by a court approved disclosure statement").

[178] *Keach*, *supra* note 8, at 45-46 (questioning the rationale of interpreting as solicitation negotiations between "sophisticated parties, represented by counsel, with access to all information" because the legislature intended the disclosure requirement to protect unsophisticated investors).

[179] *In re* Lionel Corp., 722 F.2d 1063, 1069 (2d Cir. 1983) (stating that "[f]irst and foremost is the notion that a bankruptcy judge must not be shackled with unnecessarily rigid rules when exercising the undoubtedly broad administrative power granted him under the Code"); Novikoff & Polebaum, *supra* note 70, at 10-11 (citing *In re* NII Holdings, Inc., No. 02-11505, Docket No. 394, *Transcript* (Oct. 22, 2002) (refraining from declaring lockup agreements per se impermissible).

[180] Novikoff & Polebaum, *supra* note 70, at 7 (citing *In re Stations Holding*, No. 02-10882, Docket Nos. 190 & 196, Transcript of Sept. 25, 2002, at 22-27).

Code, the bankruptcy court emphasized that negotiations were still encouraged and pre-petition solicitations, which are not proscribed by the Code, would not be disturbed.

b. Lockup Agreements Upheld Where Necessary to Preserve the Debtor Estate

On the other hand, where lockup agreements help to preserve the creditor's best interests, courts are more inclined to approve such arrangements. For example, in *In re Bush Industries, Inc.*, the bankruptcy court approved a lockup agreement in spite of its potential to discourage competing bids.[181] Despite the company's efforts to stabilize its financial situation, Bush Industries continued to sustain losses, and its secured creditors refused to extend any further credit.[182] However, through a lockup agreement, seven of Bush Industries' eight secured creditors agreed to endorse a reorganization plan, that provided the financing necessary to continue operations and satisfy the company's debts to its creditors.[183] The bankruptcy court recognized that without the lockup, unsecured creditors would likely have received no compensation.[184] Essentially, the court suggested that the security the lockup afforded the small creditors balanced any potential harm in restraining other offers. In this case, approving the lockup agreement served creditor interests.[185]

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[181] *In re* Bush Indus., Inc., 2004 Bankr. LEXIS 1790, at *29 (Bankr. W.D.N.Y. Oct. 8, 2004); *see also In re* Union Fin. Servs. Group, Inc., 303 B.R. 390, 402 (Bankr. E.D. Mo. 2003) (approving a lockup agreement because it did not prevent the bidder from testing the market and provided a "calming effect" by allowing the company to continue its existing operations).

[182] *In re* Bush Indus., Inc., 2004 Bankr. LEXIS 1390, at *4-5.

[183] *Id.* at *5-6.

[184] *Id.* at *29.

[185] *But see* Novikoff & Polebaum, *supra* note 70, at 12 (citing *Wall Street* *Reporter* Roundtable on Distressed Securities, *at* http://www.ssgca.com/articles/feb_5_2003.asp (Nov. 7, 2002) (Mark Chesen, Moderator)) (arguing that restricting the use of lockup agreements may make reorganization plans more risky and impede the debtor's ability to secure the highest price for the assets).

c. Reconciling the Differing Treatments of Lockup Agreements by Bankruptcy Courts

Although bankruptcy courts have not reviewed the use of defensive devices consistently since first introduced from corporate law, the differing outcomes reflect efforts to balance the risks and advantages of defensive tools in individual cases and develop standards to assess these tools in light of bankruptcy principles. Whether approving or invalidating lockup agreements, bankruptcy courts retain the discretion to serve the creditors' interests by ensuring that assets are adequately exposed to the market and the debtor receives the maximum value for the assets.[186]

At the same time, bankruptcy courts also respect that their broad authority is circumscribed by the limits of the Code.[187] Rather than an insular contempt for lockup agreements, the recent decisions from the Delaware bankruptcy court represent a faithful adherence to the text of the Code.[188] For example, Section 1125(b) explicitly proscribes post-petition solicitation where a party has not satisfied the statutory requirements.[189] In light of this provision, the recent Delaware decisions are not inconsistent with *In re Texaco,* which permitted parties to solicit support for a plan pre-petition, since the bankruptcy court only prohibited the post-petition solicitation of votes.

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[186] *See, e.g.*, Pepper v. Litton, 308 U.S. 295 (1939).

[187] *See* United States v. Energy Res. Co., 495 U.S. 545, 549 (1990); N.W. Bank Worthington v. Ahlers, 485 U.S. 197, 206 (1988).

[188] *But see* Novikoff & Polebaum, *supra* note 70, at 13.

[189] *See id.* at 12 (stating that the holding in *NII Holding* barring post-petition solicitation has statutory support). Although the UST's Office of the Third Circuit has asserted that parties engaging in pre-petition lockup agreements will validly be excluded from the creditors' committee, no published case has yet rejected a pre-petition lockup agreement, and there is no further indication that Judge Walrath's opinions would be extended in such cases.

2. Bankruptcy Court Analysis of Break-Up Fees: Developing a More Rigorous Standard of Review

As with lockup agreements, bankruptcy courts have largely moved away from applying the business judgment rule[190] to break-up fees in favor of stricter standards.[191] In *In re O'Brien Environmental Energy, Inc.*, an unsuccessful bidder appealed the bankruptcy court's decision not to award the bidder the payment of a break-up fee.[192] Although courts review the use of incentives in contests for corporate control under the "business judgment" rule,[193] the bankruptcy court in *O'Brien* declined to adopt a "common law of break-up fees."[194] As a result, the bankruptcy judge reasoned that any

190 *In re* Integrated Res., Inc. 135 B.R. 746, 753 (Bankr. S.D.N.Y. 1992) (holding that so long as the break-up fee is "reasonable in relation to the bidder's efforts and the magnitude and significance of the transaction, and will enhance rather than detract from the bidding process," the "business judgment" rule will apply). Although the bankruptcy court stated that the business judgment rule was the standard, it advised that bankruptcy courts should carefully scrutinize break-up fees in Section 363 sales because they "impose expenses on the debtor's estate and do not merely affect shareholders as in the corporate control cases, but affect the debtor, creditors, and equity holders, alike." *Id.* at 751.

191 Laura D. Jones et al., *First Things First: Who Wins in the Race to Get Break-up Fees Approved?*, 22-8 AM. BANKR. INST. J. 16, at 46 (2003); Calpine Corp. v. O'Brien Envtl. Energy, Inc. *(In re* O'Brien Envtl. Energy, Inc.), 181 F.3d 527, 535, 538 (3d Cir. 1999) (declining to uphold a two-million-dollar break-up fee for a deal valued between ninety and 100 million dollars because the fee was not necessary to preserve the value of the estate and was likely to "chill" competing bids).

192 181 F.3d at 528. The Third Circuit noted that its opinion marked the first opportunity of any court of appeals to "consider the standards that should govern an award of break-up fees and related expenses in the bankruptcy context." *Id.*

193 *Id.* at 535 (stating that the "business judgment rule should not be applied as such in the bankruptcy context").

194 *Id.* at 532 (rejecting a "general common law of break-up fees," and instead inquiring whether the Code "authorizes the award of break-up fees and expenses to an unsuccessful bidder at the plan-based sale of a debtor's assets").

"post-auction payment" requests must find authorization within the text of the Code.[195]

Using as its guide Section 503, a provision sanctioning the payment of administrative expenses, the *O'Brien* court developed the "administrative expense" test, which places the burden on the requesting party to show that "the fees were actually necessary to preserve the value of the estate."[196] Because the disgruntled bidder failed to show that the break-up fee was necessary to induce or promote competitive bidding, the Third Circuit found that the bankruptcy court properly rejected the party's application for a break-up fee.[197] As the *O'Brien* decision was limited to review of post-auction payment of break-up fees, the case did not encompass situations where parties seek pre-auction approval of break-up fees.[198]

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[195] *Id* at 535 (stating that the "determination whether break-up fees or expenses are allowable under § 503(b) must be made in reference to general administrative expense jurisprudence").

[196] *Id.* at 535-36; 11 U.S.C. § 503 (2000) (stating that in relevant part that "(a) An entity may timely file a request for payment of an administrative expense, or may tardily file such request if permitted by the court for cause; (b) After notice and a hearing, there shall be allowed administrative expenses"). The court's reference to the debtor-in-possession in its analysis and framing of the issue to concern "plan-based sales" suggests that the *In re O'Brien* test does not encompass Section 363 sales. *See In re* O'Brien, 181 F.3d at 532; *In re* Bethlehem Steel Corp., 2003 U.S. Dist. LEXIS 12909, at *34 (S.D.N.Y. July 28, 2003). The *Bethlehem Steel* court suggests in dicta that *In re O'Brien* may be interpreted as permitting payment of break-up fees only when consistent with Section 503(b). However, the court counsels against this approach and suggests that such fees should be allowed under § 363(b) "unless they are unreasonable or appear more than likely to chill the bidding process than to enhance it." *Id.* at *34-35 (citing 3 COLLIER ON BANKRUPTCY, *supra* note 11, ¶ 105.01).

[197] *See In re O'Brien*, 181 F.3d at 536-37 (stating that the break-up fee was not "necessary to preserve the value of the estate" as Calpine had failed to show that the "break-up fee promoted more competitive bidding").

[198] *See id.* at 530; Jones et al., *supra* note 191, at 16.

a. Revisiting Delaware Bankruptcy Court Decisions on Defensive Devices

Similar to the treatment of lockup agreements, recent Delaware bankruptcy court decisions seem less tolerant of break-up fees.[199] In an unpublished opinion, *In re Pillowtex*, Judge Walsh extended the "administrative expense" test from *In re O'Brien* to pre-auction approval of break-up fees.[200] Although the debtor and the creditor committee in *Pillowtex* had consented to the break-up fee, the court refused to approve the use of an incentive where the parties were merely in contemplation of a potential "stalking horse" bidder.[201] In another unpublished opinion, *In re SHC Inc. (Top-Flite)*, Judge Walrath did not accept a bidder's provision for break-up fees where another bidder had made the same offer without requesting a break-up fee,[202] and this without additional expenses accruing to the estate.[203] The court gave the initial bidder, Callaway, the option of either being the

[199] *See* Jones et al., *supra* note 191, at 16; James H.M. Sprayregen et al., *First Things First: Breaking Up is Hard(er) to Do for Priority for Payment of Break-Up Fees Post-CXM*, 23-7 AM. BANKR. INST. J. 36, *36 (2004) [hereinafter *Breaking Up is Hard(er) to Do*]

[200] 22-8 AM. BANKR. INST. J. 16 (citing *In re Pillowtext Corp.*, Case No. 03-12339 (PJW) at 33).

[201] Jones et al., *supra* note 191, at 16 (stating that "everybody is aware that where a bid procedure motion is brought on with a contract with a stalking horse, it is not a difficult case to get a break-up fee in most instances. But it is a fact and circumstance decision and authorizing it in advance simply does not allow for the decision.").

[202] *Id.* (citing *In re SHC Inc.*, Case No. 03-12002 (MFW)); *But see In re* President Casinos, Inc., 314 B.R. 786 (Bankr. E.D. Mo. 2004). Although the *President Casinos* court applied the *Calpine* test, the court approved the break-up fee in spite of finding that the fee would not enhance the bidding process. *Id.* at 789. However, the bankruptcy court limited the break-up fee to the reasonable costs and expenses of the prospective purchaser. *Id.* (stating that "[a] break-up fee that is greater than the actual cost and expenses of the prospective purchaser should constitute a fair and reasonable percentage of the proposed purchase price, and should be reasonably related to the risk, effort, and expenses of the prospective purchaser") (citing *In re* Integrated Res., Inc., 147 B.R. 650, 652 (Bankr. S.D.N.Y. 1992)).

[203] Jones et al., *supra* note 191, at 52.

"stalking horse" without a break-up fee or declining the option in favor of the other bidder, Adidas.[204] Callaway agreed to remain the "stalking horse" without a break-up fee.[205] In both Delaware cases, allowing the break-up fees would have been inconsistent with *O'Brien*, for the incentives were not necessary to preserve the assets of the estate.

Although the legal import of these opinions is uncertain because they do not represent binding authority, they may be emblematic of a larger trend that courts will continue to scrutinize bidding procedures that are not shown to maximize the value of the estate.[206] For instance, in *Gey Assocs. v. 310 Assocs. (In re 310 Assocs.)*, the Second Circuit held that the district court did not abuse its discretion in rejecting an application for break-up fees and declining to recognize a prospective purchaser as a "stalking horse" because two other parties were actively bidding.[207] The Second Circuit acknowledged the appeal of such fees as an incentive to form a "stalking horse," but such considerations were moot due to the dynamic bidding contest.[208] Similarly, in *Specialty Malls of Tampa, Inc. v. Riverbank Landscape, Ltd.*, the court refused to rubber-stamp the payment of a break-up fee.[209] In contemplating a sale to Specialty Malls, the seller agreed to pay a break-up fee if the bidder lost the sale to another bidder.[210] Specialty Malls was neither the

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[204] *Id.*

[205] *Id.*

[206] The recent Delaware bankruptcy court opinions demonstrate that bidder's seeking protection in the form of break-up fees must "bring value to the estate . . . [and show] the fee is an actual, necessary cost and expense of preserving the estate". *Id.*

[207] 346 F.3d 31 (2d Cir. 2003).

[208] *Id.* at 34.

[209] No. 03 Civ. 9305, 2004 U.S. Dist. LEXIS 13572, at *12 n.2 (S.D.N.Y. July 12, 2004) (citing Judge Mukasey's analysis for evaluating break-up fees, which asks "whether the party had performed a useful service—'(1) to attract or retain a potentially successful bid, (2) to establish a bid standard or minimum for other bidders to follow; or (3) to attract additional bidders'") (citing *In re* Integrated Res., Inc., 147 B.R. 650, 661 (Bankr. S.D.N.Y. 1992).

[210] *Id.* at *2.

highest, nor second highest bidder.[211] Furthermore, the sale was never consummated because the highest bidder defaulted and the second-highest bidder opted not to buy the property.[212] According to the language in the agreement providing for the break-up fee, the obligation to pay the break-up fee never arose because the highest bidders did not close the deal.[213] Therefore, the court refused to award Specialty Mills the break-up fee.[214]

3. Stopping Short of a Per Se Rule of Invalidity

Despite academic criticism of break-up fees, bankruptcy courts have not gone so far as to declare these incentives per se unenforceable.[215] First, bankruptcy judges may believe that break-up fees actually facilitate the start of bidding and encourage a lively auction.[216] On the other hand, bankruptcy judges are cognizant of the limits the Code imposes and of their obligation to act in the best interests of the debtor estate. The *O'Brien* decision provided evidence of this recognition with the court's refusal to adopt a common law rule of break-up fees, instead grounding the authorization of break-up fees in Section 502 of the Code.[217] Because the bidder's petition for fees did not meet the requirements of Section 502 as embodied in the "administrative expense" test, the court rejected the claim.[218] Therefore, the *O'Brien* court demonstrated that it would not permit the payment of

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[211] *Id.* at *4-5.

[212] *Id.* at *5.

[213] *Id.* at *8-11; *see In re* S.N.A. Nut Co., 186 B.R. 98, 106 (Bankr. N.D. Ill. 1995) (denying a petition for a break-up fee because the sale was never consummated and the estate derived no benefit from the bid).

[214] *Specialty Malls* at *8-11.

[215] Markell, *supra* note 69, at 386 (arguing that break-up fees are inappropriate in bankruptcy sales because they do not induce bids from hesitant bidders and thus merely squander assets); *but see In re O'Brien,* 181 F.3d at 536-38 (refusing to declare break-up fees per se unenforceable).

[216] *See* Jones et al., *supra* note 191, at 16; Sprayregen et al., *Breaking Up is Hard(er) to Do, supra* note 199.

[217] *In re O'Brien,* 181 F.3d at 537-38.

[218] *Id.*

break-up fees to the extent such fees were inconsistent with the Code.

Second, bankruptcy courts abstain from drawing bright-line rules that would effectively constrain their equitable powers.[219] This broad discretion enables bankruptcy courts in all cases to maximize the value of the bankruptcy estate. In *In re CXM, Inc.*, the bankruptcy court demonstrated the true extent of this power to regulate break-up fees.[220] Although the court authorized the payment of a break-up fee to the losing bidder, the court subordinated the bidder's claim to a creditor's senior lien.[221] In this way, the *CXM* court expressed that bankruptcy courts retain the ability to preserve the best interests of the debtor estate.[222]

B. Developing a "Good Faith" Requirement under Chapter 11

The modern approach for evaluating Chapter 11 petitions parallels the bankruptcy courts' attitude toward the use of defensive devices in bankruptcy sales. In recent years, bankruptcy courts have imposed greater scrutiny to Chapter 11 petitions. To augment the *Lionel* court's low threshold requirement that a bankruptcy sale must have a "good business reason," several courts now condition the filing of a bankruptcy petition upon a finding of "good faith."[223] While some courts adopted increasingly rigid standards, bankruptcy courts more recently have rejected the use of

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[219] *Id.* at 532, 536-37 (the Third Circuit refused to develop a common law rule of break-up fees and noted that the bankruptcy court rejected the multi-factor test in favor of the more liberal "administrative expense" test).

[220] *In re* CXM, Inc., 307 B.R. 94 (Bankr. N.D. Ill. 2004).

[221] *Id.* at 104-05.

[222] Sprayregen et al., *Breaking Up is Hard(er) to Do*, *supra* note 199 at 63.

[223] *In re* SGL Carbon Corp., 200 F.3d 154 (3d Cir. 1999). The court noted that several other circuit courts considered the "absence of good faith" or a finding of "bad faith" as grounds for dismissing a Chapter 11 petition under § 1112. *Id.* at 165. *See also* Martin J. Bienenstock, *Recent Developments Affecting Chapter 11 Cases*, Subcommittee of the Section of Business Law of the American Bar Association, at 90-99 (2004).

bright-line rules in favor of case-by-case assessments.[224] In this way, bankruptcy courts have preserved the flexibility necessary to respond to the needs of each new debtor.

1. Defining Good Faith As Requiring A Valid Reorganizational Purpose

In *In re SGL Carbon Corp.*, the Third Circuit held that courts may dismiss bankruptcy petitions under Section 1112(b) upon a finding of bad faith.[225] It dismissed the district court's finding of good faith, based on the debtor's assertions that a pending antitrust litigation "posed serious threat to [SGL Carbon's] successful business operations" and that a negative judgment might cause the company "financial and operational ruin" as clearly erroneous.[226] The court acknowledged that the Code supports early filing, but stated that premature filings or those lacking a valid reorganizational purpose were not consistent with the court's good faith requirements.[227] In light of SGL's demonstrated financial health and its failure to show that an adverse judgment would significantly jeopardize its existing operations, it found only a "mere possibility of a future need to file."[228] Therefore, the court reasoned that SGL did not file

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[224] *See, e.g.*, Solow v. PPI Enters. (U.S.), Inc. (*In re* PPI Enters. (U.S.), Inc.), 324 F.3d 197, 211 (3d Cir. 2003).

[225] 200 F.3d, at 160. Although Section 1112 does not explicitly mention "good faith" among the list of enumerated reasons for dismissing a Chapter 11 petition, inclusion of the word "including" among the factors in Section 1112 implied that the list of was not exhaustive. Moreover, the court reasoned that implying such a term would be consistent with legislative history and the equitable nature of bankruptcy. *Id.* Section 363 sales, on the other hand, do include an explicit requirement of good faith to protect sales from appeal. 11 U.S.C. § 363(m); *see* Robert J. Keach et al., *Stalking-Horse Lenders and Good Faith: The Availability of Appellate Protection under §§ 363(m) and 364(e) for Asset Purchasers Extending DIP Financing*, 23-5 AM. BANKR. INST. J. 28, *60 (2004) (warning that bankruptcy courts scrutinize evidence of good faith to prevent the DIP from giving unfair advantage to stalking-horse purchasers).

[226] *In re SGL Carbon Corp.*, 200 F.3d at 162.

[227] *Id.* at 163.

[228] *Id.* at 164.

its petition in good faith.[229] In addition, the court adopted the principle that a bankruptcy petition must at least have a "valid reorganizational purpose" to comport with good faith.[230] Because it lacked the intent to reorganize in Chapter 11, the Court held that SGL did not file in good faith.[231]

2. Rejecting a Bright-Line Reorganizational Requirement in Favor of a Case-By-Case Assessment of Good Faith

Adopting a "good faith" requirement may have simply reflected the Third Circuit's disfavor for SGL's admitted use of Chapter 11 as a litigation tactic, rather than a need to interpose an additional requirement of "good faith" under Chapter 11.[232] Nonetheless, in *In re PPI Enterprises, Inc.*, the Third Circuit applied the *SGL* court's "good faith" principle.[233] Although *SGL* suggested that a party must have a valid reorganizational purpose to file in good faith, the *PPI* court indicated that no single factor is controlling and good

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[229] *Id.*

[230] *Id.* at 165-66 (stating that courts have "consistently dismissed Chapter 11 petitions filed by financially healthy companies with no need to reorganize under the protection of Chapter 11").

[231] *Id.* at 166. The court found that SGL did not have an intention to reorganize because it was not experiencing any financial difficulty. SGL's financial disclosures stated that its assets far exceeded its liabilities, it did not have any difficulty fulfilling its existing debt or obtaining access to capital, and its representatives lauded its financial health and ability to withstand an adverse judgment. Moreover, the court showed concern that SGL filed Chapter 11 as a litigation tactic to force settlement of an antitrust suit. Furthermore, although the court emphasized that it was not evaluating the good faith of SGL's reorganization plan, the court suggested that the filing was geared to frustrate the antitrust litigation and therefore further "illuminat[ed] the lack of good faith in the filing." *Id.* at 167 & nn.17 & 19.

[232] 11 U.S.C. § 1129(a)(3) (2000) includes a requirement that a plan be proposed in good faith. *See* Bienenstock, *supra* note 223, at 92 (criticizing the Third Circuit's holding as focusing incorrectly on the debtor's state of mind and predicting a deluge of litigation over the issue of a "valid reorganizational purpose").

[233] Solow v. PPI Enters. (U.S.), Inc. (*In re* PPI Enters. (U.S.), Inc.), 324 F.3d 197, 210-11 (3d Cir. 2003).

faith determinations should be made on a case-by-case basis.[234] Instead of making the intent to reorganize a per se filing requirement, the *PPI* court adopted a lighter standard that prohibits the "abuse [of] bankruptcy law by employing it for a purpose for which it was not intended."[235]

In *In re Integrated Telecom Express, Inc.*, the Third Circuit provided greater clarification by stating that Chapter 11 petitions must serve "a valid bankruptcy purpose," whether involving a liquidation or reorganization plan.[236] At the highest level of abstraction, the Code seeks to maximize value by "alleviating the problem of financial distress."[237] Accordingly, the court dismissed Integrated's petition because the company failed to establish that it suffered from financial distress or that the value of its assets "could be preserved or maximized in an orderly liquidation under Chapter 11."[238] Moreover, Integrated was already "out of business" and therefore did not have any "going concern value to preserve in Chapter 11 through reorganization or

[234] *Id.* at 211 ("good faith determination must be a fact-intensive, case-by-case inquiry"). The *PPI* court found that the *PPI* bankruptcy court had mirrored the Third Circuit's *SGL* analysis in noting that "courts have not identified with any consistency which circumstances of the debtor's filing are indicia of good faith"). *Id.* at 211 n.22.

[235] *Id.* at 211 (citing the bankruptcy court's finding that filing a Chapter 11 petition in order to avail oneself of certain Code provisions does not per se demonstrate bad faith).

[236] NMSBPCSLDHB, L.P. v. Integrated Telecom Express, Inc. (*In re* Integrated Telecom Express, Inc.), 384 F.3d 108, 119-20 (3d Cir. 2004) (stating that the basic purposes of Chapter 11 are (1) "preserving going concerns" and (2) "maximizing property available to satisfy creditors") (citing Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 N. LaSalle St. P'ship, 526 U.S. 434, 453 (1999)). The Third Circuit stated further that filing a petition as a litigation tactic is prohibited as inconsistent with good faith requirements. *Id.* at 120 (citing *In re* SGL Carbon Corp., 200 F.3d 154, 165 (3d Cir. 1999)).

[237] *Id.* at 121.

[238] *Id.* at 122. The Third Circuit rejected Integrated's additional justifications as post hoc and insufficient to establish "good faith" under Section 1112. *Id.* at 127-28. The court also rejected the *PPI* court's holding that a petitioner may file Chapter 11 merely to obtain certain procedural advantages otherwise unavailable outside of bankruptcy. *See id.* at 127-29.

liquidation."[239] Although Integrated was "experiencing a downward spiral," its problems were not related to any financial distress because it was completely solvent.[240] Rather, the business suffered from a failing business model, which could not be remedied within bankruptcy.[241] Accordingly, Integrated did not satisfy the good faith requirement because its petition did not "serve a valid bankruptcy purpose."[242]

While the Code does not explicitly require a finding of good faith, other courts overwhelmingly imply a condition of good faith in bankruptcy proceedings.[243] Although bankruptcy courts make these determinations based on the totality of the circumstances,[244] they are particularly sensitive

[239] *Id.* at 120. The Third Circuit also emphasized *SGL Carbon*'s assertion that insolvency is not a prerequisite for filing in bankruptcy. However, where a petitioner cannot demonstrate that there exists "some value that otherwise would be lost outside of bankruptcy," he has failed to show a "valid bankruptcy purpose" and thus cannot file a petition in "good faith." *See id.* at 120-22.

[240] *Id.* at 122.

[241] *Id.*

[242] *Id.* at 124-130.

[243] COLLIER BANKRUPTCY MANUAL ¶ 1112.07 (Lawrence P. King, ed., Matthew Bender & Co., Inc. 3d ed. rev. 2004) ("Every bankruptcy statute since 1898 has incorporated literally, or by judicial interpretation, a standard of good faith for the commencement, prosecution, and confirmation of bankruptcy proceedings.") (citing Little Creek Dev. Co. v. Commonwealth Mortgage Corp. (*In re* Little Creek Dev. Co.), 779 F.2d 1068, 1071 (5th Cir. 1986)). The *Collier Bankruptcy Manual* differentiated the good faith standard under Section 1112(b) from the general ability of a bankruptcy judge to dismiss a party "for lack of good faith in order to prevent abuse of the chapter 11 process. *Id.* Unlike the subjective test of general good faith, the standard under Section 1112(b) is an objective test; it allows a bankruptcy judge to curtail a debtor's efforts where they "have proven inadequate to the task of reorganizing his affairs effectively within a reasonable amount of time." *Id.* (citing Illum Hansen, Inc. v. Tiana Queen Motel, Inc. (*In re* Tiana Queen Motel, Inc.), 749 F.2d 146, 152 (2d Cir. 1984)).

[244] *See id.* (citing Marsch v. Marsch (*In re* Marsch), 36 F.3d 825, 828 (9th Cir. 1994); First Nat'l Bank of Sioux City v. Kerr (*In re* Kerr), 908 F.2d 400, 404 (8th Cir. 1990); Trident Assocs. Ltd. P'ship v. Metropolitan Life Ins. Co. (*In re* Trident Assocs. Ltd. P'ship), 52 F.3d 127, 131 (6th Cir. 1995); Little Creek Dev. Co. v. Commonwealth Mortgage Corp. (*In re* Little

to plans that may attempt to defraud interested parties or frustrate pending litigation.[245] In addition, despite the Third Circuit's brief flirtation with requiring a "valid reorganizational purpose" for every Chapter 11 filing, courts prefer more liberal standards to evaluate good faith.[246] This is yet another example of bankruptcy courts' reluctance to draw bright-line rules that constrain the equitable powers of bankruptcy judges to serve the best interests of the parties in any given proceeding.[247]

C. Bidding Procedures and Auction Sales

Bankruptcy practitioners recognize the tremendous impact of first-day orders on the progress of a Chapter 11 proceeding, particularly court approval of bidding procedures.[248] Bidding procedures generally dictate which

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Creek Dev. Co., 779 F.2d 1068,1071 (5th Cir. 1986)); *In re* C-TC 9th Ave. P'ship, 113 F.3d 1304, 1312 (2d Cir. 1997).

[245] For additional grounds where courts have rejected Chapter 11 petitions, *see* COLLIER BANKRUPTCY MANUAL ¶ 1112.07 (Lawrence P. King, ed., Matthew Bender & Co., Inc. 3d ed. rev. 2004).

[246] *See, e.g.*, Toibb v. Radloff, 501 U.S. 157, 161 (1991) ("The Code contains no ongoing business requirement for reorganization under Chapter 11"); Bartel v. Bar Harbor Airways, 196 B.R. 268, 273 (S.D.N.Y. 1996) (§ 1123(b)(4) allows sale of assets as part of a Chapter 11 liquidation plan).

[247] *See, e.g., In re* Lionel Corp., 722 F.2d 1063, 1069 (2d Cir. 1983) (stating "[f]irst and foremost is the notion that a bankruptcy judge must not be shackled with unnecessarily rigid rules when exercising the undoubtedly broad administrative powers granted him under the Code"); Novikoff & Polebaum, *supra* note 70, at 10-11 (citing *In re* NII Holdings, Inc., No. 02-11505, Docket No. 394, Transcript of Oct. 22, 2002) (refraining from declaring lockup agreements per se impermissible).

[248] Jones et al., *supra* note 191, at 16. Recent controversy surrounded the submission by Time Warner and Comcast of a joint bid for Adelphia Communications Corp. The casting of a joint bid may signal collusion between bidders. Adelphia ultimately acquiesced to the joint bid, likely out of concern that blocking the bid would be construed by creditors as foot-dragging. Mike Farrell, *Adelphia Heads to Stage Two: First Bidder Cut is Due at Month's End*, Multichannel News, *available at* www.multichannel.com/index.asp (Oct. 18, 2004). For an instance where a bankruptcy court rejected a joint bid as a product of collusion and for

parties are qualified to participate in an auction, prescribe the tools for evaluating competing bids, and address the potential consequences of selecting the bid of a party other than the stalking horse.[249] Accordingly, the bidding procedure adoption process tends to be the most strategic aspect of a Section 363 sale.[250] Bidding procedures prove crucially important to the outcome of an auction, as well, because courts are reluctant to disturb a consummated sale[251] and bidders generally do not have standing to object to bidding procedures ex post.

Recently, discussion has focused on the tendency of bankruptcy judges to allow nonconforming bids to participate in auction contests and to deny finality to auction sales, which some claim enervates the integrity of the auction process.[252] For instance, in *Corporate Assets, Inc. v. Paloian*, the Seventh Circuit affirmed the bankruptcy court's decision to conduct a second auction, and subsequently confirm a sale, where the challenging party, Corporate Assets, Inc. ("CAI"), held the highest bid in both auctions.[253] The bankruptcy court allowed the second auction because a bidder from the

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chilling bidding, *see* Ross v. Kirschenbaum (*In re* Beck Indus., Inc.), 605 F.2d 624 (2d Cir. 1979).

[249] Ball & Kane, *supra* note 14, at 8. *See also In re* Edwards, 228 B.R. 552, 561 (Bankr. E.D. Pa. 1998) (stating that the purpose of bidding procedures is to create a setting "designed to maximize value for the estate" and therefore, bankruptcy courts retain considerable discretion to achieve that goal).

[250] Ball & Kane, *supra* note 14, at 8.

[251] Bartel v. Bar Harbor Airways, 196 B.R. 268, 271-72 (Bankr. S.D.N.Y. 1996).

[252] *See* Robert U. Sattin, *Finality in Auction Sales: It Ain't Over Till It's Over*, 23-7 AM. BANKR. INST. J. 1, 53 (Sept. 2004) (stating "the more room for bid procedure modification at counsel's direction, the less integrity there is in the process").

[253] Corp. Assets, Inc. v. Paloian, 368 F.3d 761 (7th Cir. 2004). CAI appealed the bankruptcy court's allowance of the second auction and refusal to confirm the highest bid in the first auction as an abuse of the court's discretion. In the second auction, CAI again entered the highest bid, which was $352,500 higher than its original bid. *Id.* at 762.

first auction, Myron Bolling Auctioneers ("MBA"), sought to increase its bid after the auction had formally closed.[254]

In reviewing a bid, bankruptcy courts balance the priority of "secur[ing] the highest price for the benefit of the estate and creditors" with the "need to preserve the integrity and finality of the auction process and to recognize the reasonable expectations of the parties who participated in the first auction."[255] To further the best interests of the estate, the bidding procedures in *Paloian* reserved to the debtor the right to decline a bid or impose additional constraints on the sale process before formal court approval of a sale.[256] As CAI was aware of these reservations, the court reasoned that authorizing a second auction would not disturb CAI's "reasonable expectation[s]" because the court had not formally approved its bid.[257] On balance, the second auction resulted in a "significant boon" to the estate, since CAI raised its bid by approximately 15.7 percent.[258] Furthermore, the second auction served to "level [the] playing field" because the bidders had not all received complete disclosure of material information prior to the first auction.[259]

[254] *Id.* at 765. MBA sought to raise its bid from $2.075 million to $2.45 million because the debtor, Goss, agreed to remove a contested provision from the purchase agreement, thus making the sale more attractive. Although the debtor's attorney had informed the bidders that they had to register any objections to the sale process prior to the auction date, MBA was unable to inform all of the members of its bidding group of the change to the purchase agreement before the auction and alter its bid accordingly.

[255] *Id.* (acknowledging one of the competing concerns considered by the bankruptcy court).

[256] *Id.* at 766. Under the bidding procedures, the debtor, Goss, retained the ability to refuse a bid or alter the sale conditions to promote the best interests of the estate before the court formally approved the sale.

[257] *Id.* The bankruptcy court reserved the right to accept either the highest bidder from either the first or second auction. *Id.* at 765.

[258] *Id.* at 767. The second bid was $352,500 higher than the previous bid. *Id.* at 762-63.

[259] *Id.* at 771.

The Seventh Circuit's review reflected palpable deference to the bankruptcy court's findings,[260] for the court emphasized that "the bankruptcy court's confirmation or refusal to confirm an asset sale will only be overturned in extreme cases" for abuses of discretion.[261] The court articulated that the primary purpose of bankruptcy is "to maximize creditor recovery."[262] While bankruptcy courts should weigh competing factors, the court explained that the discretionary powers of the bankruptcy court lie along a continuum, with the greatest ebb of authority to reopen the bidding process progressively winnowing as the sale proceeds toward a "fait accompli."[263] At that point, only "narrow circumstances" will justify overturning the highest bid in favor of a subsequent auction.[264] Conceding certain facts that may have led CAI to believe that the sale was final, the court stressed the

[260] Where a bankruptcy court has not yet confirmed a sale, the court may decide that declining to confirm a sale will not jeopardize the bidder's reasonable expectations and mere "financial gain" for the debtor estate may justify reopening bidding without any further showing of price inadequacy or bad faith. *Id.* at 768. The Seventh Circuit emphasized that while the court's discretion is not "unbounded," the court enjoys "broader discretion to balance the goal of estate maximization against the interest in regularity and finality and the parties' expectations." *Id.* at 769.

[261] *Id.* at 767 (citing *In re Chung King, Inc.*, 753 F.2d at 549). The district court held that the bankruptcy court acted within its discretion in finding that the "significant boon" to the debtor estate outweighed CAI's alleged expectations in the finality of the first auction. Even though it altered the bidding procedures by consenting to a second auction, the district court concluded that the bankruptcy court acted in accordance with the bidding procedures because the debtor reserved the ability to decline a bid inconsistent with the best interests of the estate and the procedures did not provide for a "cut-off beyond which Goss could no longer accept bids." *Id.* at 766. The district court also cited to the debtor counsel's statements that they could not give "100 percent assurance" on the finality of the sale. *Id.* at 764.

[262] *Id.* at 767.

[263] *Id.* at 768.

[264] *Id.* The Seventh Circuit suggested that the bankruptcy court may only entertain late bids where a sale has been confirmed if the initial bid is "so grossly inadequate as to shock the conscience of the court" or if "the original auction was tainted by fraud, mistake, or some comparable defect." *Id.* (citations omitted).

provisions in the bidding procedures that allocated final say to the judge, thus making CAI's claim of upset expectations less compelling.[265] The court further commented that granting bankruptcy judges "broad discretion" is necessary to facilitate their efforts to "enhance the value of the estate," and for that reason it refused to adopt a "hard and fast rule" prohibiting judges from "entertaining an upset bid."[266]

Although some practitioners have argued that clearer standards are necessary to preserve the integrity of the auction process, appellate courts consistently render decisions favoring broad discretion to bankruptcy judges in

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[265] *Id.* at 770-71. In support of CAI's claim that the second auction upset its "reasonable expectations," the court noted that the bidding procedures and confirmation order contemplated a single auction and that Goss' counsel stated that "when we close the auction it will be final." Although he hedged this statement slightly, he felt that there was only a "very slim possibility" of the highest bid being upset. Moreover, the nature of the bidding was not "complex and fluid," which would leave the bidders with uncertainty as to the results of the auction. Therefore, none of the bidders contemplated any further bidding. *Id.* at 769.

In spite of this evidence, the Seventh Circuit found that the bankruptcy court was within its discretion to authorize a second auction and confirm the subsequent sale due to the facts that the court had not formally confirmed the sale, the second auction leveled the playing field because not all the bidders had notice of material information, there was no evidence of strategic bidding or bad faith from the late bidder because the party sought to enter a higher bid shortly after learning of the relevant disclosure, the debtor had obtained the support of the lender and unsecured creditor committees, the second auction resulted in a "significant boon" to the estate, and CAI was able to participate in the subsequent auction and was only prejudiced by having to pay more to secure the highest bid.

[266] *Id.* at 770. *But see In re* Gil-Bern Indus., Inc., 526 F.2d 627 (1st Cir. 1975) (holding that the bankruptcy court abused its discretion in authorizing a second auction). The Seventh Circuit distinguished *Gil-Bern* because the bankruptcy court in that case did not refuse "to confirm an adequate bid received properly and fairly conducted sale merely because a slightly higher offer has been received after the bidding is closed." Paloian, 368 F.3d at 770 (citing *In re* Gil Bern Indus., Inc., 526 F.2d at 629). Furthermore, given that the close of bidding does not always signify the finality of a sale, permitting late bids after the close of formal bidding does not necessarily upset the reasonable expectations of participating bidders. *Id.* at 770-71.

approving bidding procedures and conducting sales.[267] In *In re Farmland Industries*, the bankruptcy appellate court upheld the bankruptcy court's authorization of a second auction sale because a party with a right of first refusal was not informed of the sale.[268] Acknowledging a necessity to weigh the needs of the debtor estate with the bidders' interests, the appellate court asserted that a bankruptcy court "has broad discretion to conduct sales in the manner it deems most appropriate" before the sale is formally confirmed.[269] Because the bidding procedures provided that a sale would not be final until confirmed by the judge, the claimant could not reasonably argue that his expectations of finality were justified.[270] Similarly in *In re Financial News Networks, Inc.*, the Second Circuit upheld the bankruptcy court's decision to allow a party to increase its bid after the close of an auction.[271] The court rejected the *Gil-Bern* bright-line rule, which held that bankruptcy courts abused their discretion in reopening an auction merely because a party offered a slightly higher bid after the auction had closed.[272] The Second Circuit criticized the application of bright-line rules to bankruptcy law for their potential to compromise the

[267] *See* Robert U. Sattin, *Finality in Auction Sales: It Ain't Over Till It's Over*, 23-7 AM. BANKR. INST. J. 1, at 52 (2004).

[268] *In re* Farmland Indus., Inc., 289 B.R. 122 (B.A.P. 8th Cir. 2003).

[269] *Id.* at 126. The court stated that the "bankruptcy court has considerable discretion in approving assets sales and is granted ample latitude to strike a balance between fairness, finality, integrity and maximization of assets." *Id.* (citing Wintz v. Am. Freightways, Inc. (*In re* Wintz Cos.), 219 F.3d 807, 812 (8th Cir. 2000)).

[270] *Id.* at 127 (stating that "it is unlikely that reasonable expectations of certainty *could ever exist* prior to a hearing where court approval is required") (emphasis added).

[271] 980 F.2d 165 (2d Cir. 1992).

[272] *Id.* at 169-70 (stating that the Gil-Bern holding was particularly inapplicable where the bidding process is "complex and fluid") (citing *In re* Gil-Bern Industries, Inc., 526 F.2d 627, 628-29 (1st Cir. 1975); *See also* Corp. Assets, Inc. v. Paloian, 368 F.3d 761, 770 (declining to follow the rigid application of the *Gil-Bern* rationale).

ability of bankruptcy courts to address the competing concerns of debtors and bidders.[273]

Even where sales are final, appellate courts still review bankruptcy court confirmations with substantial deference. Appellate courts express this regard through their rigid adherence to the statutory and equitable mootness doctrines and their tendencies to uphold bankruptcy courts' findings of good faith. For example, in *In re Colony Hill Associates*, the Second Circuit upheld the bankruptcy court's rejection of a non-conforming bid, as well as a subsequent motion to stay the sale, although the party, Kabro, would have been the highest bidder.[274] Because the bankruptcy court denied Kabro's motion for stay, Kabro did not have standing to challenge the sale. Consequently, its arguments were rendered moot.[275]

On the other hand, Kabro did have standing to challenge whether the buyer was a "good faith purchaser."[276] The Code

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[273] *See In re Fin. News Networks*, 980 F.2d, at 169 (citing *In re* Lionel Corp., 722 F.2d 1063, 1069 (2d Cir. 1983)) (stating that "first and foremost is the notion that the bankruptcy judge must not be shackled with unnecessarily rigid rules when exercising the undoubtedly broad administrative power granted him under the [Bankruptcy] Code").

[274] 111 F.3d 269, 271-72 (2d Cir. 1997). The appellant, Kabro Associates, claimed that it did not comply with the initial bid requirement because it did not provide sufficient notice to that effect. *Id.*

[275] *Id.* at 273. Section 363(m) provides that a party's appeal is moot if that party fails to secure a stay of the sale. Section 363(m) provides, in relevant part, that:

> The reversal or modification on appeal of an authorization . . . of a sale or lease of property does not affect the validity of a sale or lease 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 appeal, unless such authorization and such sale or lease were stayed pending appeal.

11 U.S.C. § 363(m).

[276] The Second Circuit used the standard from the former Section 39(c) of the Bankruptcy Act of 1898 and the relevant case law that limit appellate standing to "person aggrieved," defined as "one who is 'directly and adversely affected pecunarily' by the challenged ruling of the bankruptcy court." *In re Colony Hill Associates*, 111 F.3d at 273. The court held that Kabro had standing to challenge the buyer's status as a

does not explicitly define "good faith." Nevertheless, the Second Circuit stated that good faith concerns the "equity of [the bidder's] conduct in the course of the sale proceedings" and proscribes "fraud, collusion between the purchaser and other bidders or the trustee, or an attempt to take grossly unfair advantage of the bidders" of offers where "initial sale price [was] so grossly inadequate as to shock the conscience of the court."[277] The court ultimately denied Kabro's claim because the bankruptcy court had made a specific finding that the buyer was a "good faith purchaser" and therefore had acted within its discretion to bar Kabro's bid for failing to comply with the bidding procedures.[278] The Second Circuit refrained from scrutinizing the good faith finding because the bankruptcy judge was impliedly better fit to make such determinations, as he "had presided over these proceedings for many years and . . . had before him all the facts underlying Kabro's appeal."[279]

Similarly, in *In re Polaroid Corp.*, the district court denied a party standing to appeal a sale on grounds of equitable and statutory mootness for failing to obtain a stay and upheld the bankruptcy court's finding of "good faith" in light of the party's challenge.[280] The district court held that

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good faith purchaser because his claim addressed the inherent fairness of the bankruptcy proceeding. *Id.* at 274.

[277] *Id.* at 276 (citation omitted).

[278] *Id.* at 275-76.

[279] *Id.* at 277-78.

[280] No. 03-1168-JJF, 2004 U.S. Dist. LEXIS 19822 (D. Del. Sept. 30, 2004). To determine whether the claim was equitably moot, the bankruptcy court considered:

> (1) whether the reorganization plan has been substantially consummated; (2) whether a stay has been obtained; (3) whether the relief requested would affect the rights of the parties not before the court; (4) whether the relief requested would affect the success of the plan; and (5) the public policy affording finality to bankruptcy judgments.

Id. at *7 (citing *In re* Continental Airlines, 91 F.3d 553, 560 (3d Cir. 1996). The district court held that the doctrine of equitable mootness applied because "the Plan was substantially consummated," distribution to unsecured creditors had occurred, and granting the appellant relief would be "undermining a successful reorganization. *Id.* at *7-8.

the good faith finding was sufficiently supported in the record because the bankruptcy court had concluded that the assets were adequately exposed to the market, the auction was rigorous, the bidders had equal access to relevant information and equal opportunity to bid, and the debtor's estate labored to secure the highest return.[281] Likewise, in *In re NET2000 Communications, Inc.*, the district court denied the appeal of a confirmed sale on grounds of mootness.[282] The district court applied a two-prong test that queried "(1) whether the order was stayed pending appeal and (2) whether vacating the order would affect the validity of the sale."[283] The challenger failed to obtain a stay of the sale.[284] The district court did not address whether the sale served the best interest of the estate or would benefit more from a later offer. Because the settlement had been approved and the assets had already transferred hands, the district court found that granting relief to the plaintiff would "affect the validity of the sale" and therefore denied the party's claim.[285]

Appellate courts also hesitate to overturn the confirmation of bidding procedures and deny such petitions on mootness grounds as well. In *In re O'Brien Env. Energy, Inc.*, the Third Circuit upheld the bankruptcy court's refusal to approve a break-up fee for fear that it would "perhaps chill or at best certainly complicate the competitive bidding process."[286] As merely a "disappointed prospective

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[281] *Id.* at *6-7.

[282] Nos. 01-11324 & 02-232-KAJ, 2004 U.S. Dist. LEXIS 20625 (D. Del. Oct. 5, 2004); *see In re* Gucci, 126 F.3d 380 (2d Cir. 1997) (adopting the bankruptcy court's findings of "good faith" and rejecting the appeal to repeal a sale order on grounds of mootness); *In re* Wal-Mart Real Estate Business Trust, 259 B.R. 831 (Bankr. E.D. Pa. 2001) (refusing to dismiss a bankruptcy court's sale order on grounds of statutory mootness and because sufficient grounds existed to support the bankruptcy court's good faith finding).

[283] *See In re* NET2000 Communications, 2004 U.S. Dist. LEXIS 20625, at *10.

[284] *Id.*

[285] *Id.*

[286] *In re* O'Brien Env. Energy, Inc., 181 F.3d 527, 529 (3d Cir. 1999).

purchaser," the bidder did not have the qualifying status permitting it to challenge the court's order.[287] The court in *In re Homelife Corp.* also denied a party's motion to reconsider the bankruptcy court's approval of bidding procedures because a review of the record established that the necessary requirements were met and the bankruptcy court had determined that allowing the fee was in the best interests of the estate.[288]

V. CONCLUSION

The recent academic debate among bankruptcy theorists explores whether bankruptcy sales have eclipsed reorganizations as the preferred measure within Chapter 11 and whether this trend has threatened the continued efficacy of Chapter 11 as a viable rehabilitative tool.[289] Additionally, this discourse has brought to the fore the exceedingly complex nature of the issues that attend Chapter 11. While this Note does not attempt to contribute to this normative debate, the fact that these questions remain unanswered is highly relevant to how judges approach bankruptcy sales. Each bankruptcy filing presents its own array of variables, whether involving publicly-held corporations or individual debtors, contested claims, pre-packaged plans, going concern value or failed business models, control by vulture fund puppeteers, and all are contingent on the relative strength of the economy at the time. It is demonstrably difficult to generalize the motivations behind each bankruptcy filing or the particular needs of every debtor. Recognition of this difficulty counsels against adopting a "one size fits all"

[287] *Id.* at 531.

[288] *In re* Homelife Corp., No. 01-2412, 2002 U.S. Dist. LEXIS 17915 (D. Del. Sept. 20, 2002).

[289] Baird & Rasmussen, *supra* note 3, at 788; LoPucki, *supra* note 1, at 646-47 (arguing that Baird and Rasmussen in *The End of Bankruptcy* misinterpreted as liquidation the fact that reorganizing firms shrink seventy-five percent on average after emerging from bankruptcy); Miller & Shaiman, *supra* note 5, at 195-201 (contending that reorganization remains a viable option for businesses because it provides opportunities that are unavailable in liquidation or outside bankruptcy).

approach to Chapter 11 petitions.[290] As emphasized in historical and modern cases, bright-line rules may frustrate the ability of bankruptcy judges to develop plans for the diverse spectrum of cases that they confront and therefore should be avoided.

To claim that bright-line rules are inapposite in Chapter 11 does mean that the discretion of bankruptcy judges should go unbounded.[291] Bankruptcy judges are cognizant of the constraints of the Bankruptcy Code and the requirement that their decisions should promote the best interests of the debtor estate. Nonetheless, the Code itself presents compelling evidence that bankruptcy judges possess and should employ the numerous statutory tools at their disposal to fashion bankruptcy plans and sales. Therefore, regardless of the new devices parties introduce into bankruptcy or new problems that emerge, bankruptcy judges should retain the discretion to evaluate the relative needs of the parties and to develop standards to reconcile these devices with the central principles of bankruptcy law.

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[290] *See, e.g.*, *In re* Lionel Corp., 722 F.2d 1063, 1069 (2d Cir. 1983) (stating that bankruptcy judges need "substantial freedom to tailor [their] order to meet differing circumstances").

[291] Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 206 (1988) (stating that "whatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code.").