THE IMMEDIATE AND LASTING IMPACTS OF THE 2008 ECONOMIC COLLAPSE—LEHMAN BROTHERS, GENERAL MOTORS, AND THE SECURED CREDIT MARKETS

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I. INTRODUCTION

Following the economic meltdown that began in the spring of 2008, immediate and longer term ramifications began to ripple through all aspects of the economy. Clearly, these tremors have not yet subsided, and continued fallout will be felt in the coming years. Importantly, even those companies and industries that have seemingly passed through the most immediate wave of impacts will be susceptible to the ongoing struggle to achieve sustainable growth. Many such companies may experience future defaults, largely dependent upon the strength and vitality of economic growth in the coming year and their industry performance in that timeframe.

In 2008, as the financial giants of the world began to struggle and collapse, some in the course of a few days, it was widely believed that the credit markets, and in turn the global economy, would completely seize up, causing an economic catastrophe unparalleled in modern history.[1] While tumultuous, what did in fact happen was something far less dramatic, but it had a lasting negative impact, nevertheless.

As often happens in crises, some impacts were to be expected and other events were complete surprises. For example, the resulting flight from risk by investors (both corporate and individu-

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1. *See, e.g.*, Erin McClain, *Economic Meltdown/Five Chaotic Weeks That Shook the Financial World*, PRESS OF ATLANTIC CITY, Sept. 6, 2009, at A1.

al) that occurred was quite expected once observers began to appreciate the breadth of the economic collapse.[2] Many observers expected the withdrawal of traditional lenders from the long- and short-term lending markets. Of course, any discussion of the lending environment during the financial crisis would be woefully inadequate without including the largest and most active lender during this period: the federal government ("U.S. Government" or "Government").

This article analyzes the early days of the credit crisis as well as two of the largest casualties of that period—Lehman Brothers and General Motors. In addition, by focusing on the bankruptcy proceedings of these two entities as well as other judicial decisions rendered since the financial crisis began, it examines the role that courts have played in the crisis.

II. DISCUSSION

Gauging the extent of any crisis can be accomplished in many ways. One telling method is to examine those entities most significantly affected by the events. Here, we examine the collapse of two vital American companies—Lehman Brothers and General Motors. In many ways, the crisis can legitimately be said to have exposed and exacerbated underlying weaknesses in these companies; even so, the shocking speed and individual circumstances of each collapse warrant discussion. Importantly, the disparate reaction of the U.S. Government to each collapse also warrants analysis. Accordingly, the bases for the different responses are addressed below. The crisis also signaled a shift in the secured lending environment, including a wave of court decisions demonstrating suspicion and adversity towards secured lenders. Whether such rulings were a temporary reaction or will continue remains to be seen, but the impact of the crisis on the secured lending market—the lifeblood of most major corporations—was immediate and in certain cases may be long-lasting. Analysis of each of these topics provides insight into the unprecedented impacts of the financial crisis.

2. *See, e.g.*, Paul J. Lim, *Diversify! Diversify! (Yes, Even Now)*, N.Y. TIMES, Dec. 7, 2008, at BU7.

A. *Lehman Brothers*

One of the starkest lessons provided by the financial crisis of 2008 and early 2009 is seen in the vulnerability of particular financial firms within the American (and perhaps global) financial system to economic shocks, and the resulting systemic risk arising from the interrelatedness of these firms. The collapse of Lehman Brothers Holdings Inc. ("Lehman Brothers") arguably provided the most glaring example of this latent fragility. Lehman Brothers' demise was more than merely the death of a titan of America's financial system; it laid bare just how susceptible America's major financial institutions had become to massive losses due to the use of leverage and exposure to concentrated investments. The sheer scope of Lehman Brothers' collapse threatened the very vitality of financial markets worldwide.[3] As a result, Lehman Brothers' bankruptcy proceeding raised unique issues that bear examination in assessing the lasting impacts of the financial crisis.

This section will begin with a discussion of Lehman Brothers' bankruptcy case, including: (i) a brief overview of Lehman Brothers' pre-filing business, (ii) an analysis of events leading up to Lehman Brothers' bankruptcy filing, (iii) a factual summary of Lehman Brothers' Chapter 11 proceeding, and (iv) a brief discussion of the accounting methods utilized by Lehman Brothers, as set forth in the court-appointed examiner's report. It will then provide an analysis of the unique issues raised in Lehman Brothers' bankruptcy proceeding influenced by—and in turn affecting—the financial crisis, including: (i) the speed with which the bankruptcy court approved the sale of Lehman Brothers' assets, and (ii) whether the U.S. Government should have intervened to save Lehman Brothers' business.

1. Lehman Brothers Background

Prior to filing for Chapter 11 protection on September 15, 2008, Lehman Brothers was one of the largest financial institutions in the world.[4] Its business focused on "equity and fixed income sales,

3. Louise Story & Ben White, *The Road to Lehman's Failure Was Littered with Lost Changes*, N.Y. TIMES, Oct. 6, 2008, at B1.

4. Andrew Ross Sorkin, *Bids to Halt Financial Crisis Reshape Landscape of Wall St.*, N.Y. TIMES, Sept. 15, 2008, at A1.

trading and research, investment banking, asset management, private investment management, and private equity to corporations, governments and municipalities, institutional clients and high-net-worth individuals."[5] Its business included:

> (i) advising on and structuring transactions; (ii) serving as a market-maker and/or intermediary in the global marketplace, including making securities and other financial instrument products available as both an issuer and an intermediary . . . ; (iii) originating loans for distribution to clients in the securitization or loan trading market; (iv) providing investment management and advisory services; and (v) acting as an underwriter to clients.[6]

Lehman Brothers consisted of three major business divisions: the Capital Markets division, the Investment Banking division, and the Investment Management division.[7] In short, Lehman Brothers was involved in virtually every segment of the global economy.

The Capital Markets division constituted 64% of Lehman Brothers' business.[8] Its activities included "secondary trading, financing, mortgage origination and securitization, prime brokerage and research activities in fixed income and equity products."[9] As of August 31, 2008, the Capital Markets division had reported assets of $586 billion, and it reported nine-month revenues of $16.2 billion.[10] The Investment Banking division constituted 20% of Lehman Brothers' business.[11] Its activities included advising corporate, institutional, and government clients on mergers and acquisitions, and raising capital for clients by underwriting public and private offerings of debt and equity instruments.[12] "In the nine months ended August 31, 2008, [the Investment Banking division] recorded revenues of approximately $2.3 billion . . . ."[13] The Investment Management division constituted 16% of Lehman

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5. Debtors' Disclosure Statement for Joint Chapter 11 Plan of Lehman Brothers Holdings Inc. and Its Affiliated Debtors Pursuant to Section 1125 of the Bankruptcy Code at 28, *In re* Lehman Bros. Holdings Inc., No. 08-13555 (Bankr. S.D.N.Y. Apr. 14, 2010) [hereinafter Lehman Disclosure Statement].

6. *Id.*

7. *Id.*

8. *Id.*

9. *Id.* at 29.

10. *Id.*

11. *Id.* at 28.

12. *Id.* at 29.

13. *Id.*

Brothers' business.[14] Its activities included providing "strategic investment advice and services to institutional and high-net-worth clients . . . ."[15] The division consisted of an asset management business and a private investment management business.[16] As of May 31, 2008, the Investment Management division reported $277 billion in assets under management.[17]

2. Events Leading to Lehman Brothers' Bankruptcy Filing

Lehman Brothers has been described by many as both a major cause and a major victim of the 2008 financial crisis. In the years leading up to the financial crisis, Lehman Brothers pursued an increasingly risky business strategy (in hindsight at least) that relied on massive amounts of leverage, leaving Lehman Brothers extremely vulnerable to even the smallest market downturn and consequent loss of confidence among counterparties. As described in more detail below, the sudden stress on the financial system caused by defaults in the subprime mortgage and commercial real estate markets caused a loss of investor confidence and triggered a precipitous drop in the short-term financing available to Lehman Brothers to finance its daily operations. Due to Lehman Brothers' massive size and the extent of its involvement in the global financial market, its sudden decline roiled financial markets and threatened the entire U.S. economy with collapse.

Lehman Brothers' high-risk, high-leverage business strategy is identified as the primary cause of its collapse.[18] This strategy dates back to 2006, when Lehman Brothers (and many other large institutional market participants) made a determination to substantially increase leverage on its capital, borrowing an increasingly large amount of money to operate its business.[19] During this time, Lehman Brothers transformed from a "moving" company—focusing primarily on brokerage services—to a "storage" company—using its own balance sheet to acquire assets for

14. *Id.* at 28.
15. *Id.* at 29.
16. *Id.* at 29–30.
17. *Id.* at 30.
18. Report of Anton R. Valukas, Examiner at 64–65, *In re* Lehman Bros. Holdings Inc., No. 08-13555 (Bankr. S.D.N.Y. Mar. 11, 2010) [hereinafter Examiner's Report].
19. *Id.* at 4.

long-term investment.[20] These longer-term investments focused primarily on commercial real estate, leverage loans, and private equity.[21] As a result of these investments, an increasing proportion of Lehman Brothers' assets consisted of illiquid, risky assets.[22]

Lehman Brothers was only able to sustain its high-risk, high-leverage strategy by borrowing up to hundreds of billions of dollars every day in the short-term financing markets.[23] This meant that Lehman Brothers' capacity to finance its daily operations relied heavily upon its access to lenders, which was dependent, in large part, on the continuing confidence of its counterparties.[24] The slightest loss of confidence could deprive Lehman Brothers of its only source of financing and leave it with vastly inadequate capital reserves.[25] Shortly before filing for bankruptcy, Lehman Brothers had $700 billion of assets and corresponding liabilities, and only $25 billion of capital.[26] In its July 2008 Form 10-Q report, Lehman Brothers reported that it had a net leverage ratio of 12.1:1.[27] However, according to a report released by the Joint Economic Committee of the U.S. Congress in June 2008, Lehman Brothers actually had a leverage ratio of 30.7:1 as of March 31, 2008.[28]

The collapse of Bear Stearns in March 2008 jolted the financial markets and is identified as an initial trigger in the loss of confidence that led to Lehman Brothers' collapse.[29] Lehman Brothers' counterparties, their confidence shaken by Bear Stearns' demise, stopped providing Lehman Brothers with much of the short-term financing that it needed to survive. In the first half of 2008, the value of Lehman Brothers' stock fell by 73% as it lost its sources

20. *Id.* at 59.
21. *Id.* at 60.
22. *Id.* at 62–63.
23. *Id.* at 3.
24. *Id.*
25. *Id.*
26. *Id.*
27. Lehman Brothers Holdings Inc., Quarterly Report (Form 10-Q) 55 (July 10, 2008).
28. JIM SAXTON, JOINT ECON. COMM., 110–23, THE U.S. HOUSING BUBBLE AND THE GLOBAL FINANCIAL CRISIS: VULNERABILITIES OF THE ALTERNATIVE FINANCIAL SYSTEM 1 (2008). Comparatively, during this period, certain other global banks had significant leverage positions as well. Namely, Freddie Mac had a leverage ratio of 49.1:1, Morgan Stanley had a leverage ratio of 31.8:1, Merrill Lynch had a leverage ratio of 27.5:1, and Goldman Sachs had a leverage ratio of 26.9:1. *Id.*
29. *Id.* at 5; *see also* Lehman Disclosure Statement, *supra* note 5, at 42–43.

of financing.[30] Lehman Brothers was forced to cut large portions of its workforce in multiple layoffs during 2008.[31] In what can now be seen as a last-ditch effort to save its business, Lehman Brothers attempted to finalize a sale of troubled assets to the Korea Development Bank.[32] The sale fell through, however, when the Korea Development Bank announced that it was unable to satisfy regulators and raise enough capital.[33] Meanwhile, Lehman Brothers announced on September 10, 2008 that it expected to report a $3.9 billion loss for the third quarter of 2008.[34] That same day, its share price fell 7% after it announced that it was seeking to sell a majority stake in its investment management business, a shocking announcement.[35] Lehman Brothers also announced a separate initiative to spin off its subprime commercial real estate assets to a new company owned by Lehman Brothers' shareholders.[36]

As it became increasingly apparent that a collapse of Lehman Brothers was imminent,

> emergency meetings were held at the Federal Reserve Bank of New York over the weekend of September 12, 2008, among Lehman, officials from the Federal Reserve Bank of New York, senior representatives of major New York based financial institutions, Secretary of the Treasury Henry Paulson, and SEC Chairman Christopher Cox[37] to develop a plan to deal with the Lehman Brothers crisis.[38]

During these meetings, as discussed in more detail below, Treasury officials made it clear to Lehman Brothers that, although the U.S. Government would support it to the extent possible, it would not provide emergency federal funding to stabilize it and allow it to continue operations.[39] In a last-ditch effort to save its business, Lehman Brothers negotiated a deal with Barclays, but the deal

30. Jenny Anderson & Eric Dash, *For Lehman, More Cuts and Anxiety*, N.Y. TIMES, Aug. 29, 2008, at C1.

31. *Id*.

32. *See* Greg Morcroft, *Financials Slip as Korea Snags Weigh on Lehman and Merrill*, MARKETWATCH (Sept. 4, 2008), http://www.marketwatch.com/story/financials-slip-as-korea-snags-weigh-on-lehman-and-merrill.

33. *Id*.

34. Jenny Anderson & Andrew Ross Sorkin, *Lehman Said to Be Looking for a Buyer as Pressure Builds*, N.Y. TIMES, Sept. 11, 2008, at A1.

35. Ben White, *Pressure Builds as Lehman Faces Mounting Losses*, N.Y. TIMES, Sept. 11, 2008, at A1.

36. Lehman Disclosure Statement, *supra* note 5, at 44.

37. *Id*.

38. *Id*.

39. *Id.* at 44–45; Examiner's Report, *supra* note 18, at 44–45.

fell through on September 14, 2008 when the parties learned that U.K. regulators would not waive certain requirements to allow the sale to close.[40] Recognizing that there were no remaining options for Lehman Brothers, SEC Chairman Christopher Cox recommended to the Lehman Brothers' board that they file for bankruptcy protection before the markets opened in Asia on September 15, 2008.[41] Lehman Brothers' stock had dropped from $62.19 per share on January 2, 2008, to $3.65 per share on September 12, 2008, a 94% drop.[42]

3. Lehman Brothers' Chapter 11 Case

Lehman Brothers filed for chapter 11 protection on September 15, 2008 in the United States Bankruptcy Court for the Southern District of New York, and Judge James M. Peck was assigned to its case.[43] The proceedings of the various Lehman Brothers' entities were consolidated for procedural purposes.[44] At the time of filing, Lehman Brothers listed assets worth $639 billion and liabilities worth $613 billion.[45] Shortly after filing, Lehman Brothers began new negotiations with Barclays for the sale of various components of its business.[46] Barclays refused to agree to the sale prior to the bankruptcy filing without the protection of a bankruptcy court order because, among other reasons, "it did not want to expose itself to the risk of potential fraudulent transfer and other claims."[47] However, time was of the essence because, in the turbulent financial market, the value of Lehman Brothers' assets was susceptible to sharp fluctuations.[48] Accordingly, Barclays set

40. Examiner's Report, *supra* note 18, at 52–54.

41. *Id.* at 59–60, 62.

42. *Lehman Brothers Holdings Inc. Historical Prices for Jan. 2, 2008*, YAHOO! FINANCE, http://finance.yahoo.com (enter "LEHMQ.PK" get quotes; then follow "Historical Prices" hyperlink; then enter "Jan. 2, 2008") (last visited Apr. 15, 2011); *Lehman Brothers Holdings Inc. Historical Prices for Sept. 12, 2008*, YAHOO! FINANCE, http://finance.yahoo.com (enter "LEHMQ.PK" get quotes; then follow "Historical Prices" hyperlink; then enter "Sept. 12, 2008") (last visited Apr. 15, 2011); *see also* Examiner's Report, *supra* note 18, at 39–40.

43. Voluntary Petition at 1, *In re* Lehman Brothers Holdings Inc., No. 08-13555 (Bankr. S.D.N.Y. Sept. 15, 2010).

44. Lehman Disclosure Statement, *supra* note 5, at 45.

45. *Id.* at 115.

46. *Id.* at 46.

47. *Id.*

48. *Id.*

a five-day deadline for consummation of the sale by court order.[49] On "September 16, 2008, a motion was filed requesting the bankruptcy court approve the sale procedures and set a sale approval hearing for . . . September 19, 2008."[50] The bankruptcy court approved the sale procedures on September 17, 2008.[51] On September 19, 2008, the bankruptcy court entered an order approving the sale to Barclays of Lehman Brothers' North American capital markets and investment banking business, Lehman Brothers International ("LBI"), together with the real property relating to the corporate headquarters and two data centers.[52] The sale provided $1.3 billion for the administration of Lehman Brothers' Chapter 11 proceeding.[53]

Subsequent to this initial sale, Lehman Brothers commenced a process of evaluating its businesses, owned properties, contracts and loans to determine which were appropriate to sell or monetize.[54] Notable asset dispositions to date include the sale of Lehman Brothers' Investment Management division, which spun off the Neuberger Berman Group LLC to hold the Investment Management business;[55] the sale of European and Asian assets to Nomura International Plc;[56] and various de minimis sales of less valuable assets.[57]

4. Criticism of Lehman Brothers' 363 Sale

After Lehman Brothers filed for bankruptcy protection, it was clear that speed was critical in selling components of Lehman Brothers' rapidly deteriorating business. Accordingly, as described above, both Lehman Brothers and Barclays sought court approval of an expedited sale of LBI. Federal Rule of Bankruptcy

49. *Id.*

50. *Id.*

51. *Id.*

52. *In re* Lehman Bros. Holdings Inc., No. 08-13555, 2008 WL 4385983 (Bankr. S.D.N.Y. Sept. 19, 2008); *see also* Debtors' Motion to (A) Schedule a Sale Hearing; (B) Establish Sales Procedures; (C) Approve a Break-Up Fee; and (D) Approve the Sale of the Purchased Assets and the Assumption and Assignment of Contracts Relating to the Purchased Assets at 2–6, *In re* Lehman Bros. Holdings Inc., No. 08-13555 (Bankr. S.D.N.Y. Sept. 17, 2008).

53. Lehman Disclosure Statement, *supra* note 5, at 46.

54. *Id.* at 52.

55. *Id.* at 53.

56. *Id.* at 53–54.

57. *Id.* at 54.

Procedure 2002(a)(2) requires notice twenty-one days prior to a sale of assets pursuant to § 363 of the Bankruptcy Code in order to give time for competing bids to be entered.[58] Lehman Brothers argued, however, that because LBI was a "wasting asset," the court should shorten the notice period.[59] Lehman Brothers' Chief Operating Officer Herbert McDade testified that "if a sale were not approved by September 19, [2008], Lehman would likely disappear as a going concern."[60] At the September 19, 2008 sale hearing, McDade additionally testified "that a failure to consummate this sale might ignite a panic in the financial condition of the country."[61] Accordingly, the court shortened the notice period to only two days and entered an order approving the sale on September 20, 2008.[62] In its order, the court determined, among other things, that good cause existed "to shorten the applicable notice periods that due, proper, timely, adequate and sufficient notice of the motion and hearing had been provided, and that a reasonable opportunity to object and be heard had been given to all interested persons and entities."[63] The court found that any delay in the sale would result in "immediate and irreparable harm" to Lehman Brothers.[64]

The bankruptcy court's decision to approve the sale to Barclay's became the subject of much scrutiny. For example, various investment funds that maintained prime brokerage accounts with LBI and Lehman Brothers Inc. (Europe) ("LBIE"), Lehman's major European investment banking and capital markets subsidiary, appealed the order approving the sale, alleging that the expedited hearing process had not allowed for proper debate.[65] They alleged, for various reasons, that Barclays had not purchased LBI in good faith.[66] They argued that the expedited hearing process

> (1) deprived [them] of their due process right to learn whether Barclays was a good faith purchaser of LBI and (2) did not provide an adequate basis for the bankruptcy court itself to conclude that the

58. FED. R. BANKR. P. 2002(a)(2) (2006); *see also* 11 U.S.C. § 363(b) (2006).

59. Bay Harbour Mgmt., L.C. v. Lehman Bros. Holdings Inc. (*In re* Lehman Bros. Holdings Inc.), 415 B.R. 77, 80 (Bankr. S.D.N.Y. 2009) (internal quotation marks omitted).

60. *Id.*

61. *Id.* at 80–81.

62. *Id.* at 82.

63. *Id.*

64. *Id.*

65. *Id.* at 79.

66. *Id.* at 79–84.

> sale to Barclays should be approved free and clear of liabilities due to Barclays's status as a good faith purchaser.[67]

The District Court for the Southern District of New York ultimately affirmed the sale order and dismissed the appeal,[68] but the appeal is indicative of the types of criticisms leveled at the sale process.

After the appeal was dismissed, Lehman Brothers, the Official Committee of Unsecured Creditors, and the trustee of LBI under the Securities Investor Protection Act (collectively, the "Movants") challenged Judge Peck's sale order under Rule 60(b) of the Federal Rules of Civil Procedure.[69] On February 22, 2011, Judge Peck reaffirmed the sale order in a lengthy opinion.[70] A focal point of the Movants' papers was the assertion that, as a result of the chaotic asset sale, Barclays received "a substantial windfall gain as a result of buying financial assets at a deep discount from fair value to the detriment of all creditors of the Lehman estates."[71] Among the arguments put forth by the Movants was that, due to the unprecedented speed of the September 19, 2008 hearing that resulted in the sale order, significant information was left out of the record.[72] Judge Peck held, however, that

> [d]espite what in retrospect appears to be a glaring problem of flawed disclosure, Movants have not carried their burden in establishing a right to relief from the Sale Order under Rule 60(b) becausethis new information would not have changed the outcome of the Sale Hearing or altered the form and content of the Sale Order in any material respect.[73]

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67. *Id.* at 79.

68. *Id.* at 86.

69. *See In re* Lehman Bros. Holdings Inc., Nos. 08-13555, 08-01420, 2011 WL 597970, at *1 (Bankr. S.D.N.Y. Feb. 22, 2011). Under Rule 60(b),

> the court may relieve a party or its legal representative from a final judgment, order, or proceeding for the following reasons: (1) mistake, inadvertence, surprise, or excusable neglect; (2) newly discovered evidence that, with reasonable diligence, could not have been discovered in time to move for a new trial under Rule 59(b); (3) fraud (whether previously called intrinsic or extrinsic), misrepresentation, or misconduct by an opposing party; (4) the judgment is void; (5) the judgment has been satisfied, released, or discharged; it is based on an earlier judgment that has been reversed or vacated; or applying it prospectively is no longer equitable; or (6) any other reason that justifies relief.

FED. R. CIV. P. 60(b).

70. *In re Lehman Bros*., 2011 WL 597970, at *2, *57.

71. *Id.* at *4.

72. *Id.* at *2, *6–9.

73. *Id.* at *2. Judge Peck also noted that "the failure to disclose material information . . . [did] not involve fraud, misrepresentation or misconduct." *Id.*

Movants' arguments also revolved around a "clarification letter" that was not subjected to judicial scrutiny prior to entry of the sale order, but that was agreed to shortly thereafter, and that materially changed the terms of the sale of Lehman Brothers' assets, most notably by including in the sale additional assets that were discovered on the morning of the sale hearing.[74] While admitting the serious deficiencies of the sale hearing, Judge Peck ultimately upheld the ruling, concluding that "the reality is that the transaction with Barclays would have been approved in any event because, taken as a whole, it was demonstrably better for all parties than any alternative, and no evidence has been presented to the contrary."[75]

Despite Judge Peck's reaffirmation of the Lehman Brothers asset sale, commentators have voiced substantial concerns about the impact of the sale in subsequent policy discussions regarding the long-term dangers of establishing a precedent for expedited sales pursuant to § 363 of the Bankruptcy Code. [76] In approving the proposed sale to Barclays, Judge James M. Peck stated

> I know that I need to approve this transaction . . . But I also know that this is so exceptional relative to the experience that I have had both as a bankruptcy lawyer and judge to know that it could never be deemed as precedent for future cases unless someone could argue that there is a similar emergency. It's hard for me to imagine a similar emergency.[77]

However, the Lehman Brothers case was followed shortly thereafter by the bankruptcy proceedings of Chrysler LLC and General Motors Corp., both cases in which the court approved expedited sales pursuant to § 363 of the Bankruptcy Code.[78] Lawyers and commentators fretted that the decisions in these cases, made under the highly strenuous circumstances surrounding the financial crisis, could set a precedent for future sales pursuant to § 363 of the Bankruptcy Code that would functionally allow for a reorganization plan to be accomplished without providing the many

74. *Id.* at *3.

75. *Id.* at *11.

76. John Blakeley, *Lehman, Chrysler, GM: The Fallout*, THE DEAL MAGAZINE, Aug. 7, 2009, *available at* http://www.thedeal.com/magazine/ID029091/features/lehman,-chrysler,-gm-the-fallout.php.

77. *Id.*

78. *Id.*

protections to creditors and claimants that are required by the Bankruptcy Code.[79]

Whether the expedited sale in the Lehman Brothers case will have a long-term lasting impact on bankruptcy court procedure remains to be seen. However, it serves as a striking example of the impacts of the financial crisis on established jurisprudence, and the potential long-lasting effect that the decisions rendered under the extraordinary stress of the financial crisis may have on law and business practice in the future.

5. The Government's Decision Not To Intervene to Save Lehman Brothers

As America's private sector languished in the wake of the financial crisis, the country was faced with an uncomfortable question: To what extent is it appropriate for the U.S. Government to intervene in the economy to save vital institutions and prevent a potentially catastrophic, economy-wide collapse? In the case of Lehman Brothers, the Government was faced with the particularly difficult question of whether to extend billions of dollars of taxpayer money to save a failing financial institution that could provide no collateral and had very uncertain chances of turning its business around. In a much-debated decision, the Government determined that it could not intervene to save Lehman Brothers.[80] When it became clear that Government assistance would not be forthcoming, Lehman Brothers had no choice but to file for bankruptcy protection.[81]

Notably, in the months prior to Lehman Brothers' bankruptcy filing, the New York Federal Reserve provided support to the firm by engaging in transactions with them that closely resembled financing transactions previously used by Lehman Brothers—called "Repo 105" transactions.[82] These transactions were criticized in a report released on March 11, 2010 by Anton R. Valukas, who was appointed by the bankruptcy court as examiner in the Lehman Brothers bankruptcy case.[83] The purpose of these

79. *Id.*

80. Andrew Ross Sorkin, *Lehman's Last Hours*, N.Y. TIMES, Sept. 6, 2010, at B1.

81. Jenny Anderson & Charles Duhigg, *Death and Near-Death Experiences on Wall St.*, N.Y. TIMES, Sept. 21, 2008, at BU1.

82. Examiner's Report, *supra* note 18, at 732.

83. *Id.* at 732–39. "Repo 105" transactions were similar to typical repurchase agree-

transactions was to temporarily reduce the size of Lehman Brothers' balance sheet by transferring assets that could not be easily valued and traded in the marketplace.[84] As Lehman Brothers reached the brink of bankruptcy, however, it turned to the Government for increased assistance and was denied.

Six months after the Federal Reserve lent $29 billion to facilitate the sale of Bear Stearns to JPMorgan Chase, Lehman Brothers requested financial assistance from the Government to save its failing business.[85] Unlike Bear Stearns, however, Lehman Brothers was denied support.[86] The federal Government—including Federal Reserve Chairman Benjamin S. Bernanke, Federal Reserve Bank of New York President Timothy F. Geithner, and Secretary of the Treasury Henry M. Paulson—informed Lehman Brothers that the Government did not have the legal authority to rescue Lehman Brothers.[87] The Government argued that it could not legally extend assistance to Lehman Brothers because Lehman Brothers did not have sufficient collateral to pay back any loan.[88] Thomas C. Baxter Jr., general counsel of the Federal Reserve Bank of New York at the time, argued that the Government did not have the authority to provide a "'naked'

ments utilized by financial institutions to obtain short-term financing for operations, whereby one party transfers an asset or security to another party as collateral for a short-term cash loan, while agreeing to repay the cash and take back the collateral at a specified point in time. *Id.* at 750. However, as detailed in Valukas' Report, Lehman Brothers was able to account for "Repo 105" transactions as sales, rather than financing transactions, because the collateral transferred was slightly more valuable than the cash transferred in exchange. *Id.* at 732. This practice allowed Lehman Brothers to borrow tens of billions of dollars without reporting increased leverage on its balance sheet. *Id.* at 757. While Lehman Brothers engaged in Repo 105 transactions well before the financial crisis began, its use of such transactions escalated in late 2007 and 2008. *Id.* at 740–42.

84. *Id.* at 737–38.

85. Sewell Chan, *Financial Crisis Panel Lends Sympathetic Ear to Lehman's Ex-Chief*, N.Y. TIMES, Sept. 2, 2010, at B1.

86. *Id.*

87. *Too Big to Fail: Expectations and Impact of Extraordinary Government Intervention and the Role of Systemic Risk in the Financial Crisis: Hearing Before the Fin. Crisis Inquiry Comm'n* 9 (Sept. 1, 2010) (statement of Thomas C. Baxter, Jr., Executive Vice President and Gen. Counsel, Federal Reserve Bank of N.Y.) [hereinafter Baxter Statement].

88. *Id.* at 10. The Dodd-Frank Wall Street Reform and Consumer Protection Act—signed into law on July 21, 2010—instituted a mechanism for regulators to take control of and liquidate troubled financial firms if their failure would pose a significant risk to the financial stability of the United States. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 204(a), 124 Stat. 1454 (2010) (to be codified at 12 U.S.C. § 5384). Henry M. Paulson Jr. has argued that had this mechanism been in place at the time, the government would have been empowered to save Lehman Brothers. Andrew Ross Sorkin, *Paulson Likes What He Sees in Overhaul*, N.Y. TIMES, July 13, 2010, at B1.

guarantee—one that would be unsecured and not limited in amount, and would put the U.S. taxpayers at risk for the *entirety* of Lehman's trading obligations."[89] Mr. Baxter noted that Lehman Brothers' case differed from Bear Stearns' in that Bear Stearns had a buyer, JPMorgan Chase, to ensure that its obligations could be met.[90] Lehman Brothers also differed from American International Group ("AIG")—to which the Government provided an $85 billion loan—because AIG had "sufficient collateral," in the form of its retail businesses, for the Government's loan.[91]

The sheer scope of Lehman Brothers' collapse impacted all corners of the global financial markets and threatened the very vitality of the financial system. The challenges posed in addressing Lehman Brothers' problems were unprecedented, and the decisions made in responding to this crisis will likely have lasting ramifications for both the financial services business and corporate law. One lesson learned as a result of the financial crisis is the limits of the Government's willingness to intervene on behalf of a private company. In the case of Lehman Brothers, the Government determined that it was unwilling to extend assistance on behalf of a financial behemoth that was unable to provide adequate collateral. This decision had significant meaning not only for the American public at the time, but also for setting the contours of the relationship between the Government and the private sector for years to come.

B. *General Motors*

General Motors Corporation ("General Motors") was arguably the highest-profile victim of the 2008 financial crisis, as it represented a traditional and long-established American manufacturing brand. An American institution for 100 years, General Motors was forced into bankruptcy by persistent business problems exacerbated by the stress of the 2008 financial crisis and subsequent liquidity crisis.[92] General Motors' demise threatened to topple huge segments of the domestic economy, and, like Leh-

89. Baxter Statement, *supra* note 87, at 9 (emphasis in original).

90. *Id.* at 8–9.

91. *Id.* at 10.

92. Disclosure Statement for Debtors' Amended Joint Chapter 11 Plan at 8–11, *In re* Motors Liquidation Co., No. 09-50026 (Bankr. S.D.N.Y. Dec. 8, 2010) [hereinafter GM Disclosure Statement].

man Brothers' collapse, it forced the U.S. Government and its citizenry to weigh how much government involvement in a corporate reorganization was acceptable to avert catastrophe.

This section will begin with a factual summary of General Motors' bankruptcy, including: (i) a background of General Motors' business, (ii) an analysis of the root causes of General Motors' bankruptcy, (iii) an analysis of the impact of the 2008 financial crisis on General Motors, and (iv) a brief summary of General Motors' bankruptcy case. It will then briefly address what has become perhaps the most controversial aspect of General Motors' reorganization—the unprecedented levels of U.S. Government involvement in a corporate reorganization under the United States Bankruptcy Code.

1. General Motors Background

Prior to filing for Chapter 11 bankruptcy protection on June 1, 2009, General Motors was a market leader in the automotive industry, a historical mainstay of the United States economy, and one of the most recognizable companies in the world.[93] William C. Durant founded the company in 1908 as a vehicle for the management of multiple automotive brands.[94] The well-known automotive brands owned by General Motors included Chevrolet, Pontiac, GMC, Oldsmobile, Saab, Saturn, and Cadillac.[95]

Over its history, General Motors produced nearly 450 million vehicles globally.[96] At the commencement of its chapter 11 proceeding, it employed approximately 235,000 employees.[97] Its operations included four global segments—GM North America, GM Europe, GM Latin America/Africa/Mid-East, and GM Asia Pacific.[98] As a result of its size, General Motors supported a vast network of dealerships and suppliers.[99] In the United States, for example, there were 6,099 General Motors vehicle dealers as of

93. Bill Vlasic & Nick Bunkley, *Obama Is Upbeat for G.M. Future on a Day of Pain*, N.Y. TIMES, June 2, 2009, at A1.

94. GM Disclosure Statement, *supra* note 92, at 8.

95. *Id.*

96. *Id.*

97. *In re* Gen. Motors Corp., 407 B.R. 463, 475 (Bankr. S.D.N.Y. 2009).

98. GM Disclosure Statement, *supra* note 92, at 8–9.

99. *In re Gen. Motors Corp.*, 407 B.R. at 475–76.

April 30, 2009.[100] "Substantially all of [General Motors'] worldwide car and truck deliveries (totaling 8.4 million vehicles in 2008) [were] marketed through independent retail dealers or distributors."[101] General Motors' supplier network included over 11,500 suppliers, of which over 600 relied upon General Motors for more than 30% of their annual revenues.[102]

General Motors' early success was built largely upon its unique strategy of supplying motor vehicles at a wide variety of price points, thus diversifying sources of demand and creating a distinct competitive advantage.[103] General Motors also utilized a unique "just-in-time" inventory delivery system that allowed it to produce its vehicles efficiently and minimize its fixed inventory costs by sourcing 75–85% of its components from its supplier network and assembling its cars within hours of delivery to avoid inventory accumulation.[104]

2. The Causes of General Motors' Bankruptcy

After many decades of unparalleled business success in the automotive industry, General Motors began to decline in the late twentieth century as it failed to adapt to the rapidly changing business environment and respond to increasingly intense competition from abroad. Foreign competitors such as Toyota, Nissan, and Honda, unburdened by the debilitating legacy costs that plagued General Motors, gained ever greater market share in the automotive industry.[105] General Motors, which spent $103 billion

100. GM Disclosure Statement, *supra* note 92, at 9.
101. *In re Gen. Motors Corp.*, 407 B.R. at 475.
102. *Id.* at 476.
103. GM Disclosure Statement, *supra* note 92, at 8.
104. *Id.* at 9.
105. *See* GENERAL MOTORS CORPORATION, RESTRUCTURING PLAN FOR LONG-TERM VIABILITY, *Submitted to Senate Banking Comm. & House of Representatives Financial Services Comm.*, 7 (Dec. 2, 2008), *available at* http://financialservices.house.gov/GMPlan.pdf [hereinafter GM VIABILITY PLAN]; *see also In re Gen. Motors Corp.*, 407 B.R. at 476, 478.

on funding its employee-related legacy obligations in the fifteen years prior to 2008, could not overcome this disadvantage.[106]

Some commentators argued that General Motors' decline was due primarily to poor business strategy, not merely burdensome legacy costs. In an April 2, 2009 report, for example, financial analysts at AllianceBernstein L.P. argued that General Motors remained stuck in an outdated mode of thinking that resisted reducing manufacturing capacity, product offering, and dealer density.[107] As a result, General Motors relied solely upon price-cutting to remain competitive, selling cars at "below breakeven cost" and driving industry prices downward.[108] According to the report, this high fixed-cost, low-price model "is why the company [was] hemorrhaging cash and [was] head[ed] for Chapter 11."[109] Additionally, the White House viewed General Motors as having an outdated product mix focused heavily on trucks and sport utility vehicles at a time when consumer preferences were shifting toward smaller vehicles.[110]

Regardless of the reason, General Motors' business suffered a substantial decline in the late twentieth and early twenty-first centuries. Between 1980 and 2008, General Motors' market share fell from 45% to 22%.[111] Its common stock declined from $93.62 per share as of April 28, 2000 to $1.09 per share as of May 15, 2009.[112] Its market capitalization fell by $59.5 billion.[113] By the time the financial crisis of 2008 struck, General Motors was already extremely vulnerable to any adverse market events.

Besides the deteriorating strength of the economy and loss of consumer purchasing power, General Motors' bankruptcy was precipitated in part by its difficulty managing increasingly escalating healthcare obligations to its employees.[114] General Motors

106. GM VIABILITY PLAN, *supra* note 105, at 7.

107. Max Warburton et al., *European Autos: Why a GM Bankruptcy Can Raise European and Japanese Auto Industry Returns*, BERNSTEINRESEARCH 1–2 (Apr. 2, 2009), http://blogs.ft.com/business blog/files2009/05/bernstein.pdf.

108. *Id*.

109. *Id*.

110. PRESIDENT'S TASK FORCE ON AUTOS, DETERMINATION OF VIABILITY SUMMARY: GENERAL MOTORS CORPORATION 1 (Mar. 30, 2009), *available at* http://www.whitehouse.gov/assets/documents/GM_viability_Assessment.pdf.

111. GM Disclosure Statement, *supra* note 92, at 10.

112. *Id*.

113. *Id*.

114. *Id*. at 9.

maintained trusts to provide its employees with healthcare and life insurance benefits upon retirement.[115] These trusts became increasingly burdened over time as General Motors' legacy obligations to its retirees spiraled out of control. In February 2008, General Motors entered into a settlement agreement with the United Auto Workers ("UAW") that created a new retiree benefit plan for which UAW would have exclusive responsibility and to which General Motors would be required to make fixed and capped contributions.[116] At the time of General Motors' filing, its obligations with regard to the plan totaled approximately $20.56 billion in principal amount.[117]

3. The 2008 Financial Crisis Triggers General Motors' Bankruptcy Filing

While fundamental business problems were the primary long-term causes of General Motors' bankruptcy filing, the financial crisis and subsequent liquidity crisis of 2008 accelerated General Motors' decline and forced it into bankruptcy. The tightening of credit markets that occurred after the failure of key American financial institutions, and the general anxiety of American consumers, triggered a 30% decline in U.S. auto sales over the span of only a few months.[118] At the same time, GMAC, General Motors' financing arm, was effectively cut off from secondary markets, so that the percentage of purchases for which General Motors was able to provide installment or lease financing fell from just under 50% to only 6% within a year.[119] Already weakened by structural and economic factors, General Motors was forced to seek financial assistance from the U.S. Government shortly after Lehman Brothers Holdings Inc. collapsed on September 15, 2008.[120]

On November 21, 2008, congressional leaders sent General Motors, Chrysler LLC, and Ford Motor Company a letter setting forth a framework for them to request Government loans.[121] On

115. *Id.*
116. *Id.* at 9–10
117. *Id.* at 10.
118. *Id.* at 8.
119. *Id. See also* GM VIABILITY PLAN, *supra* note 105, at 8.
120. GM Disclosure Statement, *supra* note 92, at 11.
121. *Id.*

December 2, 2008, General Motors submitted a proposed viability plan to the Senate Banking Committee and the House of Representatives Financial Services Committee.[122] The viability plan requested a total term loan of $12 billion consisting of

> an immediate loan of $4 billion to insure minimum liquidity through the end of 2008, a second $4 billion draw in January 2009, a third draw of $2 billion in February 2009, and a fourth draw of $2 billion, at an unstated date in 2009 . . . [and] access to an incremental $6 billion line of credit.[123]

Congress failed to act on General Motors' request, prompting General Motors to seek financial assistance from the United States Department of the Treasury ("U.S. Treasury").[124]

> On December 19, 2008, former President George W. Bush announced that the outgoing administration would make short-term, emergency funding available to [General Motors] and Chrysler under the Troubled Asset Relief Program ("TARP") to prevent both companies from commencing immediate bankruptcy cases. On December 31, 2008, [General Motors] and the U.S. Treasury entered into an agreement . . . that provided [General Motors] with emergency financing of up to an initial $13.4 billion pursuant to a secured term loan facility (the "U.S. Treasury Facility"). [General Motors] borrowed $4.0 billion from the U.S. Treasury on December 31, 2008 and an additional $5.4 billion on January 21, 2009. The remaining $4.0 billion was borrowed on February 17, 2009. [125]

Pursuant to the U.S. Treasury Facility, General Motors was required to "develop a proposal to transform its business and demonstrate future viability."[126] It submitted this plan to the automobile industry task force appointed by President Obama on February 17, 2009.[127] The plan focused on "long-term viability, international competitiveness, and energy efficiency . . . ."[128] On March 30, 2009, President Obama announced that "[the new viability plan] was not satisfactory and did not justify a substantial new investment of taxpayer dollars."[129] The President agreed to "extend adequate working capital for a period of another sixty days . . . ," subject to General Motors' efforts to reach an agree-

122. *Id.*
123. *Id.*
124. *Id.*
125. *Id.*
126. *Id.* at 12.
127. *Id.*
128. *Id.*
129. *Id.*

ment with its bondholders and the UAW "regarding debt reduction, and the submission of a revised business plan . . . ."[130] The United States gave General Motors until June 1, 2009 to demonstrate that its viability plan could successfully transform it into a profitable company.[131]

Simultaneously with the negotiation of the U.S. Treasury Facility, General Motors proposed an out-of-court bond exchange offer to raise additional financing to strengthen its business.[132] On April 27, 2009, General Motors "launched a public exchange offer for the approximately $27 billion of its unsecured bonds . . . ."[133] General Motors announced that, "if it did not receive enough tenders to consummate the Exchange Offer," it would be forced to file for bankruptcy in order to restructure its business.[134] Complicating matters for General Motors, the exchange offer was subject to extensive negotiations with the U.S. Treasury, which, as General Motors' largest secured creditor, sought to protect the value of its investment in General Motors. For example, the U.S. Treasury required "the conversion to equity of . . . at least 50% of [General Motors'] outstanding U.S. Treasury debt at June 1, 2009 (approximately $10 billion . . .)" as part of the exchange offer.[135] "The Exchange Offer expired on May 26, 2009 without achieving the threshold of required tendered acceptances."[136]

4. General Motors' Bankruptcy

General Motors filed for bankruptcy protection in the Southern District of New York on June 1, 2009,[137] and the case was assigned to Judge Robert E. Gerber.[138] At the time of filing, General Motors' assets on a consolidated basis totaled $82.3 billion; its liabilities totaled $172.8 billion.[139]

130. *Id*.
131. *Id*. at 13.
132. *Id*.
133. *Id*.
134. *Id*.
135. *Id*.
136. *Id*. at 14.
137. Voluntary Petition at 2, *In re* Gen. Motors Corp., 407 B.R. 463 (Bankr. S.D.N.Y. 2009) (No. 09-50026).
138. *In re* Gen. Motors Corp., 407 B.R. 463, 463 (Bankr. S.D.N.Y. 2009).
139. Voluntary Petition, *supra* note 137, Exhibit A at 1.

Prior to filing, General Motors worked with the U.S. Treasury to devise a "prepackaged" bankruptcy filing under which it would sell substantially all of its assets to a newly constituted General Motors that would be sponsored by the U.S. Treasury.[140] Under this plan, substantially all of General Motors' assets were sold pursuant to Bankruptcy Code § 363 to Vehicle Acquisition Holdings LLC, a purchaser sponsored by the U.S. Treasury ("363 Transaction").[141] The proceeds of the sale, as well as General Motors' other assets, remained in a liquidation company called Motors Liquidation Company ("MLC").[142] On July 10, 2009, a master sale and purchase agreement consummated the sale of General Motors' assets.[143] Following the sale, the purchaser took the name General Motors Company ("New GM") and continued as an operating company.[144]

5. U.S. Government Involvement

Perhaps the most unique feature of General Motors' bankruptcy proceeding, and the aspect that garnered the most commentary, was the level of Government involvement. The U.S. Government was involved with every stage of General Motors' bankruptcy. The U.S. Government's support of General Motors reflected a desire to prevent the catastrophic economy-wide impacts that would have resulted from General Motors' collapse, including the loss of hundreds of thousands of jobs, secondary impacts on dealers and suppliers, and even the potential failure of the entire U.S. automotive industry.[145] As stated in the restructuring plan that General Motors submitted to Congress on December 2, 2008, "[a] failure by [General Motors] will likely trigger catastrophic damage to the U.S. economy, precipitating failures among component and logistic suppliers, other domestic car manufacturers, raw material suppliers, technology and service pro-

140. *In re Gen. Motors Corp.*, 407 B.R. at 479–80; GM Disclosure Statement *supra* note 92, at 14.

141. *See In re Gen. Motors Corp.*, 407 B.R. at 473.

142. GM Disclosure Statement, *supra* note 92, at 16–19.

143. *Id.* at 14, 16.

144. *Id.* at 16–17.

145. *See In re Gen. Motors Corp.*, 407 B.R. at 477.

viders, retailers and their suppliers, and [General Motors'] creditors and financial institutions."[146]

As described in some detail above, the U.S. Government used its leverage as General Motors' largest secured lender to demand a complete structural overhaul of General Motors' business, including a renegotiation of its legacy obligations with the UAW, aggressive operational restructuring, and an increased emphasis on developing environmentally friendly vehicles.[147] The Obama Administration, in declining to extend additional financing to General Motors on March 30, 2009, announced the resignation of General Motors' CEO Rick Wagoner.[148]

Active Government involvement in General Motors' restructuring continued after it filed for bankruptcy on June 1, 2009. The U.S. Treasury, the Government of Canada, and the Government of Ontario agreed to provide debtor-in-possession financing to allow General Motors to finance its operations during the bankruptcy proceedings.[149] However, this funding was contingent upon General Motors selling substantially all of its assets via the 363 Transaction to a U.S. Treasury-sponsored purchaser.[150] The U.S. Government sought to utilize its strong position in General Motors' capital structure to ensure that its investment would result in a sustainable New GM and a revitalization of the U.S. automotive industry.[151]

6. Criticism of General Motors' Bankruptcy

The rapid speed of the bankruptcy court's approval of the § 363 Transaction, and the Government's close involvement with the entire process, sparked intense criticism of General Motors' bankruptcy reorganization. Many commentators objected to the fact

146. GM VIABILITY PLAN, *supra* note 105, at 8–9.

147. *In re Gen. Motors Corp.*, 407 B.R. at 479 (discussing the U.S. Government's condition that General Motors reach an agreement with UAW); PRESIDENT'S TASK FORCE ON AUTOS, OBAMA ADMINISTRATION NEW PATH TO VIABILITY FOR GM & CHRYSLER 2–3, *available at* http://www.whitehouse.gov/assets/documents/fact_sheet_GM_Chrysler.pdf (noting that the U.S. Government required GM to undergo "aggressive operational restructuring" and to develop cost effective high efficiency vehicles).

148. PRESIDENT'S TASK FORCE ON AUTOS, *supra* note 147, at 2.

149. GM Disclosure Statement, *supra* note 92, at 14; *In re Gen. Motors Corp.*, 407 B.R. at 480.

150. *In re Gen. Motors Corp.*, 407 B.R. at 480.

151. PRESIDENT'S TASK FORCE ON AUTOS, *supra* note 147, at 2–3.

that the bankruptcy court quickly approved the 363 Transaction over the objections of dissident unsecured bondholders.[152] Others argued that the sale constituted an impermissible *sub rosa* plan.[153]

At the core of the criticisms of the General Motors' bankruptcy is the idea that the bankruptcy court, under pressure from the U.S. Government to quickly approve the 363 Transaction and allow New GM to begin operations as an ongoing entity, trampled upon longstanding protections provided by the bankruptcy process.[154] Professor Douglas Baird of the University of Chicago Law School, in his testimony before the House Subcommittee on Commercial and Administrative Law, argued that the bidding procedures that the court approved essentially "locked in" the U.S. Government-favored sale by creating disincentives to other competing bids.[155] Professor Barry Adler, from New York University School of Law, took a similar position in his written statement to the Congressional Oversight Panel, arguing that the case set a dangerous precedent for the disregard of creditor rights in bankruptcy cases with dominant stakeholders (in this case, the U.S. Government).[156] These two examples demonstrate the extent of anxiety over the process by which General Motors' reorganization was achieved. While there is no doubt—as found by the court—that an expedited sale process was the only way for General Motors to restore viability,[157] this desirable outcome was

152. *See In re Gen. Motors Corp.*, 407 B.R. at 517–18 (addressing the objections raised by the unsecured bondholders).

153. *Id.* at 495; *see also* Stephen J. Lubben, *No Big Deal: The GM and Chrysler Cases in Context*, 83 AM. BANKR. L.J. 531, 539–40 (2009). As explained by Lubben in his article, the term "*sub rosa* plan" refers to a tactic of effectively implementing a reorganization plan by selling all of a debtor's assets through a § 363 sale, thus avoiding the numerous procedural protections for creditors and claimants that the Bankruptcy Code requires during the plan confirmation process. *Id.* at 533–35, 538. In other words, a *sub rosa* plan seeks not only to sell the debtor's assets, but also to allocate or dictate the distribution of sale proceeds among different classes of creditors. *See id.* at 538 (discussing the bankruptcy court's rejection of the argument that the sale was an impermissible *sub rosa* plan).

154. *See, e.g.*, *AIFP Hearing, Before the Congressional Oversight Panel*, 111th Cong. (Aug. 5, 2009) (statement of Barry E. Adler, The Charles Seligson Professor, New York University School of Law) [hereinafter Adler Statement]. *Ramifications of Auto Industry Bankruptcies, Part III: Hearing Before the Subcomm. on Commercial and Admin. Law of the H. Comm. on the Judiciary*, 111th Cong. 63–64 (July 22, 2009) (statement of Douglas G. Baird, Harry A. Bigelow Distinguished Service Professor of Law, University of Chicago Law School) [hereinafter Baird Statement].

155. Baird Statement, *supra* note 154, at 62–63.

156. Adler Statement, *supra* note 154, at 2, 7.

157. *In re Gen. Motors Corp.*, 407 B.R. at 478.

achieved only at the considerable expense of arguably disregarding established bankruptcy procedure and creating a precedent for expansive Government control over bankruptcy cases, albeit only in extreme circumstances.

C. *Secured Credit Market*

A primary theme in the collapse and bankruptcy cases of both Lehman Brothers and General Motors was the severe impact on both companies of the sudden lack of financing as lenders' confidence waned. This theme is indicative of the new "normal" lending environment that has emerged and presents a challenging environment for both lenders and borrowers. The Lehman Brothers' and General Motors' cases show the speed with which massive corporate entities can fail in the midst of lending freezes similar to that precipitated by the panic of 2008 and early 2009. The lending market is essential for the efficient and dependable operation of corporate America, but its vitality can be negatively impacted by macro- or micro-economic events. We have addressed above how economic factors combined with susceptible business models forced Lehman Brothers and General Motors to seek bankruptcy protection. The resulting economic environment also produced severe secondary impacts. Here, we now examine the secondary results of the fragile economic environment that resulted from the financial crisis and the bankruptcy filings of Lehman Brothers and General Motors,[158] and how these economic conditions ultimately affected the courts.

Besides the various rulings in the Lehman Brothers' and General Motors' bankruptcy cases, other courts have examined issues or whole cases that bore directly on the credit crisis or issues relevant thereto. The subprime crisis itself spawned numerous bankruptcy cases involving the subprime mortgage industry, including New Century Financial Corporation,[159] American Home Mortgage Investment Corporation,[160] Fremont General Corpora-

158. The economy in 2008 and 2009 was characterized by a series of interrelated implosions. *See* Vernan Smith, *There's No Easy Way Out of the Bubble,* WALL ST. J., Oct. 9, 2008, at A17. The consumer real estate crash and the accompanying subprime mortgage-related failings exemplify the complete lack of confidence and distrust that ran rampant in the asset-based lending market at the time. *Id.*

159. *In re* New Century TRS Holdings, Inc., 407 B.R. 558 (Bankr. D. Del. 2009).

160. Calyon N.Y. Branch v. Am. Home Mort. Corp., (*In re* Am. Home Mort. Corp.) 379 B.R. 503 (Bankr. D. Del. 2008).

tion,[161] Credit-Based Asset Servicing and Securitization LLC,[162] and countless others. A number of rulings shocked the secured lending markets and may have a lasting impact on secured lending jurisprudence if they are followed by other courts. Three such cases—*In re TOUSA, Inc.*,[163] *In re Yellowstone Mountain Club, LLC*,[164] and *In re Philadelphia Newspapers, LLC*[165]—are discussed in further detail below.

A decision by the United States Bankruptcy Court for the Southern District of Florida in *In re TOUSA, Inc.* to avoid nearly $500 million in liens granted to first and second lien term lenders and recover the proceeds from the term lenders and a loan transferee proceeds sent a shockwave through the secured lending market.[166] TOUSA and its subsidiaries were engaged in the business of designing, building, and marketing detached single-family residences, town homes, and condominiums.[167] The court determined that the subsidiaries that granted the liens were insolvent when the obligations were incurred, relying on both contemporaneous market evidence and expert reports and testimony.[168] Among the contemporaneous evidence considered by the court were the downturn in the housing industry that began in early 2006, TOUSA's purported early recognition of the severity of the downturn, downgrades by ratings agencies and negative reports by industry experts, and the fact that TOUSA's stock price fell from a high of $23 during 2006 to below $4 by April 2007.[169]

The court next examined whether reasonably equivalent value was received in exchange for the obligation incurred.[170] The relevant inquiry was whether the subsidiaries received reasonably equivalent value, because the subsidiaries had incurred the obli-

161. *In re* Fremont Gen. Corp., No. 08-bk-13421, 2010 WL 4739439 (Bankr. C.D. Cal. June 9, 2010).

162. *In re* Credit-Based Asset Servicing & Securitization LLC, No. 10-16040, 2010 WL 5136414 (Bankr. S.D.N.Y. Nov. 16, 2010).

163. Official Comm. of Unsecured Creditors of TOUSA, Inc. v. Citicorp N. Am., Inc. (*In re* TOUSA, Inc.), 422 B.R. 783 (Bankr. S.D. Fla. 2009).

164. Credit Suisse v. Official Comm. of Unsecured Creditors (*In re* Yellowstone Mountain Club, LLC), 415 B.R. 769 (Bankr. D. Mont. 2009).

165. *In re* Phila. Newspapers, LLC, 599 F.3d 298 (3d Cir. 2010).

166. *In re TOUSA, Inc.*, 422 B.R. at 855.

167. *Id.* at 787.

168. *Id.* at 790–839.

169. *Id.* at 790–839, 851.

170. *Id.* at 843–50.

gations by granting liens on their assets.[171] The court concluded that the subsidiaries received no direct benefit because the loan proceeds went directly to the parent company.[172] Utilizing Bankruptcy Code § 550, the court ordered disgorgement of the proceeds of the lien transfers from the recipients of the lien transfers and a group of lenders that subsequently received the proceeds in satisfaction of a pre-existing debt.[173]

Perhaps most relevant to the secured lending market, the court determined that "savings clauses," which provided for a reduction of the obligations incurred as well as liens granted by the subsidiaries to the extent necessary to prevent their insolvency, had no impact and were irrelevant because the subsidiaries were insolvent even before the transaction and received no value from the transaction.[174] In what many now view as dicta, the court further opined that the savings clauses were unenforceable.[175] The court reasoned that an interest of the debtor in "property becomes property of the estate, notwithstanding any 'provision in an agreement' that is 'conditioned on the insolvency or financial condition of the debtor' that 'effects or gives an option to effect a forfeiture, modification or termination of the debtor's interest in property.'"[176] Secured lenders should be particularly troubled by the nullification of a savings clause—a tool commonly utilized by secured lenders—that was negotiated by two sophisticated parties. The decision was appealed to the District Court for the Southern District of Florida.[177]

Upon appeal by a group of lenders referred to as the "Transeastern Lenders," Judge Alan S. Gold of the District Court for the Southern District of Florida recently quashed the bankruptcy court's decision in *In re TOUSA, Inc.*[178] In a scathing opinion, Judge Gold determined that the bankruptcy court erroneously

171. *Id.* at 867.
172. *Id.* at 844–45.
173. *Id.* at 886–87 (applying 11 U.S.C. § 550 (2006)).
174. *In re TOUSA, Inc.*, 422 B.R. at 863.
175. *Id.* at 863–64.
176. *Id.* at 863.
177. 3V Capital Master Fund Ltd. v. Official Comm. of Unsecured Creditors of TOUSA, Inc. (*In re* TOUSA, Inc.), Nos. 10-60017-CIV/GOLD, 10-61478, 10-62032, 10-62035, 10-62037, 2011 WL 522008, at *1, *52 (S.D. Fla. Feb. 11, 2011).
178. *Id.* The proceeds of the lien transfers made by the conveying subsidiaries were transferred to the Transeastern Lenders in satisfaction of a pre-existing debt. *Id.* at *52.

avoided the lien transfers.[179] In avoiding the lien transfers, the bankruptcy court held that the subsidiaries had a property interest in the proceeds of the lien transfers, that the subsidiaries received less than reasonably equivalent value from the transfer, and that the subsidiaries were insolvent when the transfer was made.[180] In his decision, Judge Gold found that the subsidiaries had no property interest in the loan proceeds because they never had control over the use of those proceeds.[181] He also determined that the subsidiaries received reasonably equivalent value in exchange for the lien transfers because the transfers allowed them to satisfy a pre-existing debt and thus stave off bankruptcy.[182] Accordingly, pursuant to Bankruptcy Code § 548, the transfers should not have been avoided.[183] The court also concluded that the proceeds of the lien transfers should not have been disgorged from the Transeastern Lenders, because those transferees did not qualify as entities "for whose benefit" the lien transfers were made.[184] Two other lender groups, first and second lien lenders, also appealed the bankruptcy court's opinion.[185] Those appeals are still pending before the district court. Despite the district court's recent decision, *In re TOUSA, Inc.* still serves to highlight the risk and unpredictability that faces secured lenders in the current political climate.

A more aggressive approach to secured lenders was taken by the United States Bankruptcy Court for the District of Montana when it equitably subordinated the claim of the secured lender against the debtors, Yellowstone Mountain Club, LLC and its affiliated entities.[186] The debtor entities in *Yellowstone* were created

179. *Id*. at *52.

180. *In re TOUSA, Inc.*, 422 B.R. at 872–75 (finding that the subsidiaries had a "property interest" in the loan proceeds).

181. *In re TOUSA, Inc.*, 2011 WL 522008, at *23.

182. *See id*. at *39–40.

183. *See id*. at *26–43. Under Bankruptcy Code § 548, a transfer may be avoided where the debtor has a property interest in the property transferred, the debtor did not receive reasonably equivalent value in exchange for the transfer, and the debtor was insolvent at the time of the transfer. 11 U.S.C. § 548(a)(1)(B)(i)–(ii) (2006).

184. *In re TOUSA, Inc.*, 2011 WL 522008, at *47. Under § 550 of the Bankruptcy Code, an avoided transfer may be recovered from a party "for whose benefit" the transfer was made. 11 U.S.C. § 550(a)(1) (2006).

185. Wells Fargo Bank, N.A. v. Official Comm. of Unsecured Creditors of TOUSA, Inc., No. 10-60018 (Bankr. S.D. Fla. Jan. 5, 2010); Citicorp North America Inc. v. Official Comm. of Unsecured Creditors of TOUSA, Inc., No. 10-60019 (Bankr. S.D. Fla. Jan. 5, 2010).

186. *See* Credit Suisse v. Official Comm. of Unsecured Creditors (*In re* Yellowstone

for the purpose of developing the Yellowstone Club, a membership-only, master-planned development situated on 13,500 acres of private land near the northwest corner of Yellowstone National Park.[187] On September 30, 2005, the debtors entered into a syndicated loan agreement for $375 million.[188] The debtors filed for bankruptcy on November 10, 2008,[189] and the Creditors' Committee filed a complaint against the secured lender seeking to subordinate its claim.[190]

In harsh language, the court noted "[t]he naked greed in this case combined with [the lender's] complete disregard for the Debtors or any other person or entity . . . , shocks the conscience of [the] Court."[191] The court's ruling was based upon its determination that the loan at issue was unrelated to the debtors' business, was based upon questionable appraisals, and seemed to only benefit the bank and one individual member of the borrower—all at the expense of unsecured creditors.[192]

While the case was eventually settled before the appellate process could proceed, and was certainly a product of the specific facts before the court, the *Yellowstone* decision is perhaps illustrative of a national climate in which adverse presumptions are drawn against secured lenders. Likewise, in *Philadelphia Newspapers*, the Third Circuit Court of Appeals addressed what has been viewed as a bedrock right of secured lenders—the right to credit bid a secured claim.[193] The court held that secured creditors did not have such a right when sought to be exercised in a sale process proceeding within a plan of reorganization.[194]

The debtors proposed a plan of reorganization that included a sale at public auction of substantially all of their assets free and clear of all liens.[195] The proposed plan would transfer the proceeds

Mountain Club, LLC), No. 08-61570-11, 2009 WL 3094930, at *7 (Bankr. D. Mont. May 12, 2009) (partial and interim order).

187. *Id.* at *2.

188. *Id.* at *3.

189. Voluntary Petition, *In re* Yellowstone Mountain Club, LLC, No. 08-61570 (D. Mont. Nov. 10, 2008).

190. *In re Yellowstone*, 2009 WL 3094930, at *7.

191. *Id.* at *9.

192. *Id.* at *7–10.

193. *In re* Phila. Newspapers, LLC, 599 F.3d 298, 304 (3d Cir. 2010).

194. *Id.* at 317.

195. *Id.* at 301.

of the sale and the headquarters to the secured lenders in full satisfaction of their claims.[196] The secured lenders objected to the plan because it required all bids on the sale to be in cash.[197] Section 363(b) of the Bankruptcy Code permits a bankruptcy trustee to sell, other than in the ordinary course of business, property of the estate.[198] When a sale is made pursuant to § 363(b) upon motion by a trustee, § 363(k) allows secured lenders to "credit-bid"—to bid up to the full amount of their secured debt claim to acquire the assets to which their lien is attached in exchange for cancellation of indebtedness in the amount of the bid.[199] This makes it easier for secured lenders to recover the value of their collateral. The *Philadelphia Newspapers* court addressed whether secured lenders have a statutory right to credit bid when assets are sold as part of a plan of reorganization, rather than in a § 363(b) sale.[200]

A plan of reorganization may be approved despite the objections of a secured creditor[201] if the plan does not discriminate unfairly and is "fair and equitable" with respect to each class of claims that is impaired under the plan.[202] Under § 1129(b)(2)(A) of the Bankruptcy Code, a plan of reorganization that contemplates an asset sale is "fair and equitable" from the perspective of a secured lender if the collateral is sold free and clear of liens, payment is made from the sale proceeds, and in most instances, the secured creditor is allowed to credit bid its claim.[203] A plan may also be "fair and equitable" if the secured creditor receives the "indubitable equivalent" of its claim under the plan.[204] The *Philadelphia Newspapers* court considered whether, under the terms of § 1129(b)(2)(A), a plan must allow a secured creditor to credit bid on an asset sale in order to meet the "fair and equitable" standard.[205]

The Third Circuit upheld the plan of reorganization over the objections of the secured lenders despite the fact that it did not

196. *Id.* at 302.
197. *Id.* at 302, 309.
198. 11 U.S.C. § 363(b) (2006).
199. *Id.* § 363(k); *In re Phila. Newspapers*, 599 F.3d at 305 n.6.
200. *In re Phila. Newspapers*, 599 F.3d at 301, 302.
201. Such a procedure is referred to as a "cramdown." *Id.* at 304.
202. 11 U.S.C. § 1129(b)(1) (2006).
203. *Id.* § 1129(b)(2)(A); *In re Phila. Newspapers*, 599 F.3d at 305.
204. *In re Phila. Newspapers*, 599 F.3d at 305 (citing 11 U.S.C. § 1129(b)(2)(A)(iii)).
205. *Id.* at 303–04.

include the right to credit bid.[206] Relying on what it characterized as the "plain meaning" of § 1129(b)(2)(A), the court held that the plan of reorganization could be confirmed as it met the "fair and equitable" standard.[207] The court determined that the dissident secured creditors realized the "indubitable equivalent" of their claims under the plan, and therefore the plan was confirmable even though it did not allow credit bidding.[208]

While an efficient solution to this ruling will be for secured lenders to insist on the right to credit bid both in plans of reorganization and in lending agreements, the fact that a bankruptcy court limited the secured lender's rights—affirmed by a United States circuit court—is controversial and concerning to the secured lending market.[209]

In general, these cases show that courts may be inclined in the current environment to make adverse presumptions against secured lenders, assuming the right facts are presented to them. Many of the cases and disputes borne out of the credit crisis in 2008 and thereafter are still being processed in the courts. We are likely to see additional decisions that reflect the economic climate, concerns, and distrust that were rampant at that time.

III. CONCLUSION

The "new" economic and lending environment, as reflected in the foregoing cases, as well as in the high-profile bankruptcies of Lehman Brothers and General Motors, is a direct consequence of the unprecedented financial crisis of 2008 and early 2009. As the U.S. economy and financial markets continue their recovery, the memory of these experiences will not lose their forcefulness. Whether lessons have been learned by key market participants that will prevent future economic catastrophes remains to be seen. What is certain, however, is that the judicial reaction sparked by the severe consequences of the financial crisis will

206. *Id*. at 318.
207. *Id*. at 304–10.
208. *Id*. at 310–14, 318.
209. *See*, Jonathan N. Helfat, Richard M. Kohn, & Jill A.G. Zellmer, *Ten Assumptions that Secured Lenders Should Not Make in 2010*, THE SECURED LENDER, Mar. 2010, at 32–35; Bobby Guy & Jennifer O'Guinn, *Attacks Continue on Lenders' Right to Credit Bid in 363 Sales*, THE JOURNAL OF CORPORATE RENEWAL, May 13, 2010, http://www.turnaround.org/Publications/Articles.aspx?objectID=12844.

have long-term ramifications for American jurisprudence. The precedent set by courts during this unique time in American history will remain in effect long after market conditions have shifted. Further, government policy and legal precedent are likely to continue to demonstrate a conservative tendency in an attempt to avoid the massive consequences of the economic strategies that led to the recent financial crisis.