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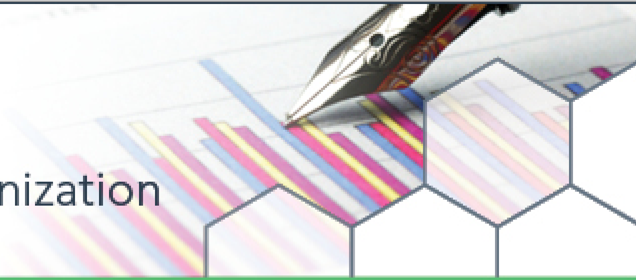

July 2016

Bankruptcy Sale Order Won't Protect New GM from Ignition Switch Claims Due to Deficient Notice

The purchaser of the assets of the former General Motors Company (Old GM) will not be shielded from certain claims against Old GM by a bankruptcy court's § 363 sale order because the claimholders did not have sufficient notice that Old GM's assets were to be sold free and clear of their claims. In reaching this decision, the United States Court of Appeals for the Second Circuit reversed, in part, the prior bankruptcy court decision (reported here) holding that so-called "New GM" could not be held liable for the prebankruptcy sale liabilities of Old GM arising out of ignition switch defects in GM cars. The decision highlights the importance of providing notice reasonably calculated to apprise creditors of developments in bankruptcy proceedings for those creditors to be bound by bankruptcy court orders.

Old GM descended into bankruptcy at the height of the financial crisis. A condition of its government-backed rescue package was that its assets be sold within 40 days to stem its alarming cash burn rate. To meet that deadline, the massive asset sale under § 363 of the bankruptcy code was quickly arranged. At the time of the sale, however, Old GM had sold an estimated 27 million cars with ignition switch defects. These defects are alleged to have caused at least 84 deaths, and millions of car owners were driving defective cars without knowing the potential risks. At least 24 Old GM engineers, attorneys, and other employees were aware of the problem—some as early as 2003.

In June 2009, Old GM filed a motion (Sale Motion) for authorization to sell its assets free and clear of all liens, claims, encumbrances, and other interests, "including specifically all successor liability claims." Old GM mailed notice of the proposed sale to all parties who had already asserted claims against Old GM (whether through litigation or otherwise). However, for car owners yet to assert claims stemming from the ignition switch defect, and who were likely unaware of the defect, notice of the Sale Motion was only provided by publication in a variety of newspapers. In granting the Sale Motion, the bankruptcy court entered an order (Sale Order) declaring that Old GM's assets were being sold free and clear of all claims (including successor liability claims) and enjoining all persons from asserting successor liability claims against New GM.

In spring 2014, New GM publicly announced the existence of the ignition switch defect for the first time, and millions of recall notices were sent to owners of defective vehicles. For some of those owners, this was the first time they had learned of the ignition switch defect and the potential economic cost of that defect to them, such as reduced resale value of their vehicles, missed work due to bringing recalled vehicles in for repair, and other similar costs. These owners, along with owners of defective vehicles involved in accidents prior to the § 363 sale and owners of nondefective GM vehicles who claimed losses due to resale value reductions (together, Claimants) sought to enforce their claims against New GM under various successor liability theories. To stop these claims, New

GM filed motions to enforce the free and clear provisions of the Sale Order. The bankruptcy court decided that the Claimants had insufficient notice of the Sale Motion but held that their interests had been adequately addressed in the 850 other objections to the Sale Motion considered prior to entry of the Sale Order. Accordingly, the bankruptcy court determined that the Claimants were not prejudiced by insufficient notice of the Sale Motion. The bankruptcy court's ruling that cut off the Claimants' successor liability claims against New GM was appealed directly to the Second Circuit.

The Second Circuit agreed with the bankruptcy court in one respect—notice by publication was insufficient to apprise the Claimants of the Sale Motion. The Second Circuit disagreed that this defect was harmless. The court noted that § 363 sales are private business transactions, and terms of sales are negotiated prior to judicial consideration of the transaction. In light of this reality, the Second Circuit decided that the question was not whether the bankruptcy court would have entered the Sale Order over the Claimants' objections; the question was whether the Claimants could have negotiated better terms by asserting objections to the Sale Motion. The Association of State Attorneys General had managed to do exactly that by negotiating the assumption of Lemon Law claims by New GM, based upon President Obama's assurances that warranty claims would survive the government-funded bankruptcy process. Given the leverage wielded by the federal government in the proceedings and the extraordinary cost that would have resulted from a delay in the proceedings (estimated at $125 million per day), the Second Circuit concluded that the Claimants had a reasonable possibility of negotiating for some accommodation of their claims in the Sale Order. On that basis, the Second Circuit reversed the bankruptcy court's decision to enjoin the successor liability claims brought by the Claimants against New GM.

The Second Circuit's decision provides a clear indication that successor liability claims can be barred by § 363 sale orders; however, due process must be afforded to creditors for parties to obtain § 363's protections. A sale order that provides for a sale of assets, free and clear of claims, may be ineffective against creditors who were not aware of an impending asset sale. In addition to the normal financial diligence that is part of many § 363 sales, asset purchasers are reminded by this decision of the critical importance of procedural and legal diligence to ensure that, to the greatest extent possible, all of the debtor's creditors have been identified and notified of a proposed § 363 sale.

For more information, please contact one of the lawyers listed below or another member of Robinson+Cole's Finance Group:

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