

[Products Liability Law Daily Wrap Up, TOP STORY—SUPREME COURT—U.S.: GM tells Supreme Court that Second Circuit ruling threatens bankruptcy process, \(Dec. 19, 2016\)](#)

Products Liability Law Daily Wrap Up

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By John W. Scanlan, J.D.

General Motors has asked the U.S. Supreme Court to reverse a decision by the Second Circuit that ruled that the sale of so-called "Old GM's" assets as part of its 2009 bankruptcy did not enjoin certain claims against "New GM" relating to the ignition switch controversy. The Second Circuit had reversed the decision of the bankruptcy court enjoining these claims, finding that the buyers had been prejudiced by Old GM's failure to provide adequate notice of the grounds of potential claims against it and, therefore, enforcing the sale order would violate procedural due process under the circumstances (*General Motors LLC v. Elliott*, December 13, 2016).

GM filed for bankruptcy in June 2009, and its assets were sold to a new entity (so-called "New GM") pursuant to Sec. 363 of the U.S. Bankruptcy Code. The sale agreement provided that New GM would purchase the assets "free and clear" of any liabilities of Old GM except as provided in the sale agreement, and the bankruptcy court's sale order barred any successor liability on the part of New GM. Old GM sent direct mail notice of the proposed sale order to known creditors (those who had contracted with or filed a demand or claim against it) and posted notice to unknown creditors in various publications. Various objections were raised by creditors but were rejected by the bankruptcy court, which found New GM to be a good faith purchaser and approved the sale.

After New GM began recalling cars in 2014 to address apparent defects in the ignition switches in a number of models, some of which pre-dated the sale, over 100 class action suits were filed against New GM, which filed a motion to enforce the sale order, asserting that these suits were barred under the "free and clear" provision of Sec. 363. The bankruptcy court administering the GM bankruptcy found that the defects were known to or reasonably ascertainable by Old GM prior to the sale order and, therefore, the plaintiffs were entitled to actual notice rather than just publication notice. However, finding that the plaintiffs had not been prejudiced by the form of notice, it agreed with New GM that it could not be sued for ignition switch claims that could have been brought against Old GM (see *Products Liability Daily's* April 16, 2015 [analysis](#)). The plaintiffs appealed, and the bankruptcy court certified the case for direct appeal to the Second Circuit.

The Second Circuit's decision. The Second Circuit reversed the portion of the bankruptcy court's order enforcing the sale order to the extent that it enjoined the claims related to the ignition switch defect, finding that the claimants had shown prejudice from the lack of direct notice. It stated that it could not say with assurance that the outcome of the sale proceedings would have been the same if Old GM had disclosed the ignition switch defect at that time and the claimants had raised objections to the "free and clear" provision in the sale agreement. It also remanded for additional proceedings the claims based on non-ignition switch defects (see *Products Liability Daily's* July 14, 2016 [analysis](#)).

Questions presented: (1) Whether the Due Process Clause requires a debtor selling its assets under Section 363 to notify its creditors not only of the details of the sale, as required by Section 363, but also of the grounds for potential claims against the seller. (2) Whether a seller's failure to provide potential creditors with adequate notice of a Section 363 sale deprives the good-faith purchaser of Section 363's "free and clear" protections.

GM's petition. According to GM, the Second Circuit committed two fundamental errors in finding that the due process clause of the U.S. Constitution requires more notice by debtors proposing sales under Sec. 363 than is required by the Bankruptcy Code, and that the remedy for this failure by the seller is to punish the good-faith

purchaser by imposing successor liability upon it. The purpose of Sec. 363, GM asserted, is to allow a debtor's assets to be sold as quickly as possible in order to maximize the value of the estate instead of allowing them to decline in value during the pendency of various legal proceedings. The "free and clear" provision of Sec. 363 allow debtors to sell their assets at maximum value because sellers would be reluctant to purchase them if doing so would potentially expose them to the same liabilities that caused the debtor to go bankrupt. GM said that the Code provides for only limited, "streamlined" notice of a Section 363 sale, rather than notice of all claims about which the debtor knew or reasonably should have known, because a Sec. 363 sale does not extinguish creditor's claims, and that the burden of notice falls only upon sellers and not upon purchasers.

GM asserted that that the government owners that purchased the assets of Old GM agreed that New GM would honor certain warranties and satisfy certain claims of Old GM, but insisted on acquiring the assets free and clear of all liabilities not expressly named in the agreement, making the free and clear provision integral to the sale. The Second Circuit's decision could not only undermine one of the biggest bankruptcies in history but also deprive future bankruptcy estates of a critical tool to protect creditors, it said. GM argued that Old GM had lost over \$9 billion in the first quarter of 2009 alone, and that delaying the sale to investigate all possible claims that could have been brought against the company by 70 million vehicle owners and then providing direct mail notice to each of these owners describing these possible claims would have caused a further decline in Old GM's position. With the company facing immediate liquidation, this result would have left all creditors noticeably worse off, it said. Furthermore, the result would be unfair to other stakeholders in the GM bankruptcy because it would allow plaintiffs, alone among creditors, to circumvent the priority scheme and seek payment in full from the purchasers. The Second Circuit's decision was inconsistent with the text and the congressional purpose of Section 363, as well as prior decisions by the U.S. Supreme Court and other Circuits, GM concluded.

The case is No. [16-764](#).

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Companies: General Motors LLC

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