

## **Bankruptcy Sales Under Section 363: The Business Judgment Test That Judges Often Cite Isn't Always the One They Use**

*By Daniel A. Lowenthal and Jonah Wacholder\**

### Introduction

Bankruptcy court approval is required when a debtor wants to sell property outside the ordinary course of its business. Courts will allow transactions that reflect a debtor's informed business judgment. When courts consider the rationale and evidence a debtor submits, they will sometimes cite the business judgment test as it has been articulated by the Delaware Supreme Court in cases involving consideration of corporate officers' fiduciary duties. But, in practice, bankruptcy courts apply a different bankruptcy-law business judgment standard when reviewing a debtor's proposed sale of estate property. In the corporate-law context, judges will not question a board's decision if there is no evidence of flaws in the decision-making process. But in the bankruptcy context, judges will make sure a debtor has a valid business reason for the proposed sale of estate property.

This article examines the sale of bankruptcy estate property under Bankruptcy Code section 363 and the business judgment test as it has been applied in certain bankruptcy cases. The article first describes basic concepts concerning section 363 and an early and leading case. It then discusses three cases from the Delaware Supreme Court that articulate the business judgment test that is used in disputes concerning corporate officers' fiduciary duties. Finally, the article reviews some bankruptcy court decisions that cite a debtor's business judgment in the context of section 363 sales. These cases reveal that while judges will discuss the Delaware business judgment test, it is not the test that they apply when reviewing a debtor's proposed sale of property outside the ordinary course of business.

### Section 363

Bankruptcy Code section 363(b) allows debtors to use, sell, or lease their property in the ordinary course of business without court permission. But transactions outside the ordinary course of business require court approval under section 363(b).<sup>1</sup> Courts will evaluate if a proposed deal reflects a debtor's reasonable business judgment and has an articulated business justification.<sup>2</sup> Debtors sell property of value either by public auction or

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private sale. For an auction, debtors will seek a so-called “stalking horse” bidder to set the base bid. The bankruptcy court will approve auction procedures. Stalking horse bidders who lose auctions often will receive a “break-up” fee to cover costs of due diligence.

The basic legal framework governing section 363 cases is illustrated by *In re Lionel Corp.*<sup>3</sup> Lionel is one of the most storied names in American toy trains. The company was founded in 1900. Ownership changed several times in the 20th Century. In the early 1980s, Lionel’s retail operations lost \$22 million over a two-year period, and the company filed for chapter 11.

Lionel’s best asset was an 82 percent ownership interest in the common stock of Dale Electronics Inc., a financially sound company. Dale was not put into bankruptcy, but the unsecured creditors’ committee pushed the chapter 11 debtors to sell their Dale stock. The winning bidder offered \$50 million. A committee of equity security holders and the U.S. Securities and Exchange Commission objected on the grounds that the sale amounted to an evasion of the chapter 11’s plan confirmation requirements of disclosure and solicitation and acceptance by creditors.<sup>4</sup>

The objectors appealed the court’s decision to allow the sale. The U.S. Court of Appeals for the Second Circuit stated that “there must be 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 such disposition under section 363(b).”<sup>5</sup> Significantly, the Second Circuit focused on whether the bankruptcy judge had articulated a sound business reason.

The Second Circuit required “a judge determining a § 363(b) application expressly find from the evidence presented before him at the hearing a good business reason to grant such an application.”<sup>6</sup> The bankruptcy judge should “consider all salient factors pertaining to the proceeding and, accordingly, act to further the diverse interests of the debtor, creditors, and equity holders, alike.”<sup>7</sup>

The factors a judge should consider were extensive but not “exclusive”: “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 the future plans of reorganization, the proceeds to be obtained from the disposition vis-a-vis any appraisals of the property, 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.”<sup>8</sup>

The appellants argued that the sale wasn’t justified. Dale Electronics wasn’t a “wasting asset,” its stock was not subject to “wide market fluctuations,” and possible purchasers would still want the stock six months later.<sup>9</sup> The Second Circuit agreed with the appellants and concluded that “there was no good business reason for the present sale” based on the insistence of the creditors’ committee.<sup>10</sup> Therefore, the Court ruled that the bankruptcy judge had erred in approving the sale.

The Second Circuit’s decision in *Lionel* is significant for at least two

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reasons. First, the court considered whether the *lower court judge* had found from the evidence a justifiable business reason to oppose the sale. As discussed below, courts sometimes instead look more to whether a *debtor* has articulated a valid business reason for a section 363 sale.<sup>11</sup> The emphasis is on what a debtor has explained based on its own decision-making process, not whether the court itself discerns from the evidence a valid business purpose. Second, the Second Circuit addressed whether there was a good business reason to justify the sale of the Dale stock. It listed factors for a court to consider, based on the court's assessment of the interests of the estate. The court did not consider the corporate-law business judgment test that would be applied in the context of a suit for breach of fiduciary duty. However, as is discussed below, some more recent decisions cite that test but apply a test that is more similar to that employed by the Second Circuit in *Lionel*.<sup>12</sup> To understand the difference, it is helpful to understand the contours of the business judgment test and the leading Delaware case law.

### Delaware Business Judgment Rule

The Delaware business judgment rule shields the business decisions of corporate directors from being second-guessed by courts absent a conflict of interest, a breach of due care, or bad faith. When the business judgment rule applies to the business decisions of corporate directors, “courts will not second-guess those business judgments.”<sup>13</sup> When the business judgment rule is rebutted due to an absence of one of its prerequisites, however, the decision is subject to entire fairness review, and “the defendants must prove to the court's satisfaction that the transaction was both a product of fair dealing and fair price.”<sup>14</sup> At the outset, then, the business judgment rule shifts the analysis from the substantive rationale for the decision to the circumstances under which it is made. Significantly, a court considering whether the business judgment rule applies does not directly evaluate the business judgments of corporate directors. Instead, it looks to see whether there were problems with the directors (such as a conflict of interest) or with the decision-making process (such as a failure of the directors to reasonably inform themselves) that justify suspending the normal presumption that directors rather than courts manage the affairs of corporations. Only when such defects are present does the court use its own business judgment to assess the merits of the decision. To illustrate these points, we discuss three leading Delaware Supreme Court cases—*Aronson v. Lewis*,<sup>15</sup> *Van Gorkom v. Smith*,<sup>16</sup> and *Cede & Co. v. Technicolor*.<sup>17</sup>

*Aronson v. Lewis* involved a derivative lawsuit challenging a corporate board's approval of a consulting compensation package for Leo Fink, a 47% shareholder and retired executive of the company.<sup>18</sup> The defendant directors moved to dismiss the complaint, arguing that the plaintiff had neither demanded the board file the lawsuit before the plaintiff did so, nor established that making such demand would be futile.<sup>19</sup> The Court of Chancery denied the motion to dismiss and the defendants appealed.<sup>20</sup>

The Delaware Supreme Court explained that “the entire question of demand futility is inextricably bound to issues of business judgment and the

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To evaluate the plaintiff's claim that demand would have been futile, the Court considered the circumstances of the board's approval of the agreement under the business judgment rule. The Court focused primarily on the plaintiff's allegation that Fink so dominated the board that its decision was not a legitimate exercise of business judgment. Noting that the plaintiff did not raise particularized allegations of control, but simply alleged generally that the directors were appointed at Fink's behest, the Court found this argument unavailing.<sup>24</sup> It then rejected the plaintiff's argument that the agreement constituted corporate waste, holding that the plaintiff had failed to allege adequate facts to support the conclusion that Fink's compensation lacked consideration.<sup>25</sup> The Court did not find that the challenged compensation agreement was wise or justified, nor did it evaluate the merits at all; it simply found that the plaintiff had not made sufficient allegations to pierce the protection of the business judgment rule, and thus reversed the Court of Chancery's denial of the motion to dismiss.<sup>26</sup>

The same approach is illustrated in *Smith v. Van Gorkom*. In *Van Gorkom*, the Delaware Supreme Court considered a suit against the former directors of Trans Union Corporation claiming that they had breached their fiduciary duties when they had approved and recommended a merger.<sup>27</sup> The Board approved the merger on September 20, 1980 and reaffirmed its approval on January 26, 1981, after a market test period during which the board considered other offers.<sup>28</sup> The stockholders voted for the merger on February 10.<sup>29</sup> The defendant directors argued that the board's conduct should be considered as a whole, focusing on the board's approval of the merger agreement at the September 20 meeting together with the subsequent market test process and the board's approval on January 26.<sup>30</sup> The Court rejected this view.<sup>31</sup>

The Court explained that "fulfillment of the fiduciary function requires more than the mere absence of bad faith or fraud," which was not alleged in the case.<sup>32</sup> Directors have a duty to "act in an informed and deliberate manner," a duty which is assessed under a gross negligence standard.<sup>33</sup> The Court, in considering whether the board had acted consistently with this duty, held that there were really two questions: "whether the directors had reached an informed business judgment on September 20, 1980" and "if they did not, whether the directors' actions taken subsequent to September 20 were adequate to cure any infirmity in their action taken on September 20."<sup>34</sup>

The Court found that the directors did not reach an informed business

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judgment on September 20. It based its conclusion on several considerations. Most of the directors were not informed before the meeting that the purpose of the meeting was consideration of a cash-out merger.<sup>35</sup> The directors were presented with no documents concerning the proposed transaction or supporting the adequacy of the \$55 share price.<sup>36</sup> On the substance of the transaction, the directors relied on the oral presentation of James Van Gorkom, Trans Union's CEO, who had not seen the merger agreement.<sup>37</sup> They failed to inquire as to the source of the \$55 price, which would have revealed that it was based on the feasibility of a leveraged buy-out rather than the intrinsic value of the company, relying instead on Van Gorkom and the brief oral statement of Donald Romans, Trans Union's CFO.<sup>38</sup> They then approved the merger after only two hours' consideration, despite their lack of prior notice.<sup>39</sup>

The Court additionally held that the directors' conduct subsequent to September 20 was flawed and failed to cure the deficiencies of the September 20 meeting. On October 8, the board adopted certain amendments to the merger agreement in response to senior management's negative reaction to the proposed merger.<sup>40</sup> The amendments were intended to give more time for the market test of the merger price and to permit Trans Union to solicit and consider other offers.<sup>41</sup> But the board did not actually read or review the amendments, which were not reduced to writing until October 10, prior to its approving them.<sup>42</sup> The Court held that the amendments actually had the effect of locking the board into the merger agreement, accomplishing the opposite of what was intended.<sup>43</sup> Thus, by the time of the January 26 meeting, the board was not actually free to escape from the agreement.<sup>44</sup> Instead, on January 26 the board decided among three approaches to the shareholder vote: to recommend it, to recommend against it, or to remain neutral.<sup>45</sup> But the second two options, the Court explained, were not legally available to the board under Delaware law—it could only proceed with the merger and recommend approval, or rescind the agreement and cancel the shareholder meeting (and face a potential suit for breach of contract).<sup>46</sup> The board's decision on January 26 thus was not an informed business judgment on whether to turn down the proposal and did not cure the original deficiency.<sup>47</sup> The Court concluded that the directors had failed to reach an informed business judgment in approving the merger and had breached their fiduciary duty.<sup>48</sup>

*Van Gorkom* shows the process focus of the business judgment rule at its height. Rather than simply inquire into the adequacy of the price, the Delaware Supreme Court examined at length precisely what had happened at each stage: what the directors had known, what the directors had inquired about, and what information the directors had reviewed. Its holding that the directors had breached their fiduciary duties was predicated on their gross negligence in these respects.

*Cede & Co. v. Technicolor* provides an additional illustration of these points. In *Technicolor*, the Delaware Supreme Court considered another challenge to an acquisition, this time of the film company Technicolor by MacAndrews & Forbes Group. The Court of Chancery found, and the Dela-

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ware Supreme Court agreed, that one of the directors had a conflict of interest because of a “finder’s fee” he had received for introducing the parties, and also that the board had locked the company into the merger without adequately informing itself beforehand.<sup>49</sup> The Court considered the consequences of these findings under the business judgment rule.

The Court reaffirmed the principle that “the business and affairs of a corporation are managed by or under the direction of its board of directors.”<sup>50</sup> The business judgment rule, the Court explained, “operates to preclude a court from imposing itself unreasonably on the business and affairs of a corporation.”<sup>51</sup> To get past the business judgment rule, a plaintiff must show that the directors “breached any one of the triads of their fiduciary duty—good faith, loyalty or due care.”<sup>52</sup> Should a plaintiff meet this burden, the directors must “prove to the trier of fact the ‘entire fairness’ of the transaction to the shareholder plaintiff.”<sup>53</sup> The Court addressed both the duty of loyalty issue and the duty of care issue.

The Court explained that the duty of loyalty required disinterested directors, and “a director who receives a substantial benefit from supporting a transaction cannot be objectively viewed as disinterested or independent.”<sup>54</sup> Nonetheless, the Court rejected the view of plaintiffs that “one director’s receipt of any tangible benefit not shared by the stockholders generally is sufficient to overcome the business judgment presumption of director and board independence.”<sup>55</sup> Instead, it held that “the question of when director self-interest translates into board disloyalty is a fact-dominated question, the answer to which will necessarily vary from case to case.”<sup>56</sup> The question involves whether the director’s interest “is sufficiently material to find the director to have breached his duty of loyalty and to have infected the board’s decision.”<sup>57</sup> In the case of *Technicolor*, an additional complication was that approval of the merger effectively required either a unanimous recommendation of the board or approval by holders of 95 percent of the outstanding shares.<sup>58</sup> Since a unanimous vote was required, a breach of loyalty on the part of a single director might be more significant than it otherwise would be.<sup>59</sup> The Delaware Supreme Court remanded the duty of loyalty question for reconsideration by the Court of Chancery, which had held “[l]argely without explanation” that the finder’s fee conflict of interest was immaterial to the board’s approval.<sup>60</sup>

The Court of Chancery had rejected the breach of duty of care claim on the ground that the plaintiffs had not proved a monetary loss or quantified that loss.<sup>61</sup> The Delaware Supreme Court held that this requirement was inappropriate. Instead, once a plaintiff establishes a breach of the duty of care, the presumption established by the business judgment rule is rebutted and the transaction is subject to entire fairness review.<sup>62</sup>

*Aronson*, *Van Gorkom*, and *Technicolor* show the crucial difference between the Delaware business judgment rule and the bankruptcy-law standard under section 363. To review, in *Lionel*, the Second Circuit required a “good business reason” for a sale under section 363, and it evaluated the merits of the sale to determine whether such a reason was present. In these Delaware

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cases, however, the more important question was whether there was a conflict of interest or a gross lack of due care on the part of the directors. In the absence of one of those elements, a court will not question and rule on whether there is a good business reason for the challenged decision of the board—as explained in *Technicolor*, that is a matter for the corporation’s directors, not for the court’s consideration. The *Lionel* standard and the Delaware corporate law standard, while both sometimes using the language of “business judgment,” involve fundamentally different inquiries.<sup>63</sup>

### Bankruptcy Courts and the Business Judgment Rule

Despite the difference between the standards, bankruptcy courts have sometimes cited the Delaware standard when considering motions to approve sales under section 363. One example is *In re Integrated Resources*.<sup>64</sup> Integrated Resources was a holding company that owned many operating businesses, including insurance companies, investment programs, consulting and money management services, and more. After Integrated filed for chapter 11, Bankers Trust New York Corporation (“BT”) sought to fund a reorganization plan. The proposal called for BT to receive a break-up fee if the transaction didn’t close.

The bankruptcy court approved the break-up fee, but a committee of subordinated bondholders appealed that decision to the district court. The court cited Delaware cases that applied the business judgment rule to decisions by corporate officers and directors. “The business judgment rule ‘is a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.’ ”<sup>65</sup> The court said these principles have “ ‘vitality by analogy’ in Chapter 11, especially where, as here, the debtor Integrated is a Delaware corporation.”<sup>66</sup>

The district court noted that a corporation’s decision will be protected from “judicial second-guessing when the following elements are present: “ ‘(1) a business decision, (2) disinterestedness, (3) due care, (4) good faith, and (5) according to some commentators, no abuse of discretion or waste of corporate assets.’ ”<sup>67</sup> The court stressed that “[c]ourts are loath to interfere with corporate decisions absent a showing of bad faith, self-interest, or gross negligence.”<sup>68</sup>

The court also said judges should only consider the “entire fairness” of a transaction when it is “one involving a predominately interested board with financial interests in the transaction adverse to the corporation.”<sup>69</sup> The “entire fairness” test should be used “ ‘in the face of illicit manipulation of a board’s deliberative processes by self-interested corporate fiduciaries.’ ”<sup>70</sup> In *Integrated*, there was no showing of self-dealing and thus the “entire fairness” test didn’t apply. The court affirmed the bankruptcy court’s decision that approved the debtor’s proposed break-up fee.

In *Lubrizol Enterprises v. Richmond Metal Finishers, Inc.*,<sup>71</sup> the court similarly invoked the corporate-law business judgment rule in a bankruptcy

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case. Richmond Metal Finishers (“RMF”) filed for chapter 11 and sought to reject a contract it had with Lubrizol Enterprises (“Lubrizol”). Under the contract, RMF granted Lubrizol a non-exclusive license to use a metal coating process technology that RMF owed. The bankruptcy court permitted rejection, but the district court reversed. On appeal, the Fourth Circuit reversed the district court.<sup>72</sup>

The Fourth Circuit noted that the contract was executory under the classic definition articulated by Professor Vern Countryman: the “obligations of both the bankruptcy and the other party to the contract are so far unperformed that the failure of either to complete the performance would constitute a material breach excusing the performance of the other.”<sup>73</sup>

The decision addressed the debtor’s business judgment. The Fourth Circuit stated that “the bankrupt’s decision upon it is to be accorded the deference mandated by the sound business judgment rule as general applied by courts to discretionary actions or decisions of corporate directors.”<sup>74</sup> The Fourth Circuit stated that it is the debtor’s business judgment that matters, not the court’s. “As generally formulated and applied in corporate litigation the rule is that courts should defer to—should not interfere with—decisions of corporate directors upon matters entrusted to their business judgment except upon a finding of bad faith or gross abuse of their ‘business discretion.’”<sup>75</sup> The Fourth Circuit reversed the district court’s ruling because, the appeals court concluded, “the district court could only have been substituting its business judgment for that of the debtor.”<sup>76</sup>

In bankruptcy, the Fourth Circuit held, a court should defer to a debtor’s decision “unless it is shown that the bankrupt’s decision was one taken in bad faith or in gross abuse of the bankrupt’s retained business discretion.”<sup>77</sup> The question, the Fourth Circuit held, is whether the decision is “so manifestly unreasonable that it could not be based on sound business judgment, but only on bad faith, or whim or caprice.”<sup>78</sup> *Lubrizol* is a section 365 case, concerning the rejection of an executory contract, rather than a section 363 case about sales outside the ordinary course of business. This language, however, ultimately derived from the corporate-law context, has been widely quoted by courts considering sales under section 363.<sup>79</sup>

Both *Integrated Resources* and *Lubrizol* illustrate the transplanting of the language of the corporate law doctrine to the bankruptcy law context. Like the corporate-law business judgment rule they rely on, they emphasize the deference directors are owed by the court on the substance of business decisions, coupled with (more in *Integrated Resources* than in *Lubrizol*) attention to potential flaws in the decision-making process. The deferential language in these decisions is often cited by bankruptcy courts.<sup>80</sup>

Bankruptcy courts, however, even when they cite this deferential language, and even when they themselves cite the cases establishing the deference owed to directors in the context of general corporate law, in practice usually apply a less deferential bankruptcy-law standard more akin to the one set forth in *Lionel*. The courts require debtors to submit evidence that justifies the business decision proposed in a sale motion. Two more recent cases illustrate this tendency.



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In *In re Borders Group*, the book chain Borders Group, Inc. filed for bankruptcy in the Southern District of New York.<sup>81</sup> The debtors sought to sell assets worth less than \$1 million. The sale items were no longer needed in the stores: office furniture, tools, supplies, and more. The only objection filed to the section 363 motion was resolved before the court hearing. Even so, the court considered if the proposed sale procedures reflected a proper exercise of the debtors' business judgment.

The court said the debtors must articulate "some business justification" and not just seek "appeasement of major creditors."<sup>82</sup> Whether the test is satisfied will be based on the "facts and circumstances of each case."<sup>83</sup> The court noted that judges should "defer to a debtor's business judgment" when it identifies the highest and best bid.<sup>84</sup> The court looked to the debtor's business judgment, not its own. It cited the Delaware cases that outline the key test, including *Smith v. Van Gorkom*<sup>85</sup> ("the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company"). And the court said it should not interfere with a debtor's business decision unless there's evidence of "bad faith, self-interest, or gross-negligence."<sup>86</sup>

The court found that the procedures were "appropriate."<sup>87</sup> The debtors had outlined a "streamlined" way of selling assets that were worth little to the bankruptcy estate. Separate court approval wouldn't be needed for each item sold, maintenance and storage costs would be reduced, and the debtors would be able to clear items from stores to turn them over to landlords.

*Borders* illustrates how even bankruptcy courts that cite the Delaware business judgment rule have actually handled sales under section 363. The court in *Borders* evaluated whether there was a good business reason for the proposed sale process, instead of focusing on conflicts of interest or the decision-making process. Finding that there was, the court approved it.

The same principle is illustrated by *In re 160 Royal Palm*.<sup>88</sup> The owner of a hotel in Palm Beach that was under construction filed chapter 11. The debtor marketed the property for sale. A stalking horse bidder was identified, a base price was set at \$32 million, the court approved bidding procedures, and an auction was scheduled. But litigation sidetracked these plans. A dispute emerged involving the debtor, a former owner of the hotel, and foreign investors who alleged that funds had been misused. At the auction, the former owner sought to credit bid a claim it held against the debtor's estate and have that claim estimated.

The debtor then changed course and decided to sell the property by private sale rather than in a public auction. A buyer was willing to pay \$39.6 million. The debtor sought court permission to allow just the stalking horse bidder to make a competing offer. The public auction bidding procedures would be withdrawn and others potential bidders—including the former owner—could not bid. The bankruptcy court allowed the private sale to the new bidder free of all liens, claims, and encumbrances. The former owner appealed that ruling to the federal district court. It challenged the withdrawal of the public auction procedures, the approval of the private auction procedures, and the bankruptcy court's approval of the private sale.

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On the appeal, the district court ruled for the debtor. In explicating the standard, the court invoked *Librizol's* language requiring “bad faith, or whim or caprice” to invalidate a debtor’s decision.<sup>89</sup> The court said there was “nothing in the record to overcome deference that is owed to the Debtor’s business judgment and the Bankruptcy Court’s findings of fact.”<sup>90</sup> The court added that the “record reveals that the Debtor had actively marketed the property, employed an international real estate broker to help sell the property, and had been continuously working towards that sale since as early as October 2018.”<sup>91</sup> In addition, the court noted, “ ‘[i]n particular, the Bankruptcy Court did not clearly err in crediting the Debtor’s manager’s . . . testimony regarding the Debtor’s ‘extensive marketing’ of the property and his conclusion that the [private sale] offer was worthy of pursuit.”<sup>92</sup> Significantly, the court said, “private sales are not unheard of in bankruptcy and in fact are expressly contemplated by the rules. See Fed. R. Bankr. P. 6004(f)(1).”<sup>93</sup> Here, the Debtor’s private sale procedure served its interest in resolving the matter quickly, with the court noting that “[e]very time the sale of the Hotel is delayed, the Town’s claims continue to accrue, and the creditor’s ultimate payment date is further delayed.”<sup>94</sup>

The former hotel owner said it would have offered \$1 million more than the private-sale bid. But, the court noted, the highest bid isn’t necessarily the best.<sup>95</sup> The court also ruled that elimination of other bids “was subject to the Debtor’s business judgment.” The private sale gave the debtor “finality [and] certainty” with a higher price than stalking horse bid, and the alternative bid was only 2.5% higher.<sup>96</sup> “[T]o force the Debtor to forgo the [accepted private sale] offer and subject itself to a public auction would require this Court to use its own business judgment in place of the Debtor’s, which this Court will not do.”<sup>97</sup>

The *Royal Palm* court nonetheless thoroughly reviewed the basis on which the debtor made its decision and, in accordance with the *Lionel* standard, found good business reasons for it: the debtor’s interest in speed and certainty justified its decision. *Royal Palm* again shows that the deferential rhetoric bankruptcy courts have borrowed from corporate law often does not alter the standard applied in practice. While the court acknowledged that “a different debtor might have come to a different conclusion,” it did much more than simply check that the debtor’s decision was not a product of “bad faith, or whim or caprice.”<sup>98</sup>

#### Conclusion

Many bankruptcy courts invoke corporate-law doctrine to describe the applicable standard for approval of a sale under section 363(b). The reader of these cases should take note, however: the corporate-law business judgment rule is not the same as the business judgment standard applied in bankruptcy law. Indeed, in practice, even the courts that invoke the general corporate standard engage in meaningful review of the substance of a debtor’s or trustee’s decision-making under section 363.

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**NOTES:**

<sup>1</sup>See 11 U.S.C.A. § 363(b) (“The trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate.”).

<sup>2</sup>Bankruptcy Code section 365, concerning rejection or assumption of prepetition contracts, has been similarly interpreted. See 11 U.S.C.A. § 365; *Matter of Minges*, 602 F.2d 38, 43, 5 Bankr. Ct. Dec. (CRR) 452, 20 C.B.C. 955, Bankr. L. Rep. (CCH) P 67205 (2d Cir. 1979); *In re Orion Pictures Corp.*, 4 F.3d 1095, 1099, 24 Bankr. Ct. Dec. (CRR) 1139, 29 Collier Bankr. Cas. 2d (MB) 1341, Bankr. L. Rep. (CCH) P 75459, 123 A.L.R. Fed. 681 (2d Cir. 1993).

<sup>3</sup>*In re Lionel Corp.*, 722 F.2d 1063, 11 Bankr. Ct. Dec. (CRR) 553, 9 Collier Bankr. Cas. 2d (MB) 941, Bankr. L. Rep. (CCH) P 69510 (2d Cir. 1983).

<sup>4</sup>722 F.2d at 1066.

<sup>5</sup>722 F.2d at 1070.

<sup>6</sup>722 F.2d at 1071.

<sup>7</sup>722 F.2d at 1071.

<sup>8</sup>722 F.2d at 1071.

<sup>9</sup>722 F.2d at 1071–72.

<sup>10</sup>722 F.2d at 1072.

<sup>11</sup>See *infra* at 13–20.

<sup>12</sup>See *infra* at 13–20.

<sup>13</sup>*Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 361, Fed. Sec. L. Rep. (CCH) P 97811 (Del. 1993), decision modified on reargument, 636 A.2d 956 (Del. 1994). A decision of a board protected by the business judgment rule “will not be overturned by the courts unless it cannot be ‘attributed to any rational business purpose.’ ” *Cede & Co.*, 644 A.2d at 361 (quoting *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971).)

<sup>14</sup>*Cede & Co.*, 634 A.2d at 361.

<sup>15</sup>*Aronson v. Lewis*, 473 A.2d 805 (Del. 1984) (overruled on other grounds by, *Brehm v. Eisner*, 746 A.2d 244 (Del. 2000)).

<sup>16</sup>*Smith v. Van Gorkom*, 488 A.2d 858, Fed. Sec. L. Rep. (CCH) P 91921, 46 A.L.R.4th 821 (Del. 1985) (overruled on other grounds by, *Gantler v. Stephens*, 965 A.2d 695 (Del. 2009)).

<sup>17</sup>*Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, Fed. Sec. L. Rep. (CCH) P 97811 (Del. 1993), decision modified on reargument, 636 A.2d 956 (Del. 1994).

<sup>18</sup>472 A.2d at 808–09.

<sup>19</sup>472 A.2d at 807–08.

<sup>20</sup>472 A.2d at 807–08.

<sup>21</sup>472 A.2d at 812.

<sup>22</sup>472 A.2d at 812.

<sup>23</sup>472 A.2d at 812.

<sup>24</sup>472 A.2d at 816.

<sup>25</sup>472 A.2d at 817.

<sup>26</sup>472 A.2d at 818.

<sup>27</sup>488 A.2d at 863–64.

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<sup>28</sup>488 A.2d at 869–870.

<sup>29</sup>488 A.2d at 870.

<sup>30</sup>488 A.2d at 873–74.

<sup>31</sup>488 A.2d at 893.

<sup>32</sup>488 A.2d at 872–73.

<sup>33</sup>488 A.2d at 873.

<sup>34</sup>488 A.2d at 874.

<sup>35</sup>488 A.2d at 874.

<sup>36</sup>488 A.2d at 874.

<sup>37</sup>488 A.2d at 874.

<sup>38</sup>488 A.2d at 875.

<sup>39</sup>488 A.2d at 874, 877.

<sup>40</sup>488 A.2d at 881.

<sup>41</sup>488 A.2d at 882.

<sup>42</sup>488 A.2d at 882–83.

<sup>43</sup>488 A.2d at 884.

<sup>44</sup>488 A.2d at 888.

<sup>45</sup>488 A.2d at 887–88.

<sup>46</sup>488 A.2d at 888.

<sup>47</sup>488 A.2d at 888.

<sup>48</sup>488 A.2d at 893.

<sup>49</sup>634 A.2d at 355, 369.

<sup>50</sup>634 A.2d at 360.

<sup>51</sup>634 A.2d at 360.

<sup>52</sup>634 A.2d at 361.

<sup>53</sup>634 A.2d at 361.

<sup>54</sup>634 A.2d at 361–62.

<sup>55</sup>634 A.2d at 363.

<sup>56</sup>634 A.2d at 364.

<sup>57</sup>634 A.2d at 364.

<sup>58</sup>634 A.2d at 365–66.

<sup>59</sup>634 A.2d at 366.

<sup>60</sup>634 A.2d at 365–66.

<sup>61</sup>634 A.2d at 358.

<sup>62</sup>634 A.2d at 371.

<sup>63</sup>Cf. 3 Collier on Bankruptcy ¶ 363.02[4] (“The ‘business judgment’ test [under section 363] differs from the general corporate law business judgment rule, which protects corporate directors from liability where they exercised due care and were not self-interested in the transaction.”).

<sup>64</sup>In re Integrated Resources, Inc., 147 B.R. 650, 23 Bankr. Ct. Dec. (CRR) 1042 (S.D. N.Y. 1992).

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<sup>65</sup>147 B.R. at 656 (quoting *Smith v. Van Gorkom*, 488 A.2d 858, 872, Fed. Sec. L. Rep. (CCH) P 91921, 46 A.L.R.4th 821 (Del. 1985) (overruled on other grounds by, *Gantler v. Stephens*, 965 A.2d 695 (Del. 2009))).

<sup>66</sup>147 B.R. at 656.

<sup>67</sup>147 B.R. at 656 (quoting Dennis J. Block, Nancy E. Barton and Stephen A. Radin, *The Business Judgment Rule 12* (3D ed. 1991)).

<sup>68</sup>147 B.R. at 656.

<sup>69</sup>147 B.R. at 658.

<sup>70</sup>147 B.R. at 658 (quoting *Mills Acquisition Co. v. Macmillan, Inc.*, 559 A.2d 1261, Fed. Sec. L. Rep. (CCH) P 94401 (Del. 1989)).

<sup>71</sup>*Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.*, 756 F.2d 1043, 12 Bankr. Ct. Dec. (CRR) 1281, 12 Collier Bankr. Cas. 2d (MB) 310, 226 U.S.P.Q. 961, Bankr. L. Rep. (CCH) P 70311 (4th Cir. 1985).

<sup>72</sup>The Fourth Circuit's decision on the rejection issue has widely criticized and led to the enactment of 11 U.S.C.A. § 365(n). The discussion of *Lubrizol* here focuses on the consideration of the business judgment test, not the rejection issue.

<sup>73</sup>756 F.2d at 1045.

<sup>74</sup>756 F.2d at 1046.

<sup>75</sup>756 F.2d at 1047. *Polin v. Conductron Corp.*, 552 F.2d 797, 809, Fed. Sec. L. Rep. (CCH) P 95916 (8th Cir. 1977), which applied the Delaware business judgment rule, and *Lewis v. Anderson*, 615 F.2d 778, 782, Fed. Sec. L. Rep. (CCH) P 97153, 28 Fed. R. Serv. 2d 390 (9th Cir. 1979), which applied the similar California business judgment rule.

<sup>76</sup>756 F.2d at 1047.

<sup>77</sup>756 F.2d at 1047.

<sup>78</sup>756 F.2d at 1047.

<sup>79</sup>See, e.g., *In re 160 Royal Palm, LLC*, 600 B.R. at 126; *In re SW Boston Hotel Venture, LLC*, 2010 WL 3396863 (Bankr. D. Mass. 2010); *White v. Official Comm. of Unsecured Creditors (In re Cadkey Corp.)*, 317 B.R. 19 (D. Mass. 2004), at 22–23; *In re Aerovox, Inc.*, 269 B.R. 74, 80, 38 Bankr. Ct. Dec. (CRR) 161 (Bankr. D. Mass. 2001).

<sup>80</sup>For *Integrated Resources*, see, e.g., *In re Borders Group, Inc.*, 453 B.R. 477 (Bankr. S.D. N.Y. 2011); *In re Advanced Contracting Solutions, LLC*, 582 B.R. 285, 310, 65 Bankr. Ct. Dec. (CRR) 55 (Bankr. S.D. N.Y. 2018); *In re: Genco Shipping & Trading Limited*, 509 B.R. 455, 464, 59 Bankr. Ct. Dec. (CRR) 144, 71 Collier Bankr. Cas. 2d (MB) 1582 (Bankr. S.D. N.Y. 2014); *In re Global Crossing Ltd.*, 295 B.R. 726, 743, 41 Bankr. Ct. Dec. (CRR) 170 (Bankr. S.D. N.Y. 2003). For *Lubrizol*, see *supra* at n.77.

<sup>81</sup>453 B.R. 477 (Bankr. S.D.N.Y. 2011).

<sup>82</sup>453 B.R. at 482.

<sup>83</sup>453 B.R. at 482.

<sup>84</sup>453 B.R. at 482–83.

<sup>85</sup>*Smith v. Van Gorkom*, 488 A.2d 858, 872, Fed. Sec. L. Rep. (CCH) P 91921, 46 A.L.R. 4th 821 (Del. 1985) (overruled on other grounds by, *Gantler v. Stephens*, 965 A.2d 695, 713 (Del. 2009)).

<sup>86</sup>*Integrated Resources*, 147 B.R. at 656.

<sup>87</sup>453 B.R. at 483.

<sup>88</sup>*In re 160 Royal Palm, LLC*, 600 B.R. 119 (S.D. Fla. 2019), *aff'd*, 785 Fed. Appx. 829 (11th Cir. 2019).

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<sup>89</sup>600 B.R. at 126. The court did not cite *Lubrizol*, but rather another case that relied on this language ultimately from *Lubrizol*.

<sup>90</sup>600 B.R. at 127.

<sup>91</sup>600 B.R. at 127.

<sup>92</sup>600 B.R. at 127.

<sup>93</sup>600 B.R. at 127.

<sup>94</sup>600 B.R. at 127.

<sup>95</sup>600 B.R. at 129.

<sup>96</sup>600 B.R. at 128.

<sup>97</sup>600 B.R. at 130.

<sup>98</sup>600 B.R. at 128, 126.