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Ruling In GM Case Clarifies Liability Limits In Bankruptcies

By **Linda Chiem**

Law360, New York (April 26, 2017, 9:31 PM EDT) -- The U.S. Supreme Court's rejection of General Motors' bid to dodge responsibility for some of its predecessor company's actions even after a 2009 bankruptcy makes clear that some buyers in Chapter 11 sales cannot rely on traditional rules to escape liability when parties aren't properly notified about lingering claims, experts say.

The justices on Monday **denied GM's petition** for certiorari to review the Second Circuit's 2016 decision striking down bankruptcy decisions that had shielded New GM from liability related to ignition switch defects, teeing up the Detroit automaker to face significant liabilities potentially worth billions of dollars in ongoing litigation.

By leaving the Second Circuit's ruling undisturbed, the justices have kept intact the limits the three-judge panel placed on "free and clear" provisions of a Chapter 11 sale, experts say, specifically that such provisions will not necessarily shield a purchaser from liability if the seller fails to notify parties that could have potential claims against a debtor.

"What it means now is buyers have one more item on their checklist and one more risk factor to weigh in bankruptcy sales," Perkins Coie LLP bankruptcy and restructuring partner John D. Penn told Law360.

The "free and clear" provision in Section 363 of the U.S. Bankruptcy Code has traditionally shielded a purchaser from what's called successor liability arising from the debtor's conduct. It's been a mechanism for would-be buyers to sign onto a purchase without having legacy liabilities from the bankrupt company weighing them down, experts say.

GM had insisted the Second Circuit undermined the crucial liability-shedding provision of the bankruptcy process when it **found in July 2016** that extinguishing the ignition-switch defect claims would violate potential victims' right to due process and said that New GM can be pursued for successor liability.

What doomed GM on this issue was its failure to reveal the ignition switch issue during the bankruptcy; the company began recalling cars because of the defect in February 2014. The timing of the disclosure by GM effectively denied the plaintiffs the right to weigh in on the sale, and therefore they could not be bound by the provisions of the sale order that shielded the company from litigation, the Second Circuit had said.

"Another car manufacturer has been hoisted with its own petard for lying," Russell McRory, a partner in Arent Fox LLP's automotive practice group, said. "GM, both Old and New, is accused of lying about a defect that actually killed people. The Supreme Court has let stand a Second Circuit decision that rightly holds GM accountable for its failure to own up to deadly defects in its products."

Many, if not most, Old GM employees and managers stayed with New GM after the transition, and the plaintiffs had argued it was essentially the same company.

GM said Monday that the Supreme Court's order declining to hear the case "was not a decision on

the merits, and it's likely that the issues we raised will have to be addressed in the future in other venues because the Second Circuit's decision departed substantially from well-settled bankruptcy law."

The company has settled more than 1,000 lawsuits over the ignition-switch defect issue. And GM has said there were approximately 1,680 personal injury and wrongful death cases remaining in the multidistrict litigation as of February. After a first round of bellwether trials last year, a second round is set to start this July.

The biggest impact to New GM is that it will have to defend claims for ignition switch defects, including claims that arose under Old GM — some that may even date back to several years before the 2009 bankruptcy. But each plaintiff must still go through all the customary hurdles of proving an individual case against GM.

"They'll sort it out, they'll survive and I don't know what the scope of liabilities will be, but it's going to be significant because they were intended to be shed as part of the bankruptcy," Joel Applebaum, co-leader of Clark Hill PLC's corporate restructuring and bankruptcy practice group, told Law360.

But the Second Circuit ruling that's left in place does raise questions about what debtors have to think about, **how deftly purchasers must scrutinize** a debtor's business, and what the proper parameters are for providing "notice" of claims or liabilities ahead of a Section 363 sale, they say.

"For people who are probably unaware [their cars have a defect], how do you get notice to them and how does the court deal with them?" Applebaum said.

However, some experts say automakers outside of bankruptcy don't have much precedent to worry about. But Applebaum explained that this case might have some impact on what playbook will be used by beleaguered air bag manufacturer Takata Corp. to deal with its own legal woes — and a **planned sale** in court-ordered bankruptcy in Japan — stemming from the company's defective air bags.

"Almost every major OEM [original equipment manufacturer] — such as Honda, Toyota, GM, Ford, Chrysler and BMW — is facing enormous recall issues surrounding the Takata air bags and Takata is looking to exit and figure out a way to encapsulate the liability," Applebaum said. "Typically, they'd use this playbook where you take the good assets and sell them to Key Safety Systems or Autoliv, which are the principle bidders, and the liabilities would stay with Old Takata."

Applebaum added, "One of the things they're struggling with is, how do we do this and protect the OEMs from what are clearly Takata's sins, so how do we get notice to the affected parties?"

The case is General Motors LLC v. Celestine Elliott et al., case number 16-764, in the Supreme Court of the United States.

--Additional reporting by Cara Salvatore. Editing by Philip Shea and Mark Lebetkin.