THE CAPITOL FORUM November 21, 2014

General Motors: Relief against New GM Remains Longshot for Ignition Defect Claimants, Although Settlement Possible; Mootness Considerations Present Substantial, But Not Insurmountable, Obstacle to Relief against Old GM

Conclusion

Litigation concerning the extent to which the 2009 bankruptcy court order approving the "free and clear" sale of General Motors Corp.'s assets bars ignition defect claims is heating up. There are effectively three possible outcomes for the Claimants, with Judge Robert E. Gerber either determining that the claimants may: (a) pursue claims against New GM, as the claimants request; (b) pursue claims against Old GM only; or (c) not pursue claims against either New GM or Old GM (see below for in-depth background).

Based on our review of the papers filed to date, relevant case law, and conversations with knowledgeable bankruptcy commentators, the first outcome – the claimants being permitted to pursue claims against New GM – appears to be the least likely of the three, though one source with whom we spoke suggested that New GM may ultimately settle with the Claimants simply to avoid protracted litigation. The relative likelihood of the second and third outcomes likely turns on a delicate – and difficult – balancing of the relative harms to the Claimants and Old GM stakeholders in each of those scenarios. Key points for stakeholders to consider include:

- **Claimants face significant hurdles in seeking remedies against New GM, although one source suggested that New GM is nevertheless in for a lengthy battle.** Even if the claimants could establish that their due process rights were violated, which is itself a disputed issue, it will be very difficult for the claimants to get out from under the "comprehensive" protections given to New GM in the sale order. The claimants will be hard-pressed to demonstrate that, even if they had been given proper notice of the sale, New GM would have voluntarily assumed liability for their claims – especially given that the interests of similarly situated products liability claimants were well represented at the sale hearing, and New GM nevertheless assumed only a very narrow subset of products liability claims. That said, a bankruptcy lawyer with whom we spoke suggested that it was unlikely that New GM could get rid of the ignition defect claims without going through extensive discovery first – which might incentivize New GM to settle.

- **Equitable mootness considerations present an obstacle to remedies against Old GM.** While one could certainly understand the appeal, from Judge Gerber's perspective, of giving the claimants a "consolation prize" in the form of relief against Old GM (assuming he will not permit the claims to proceed against New GM), fashioning relief against Old GM for the claimants that does not significantly harm other Old GM stakeholders and other innocent parties will be a difficult task – meaning that there is a material risk that any request for relief against Old GM will be denied as "equitably moot." Moreover, the former bankruptcy judge with whom we spoke suggested that the plaintiffs' strategic decision to seek recoveries from Old GM as a "plan B," only to be deployed if their efforts to recover from New GM fail, could significantly hurt their chances of recovering from Old GM.

Key Points

Ultimately, the Bankruptcy Court is unlikely to give Claimants a remedy against New GM, even if the Claimants can establish a due process violation; nevertheless, one source suggests that New GM is in for a lengthy battle that may incentivize New GM to settle with the Claimants. One of the Claimants' primary

arguments for relief against New GM is that they were denied due process in connection with the Bankruptcy Court's entry of the sale order, and therefore cannot be bound by that order, which provides for the sale of Old GM's assets "free and clear" of existing liabilities and would bar the claims against New GM that the Claimants seek to assert. The due process issue arises from the fact that, although Old GM provided "publication" notice of the sale in various newspapers, the Claimants did not receive any direct mail notice of (a) the sale to New GM (and its "free and clear" nature), and (b) the fact that they may have had claims based on their ownership of vehicles with an ignition defect, and therefore were deprived of a meaningful opportunity to object to the sale.

As discussed in our prior report, the adequacy of publication notice under the circumstances depends in part on whether the Claimants were known creditors (i.e., creditors whose identity could reasonably have been ascertained through reasonably diligent efforts) or unknown creditors (i.e., creditors whose interests are conjectural or future) of Old GM – a disputed issue in the ongoing litigation between the Claimants and New GM. But even assuming that a violation of the Claimants' due process rights can be established, the Claimants will have difficulty obtaining the remedy they seek for that due process violation – i.e., claims against New GM – for the several reasons, which we outline below.

The robust protections offered to New GM under the sale order were essential terms of the sale; any request to undo those protections may be viewed as tantamount to a request to unwind the sale five years after the fact, which would be moot. The sale order provides comprehensive protection to New GM. It provides for the sale of Old GM's assets to New GM, free and clear of all liabilities except for the limited set of liabilities assumed under the purchase agreement, and expressly bars claims against New GM based on successor liability. In *Motors Liquidation Co. v. Campbell*, a prior dispute in which certain products liability claimants sought to hold New GM liable for pre-sale products liability claims, Judge Naomi Buchwald of the Southern District of New York District Court (which hears appeals from the GM bankruptcy court) found that "rewriting the Sale Order to eliminate the application of the 'free and clear' or injunctive provisions [barring successor liability claims] . . . would unravel a fundamental aspect of the integrated 363 transaction." Revocation of the entire sale order would have been moot under section 363(m) of the Bankruptcy Code, which provides that sales to good faith purchasers for value – which the sale order deems New GM to be – may not be unwound on appeal.

New GM has already made arguments that follow the *Campbell* court's reasoning with respect to the Claimants' request. Specifically, counsel to New GM argued, at a hearing on July 2, 2014, that if any due process occurred, it was committed by Old GM, and New GM constitutes a "good faith purchaser for value . . . entitled to the protections" of the sale order. In response, although Judge Gerber was careful not to pre-judge the merits of this position, he noted that he was "not surprised" by New GM's position. In addition, New GM will likely have strong equitable mootness arguments based on the fact that parties have relied on the protections of the sale order in trading New GM securities for many years now. In the end, the ability of the Claimants to undo the protections of the sale order may rest on their claims that the sale order was procured by "fraud on the court."

The legal standard applicable to these claims is the subject of ongoing briefing, but even the most Claimant-friendly standard is likely to present a very high hurdle. In a telephone interview, Professor Bruce Markell – a former bankruptcy judge for the District of Nevada and currently a professor at the Florida State University College of Law (and visiting professor at Northwestern University Law School) – expressed doubt that the Claimants could meet the stringent standards applicable to fraud on the court, and noted the possibility that Judge Gerber could find malfeasance by Old GM but simultaneously decline to find fraud on the court. Presumably, the Claimants would prefer not to have to rely on fraud on the court to have New GM's protections undone.

Even if Claimants had known of their claims and appeared at the sale hearing to object to the sale to New GM free and clear of those claims, it is unlikely that New GM would have been forced to assume those claims anyway. The interests of products liability claimants – like the Claimants – were well represented at the sale hearing by states' attorneys general and consumer advocate groups who sought to exert pressure on New GM to assume a broad set of products liability claims. But ultimately, New GM assumed only a very narrow subset of such claims, including liabilities for post-sale injuries, "glove box warranty" claims, and claims arising under state lemon laws. Any efforts to require New GM to assume the Claimants' claims are unlikely to have been successful given New GM's extraordinary leverage in negotiations, which stemmed from the fact that there were no competing bidders for the assets and the likely alternative to the sale would have been a value-destructive liquidation.

Assuming that the Claimants' ability to participate at the sale hearing would not have ultimately affected the scope of New GM's liabilities – a fair assumption for the reasons above – for Judge Gerber to allow the Claimants to proceed against New GM now would effectively give the Claimants a windfall vis-à-vis other products liability claimants who did have an opportunity to object to the sale but whose claims were nevertheless not assumed by New GM. Judge Gerber is likely to be wary of allowing such an outcome. It is important to note, however, that while these issues present substantial hurdles to the Claimants' ultimate ability to prevail in litigation against New GM, other factors – including the prospect of protracted litigation and its attendant costs – may give New GM a strong incentive to provide some value to the Claimants through a settlement.

In a telephone interview with *The Capitol Forum*, Benjamin Feder, an attorney at Kelley Drye & Warren LLP (note: certain Kelley Drye clients are Old GM creditors who could be affected by the outcome of the ignition defect dispute), noted that no matter how Judge Gerber rules in the "threshold issues" litigation, there is more to come. This is certainly true in a couple of respects. First, at this point the parties have only been asked to brief the legal standard applicable to the Claimants' assertions that the sale order was procured by "fraud on the court," and presumably some factual discovery and additional briefing would be required after the threshold issues ruling to resolve those claims. Second, Mr. Feder noted that some claims against New GM assert theories based on an ongoing cover-up of the defect by New GM, which are not as clearly barred by the sale order.

But even more broadly, Mr. Feder thinks it is highly unlikely that Judge Gerber's ruling on the threshold issues will completely shut the door on the Claimants' ability to obtain discovery on theories of relief against New GM that would attribute any malfeasance by Old GM to New GM. Accordingly, Mr. Feder views the threshold issues litigation as "round one" in a lengthy "war of attrition" that is likely to play out over a long period of time, with Judge Gerber's ruling on the threshold issues affecting the relative negotiating leverage of New GM, the GUC Trust, and the Claimants, but not disposing of the litigation entirely. Given the possibility that New GM may face a "long slog," Mr. Feder would not be surprised if New GM decided to settle with the Claimants.

Potential harm to innocent parties from granting the claimants relief against Old GM, and plaintiffs' strategic decision to wait to seek any such relief, bolster GUC Trust's argument that any claims against Old GM would be "equitably moot." The only one of the "threshold issues" briefed by the GUC Trust unitholders/administrators is whether, if any of the ignition defect claims could properly be asserted against Old GM/the GUC Trust, those claims should be dismissed or disallowed under the doctrine of "equitable mootness." The doctrine of equitable mootness requires courts to determine not only whether it is *possible* to fashion relief for a party that seeks to undo a court order (on appeal or otherwise), but also the impact of that relief on innocent parties. The Second Circuit applies a particularly stringent test to requests for relief from a prior court order, which puts the burden on the party seeking relief from an order confirming a "substantially consummated" plan (like Old

GM's plan) to establish that all of the following factors, articulated in the Second Circuit's 1993 decision in *In re Chateaugay Corp.*, are satisfied (see p. 953):

- The court can still order some effective relief;
- Such relief will not affect "the re-emergence of the debtor as a revitalized corporate entity";
- Such relief will not unravel intricate transactions so as to "knock the props out from under the authorization for every transaction that has taken place" and "create an unmanageable, uncontrollable situation for the Bankruptcy Court";
- The "parties who would be adversely affected by the modification have notice of the appeal and an opportunity to participate in the proceedings"; and
- The appellant [or party seeking to undo a prior order of the court] "pursued with diligence all available remedies to obtain a stay of execution of the objectionable order . . . if the failure to do so creates a situation rendering it inequitable to reverse the orders appealed from."

As an initial matter, the Claimants may argue in their forthcoming briefs that the relief that they would ultimately seek against Old GM does not necessarily implicate the doctrine of equitable mootness because they are not appealing from, or seeking to modify or vacate, the Old GM plan or any order of the Bankruptcy Court; rather, the claimants could characterize the relief they seek as allowance of a late-filed claim, which would not necessarily require the court to undo any prior order (and, indeed, would be consistent with a prior post-confirmation order of Judge Gerber that expressly gives the bankruptcy court authority to allow claims filed after the date of that order (which would include any hypothetical claims filed on behalf of the Claimants).

However, the GUC Trust administrator has already noted – correctly – that the Old GM plan and related documents (e.g., the agreement governing operation of the trust) do not provide for holders of claims that were not "Allowed" or "Disputed" (each as defined in the Old GM plan) as of the effective date of the plan – March 31, 2011 – to recover anything from the Old GM Trust. Accordingly, as a technical matter, it would appear some modification of the plan would be necessary to give the claimants effective relief against the GUC Trust. And even leaving these technical points aside, Mr. Feder noted that equitable mootness is a relevant consideration whenever a court is asked to fashion a remedy that threatens to defeat expectations of innocent parties that have built up over years. As discussed below, giving the Claimants a right to recover from the GUC Trust threatens to undermine the expectations of various Old GM stakeholders here, including the holders of allowed and disputed claims against Old GM as of the effective date and parties who have purchased the publicly-traded interests in the GUC Trust (the value of which is derived from expected future distributions from the GUC Trust).

Thus, one way or another, Judge Gerber is likely to reach mootness issues here. And assuming he does, the first question he will need to address is whether it's even possible to fashion relief against Old GM for the Claimants. Judge Gerber made clear in his opinion in *Morgenstein v. Motors Liquidation Co.* – a case in which products liability claimants sought to file and recover on a class proof of claim notwithstanding the passage of the deadline for filing proofs of claim and confirmation of Old GM's plan – that any request for relief that would require disgorgement of the New GM securities (stock and warrants) already distributed by the trust would be a "slam dunk" scenario for application of the equitable mootness doctrine. But, Judge Gerber could still fashion relief for the Claimants without requiring disgorgement for the following reasons:

- Based on the GUC Trust's SEC filings and other information available on its website, following the GUC Trust's distribution on November 12, the GUC Trust still holds approximately 11.5 million shares of New GM common stock, and approximately 10.5 million warrants of *each* of the two series of warrants, which have an aggregate value (based on trading prices as of November 18) of over $750 million.

- In addition, to the extent Old GM obtains an order of the Court estimating that the pool of allowed general unsecured claims exceeds $35 billion, New GM is required under the purchase agreement with Old GM to contribute additional shares of its common stock (called "Adjustment Shares") in accordance with a specified formula (see paragraph 58 of these stipulations of fact for detailed explanation), up to a maximum of 30 million. Over $31.8 billion of general unsecured claims have already been allowed, and another $1.579 billion in disputed/potentially allowable claims remain pending. The GUC Trust administrator estimates that the economic loss claims asserted by the Claimants exceed $7 billion. Thus, the allowance of these claims could trigger New GM's obligation to contribute additional shares to the GUC Trust (by our calculation, approximately 23.2 million shares if the full $1.579 billion in already disputed/potentially allowable claims, and $7 billion in ignition defect claims, are allowed).

- Judge Gerber could make the millions of shares and warrants in the trust and any additional shares New GM is required to contribute available for distribution to the holders of the ignition defect claims, as well as the holders of the $1.579 billion in potentially allowable claims, and order the trust not to make any further distributions to holders of previously allowed claims and GUC Trust units.

- If Judge Gerber ordered the Trust to distribute the remaining securities *pro rata* between the Claimants and the holders of yet-to-be-allowed claims, neither group of claimants would receive distributions proportionate to those received by holders of already allowed general unsecured claims. Judge Gerber could try to mitigate the harm to the non-Claimants whose claims have not yet been allowed by giving them a full "catch up" distribution – giving them the same number of shares/warrants per dollar of claim as the holders of already allowed claims – before allowing the Claimants to recover anything.

It is therefore possible for Judge Gerber to fashion *some* (albeit imperfect) relief for the Claimants that would not require disgorgement of securities already issued. However, that relief would have adverse consequences, ranging from mild to severe, for other GUC Trust stakeholders. Most significantly, by ordering relief along the lines of the above, Judge Gerber would wipe out all value in the GUC Trust interests overnight. Those trust instruments trade publicly and, as of November 19, had a market capitalization of almost $520 million. The value of these interests depends on the magnitude of the pool of general unsecured claims entitled to receive future distributions from the GUC Trust – the smaller that pool, the more value the interests have. Further, if New GM is required to issue "Adjustment Shares," it will have a dilutive effect on existing holders of New GM stock, including the Old GM general unsecured creditors who received distributions of New GM stock from the GUC Trust.

The well-settled expectations of the parties participating in the markets for GUC Trust interests and New GM stock will be relevant to Judge Gerber's equitable mootness analysis. Both sources with whom we spoke observed that Judge Gerber will have the difficult task of balancing the harms resulting from the frustration of those market participants' expectations against the harm to the Claimants from not awarding them any relief. The sources noted that both sides – the GUC Trust and the Claimants – would have strong fairness arguments in their favor, and each source declined to predict the ultimate result of this balancing act. As Prof. Markell noted, on the one hand, if Judge Gerber grants relief along the lines of the above, innocent parties trading GUC Trust interests would have their

reasonable assumptions about the claims pool overturned in one fell swoop. On the other, if the claimants are granted no relief against Old GM or New GM, the claimants would essentially be punished for failing to file a claim that they did not know – and had no reason to know – they had.

Whether equitable mootness should bar the Claimants from pursuing claims against Old GM is a close call. One factor that may tip the balance in favor of barring the claims is the Claimants' failure to diligently protect whatever rights they may have against Old GM. Most importantly, the claimants have not sought any stay of further distributions from the GUC Trust pending resolution of the ignition defect litigation. Prof. Markell speculated that the claimants are reluctant to seek a stay because of the typical requirement that parties seeking a stay post a bond to protect parties who could potentially be harmed by the stay – in this case, Old GM creditors and GUC Trust interest holders awaiting the distribution of hundreds of millions of dollars of securities.

Whatever their reason for doing so, the claimants' failure to seek a stay could have dire consequences. For one thing, the fifth *Chateaugay* factor above strongly militates in favor of seeking a stay. Prof. Markell observed that Judge Buchwald of the Southern District of New York District Court, in *Campbell* (see footnote 30), noted that the appellants' failure to seek a stay would have weighed strongly in favor of a finding that the appeal was equitably moot (stakeholders should note that Judge Buchwald had already found the appeal was statutorily moot, but conducted an equitable mootness analysis anyway). And from a practical perspective, in the absence of a stay, there is nothing to stop the GUC Trust from continuing to make distributions to its existing beneficiaries. If all of the assets of the GUC Trust are ultimately distributed, then it will become nearly (if not entirely) impossible for Judge Gerber to fashion effective relief for the Claimants.

In-depth Background

Update on Ignition Defect-Related Litigation. On May 2, Judge Gerber held an initial status conference, at which he laid out a general framework for the litigation around the effect of the sale order to proceed (for general background regarding the ignition defect and the related recalls, please click here). That framework required interested parties – specifically, New GM, certain holders of units in the Old GM unsecured creditors trust (the GUC Trust), and the various Claimants – to meet and confer to develop a briefing schedule on certain threshold legal issues requiring minimal (or no) discovery and attempt to stipulate to undisputed facts. This process ultimately resulted in the entry of scheduling orders that defined, and set a schedule for briefing, the four threshold issues, which are defined in the last such order (entered on July 11) as follows:

- Whether [the Claimants'] procedural due process rights were violated in connection with the Sale Motion and the Sale Order and Injunction, or alternatively, whether [Claimants'] procedural due process rights would be violated if the Sale Order and Injunction is enforced against them;

- If procedural due process was violated as described . . . above, whether a remedy can or should be fashioned as a result of such violation and, if so, against whom;

- Whether any or all of the claims asserted in the Ignition Switch Actions are claims against the Old GM bankruptcy estate and/or the GUC Trust; and

- If any or all of the claims asserted in the Ignition Switch Actions are or could be claims against the Old GM bankruptcy estate and/or the GUC Trust, should such claims or the actions asserting such claims nevertheless be disallowed/dismissed on grounds of equitable mootness.

Judge Gerber also asked the parties to brief the legal standard applicable to the Claimants' assertions that the sale order was procured through a "fraud on the court." The litigation schedule for the threshold issues is as follows:

- November 5, 2014: New GM filed its opening brief on all threshold issues except the equitable mootness issue; GUC Trust unitholders filed opening brief on equitable mootness issue only.

- December 16, 2014: Claimants are required to file a brief responding to both the New GM and GUC Trust briefs; New GM required to respond to the GUC Trust brief.

- January 16, 2015: Reply briefs due.

- On or after January 26, 2015: Judge Gerber will hold a hearing on the threshold issues.

Separately, on June 9, the United States Judicial Panel on Multidistrict Litigation consolidated the 130-plus ignition defect actions (which include a mix of economic loss and personal injury claims) filed against New GM in various federal courts around the country and transferred the consolidated case to the Honorable Jesse H. Furman in the United States District Court for the Southern District of New York. On October 14, plaintiffs involved in the multi-district litigation filed two consolidated complaints seeking damages against New GM—one seeking damages in connection with GM branded vehicles that were acquired on or after the date of the sale to New GM (July 11, 2009), and the other seeking damages in connection with recalled vehicles manufactured by old GM and purchased before the sale. On November 19, Judge Furman entered an order setting early 2016 trial dates for certain wrongful death/personal injury claims in the multi-district litigation.

Background regarding GUC Trust. The GUC Trust was created to provide plan distributions to Old GM general unsecured creditors. The property distributed by the GUC Trust to stakeholders primarily consists of 10% of the post-closing common stock of New GM, and two series of warrants to purchase New GM shares – one series of warrants has an exercise price based on a $15 billion equity valuation, and the other series has an exercise price based on a $30 billion valuation. The GUC Trust distributes these securities (as well as cash dividends accrued on the New GM shares between distributions) periodically, reserving securities necessary for distribution to holders of disputed claims that could ultimately become allowed. To the extent disputed claims are disallowed, additional securities are distributed to holders of trust interests.

The right to receive distributions from the GUC Trust is based on ownership of trust "units" that were initially issued to Old GM general unsecured creditors, but are freely tradable on public securities markets. The value of these units is tied to the value of expected future distributions from the GUC Trust, which, in turn, depends on the ultimate size of the general unsecured claims pool (i.e., as disputed claims are disallowed in full or in part, the expected distributions grow; as such claims are allowed, expected distributions shrink). The GUC Trust has already distributed the vast majority of securities in the trust. The most recent distribution was made on November 12. Following that distribution, approximately 11.5 million shares of New GM stock, and approximately 10.5 million of each series of warrants, remain in the trust.