

A Reopened GM Bankruptcy Could Land In Uncharted Waters

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Law360, New York (March 27, 2014, 8:01 PM ET) -- The federal investigation and class actions surrounding the question of whether General Motors hid a critical product defect during its Chapter 11 proceedings could lead to new precedent involving concealed claims in bankruptcies if the matter winds up back in bankruptcy court, experts say.

The possibility of GM returning to bankruptcy court has been bounced around lately as a way for the company to handle the class actions that have been popping up in response to an ignition switch defect that led to 13 deaths and the recall of 1.6 million vehicles. And in light of The New York Times' March 22 report saying the the U.S. Department of Justice is looking into whether GM committed bankruptcy fraud in its criminal probe surrounding the defect, a reopening the Chapter 11 case is becoming more likely.

Instead of battling claims on multiple fronts, GM might opt to return to bankruptcy court and ask a judge to determine how to proceed, Eugene Geekie of Arnstein & Lehr LLP said.

"GM's not going to deal with claims in different jurisdictions," he said. "What GM may very well have to do is remove all these claims back to bankruptcy court, have this case reopened, and bring all these claims in for the judge to make a decision on what to do with all of it."

If the bankruptcy case were to be reopened, the judge would likely have to determine whether GM failed to disclose potential indebtedness related to the defects that are now the subject of substantial litigation, as recent disclosures by the automaker have indicated that engineers and executives first knew of or suspected serious safety problems as far back as 2001 and abandoned internal attempts to find a fix.

Though the DOJ's criminal investigation has been going on for weeks, the Times reported that the probe includes whether the company committed bankruptcy fraud by hiding the defects during its 2009 Chapter 11 proceedings. Accusations of bankruptcy fraud are not to be tossed around lightly as they could result in sanctions, monetary

penalties, loss of professional licenses and, in the most severe case, jail time, Aaron Hammer of Sugar Felsenthal Grais & Hammer LLP said.

The criminal probe will likely have an effect on the civil bankruptcy side of the situation, experts said.

“If people sit down to think about this, not only will they see that this is an unprecedented event, it could be a case that establishes a lot of law about concealing claims and claimants and could really blow up because of the criminal implications here,” Geekie said. “It can’t just be brushed aside like some people have tried to brush it aside.”

If the company knew, before it entered bankruptcy, that claims stemming from the defects could potentially be a problem down the road, it normally would have disclosed that information in its list of creditors required at the start of a Chapter 11 case. Most debtors will go the extra mile to include any conceivable creditor, Geekie said.

GM, if it were aware of the defect-related claims, could have also mentioned them in the disclosure statement, where debtors explain to creditors voting on a plan what the company’s prospects are in the future. That would have been another place to let creditors know of potential claims that could be brought at a later date.

The current iteration of GM exited bankruptcy by purchasing the assets of the “old” GM through what is known as a 363 sale. Experts have said that the shield that generally protects reorganized entities from liabilities incurred before the bankruptcy may not be enough to keep “new” GM in the clear now.

“Failure to disclose arguably means that new GM is liable and that any claims that arose before the bankruptcy filing wouldn’t have been discharged in accordance with GM’s bankruptcy plan,” Hammer said.

The fact that the bankruptcy was resolved through an asset sale also means that a return to bankruptcy court would likely include a reopening of the sale order, according to Matt Gold of Kleinberg Kaplan Wolff & Cohen PC.

Courts will typically reopen an order if there has been an intervening fraud, he said.

Moreover, the GM sale was done rapidly, which could be problematic in light of the current accusations.

“There’s a question about whether an attack could be brought against that sale order based on fraud in obtaining the order,” Gold said.

It is not entirely clear who would have been hurt or what would have been done differently if the defects, if they in fact were known at the time, had been disclosed during the bankruptcy, which opens the door for the plaintiffs to make their case for damages.

With no bankruptcy cases as large or as complicated involving allegedly concealed claims that can be called upon as a roadmap for how the GM mess could play out, it could be up to a judge to clear a path forward in such unfamiliar circumstances.

“If there ends up being a challenge to whether injured parties can go after the new GM and if that ends up being litigated with respect to what the effects of a sale order are in bankruptcy, that could certainly be an area of developing precedent,” Gold said.

--Additional reporting by Andrew Scurria. Editing by John Quinn and Chris Yates.

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