

Whose Business Is the Judgment?: Federal Common Law in the Judicial Review of Bankruptcy Transactions Under Section 363

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ABSTRACT

From settling suits to selling companies, few provisions of the Bankruptcy Code have greater impact than Section 363(b). Yet, the Code offers no test to evaluate 363 sales. For over 30 years, that gap has been bridged by two decisions out of the Second Circuit, *Lionel* and *Integrated Resources*. Both compel the debtor to give adequate business justification for its actions. But to reach this requirement, *Integrated Resources* borrows Delaware’s business judgment rule—then applies it in reverse. What is the basis for absorbing and inverting out-of-state state law?

The “business justification” test is federal common law—a rule created not by the Code, but the court. Since *Erie*, the Supreme Court has directed judges away from common law and, even when they properly invoke it, to resort to state law wherever possible. This case law was ignored by the courts that set the 363 standard and ever since. Screening Section 363 through the Court’s precedents for the first time in scholarship, this article reveals that state law should govern. The existing standard is therefore vulnerable to reversal, with sobering consequences for the debtors and investors that rely on it and the many common-law doctrines—in bankruptcy, tax, arbitration, and elsewhere—that repeat this error.

Determining whose business it is to make the rules for judging 363 sales—state corporate law or the bankruptcy judge—dictates how billions of dollars will be disposed of each year. More than that, it illuminates trans-substantive tensions—between the Court’s formalism and equity, federalism and efficient adjudication, and judicial lawmaking and the separation of powers—while informing potential solutions. The indispensability of doctrines like the 363 standard—and of the judicial power to fill such statutory gaps—attests to the need for congressional authorization of common law in bankruptcy. In tandem with the Court’s mounting skepticism of these “major questions” being resolved outside the traditional branches, it further renews the case for Article III bankruptcy courts.