SUCCESSOR LIABILITY AFTER INSOLVENCY

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A. Introduction

1. General Rule: Absent express agreement, a purchaser of assets is not liable for claims against the seller. *See Columbia Propane, L.P. v. Wisconsin Gas Co.*, 2003 WI 38, 261 Wis.2d 70.

2. Judicially-Created Exception: Successor liability.

- Product liability claims
- Mass tort claims
- "Future" claims
- Wage and pension claims
- Environment claims

B. State Law

1. By Agreement: When the purchasing corporation expressly or impliedly agrees to assume the selling corporation's liability.

a. APA will generally say what is being assumed. Also a good idea to say what is not being assumed. But some courts have gone beyond APA, and found that conduct led to implied assumption.

b. *See Columbia Propane* (holding that purchaser did not assume unknown liabilities where APA says "then outstanding debts" are assumed); *City of Richmond v. Madison Mgmt. Group, Inc.*, 918 F.2d 438 (4th Cir. 1990) (finding successor liability by implied assumption, where successor undertook repairs on predecessor's work; also found successor liable for punitive damages).

2. Consolidation or Merger: When the transaction amounts to a consolidation or merger of the purchaser and seller.

a. Transactions couched as sale of assets, but containing elements more characteristic of a merger or consolidation.

b. Likely characteristics of a *de facto* merger: (i) continuation of the enterprise of the seller by same management, personnel, physical location, assets and general business operations; (ii) continuity of shareholders, often where buyer pays for assets with shares of buyer company that are issued to shareholders of seller; (iii) seller ceases operations and dissolves after sale; and (iv) buyer takes over seller's obligations necessary to continue operations uninterrupted.

c. Typically all need to be present, but some courts have found successor liability without all four.

3. "Mere Continuation": Purchaser is a "mere continuation" of the seller. Often regarded as a single exception with *de facto* merger. Continuity of ownership is key.

a. *Dublin v. UCR, Inc.*, 444 S.E. 2d 455 (N.C. App. 1994) (finding mere continuation where transferor transferred assets to creditor in lieu of foreclosure at time when transferor was defendant in class action litigation. Creditor immediately transferred assets to new party, which conducted business in same store with same employees, equipment and forms as old company).

b. Some courts have also found "mere continuation" liability in Article 9 sales. *E.g. G.P. Publishing v. Quebecor Printing*, 481 S.E.2d 674 (N.C. App. 1997) (holding that Article 9 sale not a *per se* bar).

c. *Douglas v. Stamco*, No. 09-1390, 2010 WL 337043 (2d Cir. Feb. 1, 2010) (rejecting "mere continuation" theory where continuity of ownership was lacking).

4. Fraud: When the transaction is entered into fraudulently to escape liability for the obligations.

a. *Budd Tire Corp. v. Pierce Tire Co.*, 370 S.E. 2d 267 (N.C. App. 1988) ("where one corporation purchases all or substantially all of the assets of another corporation, including the goodwill, in a manner deemed fraudulent, the selling corporation's creditors may follow the goodwill into the hands of the purchasing corporation and obtain a money damage award equal to its value").

C. Federal Law

1. Environmental and employment law: Exceptions may be "more expansive than in state law." *R.C.M. Exec. Gallery Corp. v. Rols Capital Co.*, 901 F. Supp. 630, 635 n.4 (S.D.N.Y. 1995).

a. *United States v. Carolina Transformer Co.*, 978 F.2d 832 (4th Cir. 1992) (applying continuity of enterprise exception in environmental case); *S&F Market Street Health Care LLC v. NLRB*, 570 F.3d 354 (D.C. Cir. 2009) (rejecting NLRB's broad construction of the "perfectly clear successor" rule, which prevents employer from misleading employees into not looking for other work, and holding that the buyer of a troubled business who retained the seller's employees on a temporary basis should not be liable for the union contracts and obligations of the seller).

D. Bankruptcy

1. Bankruptcy Code (emphasis added):

> **§ 363 Use, sale, or lease of property**
> (f) the trustee may sell property under subsection (b) or (c) of this section *free and clear of any interest in such property* of an entity other than the estate, only if—
> (1) applicable nonbankruptcy law permits sale of such property free and clear of such interest;
> (2) such entity consents;
> (3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;
> (4) such interest is in bona fide dispute; or
> (5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.
>
> **§ 1141 Effect of confirmation**
> (a) Except as provided in subsections (d)(2) and (d)(3) of this section, *the provisions of a confirmed plan bind the debtor*, any entity issuing securities under the plan, *any entity acquiring property under the plan, and any creditor, equity security holder, or general partner in the debtor*, whether or not the claim or interest of such creditor, equity security holder, or general partner is impaired under the plan *and whether or not such creditor*, equity security holder, or general partner *has accepted the plan*.
> (c) Except as provided in subsections (d)(2) and (d)(3) of this section and except as otherwise provided in the plan or in the order confirming the plan, *after confirmation of a plan, the property dealt with by the plan is free and clear of all claims and interests of creditors, equity security holders, and of general partners in the debtor*.
>
> **§ 1123 Contents of plan**
> (a) Notwithstanding any otherwise applicable nonbankruptcy law, a plan shall—
> (5) provide adequate means for the plan's implementation, such as—
> (D) sale of all or any part of the property of the estate, either subject to or free of any lien. . . .
>
> **§ 101 Definitions**
> (5) The term "claim" means—
> (A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured,

> disputed, undisputed, legal, equitable, secured, or unsecured; or
>
> (B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured.

2. "Interests" under § 363:

a. "Interests" not defined here; more than a lien? § 363(f)(3).

b. "Interests" in § 361 (adequate protection) suggests a meaning synonymous with a lien or secured claim; §§ 501 and 502 refer to stock or other equity ownership rights in the debtor.

c. Only *in rem* interests such as liens and security interests? *See, e.g., Volvo White Truck Corp. v. Chambersburg Beverage, Inc. (In re White Motor Credit Corp.)*, 75 B.R. 944, 947-50 (Bankr. N.D. Ohio 1987) (holding that § 363 was not enough to sell free and clear of a general unsecured tort claim).

d. Or does it include other types of liabilities? *See, e.g., 229 Main Street L.P. v. Mass. Dept. Envt'l. Prot.*, 262 F. 3d 1 (1st Cir. 2001) (holding that environmental expenses incurred by state and notice of intent to assert a lien constitutes an "interest").

e. A significant number of courts have held that "interest" as used in § 363(f) does not include general unsecured claims, particularly claims which arise post-sale. *See, e.g., In re Lueckie Smokeless Coal Co.*, 99 F. 3d 573 (4th Cir. 1996) (finding that "interest" includes benefit plan's and fund's right to collect premiums for health and death benefits).

3. "Claims" under § 1141: Greater protection to purchasers when sale accomplished through chapter 11 plan (or at least by using § 1141 standards).

a. Section 1123(a)(5)(D) authorizes sales of assets in a plan "free and clear," and § 1141(c) provides that property sold through a plan is "free and clear of all claims and interests of creditors."

b. Courts even use § 1141 standard in § 363 sales! *See, e.g., Volvo*, 75 B.R. at 947-50 (holding that § 363 was not enough to sell free and clear of a general unsecured tort claim, but finding that § 105 (cited in § 363 order) was enough to incorporate the "free and clear" standard of § 1141).

c. *In re Chrysler LLC*, 576 F. 3d 108 (2d Cir. 2009), *vacated as moot sub. nom. Ind. State Police Pension Tr. V. Chrysler LLC*, 130 S. Ct. 1015 (2009) (finding that § 363 sale extinguished existing product liability claims).

i. "Given the expanded role of § 363 in bankruptcy proceedings, it makes sense to harmonize the application of § 1141(c) and § 363(f) to the extent permitted by the statutory language." But sale only approved under § 363 because alternative was a disastrous liquidation; estate losing almost $100 million per day; company could not survive through protracted chapter 11 plan proceedings.

ii. "Interest" is anything that "arises from the property being sold." Here, Chrysler's assets were employed for auto production purposes; otherwise no right to seek damages for product liability.

iii. Alternative holding would produce result inconsistent with Bankruptcy Code's priority scheme. This justification has been frequently criticized.

iv. "Sub-rosa plan." Confirming that its 1983 *Lionel* decision remains the proper test for balancing concerns about the speed and efficiency of § 363 sales versus the due process safeguards provided by the slower plan confirmation process of chapter 11, the Second Circuit reaffirmed that § 363 sales are appropriate only where the moving party has demonstrated "exigent circumstances" and/or "good business reasons" for proceeding by a § 363 sale rather than waiting for a plan.

v. Second Circuit did not decide whether the bankruptcy court has the authority to extinguish future claims under § 363(f). Court chose to wait until there was an appeal involving an actual claim for an actual injury caused by Old Chrysler that occurred after the sale where the claim was otherwise cognizable under applicable state successor liability law.

4. <u>"Claims" under § 101(5)</u>

a. *In re Grossman's, Inc.*, 607 F.3d 114 (3rd Cir. 2010) (holding that "claims" arise when an individual is exposed pre-petition to a product or conduct giving rise to the injury which underlies a "right to payment") (overruling *In re M. Frenville Co.*, 744 F.2d 332 (3rd Cir. 1984)).

b. *Wright v. Owens Corning*, 450 B.R. 541 (W.D. Pa. 2011) (applying *Grossman's* to conclude that consumers' claims were discharged by plan, and publication notice was sufficient to unknown creditors).

5. <u>"Future" Claims in Bankruptcy</u>:

a. *Morgan Olson LLC v. Frederico (In re Grumman Olson Indus., Inc.)*, __ B.R. __, No. 11-2291, 2012 WL 1038672 (S.D.N.Y. Mar. 29, 2012) (holding that FedEx truck driver could sue truck parts manufacturer for

injuries sustained *after* § 363 sale was ordered "free and clear," with explicit disclaimer of successor liability, even though parts were manufactured pre-bankruptcy).

i. Answers question left unanswered in *Chrysler*.

ii. Other cases have gone the same way. *E.g., Schwinn Cycling & Fitness, Inc. v. Benonis*, 217 B.R. 790 (N.D. Ill. 1997).

b. Notice and due process: § 363 sales lack procedural safeguards to protect unsecured creditors that are present in plan confirmation proceedings. If your client benefits from minimizing successor liability exposure under a § 363(f) sale, provide as much notice and opportunity to be heard as practical. *See generally Western Auto Supply v. Savage Arms*, 43 F. 3d 714 (1st Cir. 1994) (adequate notice a key inquiry in evaluating successor liability claims). *See also In re Chicago, Milwaukee, St. Paul & Pacific R.R. Co.*, 974 F.2d 775, 786 (7th Cir. 1992) (holding that publication notice was sufficient for unknown creditors).

c. Same Result Outside Bankruptcy? *See Foskett v. Great Wolf Resorts, Inc.*, 518 F. 3d 518 (7th Cir. 2008) (holding that, in consensual sale of business assets, buyer of water park assets was required to indemnify seller for personal injuries suffered on water slide by guest after sale, but caused by pre-sale design and construction defects).

d. Mass Tort Cases: Appointing special trustee to represent the interests of future creditors in the sale process and to fund escrow from the sale proceeds for the benefit of potential future claimants. *See generally* Successor Liability, Mass Tort, and Mandatory-Litigation Class Actions, Vol. 118 Harvard Law Review 2357, 2367-73 (2005). *See also* 11 U.S.C. § 524(g) (asbestos trusts).

i. Future claims must be reasonably anticipated because of the nature of the business or products being sold.

ii. Mitigates concerns about the future claimants' due process rights.

iii. *But see In re Piper Aircraft Corp.*, 58 F.3d 1573 (11th Cir. 1995) (rejecting efforts of future claims representative to set aside funds for people who would be injured after bankruptcy by airplanes manufactured by debtor because claimants did not have sufficient pre-confirmation relationships with the debtor for them to hold "claims" that could be adjudicated in bankruptcy); *In re Hoffinger Indus.*, 307 B.R. 112 (Bankr. E.D. Ark. 2004) (same, with respect to manufacturer of swimming pools).

E. Wis. Stat. Ch. 128

1. Issue: Chapter 128 being used frequently as alternative means for secured creditors to realize on collateral, but authority of receiver to sell free and clear has not been rigorously tested and remains unsettled. Nevertheless, standard form of sale order used by receivers provides that sale of chapter 128 assets is "free and clear of all liens, judgments, claims and encumbrances, with any and all liens, judgments, claims and encumbrances attaching to the proceeds of the sale in the same priority as they existed prior to the closing of the sale."

2. Statutes: No explicit statutory guidance regarding authority of receiver to sell property "free and clear" of liens, interests or claims. Statutes provide:

a. Receiver vested as of the filing date with title to all non-exempt property owned by a debtor (§ 128.19).

b. Required to file timely written reports with the court detailing how the receiver is "dealing with the property" and "the amount of money realized by the receiver" (§ 128.20).

c. Authority to use "appropriate provisional remedies . . . [in pursuing the goal of] the equal distribution of all assets recovered among the creditors of the debtor" (§ 128.11).

d. Section 128.25(6)(c) refers to sale "free and clear," but only of liens of the secured creditor.

e. Chapter 128 otherwise silent about the terms, conditions and process by which the receiver may sell assets or what assurances the receiver may provide to a buyer that the assets may be purchased "free and clear" of all existing claims, particularly as to creditors whose claims will not arise or accrue until the future.

3. Case Law: Limited chapter 128 case law on sales until *Olsen's Mill*:

a. Subject to notice to creditors and court approval, chapter 128 receivers have authority to sell assets, even corporate assets, without approval of the corporation's board of directors or shareholders. *See Ajax Rubber Co. v. Western Petroleum Co.*, 185 Wis. 74, 200 N.W. 668 (1924).

b. *Wisconsin Brick & Block Corp. v. Vogel*, 195 N.W.2d 664, 54 Wis. 2d 321 (1972) (holding that chapter 128 receiver may, with court approval, sell the debtor's property "free of valid liens and encumbrances" if, but only if, the lien holder participates in the receivership proceeding). Even though the junior mortgagee consented to conversion of the foreclosure action into a voluntary chapter 128 assignment proceeding, and even though the

mortgagee was present at the sale hearing and had the opportunity to timely object, the property could not be sold over the junior mortgagee's post-sale objection "free and clear" of its mortgage. (Mortgage holder lost out because of laches anyway.)

c. *BNP Paribas v. Olsen's Mill, Inc.*, 2011 WI 61, 335 Wis. 2d 427 (2011) (holding that secured creditor's collateral could not be sold "free and clear" of creditor's security interest without consent). Clarifies holding in *Brick & Block*: secured creditor's participation in receivership is not sufficient, by itself, to establish consent; creditor still protects itself by objecting. Does not get to the heart of successor liability issues.

F. So What Does My "Free and Clear" Order Do For Me?

1. Section 363 may get buyer less than § 1141, unless buyer can "borrow" § 1141 for the § 363 sale.

2. Buyer may not be able to avoid successor liability just because the order says so.

a. State courts: inconsistent results. A number of cases, particularly product liability cases, reject argument of preemption and permit suits to proceed against a buyer of assets from a § 363 sale.

b. 7th Circuit: bankruptcy does not automatically terminate successor liability claims. *Chicago Truck Drivers, Helpers and Warehouse Workers Union (Independent) Pension Fund v. Tasemkin, Inc.*, 59 F.3d 48 (7th Cir. 1995) (rejecting policy arguments based on frustration of the priority scheme and that alternative holding would have "chilling effect" on sales in bankruptcy).

c. *Compare Myers v. United States*, 297 B.R. 774 (S.D. Cal. 2003) (on preemption grounds dismissing post-sale tort action against buyer of assets in a § 363(f) sale) and *In re Trans World Airlines, Inc.*, 322 F. 3d 283 (3d Cir. 2003) (dismissing post-bankruptcy sale employment discrimination claims against buyer of assets) *with John T. Callahan & Sons v. Dykeman Electric Co.*, 266 F. Supp. 208 (D. Mass. 2003) (permitting post-sale suit against purchaser of bankruptcy assets for environmental claims).

3. Buyer probably cannot avoid liability for "future" claims unless trust established with "channeling" injunction.

4. Don't forget due process, even if bankruptcy law offers protection.