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All Experience is not Good Experience – Experience Ratings & 11 U.S.C. § 363(f)

By James P. Roberts April 2017

Recently, the Bankruptcy Court for the Northern District of Alabama joined with a number of courts in finding that a debtor's ability to sell their assets free and clear of any "interests" in property encompassed the right to purge the assets of a state labor department's right to transfer a company's unemployment experience rating to a purchaser of the company's assets.[1]

An overarching purpose of bankruptcy, whether in the context of a reorganization or a liquidation, is the maximization of value for the benefit of creditors of the Estate. Section 363(b) of the Bankruptcy Code permits a debtor or trustee to sell assets outside the ordinary course of business, following notice and a hearing. When such a sale occurs, 11 U.S.C. § 363(f) provides that this type of sale can be "free and clear of any interest in such property of an entity other than the estate" if particular factors are satisfied. *See* 11 U.S.C. § 363(f)(1)-(5).

Permitting the sale of a debtor's assets "free and clear" maximizes the value that can be received for the assets being sold. Indeed, many courts recognize that "[a]n expansive interpretation of 'interest in property' that can be cut off by a 'free and clear' order under Bankruptcy Code § 363(f) [maximizes the value of the bankruptcy estate] by, *inter alia*, maximizing the assets that are being sold." *In re Old Carco LLC*, 538 B.R. 674, 683 (Bankr. S.D.N.Y. 2015). This is especially true because, absent the "free and clear" provisions of the Bankruptcy Code, "purchasers could demand a large discount for investing in a property that is laden with the risk of endless litigation as to who has rights to estate property." *In re Gucci*, 126 F.3d 380, 387 (2d Cir. 1997).

Despite the broad outlines of this policy purpose of the Bankruptcy Code, there is no singular definition of the term "interest" in 11 U.S.C. § 363(f). In examining whether the scope of interest was sufficiently elastic to encompass experience ratings,[2] the Sixth Circuit adopted a narrow interpretation of the term in *In re Wolverine Radio*, 930 F.2d 1132 (6th Cir. 1991). There the court held that the meaning of "interest" was inapplicable to the matter as it failed to "[attach] to property ownership so as to cloud its title." *Id.* at 1147. Having held this, the court determined that a

[1] On April 17, 2017, following the conclusion of oral arguments, the Court verbally granted Warrior Met Coal, LLC's ("Warrior Met") *Motion to Enforce Order Authorizing and Approving Sale of Substantially all of the Debtors' Assets and the Assumption and Assignment of Certain Executory Contracts and Unexpired Leases*, March 23, 2017 [Dkt. No. 2942] (the "Motion to Enforce"). At the date of publishing, the written order granting the Motion to Enforce is still pending.

[2] Generally, an "experience rating" is based on the combination of a company's history of layoffs, discharges, the number of former employees to draw unemployment, and similar factors. A state's department of labor will typically determine the amount owed to the state by the company, in relation to its contribution to fund the unemployment benefits pool, based on the experience rating and related factors.

purchaser did not acquire a business "free and clear" of an unemployment experience rating, and thus the purchaser could be deemed a successor to the debtor by operation of applicable state law. *Id.* at 1149.

Wolverine Radio is an outlier against a backdrop of several recently decided cases that either expressly or implicitly rejected *Wolverine Radio* and ruled that a debtor's experience rating was an "interest in property" under 11 U.S.C. § 363(f) that was cut off by a sale order provision transferring assets "free and clear" of "interests" and successor liability. *In re Old Carco LLC*, 538 B.R. 674, 685 (Bankr. S.D.N.Y. 2015); *In re PBBPC, Inc.*, 484 B.R. 860, 869–70 (1st Cir. BAP 2013); *In re Tougher Indus., Inc.*, No. 06–12960, 2013 WL 1276501, at *6–8 (Bankr. N.D.N.Y. Mar. 27, 2013); *In re USA Fleet Inc.*, 496 B.R. 79, 87–89 (Bankr. E.D.N.Y. 2013); *Ouray Sportswear, LLC v. Indus. Claim Appeals Office*, 315 P.3d 1280, 1283–84 (Colo. App. 2013).

One of the cases representative of this trend shifting away from the narrow interpretation of "interest" advanced by *Wolverine Radio* is *In re PBBPC, Inc.*, 484 B.R. 860 (B.A.P. 1st Cir. 2013). In that appeal, the court affirmed the bankruptcy court relying on the concept advanced by the Second, Third, and Fourth Circuits, that "'the term 'any interest' is intended to refer to obligations that are connected to, or arise from, the property being sold.'" *Id.* at 868 (*quoting Folger Adam Security, Inc. v. DeMatteis/MacGregor JV*, 209 F.3d 252, 258 (3d Cir. 2000); *In re Chrysler LLC*, 576 F.3d 108, 126 (2d Cir.), *cert. granted, judgment vacated sub nom. Indiana State Police Pension Trust v. Chrysler LLC*, 130 S. Ct. 1015 (2009), and *vacated sub nom. In re Chrysler, LLC*, 592 F.3d 370 (2d Cir. 2010) ("We agree with *TWA* and *Leckie* that the term "any interest in property" encompasses those claims that "arise from the property being sold.") (internal quotations omitted); *In re Leckie Smokeless Coal*, 99 F.3d 573, 582 (4th Cir. 1996) (finding that an "interest in property" existed due to the relationship between the right to demand payment and the manner in which the debtor's assets had been put to use). Adopting this framework, the *PBBPC* Court held that 11 U.S.C. § 363(f)'s free and clear provisions barred the Massachusetts state unemployment agency from transferring the unemployment experience of a debtor to the purchaser of a debtor's assets.

In essentially the same context as the cases discussed above, the Bankruptcy Court for the Northern District of Alabama, Southern Division recently considered whether the sale of assets to Warrior Met in the Walter Energy bankruptcy, *In re Walter Energy, Inc.*, Case No. 15-02741-TOM (Bankr. N.D. Ala. 2015), was made free and clear of the experience rating of Walter Energy, Inc., and its various affiliates and subsidiaries (the "Debtors"). Under Alabama labor law a purchaser of another company's assets succeeds to that company's experience ratings and contribution rates where the purchaser acquires more than 65% of the previous employer's organization, trade, employees, or business located in the State of Alabama or substantially all of the assets of the previous employer. Ala. Code §§ 25-4-8, 4-54. Similar laws exist throughout the country.

Citing this statutory authority, the Alabama Department of Labor ("ADOL") deemed Warrior Met a successor to the Debtors' experience rating for purposes of calculating the appropriate tax rate. In

response, Warrior Met filed the Motion to Enforce, seeking a determination that the sale order entered in the case[3] prohibited ADOL's actions.

The Sale Order and the APA referenced therein became effective after Warrior Met, then the stalking horse bidder, made the highest and only bid. In addition to being entered pursuant to 11 U.S.C. §§ 363(b) and (f), the Sale Order specifically provided that

> [T]he Stalking Horse Purchaser shall not and shall not be deemed to . . . (ii) be the successor of or successor employer to the Sellers, and shall instead be, and be deemed to be, a new employer with respect to any and all federal or state unemployment laws, including any unemployment compensation or tax laws[.][4]

Despite this language, ADOL argued that based on *Wolverine Radio* an unemployment experience rating was not an "interest in property", within the meaning of 11 U.S.C. § 363(f).

The Court rejected the narrow interpretation of "interest" adopted by the Sixth Circuit in *Wolverine Radio*, referencing *United Mine Workers of Am. Combined Benefit Fund v. Walter Energy, Inc.*, as binding authority, where the District Court for the Northern District of Alabama, Southern Division stated that "while a minority of courts initially interpreted the phrase 'interest in such property' in this narrow way, Section 363(f) has more often (and more correctly) been given a broad reading to effectuate the purposes of the Bankruptcy Code." 551 B.R. 631, 641 (N.D. Ala. 2016), *appeal dismissed* (May 4, 2016). The Court also explicitly rejected ADOL's argument that the unemployment experience rating could not be an interest in property because it was entirely prospective, paying special attention to the fact that the sums used in calculating the metric were based on unemployment benefits drawn by former employees immediately prior to and during the Debtors' case. After determining that 11 U.S.C. § 363(f) encompassed unemployment experience ratings, the Court further noted that such a conclusion was consistent with the purpose of the Bankruptcy Code to maximize the value of a debtor's estate.

The Court's decision reflects the modern trend of considering "interest in property" broadly. The decision serves as one more decision in a growing body of jurisprudence that says that liabilities that arise simply by virtue of an acquisition are likely subject to "free and clear" sales orders.[5]

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[3] *Order (I) Approving the Sale of the Acquired Assets Free and Clear of Claims, Liens, Interests, and Encumbrances; (II) Approving the Assumption and Assignment of Certain Executory Contracts and Unexpired Leases; and (III) Granting Related Relief*, January 6, 2016 [Dkt. No. 1584] (the "Sale Order").

[4] *Id.* at ¶17.

[5] It became clear during the litigation described above that in the past ADOL has deemed a purchaser of a debtor's assets in bankruptcy a successor without considering any order of the court. This does not appear to be unique to Alabama's Department of Labor. Where entities purchase a debtor's assets in bankruptcy, it will be important to both insist on the inclusion of "new employer" terms in the sales motion and to review unemployment compensation and tax documents to make sure those terms are being complied with.

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