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Introduction

The Bankruptcy Code allows a debtor to sell its assets free and clear of any interest in such property, pursuant to section 363(f) of the Bankruptcy Code. Section 363(f) is used to allow the trustee to sell assets not in the ordinary course of business and to allow purchasers to buy assets without the fear of liability. The Bankruptcy Code does not define the term "interest." Thus, in interpreting section 363(f), a court must view interest in property expansively.[1] Using section 363(f), courts have extinguished several types of claims and interest in property including: possessory interests, employment related claims, and withdrawal liability.[2]

Generally, a majority of courts have interpreted the term "interest" broadly to encompass other obligations that may flow from ownership in property.[3] As courts determine what is considered "interest" under 11 U.S.C. section 363(f), the question of whether a free and clear sale under section 363(f) prevents successor liability arises. Though the general rule is that a purchaser of assets does not acquire the seller's liabilities, successor liability is an equitable tool

[1] *See In* re Norrenberns Foods, Inc., 642 B.R. 825, 831 (Bankr. S.D. Ill. 2022).
[2] *See id.* at 829.
[3] *See In re* Motors Liquidation Co., 829 F.3d 135, 155 (2d Cir. 2016) ("Rather than formulating a single precise definition for 'any interest in such property,' courts have continued to address the phrase on a 'case-by-case basis.'"); 3 Collier on Bankruptcy ¶ 363.06 (16th ed. 2022).

that allows the seller's liabilities to attach to the purchased assets.[4] Creditors use successor liability to maintain their claim through a free and clear sale under 11 U.S.C. section 363(f).

This article will first explore whether successor liability falls under "interest in such property" under 11 U.S.C. section 363(f) and whether a sale of assets can be free and clear of successor liability. Next, this article will evaluate the exceptions to the present rule that courts have used in their analysis of successor liability. The last part reviews several equitable factors that the court considers in making their final ruling of whether successor liability survives a free and clear sale.

I. Successor Liability Can Be Extinguished Under Section 363(f)

After filing for bankruptcy, the trustee or a debtor in possession is generally allowed to sell property free and clear of any interest in such property.[5] A sale free and clear of any interest in such property is only permissible if one of the statute's enumerated conditions is satisfied. These conditions include: (1) if applicable nonbankruptcy law permits sale of such property free and clear of such interest; (2) if the creditor consents; (3) if 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 a bona fide dispute; (5) or the creditor could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.[6] To extinguish successor liability, one of these five conditions must be satisfied.

A. Statutory Interpretation Supports A Broad Interpretation Of "Interest" Under Section 363(f)

[4] *See* Chicago Truck Drivers, Helpers and Warehouse Workers Union Pension Fund v. Tasemkin Inc., 59 F.3d 48, 49 (7th Cir. 1995).
[5] *See* 11 U.S.C. § 363(f).
[6] *Id.*

Where the language of a statute is ambiguous, courts will interpret the language by taking the statute as a whole. Section 363(f)(3) states "[t]he trustee may sell property . . . free and clear of any interest in such property . . . only if 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."[7] Courts read this language as saying "liens" are a subcategory of "interest" within the meaning of the statute.[8] Because of this, courts have consistently interpreted section 363(f) broadly.[9] Reading section 363(f) completely, the use of the word "lien" in section 363(f)(3) indicates that the phrase "any interest in such property" in section 363(f) is not limited to merely liens. As a result, the argument that a successor liability claim is not an interest in property, within the meaning of section 363(f) has consistently been rejected.

A common argument posed by creditors on this issue is that their successor liability claim is not an interest in property within the meaning of section 363(f).[10] Courts have consistently rejected this argument relying primarily on the plain language Congress used in writing section 363(f).[11] Courts have concluded that if Congress had intended for "any interest in such property" to be read narrowly to only include liens, Congress would have used the word lien instead of interest like it did in section 363(f)(3).[12]

Because of this interpretation, courts have found successor liability falls under "interest in such property" under section 363(f).[13]

Successor Liability Claimants Can Be Compelled To Accept A Money Satisfaction For Such Interest

[7] 11 U.S.C. § 363(f)(3).
[8] *See id*.
[9] *See In re* Norrenberns Foods, Inc., 642 B.R. 825, 830 (Bankr. S.D. Ill. 2022).
[10] *See e.g., In re* Trans World Airlines, Inc., 322 F.3d 283, 290 (3d Cir. 2003).
[11] *See Norrenberns Foods*, 642 B.R. at 830.
[12] *See id.* ("Congress would have used the term 'lien' instead of 'interest' had it intended to restrict the scope of Section 363(f) to liens.").
[13] *See e.g., Trans World Airlines*, 322 F.3d at 293; *Norrenberns Foods*, 642 B.R. at 832.

When applying the conditions for a section 363(f) sale, courts rely on section 363(f)(5) to grant a sale free and clear of any interest in such property.[14] Section 363(f)(5) states that "[t]he trustee may sell property . . . free and clear of any interest in such property . . . only if . . . such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest."[15] In most successor liability claims, claimants are generally seeking monetary damages, so courts typically find that money satisfaction is sufficient for the claimants.[16]

Courts have held that successor liability arising from employment discrimination claims and owed travel vouchers could be satisfied by money because the claims could be monetarily valued.[17] Even when claims are ongoing and the middle of litigation at the time of the sale, courts will find that the claims can be extinguished through a money satisfaction.[18] If the claim or obligation is subject to monetary valuation, courts will compel the claimants to accept money so the debtor's assets can be sold free and clear.[19]

The condition set forth in section 363(f)(5) has been the primary reason courts have extinguished successor liability in section 363(f) sales. Despite creditors' best efforts in arguing that they do not have an interest in property, courts have given extensive leniency to free and clear sales.[20]

II. Exceptions That Bar The Sale Of Assets Free And Clear Of Successor Liability

There are limited exceptions for when a court will refuse to prevent successor liability. Courts typically apply two types of tests to see if a sale should be free and clear of successor

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[14] *See In re* Leckie Smokeless Coal Co., 99 F.3d 573, 585 (4th Cir. 1996).
[15] 11 U.S.C. §363(f)(5).
[16] *See Norrenberns Foods*, 642 B.R. at 828 ("The Court agrees that the interest in question is one for which the Fund could be compelled to accept a money satisfaction, as evidenced by the proof of claim filed by the Fund which indicates the monetary value of the claim.").
[17] *See Trans World Airlines*, 322 F.3d at 291.
[18] *See id.*
[19] *Id.*
[20] *See In re* Leckie Smokeless Coal Co., 99 F.3d 573, 586 (4th Cir. 1996) (finding that a sale could be free and clear of a debtor's future tax obligations).

liability: the substantial continuity test, and the traditional common law test.[21] The majority of courts evaluate these free and clear sales using the substantial continuity test, but a minority of courts, including New York, evaluate certain successor liability claims using either solely the traditional common law test, or use both tests in making their determination.[22] These tests are very fact intensive and look at both the seller and purchaser to determine whether the sale is going to an entirely new business or whether the purchaser is merely continuing the seller's old operation.[23]

A. If A Sale Of Assets Fails The Substantial Continuity Test, A Court Will Rule That The Purchaser Is a Successor In Interest And The Successor Liability Claim Will Remain

The substantial continuity test has nine factors that courts use in determining a successor's liability. The nine factors of the substantial continuity test include:

> (1) Whether the successor company had notice of the charge or pending lawsuit prior to acquiring the business or assets of the predecessor; (2) the ability of the predecessor to provide relief; (3) whether there has been a substantial continuity of business operations; (4) whether the new employer uses the same plant; (5) whether he uses the same or substantially the same work force; (6) whether he uses the same or substantially the same supervisory personnel; (7) whether the same jobs exist under substantially the same working conditions; (8) whether he uses the same machinery, equipment, and methods or production; and (9) whether he produces the same product.[24]

These factors determine if a sale of assets was a substantial continuity of the business's operations.[25] If the factors show that there is a substantial continuity of the business, courts will find that the purchasers are successors in interest and successor liability claims will not be

[21] *See* Lewis v. Blackman Plumbing Supply L.L.C., 51 F.Supp.3d 289, 312 (S.D.N.Y. 2014).
[22] *Id.*
[23] *See id.*
[24] *Id.* at 314.
[25] 503 F.2d 1086, 1094 (6th Cir. 1974).

extinguished.[26] "No one factor is controlling, and it is not necessary that each factor be met to find successor liability."[27]

In *Cobb v. Contract Transport* Inc, the court evaluated whether an employee had a successor liability claim against the defendant for the previous company's violation of the Family and Medical Leave Act.[28] In using the substantial continuity test, the court found that the employee had a continuous job with the defendant in which he carried out his mail carrying on the same exact route with the same relay stops.[29] The court found that only the management had changed with the defendant's acquisition and held that the defendant was a successor in interest to the previous company.[30]

B. If A Sale Of Assets Fails The Traditional Common Law Test, A Court Will Rule That The Purchaser Is a Successor In Interest And The Successor Liability Claim Will Remain

Another test used, particularly in New York, is the traditional common law test. Generally, a corporation that purchases the assets of another corporation is not liable for the seller's liabilities.[31] Under the common law test, there are four exceptions to the rule: (1) where the successor has expressly or impliedly assumed the predecessor's tort liability; (2) where there was a consolidation or merger of seller and purchaser; (3) where the purchasing corporation was a mere continuation of the selling corporation; and (4) where the transaction was entered into fraudulently to escape such obligation.[32] When analyzing whether a successor is a "mere continuation," the court considers four factors:

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[26] *See* Alvarez v. 40 Mulberry Restaurant, Inc., No. 11 Civ. 9107 (PAE), 2012 WL 4639154, at *4 (S.D.N.Y. Oct. 3, 2012).
[27] Battino v. Cornelia Fifth Ave., LLC, 861 F.Supp.2d 392, 404 (S.D.N.Y. 2012).
[28] 452 F.3d 543 (6th Cir. 2006).
[29] *Id.* at 557.
[30] *Id.*
[31] *Alvarez*, No. 11 Civ. 9107 (PAE), 2012 WL 4639154, at *4.
[32] *Id.*

> (1) Continuity of ownership; (2) cessation of ordinary business and dissolution of the acquired corporation as soon as possible; (3) assumption by the purchaser of the liabilities ordinarily necessary for the uninterrupted continuation of the business of the acquired corporation; and (4) continuity of management, personnel, physical location, assets, and general business operation.[33]

While similar to the substantial continuity test, this test is laxer because the court considers less factors.[34] Because the Second Circuit has not delineated what the proper test for certain successor liability should be, New York courts often make a determination applying either just the traditional common law test or applying both the common law test and the substantial continuity test.[35]

Alvarez demonstrates an analysis using the common law test to show that defendant is a "mere continuation" of the previous business. In *Alvarez*, the plaintiff was an employee of the former restaurant business who alleged violations of the Fair Labor Standards Act.[36] Defendants purchased the restaurant and claimed that they were not successors in interest, thus claiming that plaintiff had no successor liability claim.[37] The court disagreed and found that under the common law test, defendants were a "mere continuation" of the previous business.[38] To support this, the court found that both restaurants shared a host of characteristics, including physical space, equipment, personnel, menu, trade name, website, and Facebook page.[39] They also found that the new owner had spent time at the old restaurant and that the old owner was in a supervisory role

[33] *Id.* at *5.
[34] *See id.*
[35] *Id.* at *4.
[36] No. 11 Civ. 9107 (PAE), 2012 WL 4639154, at *1.
[37] *Id.*
[38] *Id.* at 6.
[39] *Id.*

in the new restaurant.[40] The court concluded that a reasonable juror could find that the defendant was a successor in interest and denied the defendant's summary judgment claim.[41]

C. Courts Occasionally Consider Equitable Factors, Such As The Time The Claim Arises, In Determining Whether A Sale Free And Clear Should Include Successor Liability

An additional factor courts occasionally consider is whether the claim arose before or during a bankruptcy proceeding. A general rule for free and clear sales is that purchasers of assets do not assume the liabilities of the seller unless the purchaser expressly agrees to do so or an exception exists.[42] Some courts, however, have carved out equitable exceptions for claimants who did not have a claim at the time of bankruptcy, nor had any relationship to the debtor.[43] Typically seen in product liability claims, this idea goes against the general notion that sales of assets free and clear of any interest includes any future claims that were or might be claims against the debtor, even if the claims arose after the close of the bankruptcy case.[44]

Courts only use this factor when claimants had "no contact or relationship—actual or presumed—" with the debtor.[45] Courts find it unfair to successor liability claimants if the claimants had no way of taking part in the bankruptcy process of the debtor.[46] In *Motors Liquidation Company*, the court allowed claimants who had purchased used, defective General Motor's cars from third parties to maintain their successor liability claims against the debtor.[47] Because these used car purchasers had no contact with General Motor's directly, they had no

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[40] *Id.*
[41] *Id.*
[42] 3 Collier on Bankruptcy ¶ 363.06 (16th ed. 2022).
[43] *See e.g.*, *In re* Motors Liquidation Company, 590 B.R. 39, 65-66 (S.D.N.Y. 2018).
[44] *See id.;* 3 Collier on Bankruptcy ¶ 363.06 (16th ed. 2022).
[45] *In re Motors Liquidation Company*, 590 B.R. at 65.
[46] *See id.*
[47] *Id.*

notice of General Motor's bankruptcy, so the court found it unfair to force them to abide by the debtor's Chapter 11 plan.[48]

Conclusion

While the analysis as to whether a free and clear sale prevents successor liability is very fact intensive, generally, courts will rule that the free and clear sale of assets does prevent successor liability claims. Courts typically want to protect bona fide purchasers from any successor liability that may arise because of the purchase of a substantial portion of the assets of a business.[49] Often successor liability claimants can be compelled to accept money satisfaction under 11 U.S.C. section 363(f)(5) to extinguish any successor claims against the purchaser. The only times in which courts will be reluctant to grant a sale free and clear of successor liability is if the sale fails the substantial continuity test or the common law test to determine if a purchaser is a successor in interest. If the court finds that a purchaser is a successor in interest, they will allow the claim to apply to the successor after a sale of assets. The final consideration courts occasionally consider are equitable considerations to the claimant. These are very narrow considerations for claims made by claimants after the bankruptcy proceedings who had no notice, such as a used car purchaser. Only then will courts evaluate whether binding the claimants to the original sale order is equitable. Without any of these exceptions present, a court will likely grant a sale free and clear of any successor liability.

[48] *See id.*
[49] 3 Collier on Bankruptcy ¶ 363.06 (16th ed. 2022).