st. john's UNIVERSITY
SCHOOL OF LAW

St. John's Bankruptcy Research Library
A project of St. John's School of Law and the American Bankruptcy Institute Law Review

2014 Volume VI No. 20

Does the "Free and Clear" Language in an Order Approving a Sale Pursuant to Section 363(f) of the Bankruptcy Code Bar a Successor Liability Claim?

Stephanie Y. Lin, J.D. Candidate 2015

Cite as: *Does the "Free and Clear" Language in an Order Approving a Sale pursuant to Section 363(f) of the Bankruptcy Code Bar a Successor Liability Claim?*, 6 ST. JOHN'S BANKR. RESEARCH LIBR. NO. 20 (2014).

Introduction

Section 363(f) of the Bankruptcy Code was enacted to empower debtors to maximize the value of their bankruptcy estate for the benefit of creditors.[1] Because the assets sold in a sale under section 363(f) (a "363 Sale") transfer "free and clear" of "any interest in such property," a purchaser would be more likely to pay a higher price for the assets.[2] In turn, a higher price paid for the assets results in more available resources to distribute among the debtor's creditors.[3] If a claim is considered an "interest in such property" and the sale order provides that the sale is free and clear of all interests in the property, then the claimant is barred from bringing the claim

[1] *See* WBO P'ship v. Commonwealth of Virginia Dep't of Med. Assistance Servs., 189 B.R. 97 (E.D. Va. 1995) ("[I]t stands to reason that the purpose behind the 'free-and-clear' language of [section **363(f)**] is to maximize the value of the asset, and thus enhance the payout made to creditors.").

[2] The Second Circuit pointed out that acquiring the assets free and clear of tort liability is often a "critical inducement" to the sale. Indiana State Police Pension Trust v. Chrysler LLC (*In re* Chrysler LLC), 576 F.3d 108, 126 (2d Cir.2009), *cert. granted and judgment vacated on other grounds,* 558 U.S. 1087 (2009).

[3] *In re* Eveleth Mines, LLC., 312 B.R. 634, 650 (Bankr. D. Minn. 2004) ("By affording clear title to purchasers from the estate, sales under § 363(f) make the estate's assets more attractive in the market. This, in turn, can maximize the value of the asset[s], and thus enhance the payout made to creditors on a full administration of the estate.") (citation omitted).

under a successor liability theory.[4]

In determining whether a 363 Sale Order precludes a successor liability claim, a court will focus on the text of section 363, particularly the phrase "interest in such property."[5] A common scenario in which this arises is when a defective product manufactured by a debtor prior to bankruptcy injures someone after the bankruptcy proceedings. Whether the injured party can bring a products liability claim under successor liability against the new owner who bought the debtor's assets in a 363 Sale depends on how the court construes "interest in such property." If a court finds that the injured party's claim is an "interest in such party," then the injured party will not be able to sue the new owner. On the other hand, if the court determines that the claim is not an "interest in such property," then the injured party can bring a suit against the new owner under successor liability.

There are three ways to interpret "interest in such property." The first method is to apply state law. Under this method, if the injured party's claim is an interest in property under state law, then it will be an "interest in such property" for the purposes of a 363 Sale. The second method is to construes the phrase as applying only to *in rem* interests in the property. The third method is to interpret the phrase broadly to encompass *in personam* interests.

Regardless of which interpretation a court follows, if a claimant's constitutional due process rights were not met, a court generally will not allow a 363 Sale Order to bar the claimant's successor liability claim.[6] Creditors must be given notice of the debtor's bankruptcy proceedings and an opportunity to be heard. This is no different for future claimants. Indeed, some courts note that the goal of maximizing the value of assets sold to maximize the value of a

[4] *In re* Grumman Olson Indus., Inc., 467 B.R. 694, 702–03 (S.D.N.Y. 2012).
[5] *In re* Mundy Ranch, Inc., 484 B.R. 416, 421 (Bankr. D.N.M. 2012).
[6] *In re Grumman Olson Indus., Inc.*, 467 B.R. at 711.

bankruptcy estate must be tempered by meeting constitutional due process.[7]

This constant tension between the purpose of "free and clear" sales and meeting due process creates unpredictability as to whether a successor liability claim will be barred by a 363 Sale Order. This Memorandum endeavors to shed light on the uncertainty. The first Part of this Memorandum discusses the various ways courts have construed the text of section 363(f), and how their interpretation of the terms "interest in such property" affects the scope of a section 363 Sale Order. The second Part discusses the implications of these interpretations in the context of future tort claims.

I. Section 363 Sale: Interpreting "Interest In Such Property"

To maximize the value of a debtor's bankruptcy estate, section 363(f) provides that assets can be sold "free and clear" of existing interests in such assets.[8] Specifically, § 363(f) states:

> (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 the 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.[9]

If any one of these five statutory provisions are met, then the debtor can sell its assets free and

---

[7] *See id.* at 707 ("Courts have rejected the premise that maximizing the value of the estate outweighs the due process rights of potential claimants."); *cf.* Wright v. Corning, 679 F.3d 101, 101 (3d Cir. 2012) (discussing the implications of "the Bankruptcy Code's goal of providing a debtor with a fresh start by resolving all claims arising from the debtor's conduct prior to its emergence from bankruptcy" juxtaposed against and the "rights of individuals who may be damaged by that conduct but are unaware of the potential harm at the time of the debtor's bankruptcy").

[8] 11 U.S.C. § 363(f)

[9] *Id.*

clear pursuant at a 363 Sale.[10] When the debtor has sold all or substantially all its assets at the 363 Sale, there will not be much left for potential future claimants to collect for their prospective judgments. In this situation, selling the debtor's property free and clear is often in tension with the common law of successor liability.

Under traditional common law, a corporation that purchases the assets of another corporation is generally not liable for the seller's liabilities.[11] However, most state courts will impose a seller's liability on a purchaser if (1) the purchaser expressly or impliedly agrees to assume such debts; (2) the transaction amounts to a merger or consolidation of the seller and purchaser; (3) the purchasing entity is a mere continuation of the selling entity; or (4) the sale was a fraudulent transaction designed to avoid the seller's liabilities.[12]

In the context of a 363 Sale, the question courts grappled with is whether a 363 Sale Order bars a claimant from bringing a particular claim against a purchaser under a state successor liability theory.[13] To answer this question, courts scrutinize the statutory language to whether the particular claim at issue constitutes an "interest in such property."[14] If the successor liability claim is an "interest in such property" within the meaning of section 363, then it will be barred by the 363 Sale Order because the property was purchased free and clear of such interest in property. But if the claim is not an "interest in such property," then the claim is outside the purview of section 363(f), and the 363 Sale Order will not bar the claimant from pursuing the claim against a purchaser under a successor liability theory.

---

[10] Except for those liabilities expressly assumed by the buyer in the sale order or transaction agreement. *In re* Old Carco, 492 B.R. 392, 398 (S.D.N.Y. 2013).
[11] New York v. National Service Industries, 460 F.3d 201, 209 (2d Cir. 2006).
[12] *Id.; see also* Brzozowski v. Correctional Physician Servs., Inc., 360 F.3d 173, 177 (3d Cir. 2004); Johnston v. Amsted Industries, Inc., 830 P.2d 1141, 1142–43 (Colo.App. 1992); Kleen v. Laundry v. Total Waste Mgmt. Corp., 817 F.Supp. 225, 230 (D.N.H. 1993).
[13] *In re Grumman Olson Indus., Inc.*, 467 B.R. at 702–03.
[14] Lefever v. *K.P. Hovnanian Enterprises, Inc.,* 734 A.2d 290, 295–96 (1999).

However, the Bankruptcy Code does not define "interest in such property,"[15] and the legislative history of section 363 does not provide any guidance as to the meaning of the phrase.[16] Thus, the courts are left to define the phrase. Although the Supreme Court has not ruled on the scope of the phrase "interest in such property" as it is used section 363, the Court has interpreted to the phrase as it is used in other sections of the Bankruptcy Code.[17]

For example, in *Barnhill v. Johnson*,[18] the Court was faced with the issue of whether a transfer made by check was a "transfer of an interest of the debtor in property" within the meaning of section 547(b) of the Bankruptcy Code.[19] After finding no clear definition in section 101(54), the *Barnhill* Court reiterated the principle established in *Butner v. United States*[20] that "

[i]n the absence of any controlling federal law . . . 'interests in property' are creatures of state law."[21] In other words, for the purposes of section 547(b), an interest in property is defined by state law. The few courts that have applied this principle to 363 Sales have not used it in the context of successor liability claims.[22]

The courts that do address whether successor liability claims are "interests in such property" under section 363(f) decide the issue under the *in rem* interpretation of the phrase or

---

[15] *In re* Eveleth Mines, LLC, 32 B.R. 634, 650 (Bankr. D. Minn. 2004).
[16] The Congressional Report only states that § 363(f) "permits sales of property free and clear of any interest in the property of an entity other than the estate." H.R. REP. 95-595, 1978 U.S.C.C.A.N. 5963, 6302, S. REP. 95-989, 1978 U.S.C.C.A.N. 5787, 5842.
[17] Barnhill v. Johnson, 503 U.S. 393 (1992).
[18] *Id.* at 393.
[19] *Id. at* 400.
[20] 440 U.S. 48 (1979).
[21] *Barnhill*, 503 U.S. at 398.
[22] *See In re* Eveleth Mines, LLC, 312 B.R. 634, 650–56 (Bankr. D. Minn. 2004) (looking to state law to determine whether a tax scheme and its application was an "interest" within the scope of section 363); *cf. In re* Atlantic Gulf Communities Corp., 326 B.R. 294, 299–300 (Bankr. D. Del. 2005) (rationalizing that under Florida law, litigation rights—other than personal injury claims—are property interests and thus are property of the estate and may be sold under § 363).

the *in personam* interpretation.[23] The first interpretation narrowly construes "interest in suchproperty" to apply only to *in rem* claims—claims that arise from the property, such as liens and mortgages.[24] Courts that follow this interpretation limit section 363(f)'s application to claims that have attached to assets.[25] Under this interpretation, a claim that is not tied to a specific property of the debtor seller, including certain tort claims, is not an "interest in such property" and therefore is not barred by a363 Sale Order.[26]

Under the second interpretation, the term "interest in such property" is broadly construed to include both *in rem* and *in personam* claims—claims that arise from the ownership of the asset.[27] The Second, Third, Fourth and Seventh Circuits, and the Bankruptcy Appellate Panel for the First Circuit, have applied this broad interpretation to include obligations that may arise from the ownership of such property.[28] These courts base their expansive interpretation on the goal of

---

[23] *In re* Trans World Airlines, Inc., 322 F.3d 282, 290 (3d Cir. 2003).
[24] *In re Chrysler LLC,* 576 F.3d 108, 126 (2d Cir.2009), *granting cert. & vacating judgment, I*ndiana State Police Pension Trust v. Chrysler LLC*,* 558 U.S. 1087, 130 S.Ct. 1015, 175 L.Ed.2d 614 (2009); *In re Trans World Airlines,* 322 F.3d at 289–90.
[25] *In re* Fairchild Aircraft Corp., 184 B.R. 910, 917–18 (Bankr. W.D. Tex. 1995) *vacated on other grounds* 220 B.R. 909 (Bankr. W.D. Tex. 1998).
[26] *See id.*; *In re* White Motor Credit Corp., 75 B.R. 944 (Bankr. N.D. Ohio 1987); *In re* New England Fish Company, 19 B.R. 323, 326. However, if an *in personam* claim had been converted into a judgment lien on the debtor's property prior to the sale, then the lien could be discharged in a § 363 sale. *In re* Allied Prods. Corp., 288 B.R. 533, 536 (Bankr. N.D. Ill. 2003), *aff'd*, No. 03-C-1361, 2004 WL 635212 (N.D. Ill. Mar. 31, 2004) (citing the legislative history to emphasize that "adequate protection" in connection with a § 363 sale free and clear of other interests generally requires that the liens attach to the sale proceeds).
[27] *In re* Grumman Olson Industries, Inc., 445 B.R. 243, 249 (Bankr. S.D.N.Y. 2011). Even in circuits where "interest in such property" has not been defined, courts in these circuits have recognized a trend towards a more expansive construction. *In re* Mundy Ranch, Inc., 484 B.R. 416, 421 (Bankr. D.N.M. 2012) ("However, 'the trend seems to be toward a more expansive reading of interest in property as encompassing other obligations that may flow from ownership of the property.'") (citing *In re* Telluride Income Growth, L.P., 364 B.R. 390, 405 (10th Cir. BAP 2007).
[28] *In re* Tougher Indus., Inc., 06-12960, 2013 WL 1276501, at *6 (Bankr. N.D.N.Y. Mar. 27, 2013).

"free and clear" sales to maximize the value of a debtor's estate for the benefit of creditors.[29] These courts reason that allowing claims to follow assets that were purchased by a good-faith purchaser would lower the price a purchaser would be willing to pay for the assets, compromising the debtor's ability to maximize the value of its estate, thereby frustrating the purpose of a "free and clear" sale.[30]

Another concern these courts consider is adhering to the Bankruptcy Code's scheme for priority distribution.[31] When a debtor files for bankruptcy, generally, creditors are paid from the proceeds of the estate sale. Broadly speaking, secured creditors have priority in the distribution of the debtor's estate.[32] Any residual resources are then distributed among unsecured creditors.[33] However, often, the estate sale does not produce enough to fully pay all creditors. In such cases, the creditors are limited to what they get in the distribution, if they get anything. Claimant creditors, including successor liability claimants, are usually unsecured creditors. Because successor liability claims are brought against the purchaser of a debtor's assets, claimants are not limited to proceeds of the debtor's estate sale and are likely paid in full. Thus, successor liability claimants are unsecured claimants that will be paid in full before the secured creditor. Allowing these unsecured claimants to bring claims against a purchaser, whereas secured creditors are limited to the proceeds of the estate sale, would run counter to the Bankruptcy Code's scheme

[29] *In re Trans World Airlines*, 322 F.3d at 292–93.
[30] The Second Circuit pointed out that acquiring the assets free and clear of tort liability is often a "critical inducement" to the sale. Indiana State Police Pension Trust v. Chrysler LLC (*In re* Chrysler LLC), 576 F.3d 108, 126 (2d Cir.2009), *cert. granted and judgment vacated on other grounds,* 558 U.S. 1087 (2009).
[31] *See In re* Lady H Coal Co., Inc., 199 B.R. 595, 605 (S.D.W. Va. 1996); *see also In re Trans World Airlines*, 322 F.3d at 292 (discussing the Bankruptcy Code's priority scheme).
[32] 11. U.S.C. § 507
[33] *Id.*

for giving secured creditor's priority.[34]

II. Successor Liability For Future Tort Claims

How a court interprets "interest in such property" directly affects successor liability for future tort claims—tort claims brought after bankruptcy proceedings. Generally, future tort claims are *in personam* claims because they arise from the ownership of property, not the property themselves.[35]

The minority of courts that interpret "interest in such property" to encompass only *in rem* claims hold that future tort claims are not within the scope of section 363(f) and thus cannot be barred by the 363 Sale Order.[36] Accordingly, future tort claims can be brought against a purchaser of assets in a 363 Sale under successor liability theory.[37] Conversely, jurisdictions that interpret "interests in such property" broadly to include both *in rem* and *in personam* claims hold that future tort claims are within the purview of section 363(f). Consequently, a 363 Sale Order can bar future tort claims from being asserted against a purchaser of assets in a 363 Sale.

---

[34] *In re Trans World Airlines*, 322 F.3d at 292. ("[t]he Bankruptcy Act is clearly designed to give liens on the bankrupt's property preference over unliquidated claims.") (citations omitted).

[35] *See In re* Fairchild Aircraft Corp., 184 B.R. 910, 917–18, (Bankr. W.D. Tex. 1995) (discussing whether a 363 Sale Order would discharge future claims: "[t]he sorts of interests impacted by a sale 'free and clear' are *in rem* interests which have attached to the property. Section 363(f) is not intended to extinguish *in personam* liabilities. Were we to allow 'any interests' to sweep up *in personam* claims as well, we would render the words "in such property" a nullity.") *vacated on other grounds,* 220 B.R. 909 (Bankr.W.D.Tex.1998).

[36] *See id.* at 917–18 (discussing whether a § 363 sale order would discharge future claims: "[t]he sorts of interests impacted by a sale 'free and clear' are *in rem* interests which have attached to the property. Section 363(f) is not intended to extinguish *in personam* liabilities. Were we to allow 'any interests' to sweep up *in personam* claims as well, we would render the words "in such property" a nullity.").

[37] *See In re* Fairchild Aircraft Corp., 184 B.R. 910, 917–18, (Bankr. W.D. Tex. 1995) (discussing whether a 363 Sale Order would discharge future claims: "[t]he sorts of interests impacted by a sale 'free and clear' are *in rem* interests which have attached to the property. Section 363(f) is not intended to extinguish *in personam* liabilities. Were we to allow 'any interests' to sweep up *in personam* claims as well, we would render the words "in such property" a nullity.") *vacated on other grounds,* 220 B.R. 909 (Bankr.W.D.Tex.1998).

A. *Minority View*

Generally, in jurisdictions that narrowly construe "interest in such property" to apply only to *in rem* interests, *in personam* future tort claims will not be barred by the 363 Sale Order and thus cannot be brought against a successor.[38] For example, in *In re Fairchild Aircraft Corporation*,[39] Fairchild Aircraft Corporation ("FAC"), a manufacturer of airplanes, filed for bankruptcy in 1990.[40] Fairchild Acquisition, Inc ("FAI") purchased FAC's assets free and clear at a 363 Sale.[41] On April 1, 1993, three years after FAC's bankruptcy filing, one of the planes that manufactured and sold by FAC approximately five years prior to its bankruptcy, crashed.[42] Four individuals lost their lives in the crash.[43] Their estates brought a product liability suit against FAI, alleging that the aircraft was defectively manufactured by FAC, and that "FAI [was] now liable for the manufacture and sale of a defective product on a successor liability theory."[44]

The *Fairchild* court examined whether future claims could be discharged in bankruptcy, particularly in the context of a 363 Sale.[45] Ultimately, the court reasoned that section 363(f)'s "free and clear" provision does not apply to "*any interest,* but rather of *any interest in such property*."[46] Parsing the terms "any interest in such property" the court opined that the text refers to *in rem* interests that have attached to the property.[47] Hence, the court concluded that section 363(f) was "not intended to extinguish *in personam* liabilities."[48] Thus, the court held

---

[38] *See id.*
[39] *Id.*
[40] *Id.* at 913.
[41] *Id.* at 914.
[42] *Id.* at 915.
[43] *Id.*
[44] *In re Fairchild Aircraft Corp*., 184 B.R.at 915.
[45] *Id.* at 910.
[46] *Id.* at 917.
[47] *Id.*
[48] *Id.* at 917–18.

the 363 Sale Order did not insulate FAI from future tort claims.[49]

B. *Majority View*

The majority of jurisdictions interpret "interest in such property" broadly to encompass both *in rem* and *in personam* interests. Under this expansive reading, an "interest in such property" can refer to any claim or obligation that is connected to or arises from the property being sold in a 363 Sale, and such claim or obligation will be barred against a purchaser.[50] Most courts reason that since most tort claims arise from the ownership of property, they are generally *in personam* claims and are thus within the purview of section 363.[51] Accordingly, most jurisdictions enforce 363 Sale Orders against future tort claims, provided that due process was met.[52]

For example, *In re Trans World Airlines*, the Third Circuit had to determine whether a 363 Sale Order extinguished the liability of American Airlines, the purchaser of Trans World Airlines' assets, for employment discrimination claims against Trans World Airlines.[53] First, the court parsed the text of section 363(f) and opined that limiting "interest in such property" to encompass only *in rem* interests such as liens, mortgages, money judgments, writs of garnishment and attachment was "inconsistent with section 363(f)(3)."[54] Since section 363(f)(3) expressly addresses situation in which an interest is a lien, the court determined that there must

---

[49] *In re Fairchild Aircraft Corp*., 184 B.R.at 934 ("The order of sale did not insulate FAI, and this court lacked the jurisdiction to enjoin these claimants, because they did not hold "bankruptcy claims" as defined in this decision.").
[50] *In re Trans World Airlines*, 322 F.3d at 289–90.
[51] Consol. Rail Corp. v. Ray ex rel. Estate of Boyd, 632 F.3d 1279, 1282 (D.C. Cir. 2011) ("[M]any courts have interpreted 'interest in such property' to include liability for an in personam tort claim").
[52] *In re Trans World Airlines*, 322 F.3d at 289 (noting that the expansive reading of "interests in such property" may encompass obligations that flow from ownership of the property).
[53] *In re* Trans World Airlines, Inc., 322 F.3d 282, 282 (3d Cir. 2003).
[54] *Id.* at 290.

be situations in which an "interest" refers to something other than a lien; otherwise, section 363(f)(3) would not need to specify cases in which an interest is a lien.[55]

Next, the Third Circuit proclaimed that the Bankruptcy Code's priority scheme "support[ed] transferring [Trans World Airlines'] assets free and clear of the claims."[56] In particular, the court noted that plaintiff's claims were "general unsecured claims, and, as such, [were] accorded low priority" in the distribution of Trans World Airlines' bankruptcy estate.[57] The court reasoned that allowing the plaintiffs to seek successor liability claims against American Airlines "while limiting other creditors' recourse to the proceeds of the asset sale" would accord these unsecured claimants a higher priority over creditors with secured claims, thereby subverting the Bankruptcy Code's distribution scheme.[58]

Finally, the Third Circuit also discussed the effect of allowing successor liability claims on Trans World Airline's ability to maximize its bankruptcy estate.[59] The court reasoned that if Trans World Airlines' assets were not sold free and clear of successor liability claims, American Airlines may have paid less for the assets, thereby reducing Trans World Airline's ability to maximize the value of its estate for the benefit of its creditors.[60] After evaluating the text of section 363(f), the Bankruptcy Code's distribution scheme, and the purpose of maximizing a debtor's estate by transferring the debtor's assets free and clear, the court held that the 363 Sale Order barred the plaintiffs' from bringing employment discrimination claims against American

---

[55] *Id.*
[56] *Id.* at 291.
[57] *In re Trans World Airlines*, 322 F.3d at 292.
[58] *See id.* ("[t]he Bankruptcy Act is clearly designed to give liens on the bankrupt's property preference over unliquidated claims.") (citations omitted).
[59] *Id.* at 292–93.
[60] *Id.*

Airlines.[61]

The decision in *In re Trans World Airlines* is in line with the majority of courts. However, even in these jurisdictions where the scope of section 363 includes *in personam* claims, a 363 Sale Order will not preclude all future tort claims. In particular, where constitutional due process requirements have not been met, a future tort claim may not be barred.

III. Constitutional Concerns: Due Process Requirements

Due process generally requires "notice reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objection."[62] To meet constitutional due process, section 363(b)(1) requires "notice and a hearing" in order for a debtor's assets to be sold free and clear.[63] In the context of future tort claims, sometimes the claimant will not suffer injury from an asset sold by the debtor until after the debtor files for bankruptcy.[64] In such a situation, "[t]he potential victims are not only unidentified, but there is no way to identify them."[65] Thus, giving notice to these potential claimants can be difficult, and in some cases, impossible.[66]

If adequate notice of a debtor's bankruptcy proceedings was not provided to the claimant, a court may find that due process was not met and refuse to enforce a 363 Sale Order against the claimant's claims.[67] For example, in *In re Grumman*,[68] the District Court for the Southern District of New York affirmed the bankruptcy court's decision that a 363 Sale Order did not

---

[61] *Id.* at 293.
[62] *In re* Chance Indus., Inc., 367 B.R. 689, 708 (Bankr. D. Kan. 2006), citing Mullane v. Central Hanover Bank & Trust Co., 339 U.S. 306 (1950).
[63] 11 U.S.C. 363(b)(1).
[64] United States v. LTV Corp. (*In re* Chateaugay Corp.), 944 F2d. 997, 1003 (2nd Cir. 1991).
[65] *Id.*
[66] *Id.*
[67] *In re* Grumman Olson Indus., Inc., 467 B.R. 694, 707 (S.D.N.Y. 2012).
[68] *Id.*

preclude the plaintiff from bringing a successor liability claim against a purchaser of assets in a 363 Sale because the due process was not met.[69] There, the debtor, Grumman Olson Industries ("Grumman) sold its assets to MS Truck Body Corp., a predecessor of Morgan Olson LLC ("Morgan") "free and clear" pursuant to section 363.[70] On July 1, 2003, the bankruptcy court entered a Sale Order approving the sale of some of the debtor's assets to Morgan.[71] In addressing *in rem* claims, the 363 Sale Order provided:

> The sale . . . of the assets to be purchased . . . shall be free and clear of all . . . claims . . . and other interests . . . and all debts arising in any way in connection with any acts of the Debtor, claims (including but not limited to "claims" as that term is defined in the Bankruptcy Code) . . . and matters of any kind and nature, whether arising prior to or subsequent to the commencement of this Chapter 11 case . . . .[72]

The Sale Order also released Morgan from certain *in personam* claims, including successor liability claims:

> [T]he Purchaser shall have no liability or responsibility for any liability or other obligation of the Debtor arising under or related to the [assets] other than for the purchase price . . . . [T]ransfer [of the assets] . . . will not subject the Purchaser to any liability for claims against the Debtor or the [assets], including, but not limited to, **claims for successor or vicarious liability** . . . .[73]

In the fall of 2009, Denise Frederico, a FedEx employee, suffered personal injuries when driving a defective truck that was manufactured and sold by the debtor in 1994.[74] FedEx purchased the truck and Frederico was driving it within the scope of her employment when she crashed into a telephone pole.[75] Frederico and her husband brought a personal injury action

---

[69] *Id.* at 711.
[70] *In re* Grumman Olson Indus., Inc., 445 B.R. 243, 245 (Bankr. S.D.N.Y. 2011), *aff'd*, 467 B.R. 694 (S.D.N.Y. 2012).
[71] *Id.*
[72] *Id.* at 246.
[73] *Id.* (emphasis added).
[74] *Id.* at 247.
[75] *Id.*

against Grumman and Morgan in the Superior Court of New Jersey.[76] Morgan contended that the 363 Sale Order freed it from successor liability of the Fredericos' claims.[77] Despite the terms of the 363 Sale Order,[78] the bankruptcy court determined that the Fredericos' claims were not barred.[79]

The district court affirmed the bankruptcy court's decision on grounds that the Fredericos was denied due process.[80] In particular, the district court emphasized that Section 363 sales require "notice and a hearing" prior to the sale to give claimants an opportunity to contest the sale.[81] The court further stressed that the failure to give proper notice "violates the rudimentary demands of due process of law."[82] As such, the court then found that the Fredericos did not receive "adequate notice of their potential claim" in the debtor's bankruptcy proceedings because, at the time of the proceedings, there was "no way for anyone to know" that the Fredericos would ever have a claim.[83] Thus, the court concluded that allowing the sale order to bar the Fredericos' "right to seek redress . . . when they did not have notice or opportunity to participate in the proceedings that resulted in that order would deprive them of due process."[84]

In contrast, if a court finds that adequate notice of a debtor's bankruptcy proceedings was given to potential claimants, enabling claimants to be heard in the proceedings, the court will

---

[76] *Id.*
[77] *Id.* at 245.
[78] The 363 Sale Order provided that the purchaser shall not be deemed to have successor liability or responsibility for claims against or obligations of the Debtor arising prior to or as a result of the purchase and sale [of the assets]. *In re Grumman Olson Indus., Inc.*, 467 B.R. 694, 697, note 1 (S.D.N.Y. 2012).
[79] *In re* Grumman Olson Indus., Inc., 445 B.R. at 243 (Bankr. S.D.N.Y. 2011), *aff'd*, 467 B.R. 694 (S.D.N.Y. 2012).
[80] *In re Grumman*, 467 B.R. at 708–09.
[81] *Id.* at 706.
[82] *Id.* (citations omitted).
[83] *Id.* at 708.
[84] *Id.*

generally enforce a 363 Sale Order against the claimant's tort claims.[85] For example, in *In re Old Carco*,[86] the bankruptcy court recently held that a group of plaintiffs' tort claims against Chrysler Group, LLC ("New Chrysler") were barred by the 363 Sale Order because there was sufficient notice of Chrysler's bankruptcy for the claimants to participate in the bankruptcy proceedings.[87]

There, the plaintiffs had filed a class action against Chrysler Group LLC ("New Chrysler") alleging that their vehicles, which were manufactured and sold by Old Carco LLC ("Old Chrysler"), suffered from a design flaw.[88] The design flaw, called "fuel spit-back" causes fuel to spill out during refueling.[89] When Old Chrysler learned of the problem, it issued three safety recalls; the first in 2002, the second in 2005, and the third in January 2009.[90] The plaintiffs owned new or pre-owned cars manufactured by Old Chrysler between 2005 and 2007.[91] They commenced action against New Chrysler in Delaware state court on November 29, 2011, two years after Old Chrysler filed for bankruptcy.[92]

Old Chrysler filed for bankruptcy in April of 2009.[93] On June 10, 2009, New Chrysler purchased Old Chrysler's assets in a 363 Sale.[94] In the Master Transaction Agreement ("MTA"), New Chrysler assumed liability for three types of claims: (1) repair warranty for the repair and/or replacement of parts under warranties that accompanied the purchase of new vehicles or when acquired under extended warranties, (2) Lemon Law claims for vehicles manufactured by Old

---

[85] *See In re* Old Carco LLC, 492 B.R. 392 (Bankr. S.D.N.Y. 2013).
[86] *Id.* at 403.
[87] *Id.*
[88] *Id.* at 394.
[89] *Id.* at 395.
[90] *Id.*
[91] *Id.* at 399.
[92] *Id.*
[93] *Id.* at 396.
[94] *Id.*

Chrysler in the five years prior to June 10, 2009, when the sale closed (the "Closing Date"), and (3) product liability arising from accidents.[95]

The MTA also listed liabilities that were barred against New Chrysler including "all Liabilities in strict liability, negligence, gross negligence or recklessness for acts or omissions arising prior to or ongoing at the Closing" and "all Product Liability claims arising from the sale of Products or Inventory on or prior to the Closing."[96] "Product Liability Claim" was defined as:

> any Action arising out of, or otherwise relating to in any way in respect of claims for personal injury, wrongful death or property damage resulting from exposure to, or any other *warranty claims,* refunds, rebates, property damage, product recalls, defective material claims, merchandise returns and/or any similar claims . . . .[97]

The Sale Order reinforced that New Chrysler was buying Old Carco's assets free and clear of successor liabilities, except for the ones assumed by New Chrysler:

> "[t]he transfer of the Purchased Assets to [New Chrysler] will . . . transfer . . . the Purchased Assets free and clear of all Claims that are not Assumed Liabilities (including, specifically and without limitation, any products liability claims, environmental liabilities, employee benefit plans and **any successor liability claims**), except as otherwise provided in this Sale Order."[98]

Accordingly, New Chrysler argued that the plaintiffs' claims were barred by the Sale Order entered in the Chrysler bankruptcy case.[99] The plaintiffs cited *In re Grumman*[100] and contended that the Sale Order cannot cut off their claims if their damages incurred after the Closing Date.[101] The court disagreed and distinguished the case from *Grumman*.[102]

Despite similarities with *Grumman*, the *Old Carco* court noted that the case was

---

[95] *Id.* at 396–98.
[96] *Id.* at 397.
[97] *Id.*
[98] *Id.* at 398–97 (emphasis added).
[99] *Id.* at 394.
[100] *In re* Grumman Olson Indus., Inc., 467 B.R. 694 (S.D.N.Y. 2012).
[101] *In re Old Carco LLC*, 492 B.R. at 401.
[102] *Id.* at 402–03.

distinguishable because the *Old Carco* plaintiffs' constitutional right to due process was met, whereas the *Grumman* plaintiffs' rights were not. In *Grumman*, the plaintiffs had no pre-petition relationship with the debtor because it was FedEx that purchased and owned the defective truck.[103] Also, the court noted that the plaintiffs did not have a claim against the debtor at the time of Grumman's bankruptcy proceedings because Frederico's accident occurred years after the bankruptcy sale.[104] Therefore, the plaintiffs did not receive "meaningful notice" of the bankruptcy proceedings because prior to the accident, they had "no basis to pay any attention to the bankruptcy case or do anything about it."[105]

On the contrary, the *Old Carco* plaintiffs or their predecessors—if the plaintiff had bought a used car—had a "pre-petition relationship" with Old Chrysler because they owned cars were purchased from Old Chrysler before their bankruptcy in 2009.[106] Moreover, the "fuel spit-back" design flaw existed prior to Old Chrysler's bankruptcy filing, hence, prior to bankruptcy, the plaintiffs held contingent claims because possible future liability was "within the actual or presumed contemplation of the parties at the time the original relationship between the parties was created."[107] The court remarked, "Anyone who owns a car contemplates that it will need to be repaired, particularly when, as here, Old Chrysler had already issued at least two and possibly three recall notices for the "fuel spit back" problem . . . before the original purchasers bought their vehicles from Old Chrysler." Therefore, the court found that the plaintiffs had reasons to pay attention to Old Chrysler's bankruptcy proceedings.[108]

Since the *Old Carco* plaintiffs had a basis to pay attention to Old Chrysler's bankruptcy

---

[103] *Id.* at 402.
[104] *Id.*
[105] *Id.*
[106] *In re Old Carco*, 492 B.R. at 403.
[107] *In re Old Carco*, 492 B.R. at 403 (quoting *In re Chateaugay Corp.*, 944 F2d. at 1004).
[108] *See id.*

and the bankruptcy proceedings were "well-publicized," the court determined that the plaintiffs had adequate notice of Old Chrysler's bankruptcy proceedings and meaningful opportunity to participate in those proceedings.[109] Because the plaintiffs' due process rights were met, the court held that the 363 Sale Order did not prevent the plaintiffs' claims that arose under the three types of liabilities New Chrysler assumed, however, all other claims that arose prior to the closing date were barred.[110]

IV. Conclusion

Assets purchased in a 363 Sale are transferred "free and clear of any interest in such property," however, the enforceability of a 363 Sale Order against successor liability claims depends on a court's interpretation of "interest in such property." In jurisdictions that narrowly interpret "interest in property" to mean only *in rem* interests, future tort claims, which are generally *in personam* interests, will not be barred by a 363 Sale Order from being asserted against a purchaser under successor liability. Conversely, courts that construe "interest in such property" expansively to encompass both *in rem* and *in personam* interests generally find that a 363 Sale Order will bar a future tort claim from being brought against a purchaser. However, even in jurisdictions that broadly interpret "interest in such property," a court may not enforce a 363 Sale Order to preclude a successor liability claim if the claimant did not receive adequate notice of the debtor's bankruptcy proceedings. Because of the various and divergent approaches taken by the circuits in determining whether a 363 Sale Order will bar a successor liability claim from being asserted against a purchaser, bankruptcy practitioners and business planners should note that assets purchased "free and clear" in a 363 Sale may not be all that "free and clear."

[109] *Id.* at 396.
[110] *Id.* at 407.