"Contingent Claims: Roadblocks to a Sale or Just Bumps in the Road?"

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If you are working with an insolvent company in bankruptcy and working toward a sale process, certain creditor groups may bring up seemingly far-fetched ideas for potential claims that may be left behind as part of the sale process. Some of these claims may seem ridiculous in your view, but they may be considered as part of the bankruptcy process. What about personal injury claimants from car crashes many years later (related to a faulty part that that the company knew existed)? What about claims by children of mothers who took certain medication while pregnant, later causing health problems for the child? Depending on the circumstances, these potential claims – even though they have not occurred prior to or during the bankruptcy (and will not occur for some time) – must be considered as a company is making its reorganization plans and / or preparing to sell its assets through the bankruptcy case. A recent case out of the U.S. Bankruptcy Court for the Eastern District of Michigan (and which is currently up on appeal before the District Court for the Eastern District of Michigan) focuses on another type of possible claim that has not yet occurred (known in bankruptcy cases as contingent claims): withdrawal liability for a company's withdrawal from a union pension fund. The court in *In re K&D Industrial Services Holding Co. Inc. et al.*, No. 19-43823, 2019 WL 2158771 (Bankr. E.D. Mich. May 16, 2019) held that two bankrupt industrial cleanup companies can sell assets free and clear of their potential liability to a union pension fund, rejecting the pension fund's argument that the sale would prejudice a claim that does not yet exist. The application of this case beyond just potential pension fund liability bears some explanation.

The bankrupt company in this case – K&D Industrial Services Holding Co. – owns seven environmental and industrial cleanup companies in Michigan, Ohio, Wisconsin and Illinois. Two of the companies — K&D Industrial Services Inc. and K&D Industries West Inc. — had collective bargaining agreements with the union that required them to contribute to the union's pension fund. In early 2018, the K&D companies determined they needed either a substantial cash infusion or a refinancing of their debt. However, the companies faced an obstacle in obtaining funding and creating their restructuring plan: they noted that a potential large withdrawal liability would be triggered if they withdraw from the pension fund. Notably, however, the company had not actually already withdrawn from the pension fund – they were merely contemplating that they would do so shortly.

The companies filed for chapter 11 bankruptcy on March 15, 2019, seeking to sell their assets and liquidate. The companies listed the pension fund as an unsecured creditor holding a nearly $3.4 million contingent claim for "withdrawal liability." After marketing their assets, the debtors moved for permission to auction vehicles, machinery, and other assorted assets free and clear of liens, claims, and encumbrances according to section 363 of the Bankruptcy Code.

Because the potential buyer would not agree to the deal if it came with $3.4 million in potential liability, the debtors' sale motion requested authority to sell the assets 11 U.S.C. § 363(f), "free and clear of the pension fund's possible employer withdrawal liability claim against the debtors." No competing bids were received for the assets, and no party objected to the sale itself. However, the pension fund objected to the companies' request that the sale allow the companies to leave the potential union withdrawal liability behind after the sale.

The fund conceded that "Section 363(f) free-and-clear sales are routinely used in bankruptcy cases throughout the country to permit debtors and trustees to maximize the recovery of proceeds for a {8233078:2 } debtor's creditors." However, the fund argued that because the debtors have not yet withdrawn, it does not currently have a claim, and the sale cannot be made free and clear of the debtors' potential withdrawal liability for its future claim. The debtors countered that the fund has a contingent right to payment and thus has a claim. While the debtors' liability hinges on their withdrawal from the fund, which has not happened yet, it is "simply a contingency" that is "certain to occur," and contingent claims are still treated as "claims" under the Bankruptcy Code. The court agreed with the debtors that the pension fund had a right to payment subject only to a contingency — the debtors' withdrawal from the fund — that will occur during the course of the bankruptcy. The pension fund argued that even if it did have an existing claim against the debtors for withdrawal liability, section 363(f) would not apply because that statute permits sales of estate property free of any "interest in such property," not free of claims. Rejecting that argument, the court noted that the 6th U.S. Circuit Court of Appeals and other federal appeals courts have construed section 363(f) as allowing a sale free and clear of both claims against debtors and interests in estate property – if they relate to prepetition conduct of the debtors.

While the court held that the debtors' potential withdrawal from the pension fund is the "contingency that triggers the maturity of the withdrawal liability, it is the prepetition conduct of K&D Industrial and K&D West that gives rise to the pension fund's claim." "The pension fund's claim for withdrawal liability, while not an in rem interest in the assets to be purchased by CCI, is an interest in such assets for purposes of Section 363(f)." Judge Shefferly ultimately approved the sale, including the "free and clear" language. The matter is currently pending appeal before the District Court for the Eastern District of Michigan, Case No. 19-11629. If the holding is affirmed by the District Court and upheld in any further appeal to the Sixth

Circuit, this case could have potentially broad implications; this holding could be applied to cases where a debtor seeks to leave behind potential, not-yet-occurred claims relating to prepetition conduct – even if the liability has not yet actually occurred and may not occur for some time.

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