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Alabama Aircraft – A Blueprint for Transferring a Debtor's Interest in Non-assignable Prejudgment Litigation

ASSET SALES



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Maximizing the value of its estate for the benefit of creditors is the primary responsibility of a debtor in bankruptcy, and many times in the context of a bankruptcy case, a debtor ultimately determines that a sale pursuant to Section 363 of the Bankruptcy Code is the best way to meet that goal. Pursuant to Section 363(b)(1) of the Bankruptcy Code, a “trustee, after notice and an hearing, may ... sell ... other than in the ordinary course of business, property of the estate.”¹ Identifying all tangible and intangible assets and their respective values in the market place is a key component in any successful sale process. In some cases, the debtor's interest in prejudgment litigation may be one of the debtor's most valuable assets but conveying the interest in that litigation may be problematic in the context of a Section 363 sale.²

¹ 11 U.S.C. 363(b)(1).

² See *Integrated Solutions, Inc. v. Service Support Specialties, Inc. (In re Integrated Solutions)*, 124 F.3d 252 (3d Cir. 1997) (holding purported purchaser of prejudgment tort claims from a Chapter 7 trustee estate did not have standing to prosecute such claims because New Jersey law prohibited assignment of prejudgment tort claims and was not preempted by the Bankruptcy Code).

However, the ruling by the United States Bankruptcy Court for the District of Delaware in the Alabama Aircraft Industries bankruptcy case and the subsequent recent rulings on appeal may have provided a blueprint of how a debtor may effectively convey its interest in prejudgment litigation notwithstanding state-law restrictions.

The Chapter 11 Cases, the Proposed Sale and Litigation Trust Agreement

Alabama Aircraft Industries, the debtors, were an aerospace and defense company whose primary business was providing aircraft maintenance and modification services to the United States Government, including complete airframe inspection, maintenance, repair and custom airframe design and modification. They specialized in providing programmed depot maintenance on large transport, tanker and patrol aircraft. On February 15, 2011, due to a maturing secured debt and an unsuccessful attempt to reach an agreement to modify their collective bargaining agreement, the debtors filed voluntary petitions for relief under Chapter 11 of the Bankruptcy Code.

Prior to and during the bankruptcy cases, the debtors continued to look for capital investments in an attempt to reorganize. However, those efforts were also unsuccessful, and the debtors ultimately determined that a sale of substantially all of their assets pursuant to Section 363 of the Bankruptcy Code would maximize value and was in the best interest of their estates and their creditors. After an extensive marketing process, the debtors entered into an asset purchase agreement (“APA”) with Kaiser Aircraft Industries Inc. (“Kaiser”), pursuant to which the debtors agreed to sell Kaiser substantially all of their operating assets for \$500,000. In addition, pursuant to the APA, the parties entered into an agreement (the “Litigation Trust Agreement”) that established a litigation trust (the “Litigation Trust”), in which Kaiser and the debtors each would have a beneficial interest. The Litigation Trust was established to pursue certain causes of action that the debtors and their estates potentially had

against other third parties, most notably, prejudgment contract and tort law claims that the debtors potentially had against Boeing Company (“Boeing”) as a result of a prepetition business relationship.

Pursuant to the Litigation Trust Agreement, Kaiser would fund the prosecution of the litigation and would receive 90% of any recoveries with the other 10% going to the debtors' estates, up to a maximum of \$30 million. Kaiser's beneficial interest in the Litigation Trust was considered a Purchased Asset under the APA.

Pursuant to the terms of the Litigation Trust Agreement, a trustee and oversight committee would be appointed with the trustee having fiduciary obligations to the debtors and Kaiser as the beneficiaries of the Litigation Trust.

Boeing and United States Trustee Objection

Boeing argued, among other things, that the assignment of prejudgment litigation was prohibited under the applicable state law, and therefore, the establishment of the Litigation Trust, which amounted to a sale or assignment of a prejudgment litigation, was prohibited under *In re Integrated Solutions*. In addition, Boeing also argued that there was no authority in the Bankruptcy Code to create such a trust and vest it with estate causes of action other than in the context of a Chapter 11 plan pursuant to Section 1123(b)(3)(B) of the Bankruptcy Code and that to permit the establishment of the Litigation Trust was the equivalent of a sub rosa plan.

The United States Trustee for the District of Delaware (the “Trustee”) joined in the objection also arguing that the establishment of the Litigation Trust should be done through a Chapter 11 plan and not through a pre-plan Section 363 sale.

Alabama Aircraft Industries and Kaiser Response

The debtors and Kaiser argued, among other things, that this was neither a “sale” nor an “assignment” of the prejudgment causes of action, but rather, was simply a delegation or vesting of the debtors' rights to pursue certain causes of action to the Litigation Trust with Kaiser holding an interest in some of the recovery. Thus, the debtors and Kaiser argued that *In re Integrated Solutions* was not applicable in this case. Instead, the debtors and Kaiser argued that this was an appropriate “use” of the debtors' property pursuant to Section 363(b) of the Bankruptcy Code and was analogous to *In re Cybergenics Corp.*, where the Third Circuit ruled that it was within the bankruptcy court's equitable powers under Section 105(a) of the Bankruptcy Code to grant a non-debtor party (there, a creditors' committee) derivative standing to bring avoidance actions on behalf of the estate when the debtor unreasonably refused to pursue them.³ In essence, the debtors and Kaiser argued that the debtors' inability to bring the cause of action on behalf of their estates (for want of funding) could serve as the basis of a grant of derivative standing to the Litigation Trust under *In re Cybergenics Corp.*

³ 330 F.3d 538, 580 (3d Cir. 2003).

The proposed sale to Kaiser was also supported by the creditors' committee who argued that the Litigation Trust preserved the debtors' institutional knowledge necessary to prosecute any claims because many of the employees were being retained as part of the sale and because it provided for the requisite funding of the litigation by Kaiser.

The Bankruptcy Court and District Court Rulings

At the conclusion of an evidentiary hearing and oral argument, The Honorable Peter J. Walsh, ruling from the bench, granted the sale motion and entered an order (the “Sale Order”) approving the sale. In relevant part, paragraph K of the Sale Order provided:

The establishment of the Litigation Trust pursuant to the terms of the APA and the Litigation Trust Agreement is a fair and appropriate use of the Debtors' property.

Sale Order, Paragraph K on page 6.

In addition, pursuant to the Sale Order, Judge Walsh also found that Kaiser was a good faith purchaser and was entitled to the protections of Section 363(m).⁴ Specifically, paragraph L of the Sale Order provided:

⁴ Section 363(m) provides:

The reversal or modification on appeal of an authorization under subsection (b) or (c) of this section of a sale or lease of property does not affect the validity of a sale or lease under such authorization to an entity that purchased or leased such property in good faith, whether or not such entity knew of the pendency of the appeal, unless such authorization and such sale or lease were stayed pending appeal.

The APA and all ancillary documents thereto, including, without limitation, the Litigation Trust Agreement, were negotiated and proposed, and have been entered into by the parties in good faith within the meaning of Section 363(m) of the Bankruptcy Code, at arm's length bargaining positions, and without collusion; the Purchaser is a good faith purchaser within the meaning of Section 363(m) of the Bankruptcy Code and entitled to the protections thereof ...

Sale Order, Paragraph L on page 6.

In response to the argument made by Boeing and the Trustee that a litigation trust had never been done outside of a plan, the Bankruptcy Court pointed out that there was precedent for such in *In re Cybergenics*. Boeing's oral motion before Judge Walsh for a stay of the sale order pending appeal was denied.

Boeing subsequently appealed the sale order to the District Court of Delaware (the "District Court") but neither sought nor obtained a stay pending the appeal. Kaiser moved to dismiss Boeing's appeal arguing that it was moot under Section 363(m). On January 17, 2012, the District Court issued an opinion and order ruling in favor of Kaiser and dismissed the appeal.⁵ In dismissing the appeal, the District Court ruled that it was clear from the Sale Order and from the transcript that the Bankruptcy Court intended to provide Section 363(m) protection to Kaiser, and that this was actually a sale of the beneficial interest in the prejudgment litigation against Boeing. The District Court further ruled that even if the establishment of the Litigation Trust could be characterized as a "use" of estate property rather than a sale, that there was ample support in the Third Circuit for the proposition that Section 363(m) protection is appropriate when the transaction is an integral part of the sale whether or not the transaction itself is a sale under Section 363.⁶ Boeing appealed the District Court's ruling to the Third Circuit arguing that the debtor could not take inconsistent positions by, on the one hand, arguing that the Litigation Trust structure was not an impermissible "sale" of a prejudgment litigation action, while on the other hand, seeking protections under Section 363(m) afforded in a sale context. Accordingly, Boeing asked the Third Circuit to reverse the vesting of the prejudgment causes of action in the Litigation Trust, or in the alternative, to vacate the District Court's dismissal of Boeing's appeal and remand for consideration whether the creation of the Litigation Trust was proper could be revisited.

⁵ See *In re Alabama Aircraft Industries*, 464 B.R. 120, 123-26 (D. Del. 2012).

⁶ *Id.* at 124, citing, *Cinicola v. Scharffenberger*, 248 F.3d 110, 125-26 (3d Cir. 2001) (providing assumption and assignment of employment contracts Section 363(m) protection because they were "inextricably intertwined" with the debtor's asset sale).

Third Circuit Ruling and Analysis

The Third Circuit panel, in an unreported opinion, agreed with the District Court's reasoning.⁷ The Court ruled that an appeal of an order approving a sale may be dismissed as moot if (i) the sale was not stayed pending appeal and (ii) reversal or modification of the sale order would affect the validity of the sale.⁸ Here, the Third Circuit held that Boeing did not seek a stay of the Sale Order pending appeal and that the value of the assets purchased by Kaiser would be affected if the prejudgment causes of action against Boeing were carved out of the sale.⁹ Accordingly, the Third Circuit dismissed the appeal as moot.

⁷ See *In re Alabama Aircraft Industries*, No. 12-1290 2013 BL 58127 (3d Cir. March 5, 2013)(16 MALR 439, 3/18/13).

⁸ *Id.* at *1.

⁹ *Id.* at *2.

Although this was an unreported opinion issued by the Third Circuit panel, it gives some insight as to at least some members of the Court's broad application of the mootness doctrine to include not just sale transactions, but also other transactions which are integral to the sale itself. In addition, and more importantly, the panel's implicit blessing of Judge Walsh's *Cybergenics* type solution possibly creates a blueprint for debtors to convey non-assignable causes of action and potentially other non-assignable claims in the context of a Section 363 sale.

General Information

Topic

Bankruptcy Law; Transportation Law