

**THIRD CIRCUIT HOLDS SALES OF ASSETS IN CHAPTER 11 CASES  
ARE FREE OF SUCCESSOR LIABILITY**

PETER PANTALEO  
MARK THOMPSON  
STEVE FUHRMAN  
KENNETH ZIMAN  
MIKE SIGAL  
KATHRINE MCLENDON  
SIMPSON THACHER & BARTLETT LLP

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**INTRODUCTION**

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On March 13, 2003, the United States Court of Appeals for the Third Circuit held that sales of assets in bankruptcy cases can be free and clear of successor liability.<sup>1</sup>

*In re Trans World Airlines Inc.* will have important implications because many large Chapter 11 bankruptcy cases involving the sale of assets by debtors are filed within the Third Circuit, which includes Delaware. With this decision, the court has given greater clarity and certainty to purchasers of assets from bankrupt companies that they will not suffer successor liability, which should, in turn, encourage more and higher bids for the assets being sold.

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**BACKGROUND**

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In 1995, lawsuits filed against Trans World Airlines (“TWA”) contending that TWA’s former maternity leave of absence policy for flight attendants constituted sex discrimination in violation of Title VII of the Civil Rights Act of 1964, as amended, were settled under a court-approved settlement. The terms of the settlement required TWA to provide ten travel vouchers for each covered pregnancy to each eligible member of the plaintiffs in the class-action suit (the “Travel Voucher Program”). Most flight attendants elected to save the vouchers for trips to be taken after retirement.

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<sup>1</sup> *In re Trans World Airlines, Inc.*, No. 01-788 (3<sup>rd</sup> Cir. 3/13/2003).

In addition to the above suits, twenty-nine charges of discrimination had been filed against TWA with the Equal Employment Opportunity Commission (“EEOC”). The charges alleged various violations of several federal employment discrimination statutes. The appellants, the EEOC and the United States asserted that they were unable to estimate the value, if any, of these claims.

The EEOC and Travel Voucher Program claimants were the appellants in the case discussed in this memorandum. TWA filed a Chapter 11 bankruptcy petition on January 10, 2002; on January 3, 2002, American Airlines (“American”) agreed to purchase substantially all of its assets, subject to an auction and Bankruptcy Court approval. American expressly did not assume TWA’s obligations to the EEOC or the Travel Voucher Program claimants. The Bankruptcy Court order approved the proposed sale of assets over the objections of the appellants. The appellants then appealed the order to a District Court, which affirmed the Bankruptcy Court’s decision. This bankruptcy case was an appeal of the District Court’s order affirming the Bankruptcy Court’s sale order.

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### ANALYSIS

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The dispute in the case centered on the meaning of the phrase “interest in such property” (hereinafter “interest in property”) in Section 363(f) of the Bankruptcy Code. That section permits the sale of property “free and clear of any interest in such property of an entity other than the estate.” The appellants asserted that the Travel Voucher Program and the pending EEOC charges were improperly extinguished by the sale order, since those were not interests in property within the meaning of the Bankruptcy Code section. Instead, they argued, the interest in property under the Code section meant items such as liens, mortgages, money judgments or writs of garnishment, and could not include successor liability claims arising under federal anti-discrimination statutes and judicial decrees implementing those statutes.

In disagreeing with the appellants, the Court stated that since Congress did not explicitly indicate any intent to limit the scope of Section 363(f) to *in rem* interests, narrowly defined, the Court was disinclined to adopt such a restrictive reading.<sup>2</sup> Instead, the term “any interest” is intended to refer to obligations that arise from the property being sold. In this case, the assets of TWA gave rise to the claims. Had TWA not invested in airline assets, which required the employment of the EEOC claimants, those successor liability claims would not have arisen. Furthermore, TWA’s investment in commercial aviation was inextricably linked to

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<sup>2</sup> The Court drew analogies to the Fourth Circuit’s decision in *In re Leckie Smokeless Coal Co.*, 99 F.3d 573 (4<sup>th</sup> Cir. 1996), in which the Fourth Circuit held that, under Section 363(f), the bankruptcy court could properly extinguish all successor liability claims against the purchasers of the debtors’ assets arising under the Coal Act by entering an order transferring the assets free and clear of those claims, regardless of whether the purchasers were successors in interest.

its employment of the Travel Voucher Program claimants as flight attendants. Thus, while it was true that the claims were not *in rem* interests, they were interests in the property within the meaning of Section 363(f) in the sense that they arose from the assets being sold.

In addition, the court agreed with the Bankruptcy Court that, because both the EEOC and Travel Voucher Programs claims were subject to monetary valuation, the fifth of five possible conditions had been satisfied for a sale free and clear of an interest in property under Section 363(f). Had TWA's assets been liquidated, the claims would have been converted to dollar amounts and the claimants would have received the distribution provided to other general unsecured creditors on account of their claims.

Other considerations also factored in the Court's decision. The Court stated that the statutory priority scheme of the Bankruptcy Code supported the transfer of TWA's assets free and clear of the appellants' claims. While citing previous cases, the court stated that although the EEOC and Travel Voucher claims were general unsecured claims, in the context of a bankruptcy, they were to be accorded low priority. To allow such claimants to assert successor liability claims against the purchaser while limiting other creditors' recourse to the proceeds of the asset sale would be inconsistent with the priority scheme of the Bankruptcy Code.

Moreover, stated the Court, absent the order providing for a sale of TWA's assets free and clear of the claims, American would likely have offered a discounted bid. This would have been especially true given that the EEOC was unable to estimate the number of claims it would pursue or the damages it would seek. In the absence of a sale of TWA's assets, the EEOC would have been relegated to holding an unsecured claim in what was likely to be a piece-meal liquidation of TWA; the claims would have been unlikely to have any value at all in such a context.

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#### SUMMARY

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While Congress did not explicitly define "interest in property" in Section 363(f) of the Bankruptcy Code, the Third Circuit read the phrase broadly to authorize a bankruptcy court to bar any interest that could potentially travel with the property being sold, even if the asserted interest is unsecured. By diminishing the risk of successor liability in asset purchases in bankruptcy, the Court gave greater clarity and certainty to buyers, which should in turn produce more and higher bids for those assets.

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If you have any questions or comments concerning the *In re Trans World Airlines, Inc.* decision, please do not hesitate to contact any of the following Simpson Thacher & Bartlett attorneys: Peter Pantaleo (212-455-2220; ppantaleo@stblaw.com), Mark Thompson (212-455-7355; mthompson@stblaw.com), Steve Fuhrman (212-455-7235; sfuhrman@stblaw.com),

Kenneth Ziman (212-455-2565; kziman@stblaw.com), Mike Sigal (212-455-7140; msigal@stblaw.com) and Kathrine McLendon (212-455-2589; kmclendon@stblaw.com).

SIMPSON THACHER & BARTLETT LLP