LIMITATIONS TO BANKRUPTCY ALTERNATIVES: SUCCESSOR LIABILITY, THE UNIFORM FRAUDULENT TRANSFER ACT, PIERCING THE CORPORATE VEIL, AND PERSISTENT LIABILITIES.[1]

Rafael X. Zahralddin-Aravena[2]

Elliott Greenleaf, Wilmington, Delaware

[1] Prepared with the able research and editing of Andrew Mirisis and Phil Giordano of Elliott Greenleaf in Wilmington, Delaware.

[2] Managing Shareholder, Elliott Greenleaf, Wilmington, Delaware.

I. Introduction

Whether entities facing insolvency, or which are insolvent, seek recourse through a bankruptcy alternative,[3] or through the United States Federal Bankruptcy Code, a constant is a process which seeks to satisfy liabilities through remaining assets of the entity, if any, and often through a transfer of assets. Hanging over the process is the possibility that the liabilities will not be extinguished. An aggrieved party will seek redress from either those associated with the entity in trouble or whoever has acquired the assets. These issues can arise in corporate or alternative entity dissolutions and wind-downs, in addition to arising under a state law receivership or assignment for the benefit of creditors.

Causes of action that are used in response to the actions of an insolvent entity revolve around issues of successor liability, allegations of fraudulent transfers and through the use of traditional corporate law theories such as piercing the corporate veil. Certain types of claims are also resilient and render parties susceptible to liability if care is not taken.

Though the bankruptcy process is the more conservative route, and one which brings more comfort that liabilities will be extinguished, or satisfied, even in a traditional § 363 sale, or in the context of a reorganization, recent decisions have carved out circumstances in which successor liability might survive even in the safety of a bankruptcy sale or plan.

II. Successor Liability

The concept of successor liability is a judicially crafted exception to the general rule that the sale or transfer of a corporation's assets to another corporation generally does not bring with it liability for the liquidated or unliquidated debts of the selling corporation. *See* 15 FLETCHER CYC. OF THE LAW OF CORPORATIONS § 7123 (2008). Under the law of the Third Circuit and the

[3] Common alternatives are an assignment for the benefit of creditors, a state or federal receivership or a consensual or Court mandated wind-down.

law of most states, Courts recognize four[4] exceptions where a purchaser of assets may be held liable for the debts of, or claims against, the seller:

(1) there is an expressed or implied assumption of liability;

(2) the transaction amounts to a consolidation, merger or similar restructuring of the two business entities;

(3) the successor is a mere continuation of the predecessor; or

(4) the transaction is a fraudulent attempt to avoid the liabilities of the predecessor. *Conway v. White Trucks*, 885 F.2d 90, 93 (3d Cir. 1989); *See, e.g. Philadelphia Elec. Co. v. Hercules Inc.*, 762 F.2d 303, 308-09 (3d Cir. 1985); *Knapp v. North American Rockwell Corp.*, 506 F.2d 361, 363-64 (3d Cir. 1974).

Determining which of the four exceptions a successor liability claim might fall under is fact driven and there are scenarios in which a successor liability claim could fall into more than one category. Two of the four scenarios have received special attention in the case law, the continuation of corporate successor liability and the de facto merger.

First, the continuation theory of corporate successor liability has been construed narrowly by Delaware Courts. *Ross v. DESA Holdings Corp.*, C.A. No. 05C-05-013, 2008 WL 4899226, at *4 (Del. Super. Ct. Sept. 30, 2008). "Mere continuation requires that the new company be the same legal entity as the old company." *Id.* "Imposition of successor liability is appropriate only where the new entity is so dominated and controlled by the old company that separate existence must be disregarded." *Id.*

[4] A possible fifth ground for successor liability is the "product line" theory, where a buyer that acquires a manufacturing business and continues the output of its line of products assumes strict tort liability for defects in units of the same product line previously manufactured and distributed by the entity from which the business was acquired. *See Ray v. Alad Corp.*, 560 P.2d 3, 11 (Cal. 1977).

The Delaware District Court has noted that despite the lack of a clear test on the continuation theory, "[t]here are common factors that courts have consistently relied upon in the analysis, and these have included common identity of ownership and control such as common stockholders and directors, common officers, adherence to common business plans, and sameness of product lines." *U.S. v. Chrysler Corp.* C. A. Nos. 88-341; 88-534, 1990 WL 127160, at *5 (D. Del. Aug. 28, 1990) (citing *Tucker v. Paxson Machine Co.,* 645 F.2d 620, 625-26 (8th Cir.1981); *Michigan v. Thomas Solvent Co.*, 725 F.Supp. 1446, 1458 (W.D. Mich.1988); *United States v. Vertac Chem. Corp.,* 671 F.Supp. 595, 614-15 (E.D. Ark. 1987), *vacated and remanded on other grounds,* 855 F.2d 856 (8th Cir. 1988)).

If the sale between the seller and the buyer is an arm's length transaction between the parties, this is evidence that the entity is not a mere continuation. *Fountain v. Colonial Chevrolet Co.*, 1988 WL 40019, at *9 (Del. Super. Ct. April 13, 1988). If a company still operates under the same name, evidence that the selling price included the business name and equipment would dispel suspicions that the entities were in fact the same. *Id.* Keeping the same personnel, even insiders as consultants, also would fail to prove continuation if the aim was "to effectuate a smooth transition of management, to lend expertise to the buyers, to aid buyers in meeting their business obligations, to meet customers and continue business contracts." *Id.*

Second, if there is a judicial determination that a transaction, although portrayed as a sale of assets by the parties, is in fact a merger, the so-called de facto merger may create transferee liability where none would have otherwise existed. *Greenway Center, Inc. v. Essex Ins. Co.*, C.A., No. 08-3724, 2010 WL 827836, at *3 (3d Cir. March 11, 2010). *See also Western Res. Life Ins. Co. v. Gerhardt*, 553 S.W.2d 783, 786-787 (Tex. App. 1977). If transferee liability for claims against the transferor exists, it may be limited to the value of the assets received from the transferor, under a trust fund theory. *Kinsella v. Marquette-Easton Fin. Corp.*, 28 S.W.2d 427, 429 (Mo. Ct. App. 1930). However, other Courts, do not limit the transferee's liability. In the case of a tort claim, if transferee liability exists, it extends to punitive or exemplary damages. *Western Res. Life Ins. Co. v. Gerhardt*, 553 S.W.2d at 787. All defenses that would have been available to the transferor corporation, such statute of limitations, are equally available to the transferee. *See Equifax Serv., Inc. v. Hitz*, 905 F.2d 1355, 1361 (10th Cir. 1990) (applying Kansas contract law and explaining that in the context of a merger, the surviving corporation succeeds to the rights of the merged corporation).

Notably the Third Circuit, apparently applying federal common law, but borrowing from the law of Pennsylvania, has held that "acquisition of small, privately-held battery manufacturer by the purchasing corporation constituted a de facto merger so as to render purchaser and its successor responsible under Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) for liability of battery manufacturer." *United States v. Gen. Battery Corp., Inc.*, 423 F.3d 294, 305 (3d Cir. 2005) ("The majority standard generally tracks the inquiry under Pennsylvania law.").

The *General Battery* Court held that there are four elements under the majority standard for the de facto merger rule:

(1) There is a continuation of the enterprise of the seller corporation, so that there is a continuity of management, personnel, physical location, assets, and general business operations.

(2) There is a continuity of shareholders which results from the purchasing corporation paying for the acquired assets with shares of its own stock, this stock

ultimately coming to be held by the shareholders of the seller corporation so that they become a constituent part of the purchasing corporation.

(3) The seller corporation ceases its ordinary business operations, liquidates, and dissolves as soon as legally and practically possible.

(4) The purchasing corporation assumes those obligations of the seller ordinarily necessary for the uninterrupted continuation of normal business operations of the seller corporation.

General Battery Corp., Inc., 423 F.3d at 305 (citing *Bud Antle, Inc. v. Eastern Foods, Inc.*, 758 F.2d 1451, 1457-58 (11th Cir. 1985) (stating the "majority" de facto merger standard)); *Keller v. Clark Equip. Co.*, 715 F.2d 1280, 1291 (8th Cir. 1983) (same)); *see also* 15 FLETCHER CYC. OF THE LAW OF CORPORATIONS § 7124.20, at 302 (stating majority rule and collecting cases).

Foreclosures can be very vulnerable to successor liability claims. *See Continental Ins. Co. v. Schneider, Inc.*, 873 A.2d 1286, 1293-94 (2005). The Supreme Court of Pennsylvania, summarizing the majority rule in the United States, has stated that there is *no safe harbor* under a sale under 9-505 of the UCC for a purchaser from successor liability. *Id.* The Court quoted with approval the Courts of North Carolina which stated that a "'successor liability claim is not *absolutely* barred where a secured creditor purchases the debtor's assets via Article 9 . . . ,' thereby rejecting the plaintiff's argument that section 9-504 'necessarily preempts a mere continuation claim because the very purpose of conducting such a sale is to extinguish all inferior interests and convey title free of all claims or encumbrances.'" *Id.* (quoting *G.P. Publ'ns, Inc. v. Quebecor Printing-St. Paul, Inc.*, 481 S.E.2d 674, 679-80 (N.C. Ct. App. 1997) (emphasis in original)).

Courts in Pennsylvania and New York have held that a foreclosure sale does not preclude imposition of successor liability. *See Miller v. Forge Mench Partnership Ltd.*, No. 00 Civ. 4314, 2005 WL 267551, at *7-14 (S.D.N.Y. 2005) (holding that the purchasing company can be held liable on the assets purchased in a foreclosure where the purchasing company and selling company conducted a de facto merger and the succeeding company was merely a continuation of the first). The Pennsylvania Supreme Court has held that the purchaser can be liable if it is established to be a "mere continuation" of the predecessor company. *See Continental Ins. Co.*, 873 A.2d at 1294. A foreclosure sale by itself simply does not extinguish potential successor liability claims. *Id.*

II. Uniform Fraudulent Transfer Act

Successor liability claims are often paired with alleged violations under a state law adaptation or adoption of the Uniform Fraudulent Transfer Act ("UFTA"),[5] such as the Delaware Uniform Fraudulent Transfer Act ("DUFTA"). Some typical factual scenarios that give rise to a successor liability claim mirror those for a claim under UFTA. For instance, a violation of DUFTA by transferring the assets of company A into company B to avoid liability, while the successor company B is a mere continuation of company A, as all of the assets were transferred, and company B retained the same management as company A, could trigger both exceptions three and four noted above as well as a fraudulent conveyance claim. *See* DEL. CODE ANN. tit. 6, § 1305.

DUFTA finds a fraudulent conveyance if the debtor made the transfer or incurred the obligation with "intent to hinder, delay or defraud any creditor of the debtor;" or "[w]ithout receiving a reasonably equivalent value in exchange for the transfer or obligation." DEL. CODE

[5] The Uniform Fraudulent Transfer Act ("UFTA"), adopted by the National Conference of Commissioners on Uniform State Laws in 1984, was enacted by most of the states.

ANN. tit. 6 §§ 1304(a)(2) and 1305(a); *see also In re Hechinger Inc. Co. of Del.*, 327 B.R. 537, 551 (D. Del. 2005); *China Res. Prods. (U.S.A.) v. Fayda Int'l, Inc.*, 856 F. Supp. 856, 863 (D. Del. 1994); *In re MDIP, Inc.*, 332 B.R. 129, 132 (Bankr. D. Del. 2005). The debtor must also be engaged or about to engage in a business or a transaction for which the remaining assets of the debtor were "unreasonably small in relation to the business or transaction," or intended, had a belief, or should have believed, that the debtor would "incur, debts beyond the debtor's ability to pay as they became due." *In re MDIP, Inc.*, 332 B.R. at 132. If a creditor prevails on a claim under the DUFTA, the statute empowers the Court to appoint a receiver to take charge of the transferred asset or other property of the transferee. DEL. CODE ANN. tit. 6 § 1307(a).

Notably, intent under DUFTA can be found if the transfer or obligation was to an insider, if the debtor retained possession or control of the property transferred after the transfer, the transfer was of substantially all the debtor's assets, the debtor removed or concealed assets, the debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred, the transfer occurred shortly before or shortly after a substantial debt was incurred, or the debtor transferred the essential assets of the business to a lienor who transferred the assets to an insider of the debtor. DEL. CODE ANN. tit. 6 § 1304(b). All of these facts, if present, would be useful in framing a successor liability claim as well.

III. State Corporate Law - The Delaware General Corporation Law ("DGCL")

Often paired with a general successor liability claim and a fraudulent transfer claim, successor liability claims also arise where a creditor seeks to pierce the corporate veil and impose liability on a parent corporation, or the principals of the parent corporation for the acts of the parent's subsidiary. *See*, *e.g.*, *Trustees of Nat. Elevator Indus. Pension, Health Benefit and Educ. Funds v. Lutyk*, 332 F.3d 188, 192 (3d Cir. 2003).

Piercing the corporate veil is an appropriate equitable remedy, but a difficult hurdle under Delaware law as noted by Vice Chancellor Noble: "[P]ersuading a Delaware Court to disregard the corporate entity is a difficult task. The legal entity of a corporation will not be disturbed until sufficient reason appears." *Mason v. Network of Wilmington, Inc.*, C. A. No. 19434, 2005 WL 1653954, at *2 (Del. Ch. July 1, 2005) (quoting *David v. Mast,* 1999 WL 135244, at *2 (Del. Ch. Mar. 2, 1999) (internal quotations omitted)). The Vice Chancellor went on further to say: "Corporate form will be disregarded and individuals will be held personally liable 'in the interest of justice, when such matters as fraud, contravention of law or contract, public wrong, or where equitable consideration among members of the corporation require it, are involved.'" *Id.* (quoting *Pauley Petroleum Inc. v. Continental Oil Co.,* 239 A.2d 629, 633 (Del. 1968)). This analysis is also known as the "alter ego" analysis, because the Court determines whether there are legally distinct entities involved in the transaction or not. *Id.* (citing *e.g., Trustees of the Village of Arden v. Unity Constr. Co.,* C.A. No. 15025, 2000 WL 130627 (Del. Ch. Jan. 26, 2000)).

Vice Chancellor Noble also quotes from the Delaware District Court which discusses the various factors used under a federal common law analysis of the veil piercing argument. Federal common law has developed for the alter ego analysis because of its application in federal question and diversity cases, notably in environmental and labor disputes.

His discussion is useful because it highlights several factors which would assist in claim of successor liability against a purchaser or against prior insiders. *Id.* at *3 (citing *United States v. Golden Acres, Inc.,* 702 F.Supp. 1097, 1104 (D. Del. 1988)). Essentially, the analysis "must start with an examination of factors which reveal how the corporation operates and the particular defendant's relationship to that operation." *Id.* Adequate capitalization, payment of dividends, corporate record keeping, the manner in which officers and directors functioned, and whether corporate formalities were observed, and especially abuses by an insider as to corporate funds and the use of the corporation "as a facade for the" insider are all relevant factors under the analysis. *Id.* The biggest difference in the analysis between the federal common law and Delaware law was the requirement of "an element of fraud to pierce the corporate veil." *Id.*[6]

IV. Certain Resilient Surviving Liabilities

Although in the context of a § 363 sale of assets under the Bankruptcy Code or confirmation of a plan of reorganization, there is a differentiation between tort claims and other claims (as noted below), Delaware state law does not distinguish between the type of claim. As long as the particular liability claim would fall within one of the four exceptions previously stated in subsection I, it can be brought against a successor entity. While this list of liabilities is illustrative and not exhaustive, these particular liabilities have been heavily litigated and discussed under successor liability theories.

A. Tort

Where a company is wound down pursuant to the DGCL, it remains liable to tort claim, provided that the tort claimant brings his or her cause of action within three years of the dissolution. *Virgin Islands v. Goldman, Sachs & Co.*, 937 A.2d 760, 767 (Del. Ch. 2007). Absent compliance with the statute, a claimant would be prohibited from asserting a claim against the dissolved corporation. Delaware Courts have imposed successor liability upon asset-acquirers in product liability cases. *See Corporate Property Associates 8, L.P. v. Amersig Graphics, Inc.*, C. A. No. 13241, 1994 WL 148269, at *4-5 (Del. Ch. March 31, 1994). However, in Delaware it is an open question as to whether successor liability is only applicable

[6] "'Piercing the corporate veil under the alter ego theory requires that the corporate structure cause fraud or similar injustice. Effectively, the corporation must be a sham and exist for no other purpose than as a vehicle for fraud.'" *Id.* quoting *Wallace ex rel. Cencom Cable Income Partners II, Inc., L.P. v. Wood,* 752 A.2d 1175, 1184 (Del. Ch.1999).

to tort claimants. *See*, *e.g.*, *id.* (explaining that if the asset transfer between Company A to Company B fell within any of the four categories cited in *Knapp v. North American Rockwell Corp.,* 506 F.2d 361, 363-64 (3d Cir.1974), the claimant would hypothetically have a cause of action); *Mason v. Network of Wilmington, Inc.*, 2005 WL 1653954, at *5, n.43.

B. Employment Discrimination

The Third Circuit has repeatedly held that in employment discrimination cases "the doctrine of successor liability applies where the assets of the defendant-employer are transferred to another entity." *Rego v. ARC Water Treatment Co. of Pennsylvania*, 181 F.3d 396, 401 (3d Cir. 1999). As a result, an aggrieved employee may enforce a claim or judgment against a successor that would have been valid against the predecessor. *Id.* The Court noted that the doctrine is derived from equitable principles, and fairness is the overriding consideration in its application. *Id.* (citing *Criswell v. Delta Air Lines, Inc.*, 868 F.2d 1093, 1094 (9th Cir.1989)).

In *Rego,* the Third Circuit listed three principal factors applicable to successor liability in the employment discrimination field: "(1) continuity in operations and work force of the successor and predecessor employers; (2) notice to the successor-employer of its predecessor's legal obligation; and (3) ability of the predecessor to provide adequate relief directly." *Id*. at 402. If these factors are satisfied, equitable considerations require the Court to apply the doctrine. *Id. See also NLRB v. Burns Int'l Sec. Servs., Inc.*, 406 U.S. 272, 277-81 (1972) (holding that a prevailing competitive bidder which hired a substantial complement of the prior employer's workers was a "successor employer" for purposes of duty to bargain); *Brzozowski v. Correctional Physician Services, Inc.*, 360 F.3d 173, 178 (3d Cir. 2004) (reaffirming and expounding on *Rego*); *See, e.g., Rojas v. TK Commc'n, Inc.*, 87 F.3d 745, 750 (5th Cir. 1996) (discussing successor liability in the Title VII context); *EEOC v. G-K-G, Inc.*, 39 F.3d 740, 748-

749 (7th Cir.1994) (same); *Slack v. Havens*, 522 F.2d 1091, 1094-1095 (9th Cir. 1975) (same); *Trujillo v. Longhorn Mfg. Co., Inc.*, 694 F.2d 221, 224-225 (10th Cir. 1982) (same); *In re Nat'l Airlines, Inc.*, 700 F.2d 695 (11th Cir. 1983) (same).

C. Medicare/Medicaid Provider Agreements

Section 363(f) of the Bankruptcy Code provides that the debtor may sell property "free and clear of any interest in such property" if certain conditions are present, such as (i) the property is to be sold at a price greater than the value of the liens on the property, (ii) the secured creditor's lien is in bona fide dispute, or (iii) the secured creditor or other "interest holder" could be compelled in a legal or equitable proceeding to accept a money satisfaction of such interest. 11 U.S.C. § 365(f). The Third Circuit has held that Medicare/Medicaid provider numbers cannot be sold free and clear of liabilities because provider agreements under 42 C.F.R. § 489.18 are required to be assigned subject to the Medicare/Medicaid regulations and also because they are executory contracts, such that a transfer of the agreement requires the "cure" of defaults. *See, e.g. In re Universal Med. Ctr.*, 973 F.2d 1065, 1075 n.13 (3d Cir. 1992) (explaining that Medicare provider agreement "easily fits" within the definition of an executory contract).

The holding of *In re Universal Medical Center* can be circumvented if the agreement to sell a hospital is conditioned upon assumption and assignment of the Medicare provider agreements free and clear of any claims. *See In re Charter Behavioral Servs.*, 45 Fed. Appx. 150 (3d Cir. 2002). In *In re Charter Behavioral Servs.*, the debtor reached out to the claimants beforehand, and the claimants agreed to waive successor liability rights against the purchaser. Thus, the purchaser could begin operating without fear of set-off for the seller's past liabilities. In *United States v. Pisani,* 646 F.2d 83, 88-89 (3d Cir. 1981), the Court used the federal common law of veil piercing in action to recover Medicare overpayments to a corporation owned by a doctor directly from the doctor. The Court specifically refused to adopt the state law of New Jersey, which like Delaware, would have required a showing of fraud. *Id.* at 87-88.

V. New Limits on the Bankruptcy Code Protections under §363 and Under a Plan

A. Section 363 Sales

A distressed company that sells its assets to a successor company under § 363(b) of the Bankruptcy Code is permitted to convey those assets "free and clear," thereby maximizing value by removing the uncertainty of successor liability, fraudulent transfer claims and lien issues that often accompany asset purchases outside of bankruptcy. Further, §363(f) of the Bankruptcy Code provides for a sale free and clear of "interests in such property." Accordingly, the Bankruptcy Court's ability to extinguish successor liability under 11 U.S.C. § 363 is limited by the scope of the phrase "interests in property," however the definition of "interests" under § 363 is not a settled issue.

The Third Circuit has held that "interests" as used in § 363(f) of the Bankruptcy Code has not been limited to liens and includes "obligations that are connected to, or arise from, the property being sold." *In re Trans World Airlines*, 322 F.3d 283, 289 (3d Cir. 2003). Arguably, this would include *in personam* claims and equitable rights. For example, Courts have upheld limiting successor liability for diverse categories of general unsecured claims, including intellectual property rights, leasehold interests, future pension obligations, personal injury actions and product liability claims. *See*, *e.g.*, *id.* at 289-90 (citing *In re All American of Ashburn, Inc.*, 56 B.R. 186, 190 (Bankr. N.D. Ga.1986) (products liability claims); *In re Leckie Smokeless Coal Co.*, 99 F.3d 573 (4th Cir.1996) (employment benefit plans)).

Conversely, other jurisdictions, such New York, have limited the scope of "interests" extinguishable under section 363(f) to a narrower category of claims, excluding from its scope certain in personam claims and equitable rights or defenses of third parties. *See In re Oyster Bay Cove*, 196 B.R. 251, 255 (E.D.N.Y. 1996) ("'Free and clear' should be interpreted as speaking of interests against the property, such as liens or mortgages, which now attached to the proceeds of the sale."). In *In re Chrysler LLC*, 405 B.R. 84, 111 (Bankr. S.D.N.Y. 2009) the Court held that both *in personam* and *in rem* actions held by claimants were extinguished by the Court's sale order, and all of the assets were sold free and clear of those interests. Shortly thereafter, the Bankruptcy Court for the Southern District of New York revisited the issue in *In re General Motors Corp.*, 407 B.R. 463 (Bankr. S.D.N.Y. 2009). Despite that Court's earlier ruling in *Chrysler*, the Court held that issues regarding successor liability claims of asbestos claimants whose symptoms were not yet manifested, required modification of the injunction provision of the sale order. *Id*. at 506-507. The Court explained that precluding asbestos claimants from bringing claims that did not yet exist, raised constitutional concerns, and, as a result, the sale order was modified to "applicable (only) to asbestos claims and demands," making the injunction enforceable "to the fullest extent constitutionally permissible." *Id.* at 507.

As a result of the Circuits' conflicting definitions of "interests," there is little consensus regarding the outer reaches of the scope of "interests" which may be subject to 11 U.S.C. § 363(f). Courts have provided little definitive guidance regarding how the interests of future claimants should be treated under section 363.

B. Plan Confirmation

Plan confirmation typically discharges the claims associated with a debtor's property. Under 11 U.S.C. § 1141(c) & (d)(1) of the Bankruptcy Code, the debtor gets a "fresh start" through confirmation and is discharged "from any debt that arose before the date of such confirmation" and "the property dealt with by the plan is free and clear of all claims and interests of creditors, equity security holders, and of general partners in the debtor."

Entities that are liquidated in bankruptcy do not require a fresh start, as the entity survives only to be wound down and there is no restructuring so § 1141 does not apply to corporations or partnerships that are being liquidated in bankruptcy whether liquidated under Chapter 7 or Chapter 11. Without a statutory discharge, care must be taken to address the risk of successor liability. "Creditor," as defined in the Bankruptcy Code, limits claimants to an "entity that has a claim against the debtor that arose at the time of or before the order of relief concerning the debtor." 11 U.S.C. § 101(10)(A). A "claim," under 11 U.S.C. § 101(5), is defined as a "right to payment" or a "right to an equitable remedy for breach of performance if such breach gives rise to a right to payment," "whether or not reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured or unsecured." 11 U.S.C. § 101(5). A dischargeable claim under 11 U.S.C. § 1141 must be both a valid "claim"or "interest" and second, such claim or interest must have arisen pre-petition. As Courts differ in determining when a claim arose, §1141(c) does not entirely shield the purchaser from successor liability.

Under the conduct theory utilized by some Courts, a "claim arises at the time of conduct only if the claimant had a specific relationship with the debtor at the time the conduct occurred." *In re Parker*, 313 F.3d 1267, 1269 n.1 (10th Cir. 2002)*; In re Manville Forest Products,* 209 F.3d 125, 129 (2d Cir. 2000) (holding an indemnification obligation was a valid, contingent, pre-petition claim properly discharged by plan confirmation, even though the event that would give rise to the indemnification obligation had not occurred prior to the petition date). Other Courts, notably the Third Circuit, have followed an accrual theory; the right to payment, as determined by state law, must exist pre-petition before a claim can exist. S*ee In re M. Frenville Co., Inc.*, 744 F.2d 332 (3d Cir. 1984).

Problems in application of the conduct test arise when a tortious act may have occurred pre-petition, but the causes of action may not manifest themselves until long after confirmation. The "relationship theory," which recognizes that certain contingent claims are simply too remote to fall within the scope of § 105(a), has been applied to environmental clean-up costs, personal injury or product liability claims. Under this theory, a claim is based on the claimant's pre-petition relationship with the debtor. *See In re Jensen*, 995 F.2d 925, 929-930 (9th Cir. 1993); *In re Chateaugay Corp.*, 944 F.2d 997, 1004 (2d Cir. 1991) (CERCLA claims held valid); *Lemelle v. Universal Mfg. Corp.*, 18 F.3d 1268, 1276 (5th Cir. 1994) (products liability claims failed); *see also Matter of CMC Heartland Partners*, 966 F.2d 1143, 1147 (7th Cir. 1992) (an equitable injunction may not be a dischargeable "claim" within the meaning of 11 U.S.C. § 1141 realted to contaminated sites that may be subject to a federal cleanup order under CERCLA); *Cf. Ohio v. Kovacs*, 469 U.S. 274, 283-85 (1985) (noting that if a governmental cleanup order gives rise to a "right to payment," such liabilities may be dischargeable).

On June 2, 2010, the Third Circuit reversed its own precedent, which held that a plan of reorganization did not discharge asbestos-related tort claims. *See In re Grossmans*, No. 09-1563, 2010 WL 2181291 (3d Cir. June 2, 2010), overturning, *Avellino & Beines v. M. Frenville Co.*, 744 F.2d 332 (3d. Cir. 1984). In *In re Grossmans*, the Third Circuit overruled *Frenville*, and held that a plan of reorganization could discharge asbestos related tort claims where the exposure occurred pre-petition, but the injury was not manifested until post-petition. Under *Frenville,* a claim arose when the underlying state law cause of action accrued. In the case of the claimant in *Grossmans*, under New York law, a cause of action for asbestos-related injury did not accrue until the injury was manifested. As a result, the Bankruptcy Court and the District Court found that the claimant did not yet have a claim that was discharged under the Code. Overturning *Frenville*, the Third Circuit held that the accrual test imposes too narrow an interpretation of a "claim" under the Code and that depending on factors[7] related to whether there was a claim to be discharged, an asbestos related claim that did not manifest itself until after the petition date could be discharged under a plan of reorganization. *Id*. at *5.[8]

[7] "In determining whether an asbestos claim has been discharged, the court may wish to consider, inter alia, the circumstances of the initial exposure to asbestos, whether and/or when the claimants were aware of their vulnerability to asbestos, whether the notice of the claims bar date came to their attention, whether the claimants were known or unknown creditors, whether the claimants had a colorable claim at the time of the bar date, and other circumstances specific to the parties, including whether it was reasonable or possible for the debtor to establish a trust for future claimants as provided by § 524(g)." *In re Grossmans*, 2010 WL 2181291, at *10 (June 2, 2010).

[8] In remanding the case the Court noted that whether a particular claim should be discharged must be decided on whether the discharge "would comport with due process, which may invite inquiry into the adequacy of the notice of the claims bar date. . . . Whether a particular claim has been discharged . . . depends on factors applicable to a particular case and is best determined by the particular bankruptcy or district court." *In re Grossmans*, 2010 WL 2181291, at *10.