

DEBTOR/CREDITOR

July 2012

Bankruptcy Sale Cleans Assets

Massachusetts requires employers to pay premiums into the state's unemployment insurance fund, in an amount determined by the "experience rating" that the employer develops based on its history. Employers with a history of many unemployment claims pay at a higher rate than employers whose employees have in the past filed fewer claims. Where substantially all of the assets of a business are transferred to a new entity, the new owner of the business inherits the experience rating of its predecessor.

OPK Biotech purchased all of the assets of Biopure Corp. at a sale in the latter's Chapter 11 case. Like most bankruptcy sales, this sale was free and clear of all liens and interests. When Massachusetts applied Biopure's poor experience rating to OPK, as successor, OPK objected, arguing that the experience rating was an "interest" in Biopure's property that the bankruptcy sale had removed. The bankruptcy court agreed. OPK was entitled to the lower premiums of a new business without the baggage of Biopure's experience rating.

This case illustrates the utility of bankruptcy law to accomplish the transfer of assets free not only of traditional liens and claims, but also free of more exotic encumbrances, such as the experience rating here.

In re PBBPC, Inc., 467 B.R. 1 (Bankr. D. Mass. 2012).

Tax Filing Status is Estate Property

MSC was a wholly-owned subsidiary of BDI. BDI elected treatment as a subchapter S corporation under the Internal Revenue Code. As an "S" corporation, BDI's income and losses were not taxed to it, but were passed through to its sole shareholder and taxed to him. MSC was classified as a QSub under the IRC, which passed its income and losses through to its corporate parent. Because of these elections, neither MSC nor BDI paid any income tax. The tax generated by their income was paid by the shareholder.

After MSC filed a bankruptcy petition, BDI terminated its "S" status, thereby automatically revoking MSC's tax-free QSub status. This resulted in \$2.26 million of income tax liability to MSC rather than the shareholder.

The Delaware bankruptcy court ruled that MSC's QSub status was property of MSC's bankruptcy estate, and that BDI's election to change its "S" status was a violation of the automatic stay in MSC's bankruptcy case. The tax status change was void with respect to both corporations.

Majestic Star Casino, LLC v. Barden Development, Inc. (In re Majestic Star Casino, LLC), 466 B.R. 666 (Bankr. D. Del. 2012).

Costly Mistake

SunTrust Bank loaned money to John McCormick secured by a mortgage on two contiguous parcels of his real estate. However, the mortgage was only recorded in the land records as to Tract 2.

Mr. McCormick filed a bankruptcy case. The bankruptcy statute gave his trustee the status of a bona fide purchaser. A bona fide purchaser of only Tract 1 would not have known of the mortgage and would acquire Tract 1 free of the mortgage. Thus, even though the trustee knew of the mortgage, because it was recorded as to Tract 2, he could successfully void SunTrust's mortgage lien on Tract 1. The recording error cost SunTrust its collateral.

SunTrust Bank v. Macky (In re McCormick), 669 F.3d 177 (2012).

○ ○ ○

This newsletter is intended to inform its readers of developments in the area of debtor/creditor relations. It is not legal advice or a legal opinion regarding any specific matter. You should consult a lawyer regarding any questions relating to your particular situation.

Prepared by James C. Olson, Attorney and Counselor at Law