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When Worlds Collide: Bankruptcy, State Law and Unemployment Insurance

Neenah Foundry Co. ("Neenah") saw demand for its products dramatically plummet in the economic collapse of 2008 and 2009. The company was forced to lay off a large part of its workforce, giving Neenah an adverse experience rating under Wisconsin's unemployment insurance system. This precipitated a significant increase in the company's contribution rates. By contrast, new employers in Wisconsin are charged unemployment insurance contributions at a fixed rate for three years, and only thereafter is their layoff experience taken into account.

Driven by its financial circumstances, in February 2010, Neenah filed a petition under Chapter 11 of the United States Bankruptcy Code, 11 U.S.C. §§ 101–1532 (the "Bankruptcy Code"). In July 2010, Neenah confirmed a plan of reorganization pursuant to which the common stock of Neenah's ultimate parent corporation, Neenah Enterprises, Inc., was cancelled and new common stock was issued to the creditors of the corporate family. In addition, a new board of directors was elected, and the new board elected a new president and chief financial officer. However, six of Neenah's eight senior executives, including the chief operating officer and the corporate controller, remained in their positions and Neenah's 833 employees continued to be employed at the plant the company operated pre-bankruptcy.

After Neenah confirmed its reorganization plan and changed its equity ownership, board of directors and senior top management, Neenah filed a request with the Department of Workforce Development ("DWD") to be treated as a new employer with no adverse layoff experience in an attempt to reduce its unemployment insurance contributions by up to $560,000. The DWD denied this request and, on appeal, an administrative law judge ("ALJ") affirmed the DWD's decision.

The Issues Addressed

Neenah sought review of the ALJ's decision before the Wisconsin Labor and Industry Review Commission ("LIRC"), raising four issues. The first three were:

- whether the plan of reorganization constituted a transfer within the meaning of Wisconsin Statutes section 108.16 (8)(a);

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- whether, after the confirmation of its reorganization plan, Neenah was a mandatory successor under Wisconsin Statutes sections 108.16(8)(e)1; and
- whether the Bankruptcy Code preempted Wisconsin law with respect to the mandatory successor issue.

The LIRC also denied Neenah's request so Neenah appealed to the Court of Appeals. *See Neenah Foundry Co. v. LIRC*, Cir. Ct. No. 2014AP1113, 2105 WL 357469 (Wis. Ct. App. Jan. 29, 2015). On appeal, Neenah raised a fourth issue—whether the applicability of the mandatory successor provisions of Wisconsin Statutes section 108.16(e) to an employer emerging from Chapter 11 was a question of first impression in Wisconsin and therefore the LIRC's decision merited no deference. *Id*. at ¶18.

The court assumed without deciding that Neenah's Chapter 11 reorganization resulted in a transfer under Wisconsin Statutes section 108.16(a). *Id*. at ¶12. It next took up the issues of whether the decisions of the LIRC merited deference, and if so, how much; and whether Neenah was a mandatory successor under Wisconsin Statutes section 108.16(e).

The LIRC's Decision Was Entitled to Deference

Regarding Neenah's claim that the facts presented an issue of first impression, the court stated that simply having a fact pattern that the LIRC had not previously ruled upon did not make it a matter of first impression. Rather, an issue of first impression applies when an agency is interpreting a statute for the first time. *Id*. at ¶19. The court found that the LIRC had previously interpreted the mandatory successor provisions of the statute many times and in a variety of circumstances. *Id*. at ¶25. Although the question was presented in the context of a bankruptcy proceeding, the issue of whether Neenah was a mandatory successor required the LIRC to compare the company's ownership, management and control before and after the Chapter 11 proceeding, which was one the LIRC had frequently addressed. In addition, the court noted that nothing about the mandatory successor issue depended upon bankruptcy law. *Id*. at ¶26. The court therefore concluded that the mandatory transfer decision of the LIRC was entitled to great weight deference under Wisconsin case authority. *Id*. at ¶27.

Reorganized Neenah Was a Mandatory Successor

The court next turned to the reasonableness of the LIRC's decision that reorganized Neenah was a mandatory successor. Despite complete changes in equity ownership, the board of directors and senior management, the LIRC found that the question turned upon who "managed" Neenah, rather than who "owned" or "controlled" it, post-bankruptcy. *Id*. at ¶29.

Neenah argued that board members and not officers "manage" a corporation within the meaning of Wisconsin Statutes section 108.16(8)(e)1. *Id*. at ¶31. The LIRC contended that officers can also manage a corporation's affairs, citing 2A *Fletcher Cyclopedia of the Law of Corporations* § 665, at 233 (rev. vol. 2009) and Wisconsin Statutes sections 180.0840 and 180.0841, which provide that officers shall have the duties set forth in the bylaws or prescribed by the board of directors. *Id*. The court found that the LIRC's interpretation was reasonable, noting that a company's executive officers typically engage in the management of a company and that the LIRC reasonably could infer that the retained officers exercised significant management authority. *Id*.

Wisconsin Statutes section 108.16(8)(e)1 provides that a party is a mandatory successor if at the time of the transfer, "the transferor and the transferee are owned, managed, or controlled *in whole or in substantial part* ... by the same *interest or interests*." (emphasis added). Neenah argued that corporate officers cannot be "interests," but rather that they serve the interests of the company's owners and the board of directors. *Id*. at ¶32. Rejecting this position, the court held that this would make officers irrelevant under the statute in terms of who "managed" the company. Moreover, the court found reasonable the LIRC's conclusion that officers who exercise managerial authority are persons with an interest in the company, even if they also serve the interests of others. *Id*.

Also reasonable, said the court, was the LIRC's determination that six of the eight officer positions remaining unchanged was sufficient to find that reorganized Neenah was managed in "substantial part" by the same interests. *Id*. at ¶33. Acknowledging that "... reasonable minds may differ on whether management has changed 'in substantial part' under facts like those here ...," the court stated that the LIRC was better suited than the court to decide this issue. *Id*. at ¶35.

State Law Was Not Preempted

Lastly, Neenah argued that federal bankruptcy law preempted the LIRC's mandatory successor determination because the Bankruptcy Code prevented the application of pre-bankruptcy experience rating to increase a reorganized entity's unemployment taxes. *Id*. at ¶40.

The court of appeals pointed out that in *Hollytex Carpet Mills, Inc. v. Oklahoma Employment Security Commission*, 73 F.3d 1516 (10th Cir. 1996), one of the cases cited by Neenah, the Tenth Circuit actually held that in most circumstances, a state agency is permitted to utilize a reorganized debtor's prepetition history and experience factors when determining unemployment contribution rates. Id. at 1522. The Hollytex court concluded, however, that the preemption analysis is different if the adverse rating is due to failure to make pre-Chapter 11 contributions, as contrasted with other factors, such as lay off experience. Where the rating is based upon a prepetition debt for delinquent contributions which is discharged, preemption is applicable. *Id*. at 1522-24.

The court of appeals observed that Neenah's post-petition rating was not based upon any prepetition delinquencies because Neenah stipulated it was current with contributions as of the filing of the bankruptcy petition. Instead, Neenah's rating was based solely upon its prepetition layoff history. *Neenah Foundry Co. v. LIRC*, 2015 WL 357469, ¶45.

Neenah cited other cases dealing with asset sales under section 363 of the Bankruptcy Code, which provides that a trustee may sell property free and clear of any interest of an entity other than the estate. In each of those cases, the courts found that the debtor's experience rating could not be transferred to the purchasing entity. The DWD countered that each case was inapposite because under Neenah's reorganization plan, there was no asset sale to a third party purchaser. *Id*. at ¶47.

Nonetheless, Neenah contended that the language in Bankruptcy Code section 363 is similar to the language in Bankruptcy Code section 1141(c), which provides that property dealt with in a plan of reorganization is free and clear of all claims and interests of creditors, among others. *Id*. at ¶48. The court noted that the DWD was not a creditor of Neenah prepetition, and rejected Neenah's argument that incurring unemployment compensation obligations during the Chapter 11 caused the DWD to become a creditor. *Id*. at ¶50. Additionally, even if the contribution obligations Neenah incurred during the Chapter 11 were an "interest" of a "creditor," it did not follow that Neenah's employment experience rating was an interest covered by Bankruptcy Code section 1141(c). *Id*. at ¶51.

Finally, the court rejected as undeveloped Neenah's claim that its reorganization plan, which provided that all of Neenah's property vested post-petition free and clear of all claims, liens, charges, other encumbrances and interests, covered the adverse experience rating because Neenah cited no authority or other support for this proposition. *Id*. at ¶53.

The court held that the LIRC's determinations were reasonable and affirmed its decision.

Conclusion

The court's conclusions regarding Neenah's preemption arguments seem correct. Conversely, its conclusions regarding the mandatory successor issue seem wrong. A reorganized Chapter 11 debtor who emerges with new owners, new directors and new senior management, but with some (but not all) subordinate executives in place cannot be said to be managed "in substantial part" by the same interests as the prepetition company. Even with the LIRC's decisions being given great weight deference, the court finding reasonable the LIRC's determinations that subordinate executives "manage" the affairs of the enterprise, and that such subordinate executives have "interests" of the type contemplated by Wisconsin Statutes section 108.16(e)1, seems especially strained.

The decision suggests that a reorganizing Wisconsin company that completely changes equity ownership, its board of directors and senior management, but that retains any subordinate management personnel post-bankruptcy, is at risk of being found to be a mandatory successor burdened with a legacy issue arising from the circumstances which likely helped precipitate its bankruptcy filing in the first place. This is not the "fresh start" the Bankruptcy Code was enacted to foster.

If you have any questions on the topics discussed in this e-alert, please contact your Reinhart attorney or any member of Reinhart's Business Reorganization team.