A Summary of the 6th Circuit Court of Appeals' Decision in *Kohut v. UnitedHealthcare Insurance Co.*

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On July 18, 2017, the U.S. Court of Appeals for the 6th Circuit handed down its decision in the matter of *Kohut v. United Healthcare Insurance Co.*, Case No. 16-2324, on appeal from the U.S. Bankruptcy Court decision in *In re LSC Liquidation, Inc.*, Case No. 15-45784 (E.D. Mich. 2016), that affirmed the use of Fed. R. Civ. P. 60(b)(1) to amend a § 363 sale order to include the debtor's health insurance contracts with United Healthcare Insurance Co. ("United") as assumed contracts under § 365. The result of the decision allowed United to claim a complete defense to alleged preferential transfer claims asserted by the liquidating trustee ("Trustee") against United and the ultimate dismissal of the adversary proceeding with prejudice.

BACKGROUND

In 2014, the debtor, Lee Steel Corporation ("Lee Steel" and now known as LSC Liquidation, Inc.), entered into contracts with United to provide health insurance to Lee Steel's employees. On April 13, 2015, Lee Steel filed for relief under chapter 11 of the Bankruptcy Code. Shortly thereafter, Lee Steel filed a motion to establish bidding procedures for the sale of substantially all of its assets,

as well as for procedures for the assumption and assignment of executory contracts. United was listed as a party holding an executory contract with Lee Steel subject to assumption and assignment. Thereafter, on July 31, 2015, Lee Steel filed its motion to sell substantially all of its assets, together with a Sale Agreement, which motion included language that contracts may be assumed and assigned to the proposed buyer, Union Partners I, LLC ("Union Partners"). On August 12, 2015, the Bankruptcy Court entered a Sale Order approving, in relevant part, the purchase of the assets of Lee Steel by Union Partners, and authorizing pursuant to § 365 the assumption and assignment of executory contracts to be included in the final schedules of the Sale Agreement. The Sale Order also contained a provision that provided, in material part, that the Sale Order could be "modified…by agreement of the debtor and the buyer, without further order of the Court; provided…any such…modification…is not material and substantially conforms to, and effectuates, the Sale Agreement," and authorized the bankruptcy court to approve other material modifications by motion. The sale to Union Partners closed September 18, 2015; however, the final schedules to the Sale Agreement, as of closing, failed to include the United health insurance policies.

On November 24, 2015, the Bankruptcy Court confirmed Lee Steel's plan of liquidation, which plan provided that any executory contracts that had not been assumed and assigned prior to confirmation were deemed rejected.

As United had not received any notice that the health insurance contracts were assumed and assigned to Union Partners, United sent formal notice to Union Partners that the health insurance contracts were to be terminated as of December 1, 2015 and all coverage would cease. Upon receipt of the notice, Union Partners contacted United asserting that it was their intent to have assumed the policies under the Sale Agreement and requested that the policies not be terminated. Thereafter, on December 3, 2015, Union Partners, Lee Steel and United entered into a letter agreement ("Letter Agreement") memorializing that the health insurance contracts were to be deemed purchased assets and assumed under the Sale Agreement.

On December 15, 2015, the Unsecured Creditor Committee,[1] unaware of the December 3, 2015 Letter Agreement, made demand on United for return of $211,000 in premium payments received from Lee Steel as alleged preferential transfers. The Committee refused to acknowledge the validity of the December 3, 2015 Letter Agreement as a valid assumption and assignment of the United health insurance contracts under the Sale Agreement, Sale Order or otherwise pursuant to § 365, and instituted an adversary proceeding under § 547 of the Bankruptcy Code.

[1] Pursuant to the confirmed plan, on or about April 1, 2016, the remaining assets, claims and causes of action of the debtor's estate were transferred to a liquidation trust, with Gene Kohut acting as the Trustee.

In response to the adversary proceeding, United filed a motion to amend the Sale Order to clarify and confirm that the United health insurance contracts were properly and effectively assumed and assigned by the Letter Agreement and within the framework of the Sale Order and Sale Agreement. The Committee objected to the motion based primarily on the argument that the United health insurance contracts were rejected pursuant to the confirmed liquidation plan on November 24, 2015, and therefore could not subsequently be assumed and assigned by the Letter Agreement on December 3, 2015, as well as on other procedural grounds.

BANKRUPTCY COURT DECISION

After hearing oral argument, the Bankruptcy Court ruled that the Sale Order could be properly amended under Fed. R. Civ. P. 60(a) and 60(b)(1).

Rule 60(a) states as follows: ". . . the court may correct a clerical mistake or a mistake arising from oversight or omission whenever one is found in a judgment, order, or other part of the record."

Finding in favor of United on the basis of Rule 60(a), the Court relied heavily on the case of *In re Walter*, 282 F.3d 434 (6th Cir. 2002), which held: "The basic purpose of the rule [Rule 60(a)] is to authorize the court to correct errors that are mechanical in nature that arise from oversight or omission…The rule does not, however, authorize the court to revisit legal analysis or correct an error of

substantive judgment." (internal citations omitted). The *Walter* decision continued by stating: "…a court properly acts under Rule 60(a) when it is necessary to correct mistakes or oversights that cause the judgment to fail to reflect what was intended at the time of trial." Based upon the facts as presented, the Court concluded that: "In the context of this case…had the issue actually come before the court in some form of contested matter, it was the intention of the parties for the healthcare contracts to be assumed, and this can be corrected under [Rule] 60(a)."

Alternatively, the Bankruptcy Court ruled that Rule 60(b)(1) was appropriate to grant relief. Rule 60(b)(1) states, in pertinent part, as follows: "On motion and just terms, the court may relieve a party or its legal representative from a final judgment, order, or proceeding for the following reasons: mistake, inadvertence, surprise or excusable neglect."

In ruling that Rule 60(b)(1) also allowed for relief to amend the Sale Order, the Bankruptcy Court addressed the case of *In re UAL*, 411 F3d 18 (7th Cir. 2005) where the court set aside a provision of a sale order that mistakenly omitted a term that was agreed to by the parties. Applying the *UAL* analysis to the case at hand, the Bankruptcy Court concluded that all "the affected parties - debtor, purchaser and United Healthcare - all agree that it was the intention of the parties to include the assumption [of the United health insurance contracts] in the Sale Order. All

affected parties acted in reliance on the assumption of the contracts. The omission of the specific language regarding assumption was a mistake."

Additionally, the Court noted that in the event the issue of the assumption and assignment of the United health insurance contracts had been raised at the time of entry of the Sale Order, the Committee would not have had any standing or basis to object. Accordingly, they were not prejudiced by the granting of the motion to amend, nor was the loss of a windfall preference action based solely on a mistake by the parties the kind of harm the court should endeavor to avert.

The Bankruptcy Court therefore granted the motion of United to amend the Sale Order to provide for the assumption and assignment of the United health insurance contracts. The Trustee subsequently appealed to the District Court, which affirmed the Bankruptcy Court ruling, and then to the Sixth Circuit Court of Appeals.

SIXTH CIRCUIT OPINION

On appeal to the Sixth Circuit, the Court overturned the decision of the Bankruptcy Court as to its application of Rule 60(a). The Court noted that Rule 60(a) applies to errors or oversights by the court, not by the parties to the case. In the instant matter, the oversights or omissions were not the result of error by the court, but rather, it was the parties and counsel in the case that failed to make the

Sale Agreement and Sale Order accurately reflect their intention. Accordingly, modification of the Sale Order under Rule 60(a) was not appropriate.

However, in analyzing whether to grant relief under Rule 60(b)(1), the Court indicated that courts consider three factors: (1) culpability/excusable neglect; (2) prejudice to the opposing party; and (3) whether the party holds a meritorious underlying claim or defense. *In re Yeschick*, 675 F.3d 622, 628 (6th Cir. 2012). In the case at hand, the bankruptcy court applied – although not explicitly – the *Yeschick* factors in finding that (i) there was excusable neglect because all the parties were operating under the assumption that the United health insurance contracts were assumed; (ii) the Trustee did not suffer any prejudice based upon his lack of standing to object to the assumption and assignment of the contracts if originally included in the Sale Agreement and Sale Order; and (iii) all the parties acted in reliance on the assumption of the contracts.

Accordingly, the Sixth Circuit affirmed the decision of the Bankruptcy Court under Rule 60(b), but denied relief under Rule 60(a).

TAKEAWAY

In the rush to close a deal, many times the small details can be overlooked, especially in the circumstance when a debtor is liquidating and there is less incentive to cross the t's and dot the i's. Therefore, practitioners representing

purchasers of assets in § 363 sales, as well as 3rd parties to executory contracts with debtors, should be more diligent and vigilant to ensure the sale documents are complete and represent the intentions of the parties in order to avoid potential conflicts and costly litigation in the future.