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A Lesson From 6th Circ. On 'Applicable Nonbankruptcy Law'

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In Metropolitan Government of Nashville & Davidson County v. Hildebrand, the U.S. Court of Appeals for the Sixth Circuit explains how to read the phrase "applicable nonbankruptcy law" as it is used in the United States Bankruptcy Code. The case — a Chapter 13 individual bankruptcy case — discussed the phrase in the context of Section 511(a) of the Bankruptcy Code, which deals with the appropriate rate of interest applicable to tax claims. However, the issue is relevant to other circumstances as well (including Chapter 11 corporate reorganization cases), and bankruptcy practitioners should take note because the phrase is also used elsewhere in the Bankruptcy Code, including in sections dealing with a debtor's power to sell assets free and clear of liens under certain circumstances (Section 363(f)), a debtor's inability to assume certain kinds of contracts and leases (Section 365(c)), and the enforceability of a subordination agreement in the context of a bankruptcy (Section 510(a)).

The Hildebrand case involved a Chapter 13 plan that proposed to pay post-petition interest, but not penalties, on overdue property taxes. The taxes were due under a Tennessee state statute that was amended in 2014 in an attempt to legislate around the general prohibition against assessing post-petition penalties on tax claims in bankruptcy cases. In particular, the Tennessee Legislature crafted the following language deeming tax penalties to be an assessment of interest in the event of a bankruptcy filing:

> For purposes of any claim in a bankruptcy proceeding pertaining to delinquent property taxes, the assessment of penalties pursuant to this section constitutes the assessment of interest.

Tenn. Code Ann. § 67-5-2010(d).

Section 511(a) of the Bankruptcy Code generally provides that the appropriate interest rate for tax claims is whatever "applicable nonbankruptcy law" provides. The focus of the Sixth Circuit's analysis, therefore, was whether the Tennessee statutory language quoted above was a "nonbankruptcy" law. Based on the plain language of Section 511(a) of the Bankruptcy Code, the Sixth Circuit concluded that the phrase "applicable nonbankruptcy law" refers to "any law that is not aimed solely at bankruptcy proceedings." Accordingly, the Sixth Circuit ruled that the Tennessee statute at issue is a bankruptcy law because its content is applicable solely in bankruptcy proceedings. The court therefore held that the Tennessee statute does not govern the appropriate rate of interest on tax claims under Section 511(a) of the Bankruptcy Code.

The Sixth Circuit based its ruling, in part, on its prior rulings acknowledging that states have concurrent authority to pass bankruptcy laws, and that the content of this particular Tennessee statute was clearly aimed only at bankruptcy proceedings. The court further noted that if Congress intended for Section 511(a) to mean any law other than the Bankruptcy Code, then it could have easily used other language to convey that intention (e.g., "laws outside the Bankruptcy Code"). Indeed, while not specifically noted by the Sixth Circuit, many other Bankruptcy Code sections use other variations of the phrase, like "applicable law" in Section 365(c)(1)(A) and "applicable provisions of this title" in Section 1129(a)(1) and (a)(2). Instead, in Section 511(a), Congress chose to use language focused on the content of the law. To determine whether a specific law is a

"nonbankruptcy" law, the Sixth Circuit's ruling says to look to the content of the law itself, not who enacted the law or where it can be found.

When bankruptcy practitioners are faced with a circumstance involving a section of the Bankruptcy Code referring to applicable nonbankruptcy law, it is incorrect to assume that it means any applicable law outside of the Bankruptcy Code. State laws can still be considered "bankruptcy" laws depending upon their content — an important distinction to be leveraged when faced with an otherwise unfavorable "applicable law" outside of what is strictly contained in the Bankruptcy Code.

Consider, for example, a state statute permitting a sale of assets free and clear of liens, but only if the sale is through a bankruptcy proceeding. Would that statute be considered "applicable nonbankruptcy law," such that a debtor could argue it has met the standard for a sale free and clear of liens under Section 363(f)(1) of the Bankruptcy Code and that it does not need to obtain consent under Section 363(f)(2) or demonstrate the existence of other circumstances delineated under Section 363(f)? Under the Sixth Circuit's ruling, such a statute would likely be considered a bankruptcy law, even though it is not included in the Bankruptcy Code, because its content is focused solely on bankruptcy.

State lawmakers can learn lessons from the Hildebrand ruling as well. When enacting statutes intended to apply only in bankruptcy, state legislatures should be cognizant of the Sixth Circuit's ruling, and perhaps consider making the statute applicable in circumstances other than solely bankruptcy. Careful legislative drafting may very well avoid these issues. Enforceability will depend upon the content of the statute. If the Tennessee Legislature were to revise the language of the tax statute quoted above to make it applicable in all cases, and not just in bankruptcy, the statute may very well be enforceable the next time the issue arises. Content matters.

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