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Editorial Offices

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# Kentucky Bankruptcy Court Holds That Coal Mining Lease is Not an Executory Contract or Unexpired Lease and is Transferable Pursuant to Section 363 Despite an Anti-Assignment Provision

*By Charlie Chen\**

*The author of this article discusses a recent U.S. Bankruptcy Court for the Eastern District of Kentucky ruling that a coal mining lease is not an executory contract or unexpired lease.*

When a contract is called a lease and has some characteristics of a lease, but operates to grant the lessee the exclusive right to mine and remove coal from the premises, how should the contract be treated in bankruptcy? Similar to oil and gas leases, in *In re Manalapan Mining Company, Inc.*,<sup>1</sup> the United States Bankruptcy Court for the Eastern District of Kentucky looked to applicable non-bankruptcy law (*i.e.*, state law) to determine whether Section 365 of the Bankruptcy Code would apply to a coal mining lease. In *Manalapan*, the court determined that under Kentucky state law, a transfer of an interest in coal is generally considered a conveyance of an interest in real property unless “the terms of the instrument require a different construction.” After concluding that the instrument was not an executory contract or unexpired lease, the court went on to overrule the lessor’s objections and authorized the coal mining lease to be transferred pursuant to Section 363(b) of the Bankruptcy Code,<sup>2</sup> despite the existence of an anti-assignment provision.

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\* Charlie Chen is an associate in the Business Finance & Restructuring Department of Weil, Gotshal & Manges LLP. Resident in the firm’s Dallas office, he may be contacted at [charlie.chen@weil.com](mailto:charlie.chen@weil.com).

<sup>1</sup> No. 13-61502, GRS (Bankr. E.D. Ky. June 19, 2015).

<sup>2</sup> Sec. 363. Use, sale, or lease of property

. . . (b)(1) The trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate, except that if the debtor in connection with offering a product or a service discloses to an individual a policy prohibiting the transfer of personally identifiable information about individuals to persons that are not affiliated with the debtor and if such policy is in effect on the date of the commencement of the case, then the trustee may not sell or lease personally identifiable information to any person unless—

(A) such sale or such lease is consistent with such policy; or

(B) after appointment of a consumer privacy ombudsman in accordance with section 332, and after notice and a hearing, the court approves such sale or such lease—

(i) giving due consideration to the facts, circumstances, and conditions of such sale or such lease; and

(ii) finding that no showing was made that such sale or such lease would violate applicable nonbankruptcy law.

(2) If notification is required under subsection (a) of section 7A of the Clayton Act in the case of a transaction under this subsection, then—

(A) notwithstanding subsection (a) of such section, the notification required by such subsection to be

## BACKGROUND

Manalapan Mining Company and its related debtor, Left Fork Mining Company, were both lessees to coal mining leases in Kentucky with the same lessor. After the debtors filed for bankruptcy protection, they sought court approval pursuant to Section 363 of the Bankruptcy Code to transfer their respective leases free and clear of all liens. The lessor objected to the transfer on the basis that the leases were subject to the Section 365(d)(4) deadline applicable to assumption or rejection of nonresidential real property leases, and because the leases were not assumed or rejected within the first 120 days after the petition date and no further extension was obtained, the leases were deemed rejected. Alternatively, the lessor argued that Section 363 did not permit the transfer of the leases because the debtors had not met the requirements of Section 363, including evidence of benefit to the estates, and due to an anti-assignment provision in the leases. The lessor also argued that the Left Fork lease had expired pursuant to its terms.

## THE MANALAPAN COAL MINING LEASE IS NOT A LEASE UNDER KENTUCKY LAW

Relying upon two Sixth Circuit cases, *Sloan v. Hicks*<sup>3</sup> and *Cox v. Philbeck*,<sup>4</sup> which analyzed the status of a coal mining lease in bankruptcy under Kentucky law, the court determined that the Manalapan lease was a conveyance of an interest in real property, and, thus, not subject to Section 365 of the Bankruptcy Code as a lease.

The court found *In re Philbeck* to be instructive, which determined that a coal mining lease was a transfer of a real property interest and not an executory contract. Following the *Philbeck* court's analysis, the court reviewed the debtor's lease and noted that certain provisions may indicate a true lease. For example, the debtor's lease:

- contained express words such as “demise” and “let” which signify a lease;
- provided that improvements accrue to the lessor;

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given by the debtor shall be given by the trustee; and

(B) notwithstanding subsection (b) of such section, the required waiting period shall end on the 15th day after the date of the receipt, by the Federal Trade Commission and the Assistant Attorney General in charge of the Antitrust Division of the Department of Justice, of the notification required under such subsection (a), unless such waiting period is extended—

- (i) pursuant to subsection (e)(2) of such section, in the same manner as such subsection (e)(2) applies to a cash tender offer;
- (ii) pursuant to subsection (g)(2) of such section; or
- (iii) by the court after notice and a hearing.

See *In re Quinn*, 299 B.R. 450, 460 (Bankr. W.D. Mich. 2003), *rev'd on other grounds sub nom Teachers Insurance and Annuity Assoc. v. Bareham (In re Quinn)*, 327 B.R. 818 (W.D. Mich. 2005); *In re American Home Mortg. Holdings, Inc.*, 402 B.R. 87, 102 (Bankr. D. Del. 2009); *Newport Acquisition Co. No. 1 v. Schiro (In re C-Power Prods., Inc.)*, 230 B.R. 800 (Bankr. N.D. Tex. 1998). 761 F.2d 319, 321 (6th Cir. 1985) 145 B.R. 870, 871 (Bankr. E.D. Ky. 1992).

<sup>3</sup> 761 F.2d 319, 321 (6th Cir. 1985).

<sup>4</sup> 145 B.R. 870, 871 (Bankr. E.D. Ky. 1992).

- did not warrant fee simple title; and
- transferred only the right to mine coal and reserved all other mineral and surface rights.

However, the court believed that these factors were not sufficient to deem the debtor's lease a true lease subject to Section 365. In support of its conclusion, the court noted that *Philbeck* and *Becknell* also involved instruments that were nominally titled as "leases" and may have contained similar provisions found in the debtor's lease. Moreover, the debtor's lease contained most of the standard terms found in a coal mining lease. Therefore, the court determined that the debtor's lease was a conveyance of an interest in real property and not a true lease. Furthermore, the court found that the debtor's lease was not executory because, while the debtor had continuing obligations, the court did not find any continuing obligations on the part of the lessor.

### **THE MANALAPAN COAL MINING LEASE IS TRANSFERABLE PURSUANT TO SECTION 363 OF THE BANKRUPTCY CODE**

Next, the court analyzed whether the debtor's lease could be transferred to an assignee pursuant to Section 363 of the Bankruptcy Code. Overruling the objections of the lessor, the court gave deference to the reasonable business judgment of the debtor and determined that the proposed transfer would benefit the estate. The court also noted that the assertion of potential defaults under the lease was insufficient to prevent a transfer because the lessor had not declared a default or moved to enforce its rights in the event of a default.

The court also considered the impact of the anti-assignment provision in the coal mining lease which provided that "(a) Lessee shall not assign this Lease or any part thereof without the prior written approval of Lessor, *which approval Lessor shall not unreasonably withhold* . . ." The court surveyed the relevant case law in which other courts had authorized a transfer under Sections 363(b) or (f) of the Bankruptcy Code despite the existence of an anti-assignment provision.

Although the court cited the Delaware bankruptcy court decision from *In re American Home Mortgage Holdings, Inc.*, where that court authorized the transfer of a non-executory contract pursuant to Section 363(f) despite an anti-assignment provision, interestingly, the court determined that *American Home Mortgage* was not applicable here. In *American Home Mortgage*, that court analyzed the anti-assignment provision under New York law and found that the non-consenting party could be compelled to accept money damages as a result of a transfer without its consent. Therefore, pursuant to Section 363(f)(5), the court in *American Home Mortgage* determined that the debtor could sell "free and clear" of any claim for damages resulting from a non-consenting assignment. The *American Home Mortgage* court concluded that the non-consenting party could assert a damages claim against the debtor after the transfer occurred and seek adequate protection of such claim under Section 363(e).

However, in this case, the court determined that it was unnecessary to rely upon prior precedent or other Bankruptcy Code provisions to override the anti-assignment



provision in the debtor's lease. Instead, the court focused on the qualifier in the anti-assignment provision that provided the lessor could not "unreasonably withhold" consent to an assignment. Based on the court's review of the factual circumstances and potential detriment to both the estate and the lessor from any further delay, the court believed that the lessor's refusal to consent constituted "the definition of unreasonable in this context," and, thus, the court authorized the transfer of the debtor's lease.

The court also considered and rejected the lessor's request for adequate protection under Section 363(e). Finding that the lessor was not currently receiving any return from the debtor's lease and had not taken any steps to terminate the lease, the court concluded that the lessor could not argue for a monetary payment. In addition, the court dismissed the lessor's request for evidence that the assignee could perform its obligations under the lease. The court found that adequate assurance of future performance was only a requirement under Section 365(f)(2) for executory contracts and unexpired leases, not for transfers pursuant to Section 363. While the court acknowledged that such relief could be included as part of adequate protection under Section 363(e), the court believed that imposing this condition would cause further delay without providing a commensurate benefit. Specifically, the court emphasized the risk that the debtor's mining permits would be terminated by the state regulatory authority if the transfer was not promptly approved. Therefore, the court declined to impose the requirement of adequate assurance of future performance but requested that the debtor voluntarily share available information about the assignee with the lessor.

### **THE LEFT FORK COAL MINING LEASE**

The court concluded that the Left Fork lease could also be transferable under Section 363(b) using the same analysis the court applied to the Manalapan lease. In addition, the court considered the lessor's argument that the Left Fork lease had already expired pursuant to its terms. Dismissing the lessor's arguments, the court authorized the transfer of the Left Fork lease after determining that certain factors raised the possibility that the lease could have continuing validity, including: (i) the debtor had not surrendered the premises and (ii) the conduct of the parties, including the debtor's payment of property taxes and the lessor's recognition of the debtor as lessee in communications with the state government.

The court acknowledged that authorization to transfer the Left Fork lease could be moot if it was later determined that the lease had ultimately expired pursuant to its terms. In such an event, the court believed that there would be no detriment to the lessor.

### **CONCLUSION**

The decision in *Manalapan* highlights the pitfalls of relying solely upon the title of an instrument to determine its treatment in bankruptcy. The determination whether Section 365 of the Bankruptcy Code applies to a coal mining lease is governed by applicable non-bankruptcy law. This distinction is important because it mandates whether the debtor is entitled to the benefits, as well as the burdens, of

Section 365, including the Section 365(d)(4) deadline to assume or reject unexpired leases of non-residential real property within the first 120 days after the petition date or such additional time as a court may grant pursuant to Section 365(d)(4). In addition, parties to a non-executory contract or lease should exercise caution when relying upon an anti-assignment provision to prevent transfer of an agreement in bankruptcy. As the court's decision in *Manalapan* demonstrates, even if Section 365(f) cannot be used to render an anti-assignment provision unenforceable, an anti-assignment provision may still be overridden in bankruptcy on other grounds, including contract interpretation, applicable state law, and Section 363 of the Bankruptcy Code.