1-1-2022

Sigmund J. Beck Advanced Bankruptcy Roundtable -

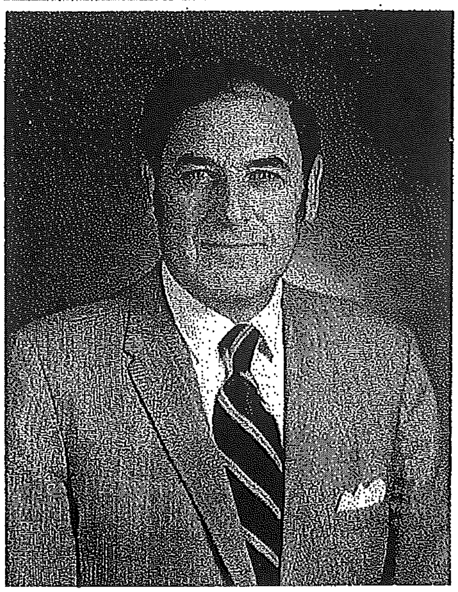
Indiana Continuing Legal Education Forum (ICLEF)

Sigmund J. Beck Advanced Bankruptcy Roundtable
August 19-20, 2022
Index

Indiana University
Maurer School of Law

The Sigmund J. Beck Award for Excellence in the Study of Bankruptcy Law

Each year the faculty of the Indiana University Maurer School of Law honor the graduating student who has been most distinguished in the study of bankruptcy law with the Sigmund J. Beck Award. The award is presented in memory of Sigmund Joseph Beck who was a distinguished attorney, bankruptcy practitioner and civic leader in Indianapolis, Indiana for many years. The award consists of a certificate and a cash stipend of $500 which the recipient is encouraged to expend in the establishment of a personal professional library.



SIGMUND JOSEPH BECK
(1915–1991)

Sig Beck was recognized as the "Dean" of the Indiana Bankruptcy Bar from the early 1950s until his death due to illness in June 1991. During this time, Sig practiced as a senior partner with the well-known law firm of Bamberger & Feibleman, handling two of the largest Chapter X bankruptcy cases in the Midwest—"Bankers Trust," 1967–1972, Presiding Judge William Steckler, Trustee–American Fletcher National Bank; and "American National Trust," 1970–1976, Presiding Judge James Noland, Trustee Jack Bradshaw. (Sig's co-counsel in "American National Trust" was former Indiana governor Matt Welsh.)

One of the exciting points of Sig's career occurred in the bankruptcy Chapter X case of "Hancock Trucking," Sheldon A. Key, trustee, in 1970. In 1967–1969, Sig took issue with the Internal Revenue Service on the subject of the "Absolute Priority Rule." In this matter, the IRS was represented by District Counsel, Bernie Boyle, who, aside from this issue, was a friend. District Judge S. Hugh Dillon decided the case in Sig's favor. On the request of Bernie Boyle, the IRS appealed unsuccessfully to the Seventh Circuit. Then to the chagrin of Sig and the young attorney who assisted him, in March 1970, the U.S. Supreme Court decided the case for the IRS. The argument was presented in January 1970. *See, United States vs. Sheldon A. Key, Trustee* 397 U.S. 322.

Sig was born March 9, 1915, in New York City, and lived there with his parents, Alfred L. and Celia Hammerstein Beck, and his brother, George, until the family moved to Far Rockaway, Long Island, where Sig went to Public School #39 for grammar school and to Far Rockaway High School, distinguishing himself in both schools, we are sure.

He went to the University of Virginia for his undergraduate studies, graduating with honors, and to the University of Virginia Law School, again graduating with distinction. It was a six-year–combined program; he got his undergraduate degree in 1935 and his law school degree in 1937. After graduating from law school, he was admitted to the New York State Bar and began practicing in New York City.

He went into the Army in 1942 and finished his service in February 1946. He trained in Hawaii and was sent to Japan shortly after the surrender. He was the JAG officer for his battalion and was highly regarded for his thoroughness and fairness. Sig was the prosecutor for a case against an American soldier who was accused and convicted of killing two Japanese men. A Japanese attorney who observed the trial noted the following outcome: "1) Social unrest was removed from Nara and vicinity; 2) The trial made people realize that justice is justice and injustice is injustice, which holds good in all countries and for all ages."

After the war, Sig returned to New York City to continue his commercial and bankruptcy practice.

Sig met his wife Rachael at a Commercial Law League convention in Chicago. They fell in love and married December 10, 1952. Rachael was Charles Feibleman's sister, and so Sig, being Sig, went to Rachael's hometown, Indianapolis, and became a partner in Charles' law firm, Bamberger & Feibleman.

Bamberger & Feibleman (1898–1999) was, during its business life, Indianapolis' oldest same-name law firm. Isadore Feibleman and Ralph Bamberger founded the firm, and it grew as a family firm when Charles Feibleman, son of Isadore, and Julian Bamberger, son of Ralph, were added to the commercial practice in the 1930s. Sig and a former Bankruptcy Referee, John Rickles, joined in 1950. Sig mentored many young bankruptcy lawyers in Indianapolis and the surrounding area, including Bernard Landman, Jr., Thomas D. Titsworth, Gene E. Wilkins, David H. Kleiman, James W. Beatty, Sid Mishkin, George Rubin, Alan Klineman, Robert A. Rose, Elliott Levin, Ed Hopper, Sally Cook, Nancy Gargula, and Nancy Endsley, among others.

Sig served as an officer in the Commercial Law League, and also as president of the Seventh Circuit Bar Association, 1971–1972. He was known from day one in Indianapolis as a lawyer who wasted no time in getting to the "crux" of the matter—niceties to the wind—and also as the champion of the underdog.

The list of Sig's many professional civic achievements is long and enduring, including active participation in several bar associations, the Jewish Community Relations Council, and the Jewish Welfare Federation. In April 1974, a fellow neighbor, Frank P. Lloyd, presented Sig with an award "for his outstanding services" at the National Conference of Christians and Jews. In his address, Mr. Lloyd **remarked that "no one with a cause that represented human need, improved relations between Jew and Gentile, Black and White, Catholic and Protestant was ever turned away from his door or pocketbook."**

Moreover, Sig and Rachel both were devoted to the concerns of the community, but in particularly to liberty, education, and the arts generally. Sig was lead counsel for the ACLU, which defended the rights of any party to speak publicly. A particular case commenced and concluded in Chicago involving the right of the Nazis party to march peacefully in Skokie, Illinois. As we all know, Sig and the Nazis were at separate ends of the continuum, but there was the central issue of freedom of speech and actions. Sig also defended the public right of the ACLU to conduct a meeting at the World War II Veterans Memorial in Indianapolis. Sig's statement in 1973 was, "ACLU members were also veterans."

Sig and Rachel passionately backed the integration of the Indianapolis Public School system in the 1960s and 1970s and showed the same zealousness in keeping the Indianapolis Symphony from being cancelled. Some may remember the slogans, **"Non-partisans for Better Schools," and "Save the Symphony's Beautiful Sounds."**

Sig and Rachel are survived by their daughter, Randy, and sons, John, Tom and Dan.

In his professional life and in his personal life with Rachel, Sig modeled for young lawyers and for his children the importance of being an independent thinker and of working for justice and the greater good, a baton handed now to this award's recipient.

Finally, surely, in her poem "confucius might say," published in her book of poetry *Plainverse,* Rachel Beck reflected their shared attitudes when she wrote:

> when you're in a hurry
> to get the conference over
> and all those problems solved
> temptation is to talk fast
> wisdom is to listen fast

The faculty of the Indiana University Maurer School of Law are proud to maintain the memory and honored reputation of Sigmund Joseph Beck through this annual award.

ICLEF Electronic Publications

Feature Release 4.1
August 2020

To get the most out of your *ICLEF Electronic Publication,* download this material to your PC and use Adobe Acrobat® to open the document. The most current version of the Adobe® software may be found and installed by clicking on one of the following links for either the free Adobe Acrobat Reader® or the full retail version of Adobe Acrobat®.

Feature list:

1. **Searchable** – All ICLEF Electronic Publications are word searchable. To begin your search, click on the "spyglass" icon at the top of the page while using the Adobe® software.
1. **Bookmarks** – Once the publication is opened using the Adobe Acrobat® software a list of bookmarks will be found in a column located on the left side of the page. Click on a bookmark to advance to that place in the document.
2. **Hypertext Links** – All of the hypertext links provided by our authors are active in the document. Simply click on them to navigate to the information.
3. **Book Index** – We are adding an INDEX at the beginning of each of our publications. The INDEX provides "jump links" to the portion of the publication you wish to review. Simply left click on a topic / listing within the INDEX page(s) to go to that topic within the materials. To return to the INDEX page either select the "INDEX" bookmark from the top left column or right-click with the mouse within the publication and select the words "*Previous View*" to return to the spot within the INDEX page where you began your search.

Please feel free to contact ICLEF with additional suggestions on ways we may further improve our electronic publications. Thank you.

Indiana Continuing Legal Education Forum (ICLEF)
230 East Ohio Street, Suite 300
Indianapolis, Indiana 46204
Ph: 317-637-9102 // Fax: 317-633-8780 // email: iclef@iclef.org
URL: https://iclef.org

ICLEF
INDIANA CONTINUING LEGAL EDUCATION FORUM

SIGMUND J. BECK

ADVANCED BANKRUPTCY ROUNDTABLE

August 19-20, 2022

WWW.ICLEF.ORG

DISCLAIMER

The information and procedures set forth in this practice manual are subject to constant change and therefore should serve only as a foundation for further investigation and study of the current law and procedures related to the subject matter covered herein. Further, the forms contained within this manual are samples only and were designed for use in a particular situation involving parties which had certain needs which these documents met. All information, procedures and forms contained herein should be very carefully reviewed and should serve only as a guide for use in specific situations.

The Indiana Continuing Legal Education Forum and contributing authors hereby disclaim any and all responsibility or liability, which may be asserted or claimed arising from or claimed to have arisen from reliance upon the procedures and information or utilization of the forms set forth in this manual, by the attorney or non-attorney.

Attendance of ICLEF presentations does not qualify a registrant as an expert or specialist in any discipline of the practice of law. The ICLEF logo is a registered trademark and use of the trademark without ICLEF's express written permission is prohibited. ICLEF does not certify its registrants as specialists or expert practitioners of law. ICLEF is an equal opportunity provider of continuing legal education that does not discriminate on the basis of gender, race, age, creed, handicap, color or national origin. ICLEF reserves the right to refuse to admit any person or to eject any person, whose conduct is perceived to be physically or emotionally threatening, disruptive or disrespectful of ICLEF registrants, faculty or staff.

INDIANA CONTINUING LEGAL EDUCATION FORUM

SIGMUND J. BECK ADVANCED BANKRUPTCY ROUNDTABLE

Agenda

ICLEF
INDIANA CONTINUING LEGAL EDUCATION FORUM

August 19, 2022

1:30 P.M. **Registration**

2:00 P.M. Program Begins

3:30 P.M. **15 Minute Refreshment Break**

5:30 P.M. Reception and Dinner

August 20, 2022

8:30 A.M. **Program Continues**

10:30 A.M. 15 Minute Break

12:15 P.M. **Adjourn**

SIGMUND J. BECK ADVANCED BANKRUPTCY ROUNDTABLE

Faculty

Mr. Thomas C. Scherer - Chair
Dentons Bingham Greenebaum LLP
2700 Market Tower
10 West Market Street
Indianapolis, IN 46204
ph: (317) 968-5407
e-mail: thomas.scherer@dentons.com

Hon. Robyn L. Moberly
United States Bankruptcy Court
Birch Bayh Federal Building & U.S. Courthouse
46 East Ohio Street, Room 335
Indianapolis, IN 46204
ph: (317) 229-3880
e-mail: robyn_moberly@insb.uscourts.gov

Ms. Kayla D. Britton
Faegre Drinker Biddle & Reath LLP
600 East 96th Street, Suite 600
Indianapolis, IN 46240
ph: (317) 237-1155
e-mail: kayla.britton@faegredrinker.com

Mr. Michael W. Hile
Jacobson Hile Kight LLC
The Elliott House
108 East 9th Street
Indianapolis, IN 46202
ph: (317) 608-1131
e-mail: mhile@jhklegal.com

Mr. Edward M. (Ted) King
Frost Brown Todd LLC
400 West Market Street, Suite 3200
Louisville, KY 40202
ph: (502) 568-0359
e-mail: tking@fbtlaw.com
cc: lsugg@fbtlaw.com

Professor Bruce A. Markell
Professor of Bankruptcy Law and Practice
Northwestern Pritzker School of Law
375 East Chicago Avenue
Chicago, IL 60611-3069
ph: (312) 503-4060
e-mail: bmarkell@law.northwestern.edu

Ms. Melissa M. Root
Jenner & Block LLP
353 North Clark Street
Chicago, IL 60654
ph: (312) 840-7255
e-mail: mroot@jenner.com

Thomas C. Scherer, Seminar Chair, Partner, Dentons Bingham Greenebaum LLP

Tom Scherer concentrates his practice in bankruptcy, restructuring and creditors' rights and has been recognized in *The Best Lawyers in America* for Bankruptcy Law since 1995. He has extensive experience representing secured creditors, creditors committees and debtors in cases under Chapter 11 of the Bankruptcy Code.

He also devotes significant time to commercial litigation, workouts and asset sales relating to financially distressed businesses. He is a veteran speaker, having given numerous presentations on bankruptcy, reorganization and commercial lending.

Thomas C. Scherer
Dentons Bingham Greenebaum LLP
2700 Market Tower
10 West Market Street
Indianapolis, IN 46204
ph: (317) 968-5407
e-mail: thomas.scherer@dentons.com

Kayla D. Britton, Partner, Faegre Drinker Biddle & Reath LLP, Indianapolis

Kayla Britton provides general and transactional representation to mid-sized businesses and publicly held companies in various industries, including financial, agribusiness, manufacturing, distribution, insurance and professional services. She has specific experience advising agribusiness clients in credit workout and transactional matters. She advises debtors and creditors in and out of bankruptcy, including representing clients in national Chapter 11 bankruptcy cases. Kayla's experience includes business reorganization, restructuring, and liquidation and representing buyers, sellers, and lenders in distressed sales transactions.

Kayla represents debtors, creditors, committees and other interested parties in bankruptcy, including national Chapter 11 bankruptcy cases. She also advises companies and boards of directors on pre-bankruptcy contingency planning, working to develop out of court solutions while also laying the necessary foundation to a successful bankruptcy proceeding if necessary.

Her experience includes advising chapter 11 debtors in the agribusiness, real estate, for-profit college, finance and manufacturing industries. She also represents clients in defending avoidance actions, advising on debtor-in-possession credit facilities, and working with potential buyers in navigating the 363-sale process.

Kayla represents creditors in developing workout, reorganization or liquidation strategies designed to maximize recoveries while minimizing risk. Her depth of experience in creditors' rights matters allows her to bring practical strategies to her clients and to know when litigation is needed or when an out-of-court solution presents the best outcome for her client.

Kayla has specific experience in managing distressed sale transactions, including navigating the unique issues and exigencies presented by a seller's insolvency and building consensus among multiple constituencies.

She also represents clients in the agribusiness, automotive, manufacturing, and professional services industries in the preparation and negotiation of commercial contracts.

Kayla D. Britton
Faegre Drinker Biddle & Reath LLP
600 East 96th Street, Suite 600
Indianapolis, IN 46240
ph: (317) 237-1155
e-mail: kayla.britton@faegredrinker.com

Michael Hile, Jacobson Hile Kight LLC, Indianapolis

Michael Hile concentrates his practice in the areas of business reorganization, workouts, and restructuring. Mike has substantial transactional experience in bankruptcy matters, including structured financing, opinion practice, mortgage-backed securities, mergers and acquisitions, workouts, securities offerings, and debtor-in-possession financing. Mike represents debtors, creditors, committees, trustees, and other interest-holders in bankruptcy cases in Indiana and throughout the country. He has participated in bankruptcy litigation, including defending and prosecuting avoidance actions and dischargeability litigation. Mike also has significant experience in commercial litigation and other business matters, focusing on guarantor liability, receiverships, and secured transaction issues in state and federal courts. Mike received his B.A. in 1982 from Andrews University and his J.D. in 1985 from Indiana University-Robert H. McKinney School of Law (Indianapolis). He is a former law clerk to Judge Kearns of the United States Bankruptcy Court for the Southern District of Indiana. After his clerkship, Mike practiced in the Manhattan office of Willkie Farr & Gallagher LLP in its bankruptcy group. He then returned to Indiana where he practiced as a member of Katz & Korin PC for 15 years and prior to that as a member of Johnson Smith, LLP. Mike has been honored by Best Lawyers for Bankruptcy and Creditor Debtor Rights / Insolvency and Reorganization Law and is admitted to the bars of the State of Indiana and the State of New York.

Michael W. Hile
Jacobson Hile Kight LLC
The Elliott House
108 East 9th Street
Indianapolis, IN 46202
ph: (317) 608-1131
e-mail: mhile@jhklegal.com

Edward M. (Ted) King, Frost Brown Todd LLC, Louisville, KY

Ted is a member of the Firm, and serves as Chairman of the Firm's Finance Committee. He practices in the Indianapolis, Indiana and Louisville, Kentucky offices and participates in both the Firm’s bankruptcy and restructuring and commercial transactions practice groups. He was honored to be named the Top Business Bankruptcy Lawyer in Louisville in the 2014 edition of *The Best Lawyers in America®* for his outstanding reputation and distinguished work. He was also selected as one of the top Ten Lawyers in Kentucky overall by *Kentucky Super Lawyers®* in Bankruptcy and has been consistently selected as a *Kentucky Super Lawyer®* in Bankruptcy and Creditor/Debtor Rights, which is an award given only to lawyers in the top five percent of their fields. He is certified as a Business Bankruptcy Specialist by the American Board of Certification and serves on the Board of Directors of that organization.

In bankruptcy matters, he represents debtors, creditors, and committees in insolvency proceedings. He assists clients in complex business bankruptcy matters - developing plans of reorganization and advising on strategies to maximize recoveries for clients at all stages of the bankruptcy process. Some of his recent engagements include co-counsel for the Debtors in the Jillian’s Entertainment Holdings, Inc. bankruptcy case and co-counsel for the Official Committees of Unsecured Creditors in the Buehler Foods, Inc., the Critical Access Health Services Corp. and Summitt Logistics Chapter 11 cases. Ted is a frequent speaker at bankruptcy conferences, including recent American Bankruptcy Institute conferences.

In transactional matters he concentrates in all aspects of financing and secured transactions, leasing, structured financings, workouts and reorganizations, and general corporate practice. His experience includes conduit transactions, secured and unsecured financing transactions, acquisition and working capital financings, leveraged buyout transactions, ESOP loans, project and asset based transactions, senior and subordinated debt transactions, private placements, letter of credit transactions, loan participations, subordination and intercreditor agreements, credit enhancements, rate swaps and other hedging devices, construction and permanent real estate financing. Ted has extensive experience and expertise in Uniform Commercial Code matters as well written counsel opinions for loan transactions.

He manages the Firm's New Markets Tax Credit Business and helps lead the Firm's New Markets Tax Credit Practice. This includes work for community development entities, tax audit interests, leverage lenders and borrowers (QALICBs) in New Markets transactions.

Ted is active in the Community. He serves on the Boards of the Friends of the Louisville Zoo, the Kentucky Bar Foundation and is a past member of the Boards of the Jewish Community Center and the Downtown Louisville YMCA.
Prior to joining Frost Brown Todd LLC, Ted clerked for William C. Lee, United States District Judge for the Northern District of Indiana. In law school, he was a Senior Notes Editor for the Federal Communications Law Journal and a research assistant for Professor William J. Hicks, revising the multi-volume treatise *Exempt Transactions Under the Securities Act of 1933.*

Edward M. (Ted) King
Frost Brown Todd LLC
400 West Market Street, Suite 3200
Louisville, KY 40202
ph: (502) 568-0359
fax: (502) 581-1087
e-mail: tking@fbtlaw.com
cc: lsugg@fbtlaw.com

Professor Bruce A. Markell, Professor of Bankruptcy Law and Practice, Chicago, IL

Bruce A. Markell was appointed the Professor of Bankruptcy Law and Practice at Northwestern in 2015. From 2013 to 2015, he was the Jeffrey A. Stoops Professor of Law at Florida State University School of Law, and before that he was a United States Bankruptcy Judge for the District of Nevada, a position he had held since 2004. After law school, he clerked for then-judge Anthony M. Kennedy on the Court of Appeals for the Ninth Circuit. Before taking the bench, he practiced bankruptcy and business law in Los Angeles for ten years (where he was a partner at Sidley & Austin), and was a law professor for fourteen. He is the author of numerous articles on bankruptcy and commercial law, and a co-author of four law school casebooks. He has been a visiting professor at, among other schools, Peking University School of Law in Beijing, and Harvard Law School. He contributes to *Collier on Bankruptcy*, and is a member of *Collier* 's editorial advisory board. He is a conferee of the National Bankruptcy Conference, a fellow of the American College of Bankruptcy, a charter member of the International Insolvency Institute, and a member of the American Law Institute. He is a founding member of the NITA-trained faculty of the Advanced Consumer Bankruptcy Practice Institute. Professor Markell also consults with the International Monetary Fund on insolvency-related issues (having been part of the IMF's missions to Ireland, Bosnia, Belarus, Montenegro, Serbia, Georgia, and Greece), and was the primary drafter of Kosovo's current bankruptcy law. He is an associate editor of the *Bankruptcy Law Letter*, and regularly contributes articles to that publication.

POSITIONS HELD:
Professor of Bankruptcy Law and Practice, Northwestern University Pritzker School of Law, June 2015 to present.
Jeffrey A. Stoops Professor of Law, The Florida State University College of Law, July 2013 to May 2015.
United States Bankruptcy Judge for the District of Nevada, July 2004 to July 2013; Member, Bankruptcy Appellate Panel for the Ninth Circuit Court of Appeals, August 2007 to July 2013.
Senior Fellow in Bankruptcy and Commercial Law, William S. Boyd School of Law, University of Nevada, Las Vegas, January 2005 to July 2013.
Doris S. and Theodore B. Lee Professor of Law, William S. Boyd School of Law, University of Nevada, Las Vegas, June 1999 to July 2004.
Professor of Law, Indiana University—Bloomington, August 1994 to May 1999, Associate Professor of Law, May 1990 to July 1994.
Partner, Sidley & Austin, Los Angeles, California, January 1988 to May 1990, (Associate

Attorney, May 1985 to December 1987).
Associate Attorney, Sachs & Phelps, Los Angeles, California, May 1983 to April 1985; Morrison & Foerster, Los Angeles, California, October 1981 to April 1983.
Clerkship, Law Clerk to the Honorable Anthony M. Kennedy, Judge, United States Court of Appeals for the Ninth Circuit, September 1980 to September 1981.

EDUCATION:
King Hall School of Law, University of California, Davis.
Degree: J.D., May 1980.
Graduated first in class; School of Law Medal; Order of the Coif.
Editor-in-Chief, 1979-1980; Member, 1978-1979; U.C. DAVIS LAW REVIEW.
American Jurisprudence Awards: Civil Procedure; Federal Jurisdiction; Wills and Trusts; Business Corporations I and II.
Pitzer College, Claremont, California.
Degree: B.A., June 1977.
Concentrations: Philosophy and Economics.
Theses (unpublished):
Grice's Recursive Definition of Truth and Wittgenstein's Views on Meaning in the Tractatus Logico Philosophicus and in the Philosophical Investigations (Philosophy).
The Proper Measure of Punitive Damages in Tort Cases (Economics).
College representative, University College exchange program, Oxford University, 1975-1976.

Complete Curriculum Vitae here...

Professor Bruce A. Markell
Visiting Professor of Law, Cornell University and,
Professor of Bankruptcy Law and Practice
Northwestern Pritzker School of Law
375 East Chicago Avenue
Chicago, IL 60611-3069
ph: (312) 503-4060
e-mail: bmarkell@law.northwestern.edu

Hon. Robyn Lynn Moberly, United States Bankruptcy Court, Indianapolis

The first female judge of the U.S. Bankruptcy Court in Indiana, Moberly served as president of the Indiana Judges Association and president of the Indianapolis Bar Association.

Hon. Robyn L. Moberly
United States Bankruptcy Court
Birch Bayh Federal Building & U.S. Courthouse
46 East Ohio Street, Room 335
Indianapolis, IN 46204
ph: (317) 229-3880
e-mail: robyn_moberly@insb.uscourts.gov

Melissa M. Root, Jenner & Block LLP, Chicago, IL

Melissa M. Root is a restructuring and bankruptcy lawyer. She has deep experience representing creditors, official committees, debtors, examiners and trustees in complex financial restructuring matters and high stakes bankruptcy litigation. Ms. Root is a member of the firm's Restructuring and Bankruptcy, Bankruptcy Litigation, Energy and ERISA Litigation practices. In addition, she is the co-chair of the firm's Hiring Executive Committee and a member of its Diversity and Inclusion Committee.

A significant part of Ms. Root's practice includes representing official committees of creditors and retired employees. She currently represents the official committee of government retirees in the Commonwealth of Puerto Rico's Title III case, and she previously represented retiree committees in The Budd Company, American Airlines, and Walter Energy chapter 11 cases. Ms. Root also has significant experience representing creditors in major energy bankruptcy cases. In addition, Ms. Root frequently represents parties in bankruptcy related appellate matters. Ms. Root recently served as counsel for the prevailing Petitioners before the United States Supreme Court in Wellness International Network, Limited v. Sharif. She also served as counsel for the American Bar Association in connection with its amicus curiae brief filed in the Supreme Court in Executive Benefits Insurance Agency v. Arkinson, and as counsel for the National Association of Bankruptcy Trustees in connection with its amicus curiae brief filed in the Supreme Court in Baker Botts L.L.P and Jordan, Hyden, Womble, Culbreth & Hozer, P.C. v. Asarco LLC.
Ms. Root also devotes significant time to pro bono work. She currently represents a class of former students in the ITT Technical Institute bankruptcy case. Ms. Root's pro bono work also includes her representation of a domestic violence shelter in its chapter 11 case, a federal habeas petitioner before the Seventh Circuit, and plaintiffs asserting 1983 claims.

Ms. Root is a leader in many professional organizations. She currently serves as the national Co-Chair of the American Bar Association Section of Litigation's Woman Advocate Committee, and for several years, she served as the national Co-Chair of the American Bar Association Section of Litigation's Bankruptcy & Insolvency Committee. Ms. Root is active in the American Bankruptcy Institute; she serves on the Advisory Committee for several conferences and was recently selected to be part of the ABI's inaugural 40 under 40 class. She also served as the Chicago Network Co-Chair of the International Women in Insolvency and Restructuring Confederation and on its Board for several years.

Locally, Ms. Root served a two-year position on the Bench/Bar Liaison Committee for the United States Bankruptcy Court for the Northern District of Illinois.

Melissa M. Root
Jenner & Block LLP
353 North Clark Street
Chicago, IL 60654
ph: (312) 840-7255
e-mail: mroot@jenner.com

The August 2022 Sigmund J. Beck
Advanced Chapter 11 Bankruptcy Roundtable

Thomas C. Scherer, Chair
Hon. Robyn L. Moberly
Edward M. ("Ted") King
Prof. Bruce A. Markell
Melissa M. Root
Kayla Britton
Michael Hile

TABLE OF CONTENTS

Topic

Inquiring Blind Eyes Want to Know: Good Faith Under § 550(b) in Madoff Fraudulent Transfer Cases

Bruce A. Markell
Sigmund J. Beck Advanced Chapter 11 Bankruptcy Roundtable
West Baden Springs Resort
West Baden Springs, Indiana
August 19-20, 2022

Materials:

Right Place, Wrong Route: Good Faith, Madoff *and the Second Circuit*, Bankruptcy Law Letter (Thomson Reuters; December 2021)

Questions:

1. For background, Section 550(b) provides that a subsequent transferee of an avoidable transaction has a defense to the extent that transferee:

> takes for value, including satisfaction or securing of a present or antecedent debt, in good faith, and without knowledge of the voidability of the transfer avoided. . . .

2. What is the connection between good faith and notice? Between notice and Section 550(b)(1)'s "without knowledge of the voidability of the transfer avoided"?

3. Do you notice any difference between or among actual notice, statutory notice, record notice, imputed notice, constructive notice, or inquiry notice? Consider what Comment *a* to Section 69 of the Restatement (Third) of Restitution and Unjust Enrichment (2011) says:

> "Notice" is a legal category that combines actual knowledge with imputed knowledge. While imputed knowledge is described in practice under such various headings as "statutory notice," "record notice," "constructive notice," and "inquiry notice," or by reference to a person's "duty of inquiry," the different labels attach to what is essentially a common idea. In particular circumstances, and for a variety of reasons, the law will treat a person as knowing a fact without requiring that such knowledge be proven directly. . . .

2. Comment *f* to Section 69 of the Restatement definition of notice is:

> A person has notice of facts of which the person has reason to know as a matter of reasonable inference, or which the person would have discovered upon appropriate inquiry. The standard that determines the inferences to be drawn and the inquiries to be made is that of a reasonable and prudent person whose interests would be served by obtaining the knowledge in question. In other words, a purchaser is charged with knowledge of the facts that a prudent and

> self-interested purchaser would infer or discover if the affirmative defenses did not exist.

Is this definition consistent with *In re Bernard L. Madoff Inv. Sec. LLC*, 12 F.4th 171 (2d Cir. 2021), *cert. denied sub nom*. Citibank, N.A. v. Picard, 142 S. Ct. 1209 (2022), the case discussed in the materials?

Bankruptcy Law Letter

DECEMBER 2021 | VOLUME 41 | ISSUE 12

RIGHT PLACE, WRONG ROUTE: GOOD FAITH, MADOFF AND THE SECOND CIRCUIT

By Bruce A. Markell

I. INTRODUCTION

Sometimes in our travels, we choose a new, modern interstate to reach an old, well-established destination. In doing so, however, we lose touch with the fact that the journey is often the best part of the trip; the newer route proves sterile, less interesting. We get to where we should be going, but without the perspectives provided by the old road.

The metaphor can be extended to law. Lawyers often create new theories or draft new statutes to attack old problems, only to find that the result remains the same. Along the way the effort loses sight of prior efforts to solve the problem.

Something along this line recently occurred at the Second Circuit. In the latest of a welter of cases involving Bernard Madoff's Ponzi scheme, the Second Circuit tackled the issue of the meaning of "good faith" in fraudulent transfer litigation. Although the court reached the correct result, it did so in a fashion that bodes ill for future commercial disputes.

II. THE CASE

The case is *Picard v. Citibank, N.A. (In re Bernard L. Madoff Inv. Sec. LLC)*.[1] In *Picard*, the Second Circuit essentially decided two points: that good faith for purposes of Sections 548(c) and 550(b) of the Bankruptcy Code encompasses a three-part, inquiry notice test; and that claims of good faith as a defense to fraudulent transfers are affir-

IN THIS ISSUE:

The full citation for the case is In re Bernard L. Madoff Inv. Sec. LLC, 12 F.4th 171 (2d Cir. 2021), cert. denied sub nom. Citibank, N.A. v. Picard, 142 S. Ct. 1209, 212 L. Ed. 2d 217 (2022)

mative defenses for which the transferee, not the trustee, bears the burden of initially pleading.

A. THE FACTS

1. BLMIS AND THE PONZI SCHEME

Picard is the liquidation trustee of Bernard L. Madoff Investment Securities LLC ("BLMIS") under the Securities Investor Protection Act ("SIPA"). BLMIS ran a Ponzi scheme from the 1990s until its collapse in 2008; it took in money from investors, created false paper returns so that the old investors would stay and new investors would be lured, and then paid off eventual withdrawals with new money from duped investors. "As a result, each time BLMIS transferred payments to a customer, it was money stolen from other customers."[2]

Since the collapse of BLMIS in late 2008, Picard has been engaged in recovering the ill-gotten gains of various investors in BLMIS' Ponzi scheme.[3] These actions were not only brought against those who received money directly from BLMIS (initial transferees to the bankruptcy cognoscenti), but also those who received their funds from those who received funds from BLMIS (subsequent transferees).

In these actions, however, Picard ultimately sought to recover from direct and indirect investors only those amounts which exceeded their investment—commonly referred to as their funds in excess of each investor's "net equity" in the scheme.[4]

Picard dealt with actions to recover approximately $213 million from initial transferee Legacy Capital Ltd. ("Legacy"), and approximately $393 million from subsequent transferees Citibank, N.A. and various affiliates (together, "Citi") and Khronos LLC ("Khronos").

2. LEGACY AND KHRONOS

Legacy invested in BLMIS for itself and for others. Around 2003, suspicious of BLMIS' returns, a hedge fund in which Legacy invested analyzed Madoff's purported investment strategy. In October 2003, that hedge fund reported that the market could not support the options volume BLMIS purported to trade, that many of BLMIS' trades were

BANKRUPTCY LAW LETTER (USPS 674-930) (ISSN 0744-7871) is issued monthly, 12 times per year; published by Thomson Reuters, 610 Opperman Drive, P.O. Box 64526, St. Paul, MN 55164-0526. Periodicals postage paid at St. Paul, MN, and additional mailing

Subscription Price: For subscription information call (800) 221-9428, or write West, Credit Order Processing, 620 Opperman Drive, P.O. Box 64833, St. Paul, MN 55164-9754.

POSTMASTER: Send address changes to: *Bankruptcy Law Letter,* 610 Opperman Drive, P.O. Box 64526, St. Paul, MN 55164-0526.

at improbable prices, and that there was no "footprint," or stable record, of its trades.[5]

As a result of these findings, the hedge fund discussed possible fraud, and what to do if it existed. It ultimately decided to redeem its investment in BLMIS in 2004. Legacy, through an agent who was on the hedge fund's investment committee, objected, and later convinced the hedge fund to delay redeeming half of the hedge's fund's investment. Legacy then bought that half in July 2004.

Legacy then instructed Khronos, which provided accounting services to Legacy, to investigate BLMIS. Khronos, however, had been co-founded by a principal of Legacy and his brother, and those two individuals were also managing directors of Khronos. As managing directors, these individuals then restricted the access of Khronos' employees to Legacy and its BLMIS account statements, even though such restrictions were contrary to Khronos' audit practices. As a result, these two managing directors were the only ones permitted to review Legacy's account details with respect to BLMIS.

Khronos' evaluation of BLMIS' trading data confirmed that the trades were "statistically impossible."[6] It also revealed that BLMIS lacked a capable auditor and "clearly lacked the staff necessary to conduct research on the investment opportunities."[7]

3. CITI

Citi did not receive transfers directly from BLMIS. Instead, it received at least $343 million in subsequent transfers between June 2005 and March 2008 from feeder fund[8] Rye Select Broad Market Prime Fund, L.P. ("Prime Fund") "as repayment of funds [Citi] loaned to Prime Fund to invest with BLMIS[]."[9]

Beginning in the spring of 2005, Citigroup Global Markets, Inc. ("CGMI"), the main Citi affiliate that conducted Citi's BLMIS-related business, uncovered facts suggesting that BLMIS was engaged in fraudulent activity. Specifically, in its diligence for deals with feeder funds, Citi was "unable to independently verify that BLMIS maintained segregated customer accounts, or even that the assets existed in any account," and it was "unable to find any evidence that BLMIS was in fact making the options trades" it was reporting to its customers.[10]

In March 2005, CGMI performed a quantitative analysis in its diligence on the deal with BLMIS feeder fund Fairfield Sentry Limited. The results revealed BLMIS was not using Madoff's purported "split strike conversion" investment strategy because BLMIS' returns outperformed the market in a manner that appeared statistically impossible. In addition, CGMI knew BLMIS lacked an independent custodian for its customers' assets, giving BLMIS sole control over customers' funds and making it more likely BLMIS could steal or misuse those funds. As a result, a managing director at CGMI stated that "either the returns are not the returns or the strategy is not the strategy."[11]

After this investigation, CGMI's deal with Prime Fund was up for renewal. Instead of posing questions related to possible fraud, it held a meeting that was a "check-the-box exercise in which CGMI sought only basic information that amounted to a 'corporate overview' of BLMIS."[12] Tellingly, however, Citi "demanded a unique contractual indemnification provision related directly to fraud at BLMIS," and insisted on it before renewing the deal.[13]

B. THE DISTRICT COURT'S "WILLFUL BLINDNESS" OPINION

After the collapse, Picard sued Legacy, Khronos and Citi under Sections 548 and 550, as those sections are generally available to SIPC trustees. All three defendants moved to dismiss the complaint on the basis that Picard had not adequately alleged a lack of good faith, which they contended required allegations of willful blindness on their part.

The district court viewed these facts and agreed, making two rulings which served as the basis for the appeal.

First, the court concluded that a lack of good faith in a SIPA liquidation requires willful blindness to the truth; that is, an intentional choice to blind oneself to red flags that suggest a high probability of fraud. In so holding, the court expressly rejected applying an inquiry notice standard.[14]

Second, the court set the pleading burden for the good faith defense, concluding that, contrary to the Bankruptcy Code, "SIPA . . . affects the burden of pleading good faith or its absence" and alters the traditional framework such that, in a SIPA liquidation, the trustee bears the burden of pleading the defendant's lack of good faith.[15]

The district court returned the cases to the bankruptcy court, which applied the standard articulated by the district court and then dismissed both actions, denying Picard the ability to amend his complaint.[16]

C. THE ANALYSIS

1. REVERSAL

The Second Circuit reversed on both points. It held that "a lack of good faith under Sections 548 and 550 of the Bankruptcy Code encompasses an inquiry notice standard,"[17] and that "good faith is an affirmative defense under Sections 548 and 550 and that SIPA does not compel departing from the well-established burden-of-pleading rules, [that] the trustee is not required to plead a transferee's lack of good faith."[18]

2. THE INQUIRY NOTICE STANDARD

Picard had proceeded under Section 548 against Legacy, and under Section 550(b) against Citi and Khronos. Both of these sections have "good faith" components. Section 548(c) provides a defense to a claim of avoidability by an initial transferee. It states that:

> a transferee . . . of such a transfer [voidable under § 548] . . . that takes for value *and in good faith* has a lien on or may retain any interest transferred . . . to the extent that such transferee . . . gave value to the debtor in exchange for such transfer[19]

Section 550(b)(1), in turn, provides a defense to subsequent transferees of property subject to the bankruptcy estate's avoidance powers. It provides that:

> The trustee may not recover . . . from— [¶] (1) a transferee that takes for value, including satisfaction or securing of a present or antecedent debt, *in good faith*, and without knowledge of the voidability of the transfer avoided[20]

The standard of good faith thus matters. If present, transferees potentially have a defense; if absent, they don't.

The district court's imposition of a willful blindness test put Picard in a pickle—the district court would have had him prove that the various defendants knew of the fraud but proceeded anyway; in colloquial terms, they turned a blind eye to the facts.[21]

So Picard argued the district court had

adopted the wrong standard. Instead of the willful blindness test, Picard stumped for the inquiry notice test.

The court responded positively. It first distinguished the two standards:

> "[A] willfully blind defendant is one who takes deliberate actions to avoid confirming a high probability of wrongdoing and who can almost be said to have actually known the critical facts." . . . . *Inquiry notice requires knowledge of suspicious facts that need not suggest a "high probability" of wrongdoing but are nonetheless sufficient to induce a reasonable person to investigate*. . . . Willful blindness also imputes a heightened sense of culpability, whereas a defendant on inquiry notice who fails to investigate does not necessarily do so with the purpose of avoiding confirming the truth.[22]

Ultimately, the court adopted the inquiry notice standard. It articulated a three-step standard as follows, which is worth quoting at length:

> [T]he good faith defense under Sections 548(c) and 550(b)(1) should be approached in a three-step inquiry. First, a court must examine what facts the defendant knew; this is a subjective inquiry and not "a theory of constructive notice." . . . Second, a court determines whether these facts put the transferee on inquiry notice of the fraudulent purpose behind a transaction—that is, whether the facts the transferee knew would have led a reasonable person in the transferee's position to conduct further inquiry into a debtor-transferor's possible fraud. . . . Third, once the court has determined that a transferee had been put on inquiry notice, the court must inquire whether "diligent inquiry [by the transferee] would have discovered the fraudulent purpose" of the transfer. . . . An objective "reasonable person" standard applies in the second and third steps, namely, in assessing whether (1) the suspicious facts were such that they would have put a reasonable person in the transferee's position on inquiry notice; and (2) the transferee conducted a reasonably diligent investigation after being put on inquiry notice.[23]

For reasons set out later, this is probably as good a formulation of good faith as is currently available. So the court got that right. But how it got there is quite a different matter.

D. THE RELIANCE ON MODERN DICTIONARIES

The court reached its result through an odd process. "Good faith" is one of the oldest of commercial law concepts, steeped in history and frosted with all manner of nuance. It plays a role in regular transactions,[24] in the processing of negotiable instruments,[25] and in parsing and terminating legal[26] and equitable interests.[27] It also has over a 450-year association with fraudulent transfer law, as will be shown below.[28] Against this background, you might think that the court would have surveyed the history of the concept as applied in fraudulent transfers, and used that survey as the basis of its holding.

Nope. The court started with of all things, ordinary meaning. It stated:

> The Bankruptcy Code does not define "good faith." "When a term goes undefined in a statute, we give the term its ordinary meaning." . . . "To assess ordinary meaning, we consider the commonly understood meaning of the statute's words at the time Congress enacted the statute, and with a view to their place in the overall statutory scheme."[29]

Really? "Good faith" in commercial law means what was the "commonly understood meaning" at the time of enactment, in this case 1978? To make it clear that the court was not talking about commonly understood in commercial law circles, it then proceeded to cite a dictionary definition from the 1978 version of the *Oxford English Dictionary* in support of its holding that good faith meant inquiry notice.[30]

It supported its analysis by reference to Supreme Court precedent.[31] Citing *Food Marketing Institute v. Argus Leader Media*,[32] the court stated that "[d]ictionary definitions and case law predating the Bankruptcy Code of 1978 [are] 'usual source[s] that might shed light on the statute's ordinary meaning.' "[33]

But the *Food Marketing* quotation was concerned with the *absence* of traditionally reliable sources, which it said included "dictionary definitions, early case law, *or any other usual source that might shed light on the statute's ordinary meaning*."[34] The Second Circuit omitted the italicized part. Moreover, *Food Marketing* was about a contemporary statute, the Freedom of Information Act. For interpretations of modern statutes creating new rights, it makes sense to consult contemporary word usage and meaning as of enactment. For ancient statutes, written long ago but which have endured to the present—not so much.

Picard was concerned with the proper meaning of "good faith" as used in fraudulent transfer law, an endeavor that has a 450-year history. It boggles the mind to think that dictionaries extant in 1978 could hold the key to the term's full meaning. Indeed, the only reason to consult dictionaries from the time of enactment would be the bizarre assumption that in 1978 Congress reexamined each term to be used in Sections 548 and 550—including "good faith"—and then imbued each term with an updated, contemporary, meaning, untethered from history.

Of course, that is not how courts typically construe commercial terms. The court redeemed itself somewhat by exploring "context," and then reviewing the history of good faith.[35] But the damage was done, and it also didn't examine much history before the early 20th Century.[36] Had the court following the spirit, if not the text, of *Food Marketing*, it should have first explored the rich history of the use of good faith in fraudulent transfer cases, the overwhelming "usual sources" for use of the term good faith as defenses to fraudulent transfers.

And there is significant early history.

III. THE HISTORY OF GOOD FAITH AND FRAUDULENT CONVEYANCES

Fraudulent transfer law begins with the Statute of 13 Elizabeth, enacted in 1571.[37] That act gave us the now-famous triplet of "hinder, delay or defraud."[38]

But it also gave us the origins of the good faith defense. In the fifth section of the statute, a defense was laid out if the conveyance "is or shal be upon good Consyderation, & bona fide lawfully conveyed or assured . . . ."[39] Of course, the Latin "*bona fide*" roughly translates as "good faith," making the 1571 statute the origin of the term and concept. Once of the first cases to interpret this provision was the enduring *Twyne's Case*,[40] decided in 1602.[41]

A. THE ORIGINAL STATUTE AND BONA FIDES

Although *Twyne's Case* is reported in *Coke's Reports*,[42] what actually happened has recently been exhaustively and captivatingly revealed by Professor Emily Kadens.[43] We know from her article that the debtor, Pearce, transferred all of his personal property (his realty already being encumbered) to Twyne for valuable consideration. But, for whatever reason, Pearce remained in possession of that property, and used it to work the farm upon which the property was located. He also possibly paid taxes on it as his own as well.

But when the undersheriff came to levy upon the property Pearce controlled to satisfy Pearce's creditors, the sheriff was met with opposition. The opposition was based on the assertion that the property that was targeted—the grain and the cattle (but not the sheep) then on the farm—belonged to Twyne, not Pearce. The Sheriff thus could not take Twyne's goods to pay for Pearce's debts.

History will note that, after the litigation Professor Kadens exhaustively examines, Twyne lost. Edward Coke, the attorney general who tried, won, and then reported the case, made sure of that. To win, however, Coke had to deal with the fact that Pearce, the debtor, did actually owe a debt to Twyne. And had to consider that the transfer of the property to Twyne, while fraudulent as to creditors, was likely good as between the Twyne and Pearce.[44] Accordingly, the transfer satisfied Pearce's debt to Twyne; it was consideration for the extinguishment of the debt.

Coke acknowledges this conclusion, but he convinced the Star Chamber that Pearce's provision of valuable consideration made no difference under the Statute of 13 Eliz. As Coke's report states:

> notwithstanding here was a true debt due to Twyne, and a good consideration of the gift, yet it was not within the proviso of the said Act of 13 Eliz. . . . for although it is on a true and good consideration, yet it is not bona fide, for no gift shall be deemed to be bona fide within the said proviso which is accompanied with any trust . . . .[45]

Here, the trust existed apparently due to the nature of the arrangement between Twyne and Pearce. Coke's report never quite spells out what this arrangement was, but the inference is that it was an arrangement different from that described in the documentation, and full of hidden understandings. In somewhat confusing language, Coke gave a hypothetical illustrating why the transaction was not bona fide:

> if a man be indebted to five several persons, in the several sums of twenty pounds, and hath goods of the value of twenty pounds, and makes a gift of all his goods to one of them in satisfaction of his debt, but there is a trust between them, that the donee shall deal favourably with him in regard of his poor estate, either to permit the donor, or some other for him, or for his benefit, to use or have possession of them, and is contented that he shall pay him his debt when he is able; this shall not be called bona fide within the said proviso.[46]

At the time, Coke was concerned with the text of the Statute of 13 Eliz. that stated that

> this act or anything therein contained shall not extend to any . . . goods or chattels, had, made, conveyed or assured, or hereafter to be had, made, conveyed or assured, which estate or interest is or shall be, upon good consideration and bona fide . . . .[47]

Coke's response was to imply that secrecy and the clandestine nature of the transfer implied an intent to hinder, delay or defraud. As he stated, "the proviso [from the Statute of Eliz.] saith on a good consideration, and bona fide; so a good consideration doth not suffice, if it be not also bona fide."[48] He followed this with a stern admonition to the reader: "therefore, reader, when any gift shall be to you in satisfaction of a debt, by one who is indebted to others also; first, Let it be made in a public manner, and before the neighbours, and not in private, for secrecy is a mark of fraud."[49] Additional admonitions included having the property appraised before transfer, and changing possession after the transfer.[50]

B. GOOD FAITH AFTER TWYNE TO THE 19TH CENTURY

1. ENGLISH VIEWS

The great bulk of cases construing *Twyne's Case* dealt with its holding that title must follow possession, not the bona fide nature of the consideration. Some 175 years later, however, Lord Mansfield picked up the thread:

> But if the transaction be not bonâ fide, the circumstance of its being done for a valuable consideration, will not alone take it out of the statute. I have known several cases where persons have given a fair and full price for goods, and where the possession was actually changed; yet being done for the purpose of defeating creditors, the transaction has been held fraudulent, and therefore void.
>
> One case was, where there had been a decree in the Court of Chancery, and a sequestration. A person with knowledge of the decree, bought the house and goods belonging to the defendant, and gave a full price for them. The Court said, the purchase being with a manifest view to defeat the creditor, was fraudulent, and therefore, notwithstanding a valuable consideration, void.-So, if a man knows of a judgment and execution, and, with a view to defeat it, purchases the debtor's goods, it is void: because, the purpose is iniquitous. It is assisting one man to cheat another, which the law will never allow.[51]

As a result, not only did there have to be valuable consideration, but the consideration given still had to be bona fide or in good faith.

2. 18TH AND 19TH CENTURY AMERICAN VIEWS

The Statute of Elizabeth and Twyne's Case were considered elemental components of commercial law. Both New York and Virginia, for example, enacted mirror-image versions of the Statute of Elizabeth in 1785[52] and 1787,[53] respectively.

American courts also explored the good faith tenet of *Twyne's Case*. Orlando Bump's 1872 treatise lists five cases related to this proposition;[54] the fourth edition of that treatise, published in 1896, lists 14.[55]

The good faith standard employed was one of inquiry notice. As the Bump treatise acknowledged:

> It is not necessary that the grantee shall have actual knowledge of the debtor's intent to delay, hinder, or defraud his creditors in order to render the transfer void. A knowledge of facts sufficient to excite the suspicions of a prudent man and to put him on the inquiry, or to lead a person of ordinary perception to infer fraud, or the means of knowing by the use of ordinary diligence, amounts to notice and is equivalent to actual knowledge in contemplation of law.[56]

This conclusion was echoed by Melvin Bigelow's treatise of 1911, which tied inquiry notice to the Statute of 13 Eliz.:

> According to general doctrines of the law, one who purchases with notice, i.e. with knowledge of facts which would put a prudent man upon inquiry leading to the truth, and a fortiori one who purchases with knowledge of a fact in itself showing a defect or taint in the title or in the sale, purchases without good faith. This is in accordance with the very language of the statute of 13th Elizabeth; and it is believed to be the better and the more general view of the meaning

> of the term 'good faith' or 'bona fide' in the statutes generally against fraudulent conveyances.[57]

At the end of the 19th Century, Congress then incorporated good faith in the 1898 Bankruptcy Act's provisions on fraudulent conveyances.[58] In addition, with respect to the requirement that a recipient of a preferential payment had to have reasonable cause of intent and nature of the transfer, *Collier* was of the view that constructive or inquiry notice was sufficient.

> If the person has constructive notice that a preference was intended, that is sufficient. But some fact must first actually come to his knowledge in order to give him constructive notice. That fact is such a fact as would induce a man of ordinary prudence, engaged in a like transaction, to make inquiry. If such a fact actually comes to a man's knowledge then he is chargeable with the duty of making inquiry, and he has constructive notice of all which he could learn by inquiries pursued with ordinary diligence. Constructive notice is sufficient upon the ground that when a party is about to perform an act by which he has reason to believe that the rights of third parties will be affected, an inquiry as to the effect is a moral duty . . . .[59]

Even the Supreme Court seemed to embrace an inquiry notice standard under fraudulent conveyance law. In the 1917 case of *Dean v. Davis,*[60] one Jones found himself in financial trouble. He had given unsecured notes to a bank upon which there were forged endorsements. The bank discovered the fraud and demanded payment, and apparently also insinuated Jones might be criminally liable for forgery. Jones, a farmer who also ran a country store, did not have the cash, and so he pleaded with his brother-in-law, Dean, to lend him $1,600. Jones also offered to give Dean a mortgage on everything he owned if the money could be found.

After talking it over with Jones and his father-in-law, Dean lent the money pursuant to several cross-defaulted notes, and took the security. There was valuable consideration for this transaction; Dean lent funds, and Jones promised to repay, and backed his promise by a grant of security.

By the time the mortgages were recorded, however, the first note in the amount of $100 was overdue, and thus the cross default clauses caused all of the remaining notes, representing the entire $1,600, to come due. Dean then took possession of everything, and would have foreclosed but for an involuntary bankruptcy filed against Jones.

Davis was appointed Jones' bankruptcy trustee, and contested the mortgage—it turned out that although Jones had assured Dean that the property would be worth five times the amount of the loan, a sale of the assets only yielded $1,634, roughly the amount of the notes Dean took. So unless the mortgage was invalidated, Dean would be repaid in full while other creditors would receive nothing.

The case was tried on both preference and fraudulent conveyance grounds.[61] Dean defeated the preference action, but lost on the fraudulent conveyance claim.[62] The Supreme Court summarized the evidence in favor of Jones' intent to hinder, delay or defraud, and of Dean's complicity as follows:

> Jones knew that he was insolvent. He knew that he was making a preferential payment. He must have known that suspension of his business and bankruptcy would result from giving and recording a mortgage of all his property to secure a note which had matured before the mortgage was executed. The lower courts were justified in concluding that he intended the necessary consequences of his act; that he willingly sacrificed his property and his other creditors to avert a

> threatened criminal prosecution; and that Dean, who, knowing the facts, cooperated in the bankrupt's fraudulent purpose, lacked the saving good faith.[63]

The Court thus affirmed that Jones had the requisite intent to "hinder, delay or defraud" creditors by offering and giving security when insolvent, and by engineering the conversion of the bank's unsecured claims into a secured debt. These facts were all inferred from what Jones knew or should have known.

In short, without citing *Twyne's Case* or Coke's report or it, the Court had before it the modern day equivalent of Coke's hypothetical involving five creditors and £20. Here, Jones had property that ultimately turned out to be worth about $1,600. He mortgaged—essentially gave—that property to Dean in consideration for Dean paying an equivalent amount to the bank, and Dean, as a good brother-in-law, then did "deal favorably with him in regard of his poor estate."[64] From those facts, a lack of good faith was found.

C. GOOD FAITH IN THE 20TH CENTURY

1. THE UFCA

The drafters of the initial Uniform Fraudulent Conveyance Act (UFCA), working between 1915 and 1918, carried forward the good faith concept when drafting the new uniform law. Indeed, the UFCA carried the concept into its innovation invention of constructive fraudulent conveyances; the definition of "fair consideration," a requirement to validate an insolvent's transfer, required "good faith" in addition to the exchange of a fair equivalent.[65]

2. THE CHANDLER ACT OF 1938

In 1938, in the Chandler Act,[66] Congress revised the fraudulent conveyance portions of the Bankruptcy Act, adopting suggestions of the National Bankruptcy Conference, and essentially adopting as federal law the central portions of the UFCA, including its concept of good faith.[67]

3. THE BANKRUPTCY CODE OF 1978

This history was not unknown to the drafters of the 1978 Bankruptcy Code. By this time, "bona fide" had settled into "good faith," and the drafters carried the "bona fide" required into the new Code not only as a specific defense (to the extent of value) in Section 548(c), but also for the protection of subsequent transferees in Section 550(b).

All agree that the origins of Section 550 lie in Section 4-609(b)(1) of the 1973 Bankruptcy Commission bill. At that time, the text read:

> (b) Liability of Subsequent Transferees.
>
> (1) The trustee may not recover property referred to in subdivision (a) from a subsequent transferee of the initial transferee who purchases for value in good faith without knowledge of the voidability of the initial transfer, or from a transferee of such a transferee.[68]

This Report started by indicating that "good faith" was "a familiar phrase" to be left "to the courts [to interpret] on a case-by-case construction."[69] It then went on to state:

> good faith clearly would not be present if the transferee knew facts that would lead a reasonable person to believe that the property was recoverable. The effect of subdivision (b) is probably the same as that of § 67a(3) as to purchasers at judicial sales and of § 70d(5) as to "purchasers"of currency or negotiable instruments. The protection is extended, however, to all subsequent transferees to avoid litigation and unfairness to innocent purchasers.[70]

Examining the sources cited by the *Report* supports the view that the Commission intended the defense to be congruent with defenses held by good faith purchasers outside of bankruptcy, that is, inquiry notice. Section 67a(3), referred to in the *Report*, provided that "the title of a bona-fide purchaser of such property shall be valid, but if such title is acquired otherwise than at a judicial sale held to enforce such lien, it shall be valid only to the extent of the present consideration paid for such property."[71] Section 70d(5), in turn, provided that "nothing in this title shall impair the negotiability of currency or negotiable instruments."[72] In support of this reading, the *Report* cites Garrard Glenn's treatise.[73] That treatise, in turn, states the proposition as a subsequent transferee "should have the full benefit of the usual rule that attaches to the idea of bona fide purchaser, which makes the inadequacy of value immaterial, although it may be evidence of notice, or may indicate that a gift was intended rather than a purchase."[74]

Pulling these citations together, it is more than plausible that the *Report* intended that defenses to be accorded to subsequent transferees were to be substantially the same as those accorded to good faith purchasers under common law and at equity.

This reading is not inconsistent with later legislative history, albeit such history is sparse and open to different interpretations. Both the House and the Senate bills that ultimately merged to become the Bankruptcy Code had identical text for Section 550(b)(1), and identical legislative history.

The House's and Senate's explanation of Section 550(b)'s components, however, were not very helpful. With respect to good faith, the reports state, in relevant part, that:

> The phrase "good faith" in this paragraph is intended to prevent a transferee from whom the trustee could recover from transfering [sic] the recoverable property to an innocent transferee, and receiving a retransfer from him, that is, "washing" the transaction through an innocent third party. In order for the transferee to be excepted from liability under this paragraph, he himself must be a good faith transferee.[75]

Thus, to the extent one looks at and gives credence to the circumstances surrounding the drafting of the language, it appears that the good faith language was intended to mirror commercial practice.

4. THE UFTA

By the time of the promulgation of the Uniform Fraudulent Transfer Act in 1984 (UFTA), the concept remained, but the focus had shifted to defenses available to transferees. No longer was good faith an element of consideration. Under Section 8(a) of the UFTA, the recipient of a transfer made with the actual intent to hinder, delay or defraud had a full defense to avoidance if he or she had given reasonably equivalent value and was in good faith.[76]

This differed from Section 548(c) of the Bankruptcy Code, which required good faith as well, but only allowed a defense *to the extent of value given* (with the change being between the numerical difference between full value and "reasonably equivalent value").[77] The Uniform Voidable Transaction Act of 2014 (UVTA), the successor to the UFTA, carries this distinction forward.[78]

IV. GOOD FAITH AND INQUIRY NOTICE GENERALLY

The realm of duties imposed based on required or expected inferences is the realm of notice and good faith. Deciding what a person should have known based upon what they did know is a policy choice. It distills common sense and accepted reasoning and makes them universally applicable, and allows courts to make judgments on actions taken that can be assessed against an objective background. But good faith is policy, and the actions it requires are triggered by what a person should know. That, in turn, is a task performed by notice. The Restatement (Third) of Restitution and Unjust Enrichment (R3RUE) encapsulates nicely the function and role of notice:

> "Notice" is a legal category that combines actual knowledge with imputed knowledge. While imputed knowledge is described in practice under such various headings as "statutory notice," "record notice," "constructive notice," and "inquiry notice," or by reference to a person's "duty of inquiry," the different labels attach to what is essentially a common idea. In particular circumstances, and for a variety of reasons, the law will treat a person as knowing a fact without requiring that such knowledge be proven directly.[79]

As a consequence, the function of "should have known" is part of "inquiry notice." Inquiry notice is a venerable and essential part of the common law. Long ago, Justice Story described it as "whatever is sufficient to put a party upon inquiry, (that is, whatever has a reasonable certainty as to time, place, circumstances, and persons)."[80] Again, the R3RUE:

> A person has notice of facts of which the person has reason to know as a matter of reasonable inference, or which the person would have discovered upon appropriate inquiry. The standard that determines the inferences to be drawn and the inquiries to be made is that of a reasonable and prudent person whose interests would be served by obtaining the knowledge in question. In other words, a purchaser is charged with knowledge of the facts that a prudent and self-interested purchaser would infer or discover if the affirmative defenses did not exist.[81]

How does inquiry notice link to good faith? Again, as stated in the R2RUE, "Because the effect of notice is to preclude the affirmative defenses, the rule of 'inquiry notice' imputes knowledge that undercuts the purchaser's legal position; it compels precisely the inferences that the purchaser—in seeking to invoke the defenses—would have reason to deny."[82]

V. CONCLUSION

In *Picard*, the Second Circuit reached the correct destination in deciding that good faith under Sections 548(c) and 550(b) requires only inquiry notice. The intertwined history of fraudulent transfers and good faith recounted above confirms this. But that history was pretty much ignored by the Second Circuit, which veered off into bizarre zone of "ordinary meaning" of historical terms. Whatever relevance ordinary meaning has for contemporary creation of rights, it is an odd and inapt fit for venerable commercial terms. It is simply bizarre to believe that terms with accepted and stable meanings in commercial law, meanings upon which millions, if not billions, of transactions rely, should take a fresh meaning every time a legislature chooses to codify (or rectify) a practice.

So, kudos to the Second Circuit for reaching the right place this time. Let's just hope that future panels don't take the same route.

ENDNOTES:

[1]In re Bernard L. Madoff Investment Securities LLC, 12 F.4th 171 (2d Cir. 2021).

[2]Picard v. Citibank, N.A. (In re Bernard L. Madoff Investment Securities LLC, 12 F.4th 171, 179 (2d Cir. 2021).

[3]In the 10 years since appointment, Picard has recovered nearly $14.5 billion in

assets. https://www.madofftrustee.com/.

[4]Picard v. Citibank, N.A. (In re Bernard L. Madoff Investment Securities LLC, 12 F.4th 171, 180 (2d Cir. 2021).

[5]Picard v. Citibank, N.A. (In re Bernard L. Madoff Investment Securities LLC, 12 F.4th 171, 183 (2d Cir. 2021).

[6]Picard v. Citibank, N.A. (In re Bernard L. Madoff Investment Securities LLC, 12 F.4th 171, 183-84 (2d Cir. 2021).

[7]Picard v. Citibank, N.A. (In re Bernard L. Madoff Investment Securities LLC, 12 F.4th 171, 184 (2d Cir. 2021).

[8]A "feeder fund" is an investment vehicle that invests for others. So here, Prime would invest in BLMIS, and then distribute its returns to a different set of investors or, in Citi's cases, to Citi in repayment of debt used to invest in BLMIS.

[9]Picard v. Citibank, N.A. (In re Bernard L. Madoff Investment Securities LLC, 12 F.4th 171, 182 (2d Cir. 2021).

[10]Picard v. Citibank, N.A. (In re Bernard L. Madoff Investment Securities LLC, 12 F.4th 171, 182 (2d Cir. 2021).

[11]Picard v. Citibank, N.A. (In re Bernard L. Madoff Investment Securities LLC, 12 F.4th 171, 182 (2d Cir. 2021). About this time, a client of CGMI, Harry Markopolos, submitted a report to the SEC detailing the evidence of fraud at BLMIS and identifying Gross as one of the experts the SEC should contact for more information. *Id*.

[12]Picard v. Citibank, N.A. (In re Bernard L. Madoff Investment Securities LLC, 12 F.4th 171, 183 (2d Cir. 2021).

[13]Picard v. Citibank, N.A. (In re Bernard L. Madoff Investment Securities LLC, 12 F.4th 171, 183 (2d Cir. 2021). Around the same time, CGMI rejected a separate proposed deal with Tremont Partners, Inc., Prime Fund's general partner, because it lacked such indemnification. *Id*.

[14]Picard v. Citibank, N.A. (In re Bernard L. Madoff Investment Securities LLC, 12 F.4th 171, 184 (2d Cir. 2021). The willful blindness standard has long been the standard with securities, as indicated by UCC Section 8-105(a)(2). Under that section, a person has notice of an adverse claim to a security if "the person is aware of facts sufficient to indicate that there is a significant probability that the adverse claim exists and deliberately avoids information that would establish the existence of the adverse claim." As Comment 4 to section 8-105 notes: "This is intended to codify the 'willful blindness' test that has been applied in such cases." Transactions in securities have been subject to this higher standard since May v. Chapman, 16 M. & W. 355, 361, 153 Eng. Rep. 1225, 1228 (Ex. 1847) (Pollock, B.) ("I agree that 'notice and knowledge' means not merely express notice, but knowledge, or the means of knowledge to which the party wilfully shuts his eyes.").

[15]Picard v. Citibank, N.A. (In re Bernard L. Madoff Investment Securities LLC, 12 F.4th 171, 184 (2d Cir. 2021) (quoting Securities Investor Protection Corp. v. Bernard L. Madoff Inv. Securities LLC, 516 B.R. 18, 24, 59 Bankr. Ct. Dec. (CRR) 119 (S.D. N.Y. 2014)).

[16]Picard v. Citibank, N.A. (In re Bernard L. Madoff Investment Securities LLC, 12 F.4th 171, 184 (2d Cir. 2021).

[17]Picard v. Citibank, N.A. (In re Bernard L. Madoff Investment Securities LLC, 12 F.4th 171, 191 (2d Cir. 2021). The court then extended this to SIPA trustees. "Lack of good faith in a SIPA liquidation therefore applies an inquiry notice, not willful blindness, standard." *Id.* at 195.

[18]Picard v. Citibank, N.A. (In re Bernard L. Madoff Investment Securities LLC, 12 F.4th 171, 196 (2d Cir. 2021).

[19]11 U.S.C. § 548(c) (emphasis supplied).

[20]11 U.S.C. § 550(b)(1) (emphasis supplied).

[21]Although undoubtedly apocryphal, the expression "turn a blind eye" is often said to have its origins in the 1801 Battle of Copenhagen, where Lord Horatio Nelson, then second in command of the English fleet, was ordered to withdraw by signal flags from the admiral of the fleet. Nelson, however, pretended not to see the signals because he looked for them through a telescope placed before an eye that had been blind since early in Nelson's naval career.

[22]Picard v. Citibank, N.A. (In re Bernard

L. Madoff Investment Securities LLC, 12 F.4th 171, 185 (2d Cir. 2021)(emphasis supplied).

[23]Picard v. Citibank, N.A. (In re Bernard L. Madoff Investment Securities LLC, 12 F.4th 171, 191-92 (2d Cir. 2021) (emphasis supplied).

[24]Good faith is part of almost every commercial contract, either by statute or by judicial decision. See UCC § 3-104; Restatement (Second) of Contracts § 205 (1981).

[25]Good faith is required for a holder of an instrument to become a holder in due course. UCC § 3-302.

[26]Section 2-403 of the UCC, as did general commercial law before it, favors good faith purchasers over those who may have legal or equitable interests against the seller.

[27]Good faith purchasers and payees receive favorable treatment against holders of equitable interests as stated in the Restatement (Third) of Restitution and Unjust Enrichment (R3RUE). *See id.* §§ 66, 67.

[28]See Section III.

[29]Picard v. Citibank, N.A. (In re Bernard L. Madoff Investment Securities LLC, 12 F.4th 171, 186 (2d Cir. 2021) (citing Taniguchi v. Kan Pacific Saipan, Ltd., 566 U.S. 560, 566, 132 S. Ct. 1997, 182 L. Ed. 2d 903 (2012), a case on what "interpreter" meant in a federal costs statue, and New York v. National Highway Traffic Safety Administration, 974 F.3d 87, 95 (2d Cir. 2020), a case on what language in federal statutes regulating fuel economy meant).

[30]Picard v. Citibank, N.A. (In re Bernard L. Madoff Investment Securities LLC, 12 F.4th 171, 186-87 (2d Cir. 2021). The court also looked at citations from 1978 versions of *Black's Law Dictionary* and *Ballentine's Law Dic*tionary.

[31]Picard v. Citibank, N.A. (In re Bernard L. Madoff Investment Securities LLC, 12 F.4th 171, 186 (2d Cir. 2021).

[32]Food Marketing Institute v. Argus Leader Media, 139 S. Ct. 2356, 2363, 204 L. Ed. 2d 742 (2019).

[33]Picard v. Citibank, N.A. (In re Bernard L. Madoff Investment Securities LLC, 12 F.4th 171, 186 (2d Cir. 2021).

[34]Food Marketing Institute v. Argus Leader Media, 139 S. Ct. 2356, 2363, 204 L. Ed. 2d 742 (2019).

[35]Picard v. Citibank, N.A. (In re Bernard L. Madoff Investment Securities LLC, 12 F.4th 171, 187-88 (2d Cir. 2021).

[36]Indeed, to the extent the court looked to cases and sources arising before 1900, they were related to the willful blindness standard. In re Bernard L. Madoff Investment Securities LLC, 12 F.4th 171, 189-90 (2d Cir. 2021).

[37]An Acte agaynst fraudulent Deedes Gyftes Alienations, &c, 13 Eliz. c. 5 (1571) (Eng). The Second Circuit unilaterally gives this statute the name "Fraudulent Conveyances Act of 1571," which is not recognized as a short title by the English Short Titles Act or Statute Law Revision Act. The court also did not recognize that the law had been repealed in 1925. The Law of Property Act, 15 Geo. 5, c. 20, sch 7 (1925). That repeal referred to the 1571 legislation as initially in this note.

[38]The statute, however, never uses this combination of words. The statute instead uses the phrases "delaye hynder or defraude" and "dysturbed hyndred delayed or defrauded." An Acte agaynst fraudulent Deedes Gyftes Alienations, &c, 13 Eliz. c. 5, § 1 (1571) (Eng).

[39]An Acte agaynst fraudulent Deedes Gyftes Alienations, &C, 13 Eliz. c. 5, § 5 (1571) (Eng).

[40]Twyne's Case, 3 Co. Rep. 80b, 76 Eng. Rep. 809 (Star Ch. 1602).

[41]As Garrard Glenn quipped, "You cannot read far in the law of fraudulent conveyances before you come to Twyne's Case." Garrard Glenn, The Rights and Remedies of Creditors Respecting Their Debtor's Property § 69, at 54 (1915).

[42]Twyne's Case, 3 Co. Rep. 80b, 76 Eng. Rep. 809 (Star Ch. 1602).

[43]Emily Kadens, A New Light on Twyne's Case, 94 Am. Bankr. L.J. 1 (2020). Conflict of interest disclosure: I am married to Professor Kadens. But don't let her lapse of judgment in selecting a husband affect your opinion of the article. Others have said it

contains "a brilliant analysis of [Twyne's Case] and the circumstances out of which it arose." Douglas G. Baird, The Fraudulent Conveyance Origins of Chapter 11: An Essay on the Unwritten Law of Corporate Reorganizations, 36 Emory Bankr. Dev. J. 700 n.7 (2020).

[44]English case law did not appear to affirmatively state this proposition until the 19th Century. Baldwin v. Cawthorne, 2 Ves. Jun. Supp. 557, 34 Eng. Rep. 1225 (Ch. 1812). ("Any man assigning property, but keeping the possession thereof himself, is, within the doctrine of Twyne's case 3 Rep. 82, and Pauncefoot v. Blunt, there cited, guilty of a fraud, as against all persons not parties to the assignment, and who are prejudiced thereby; but as between the parties themselves the transaction is binding").

[45]Twyne's Case, 3 Co. Rep. 80b, 81a, 76 Eng. Rep. 809, 814 (Star Ch. 1602).

[46]Twyne's Case, 3 Co. Rep. 80b, 81a, 76 Eng. Rep. 809, 814 (Star Ch. 1602). Today I suspect we would call this an insider preference. See Unif. Voidable Transactions Act § 5(b).

[47]13 Eliz., ch. 5, 2d ¶ (1571), repealed by The Law of Property Act, 15 Geo. 5, ch. 20, § 172 (1925).

[48]Twyne's Case, 3 Co. Rep. 80b, 81a, 76 Eng. Rep. 809, 814 (Star Ch. 1602).

[49]Twyne's Case, 3 Co. Rep. 80b, 81a, 76 Eng. Rep. 809, 814 (Star Ch. 1602).

[50]Twyne's Case, 3 Co. Rep. 80b, 81a, 76 Eng. Rep. 809, 814 (Star Ch. 1602). This reasoning was picked up in a common treatise of the time on the preparation of deeds:

> So if in this case he give all his goods to B in satisfaction of his debt, and before any suit begun by A, with any express or implicit trust as to the intent that B shall be favourable to the debtor, or that if the debtor provide the money that he shall have the goods again, or that he suffer the debtor to enjoy and use the goods and pay him as he can; in these and the like cases the deeds shall be said to be fraudulent and void, for howsoever it be made upon good consideration, yet it is not made bonâ fide.

William Sheppard, The Touch-Stone of Common Assurances 66 (1648).

[51]Cadogan v. Kennett, 2 Cowp. 433, 434, 98 Eng. Rep. 1171, 1172 (K.B. 1776).

[52]1803 Va. Acts, Chap. X, An Act to Prevent Frauds and Perjuries (originally passed as Ch. 66 on Nov. 30, 1785). As noted in Hamilton v. Russell, 5 U.S. 309, 2 L. Ed. 118, 1803 WL 940 (1803), which construed this Virginia statute, "The act of assembly, which governs the case, appears, as far as respects fraudulent conveyances, to be intended to be co-extensive with the acts of the 13th and 27th of Eliz. . . . ."

[53]An Act for the Prevention of Frauds, New York Laws, 10th Sess., Chap. XLIV, passed Feb. 26, 1787.

[54]Orlando F. Bump, Fraudulent Conveyances: A Treatise Upon Conveyances Made by Debtors to Defraud Creditors 230 n.3 (1872).

[55]Orlando F. Bump, A Treatise Upon Conveyances Made by Debtors to Defraud Creditors § 182, at 207 n.4 (James McIlvaine Gray rev., 4th ed. 1896).

[56]Orlando F. Bump, A Treatise Upon Conveyances Made by Debtors to Defraud Creditors § 184, at 210-11 (James McIlvaine Gray rev., 4th ed. 1896).

[57]Melville Madison Bigelow, The Law of Fraudulent Conveyances, Ch. XIX, § 1, at 589 (1911).

[58]Bankruptcy Act of 1898, § 67e (stating that transfers made "with the intent and purpose . . . to hinder, delay, or defraud his creditors, or any of them, shall be null and void as against the creditors of such debtor, *except as to purchasers in good faith and for a present fair consideration"*) (emphasis supplied. This section is discussed in Wm. Miller Collier, The Law of Bankruptcy and The National Bankruptcy Act of 1898, Ch. VII, § 67, at 373-76 (1899).

[59]Wm. Miller Collier, The Law of Bankruptcy and The National Bankruptcy Act of 1898, Ch. VI, at 317 (1899).

[60]Dean v. Davis, 242 U.S. 438, 37 S. Ct. 130, 61 L. Ed. 419 (1917).

[61]At the time, the bankruptcy fraudulent conveyance statute, found in § 67e of the Act, read as follows:

> That all conveyances, transfers, assignments, or incumbrances of his property, or any part

> thereof, made or given by a person adjudged a bankrupt under the provisions of this Act subsequent to the passage of this Act and within four months prior to the filing of the petition, with the intent and purpose on his part to hinder, delay, or defraud his creditors, or any of them, shall be null and void as against the creditors of such debtor, except as to purchasers in good faith and for a present fair consideration. . .

[62]The bank was not party to the suit, and thus we do not know if it was ever part of the discussions regarding avoidance, as it has received full payment on an unsecured debt within the preference period.

[63]Dean v. Davis, 242 U.S. 438, 445 (1917).

[64]Twyne's Case, 3 Co. Rep. 80b, 81a, 76 Eng. Rep. 809, 814 (Star Ch. 1602). The main difference between the facts in *Dean* and in Twyne's Case is that the federal codification had given *Dean*, the transferee, a statutory defense of good faith. But Dean, although he denied it, seems to have been in on the scam, as the lower courts found. That deprived him of the good faith defense to the established avoidance.

[65]Unif. Fraudulent Conveyance Act § 3(a).

[66]Pub. L. No. 696, 52 Stat. 575 (1938).

[67]"We have condensed the provisions of the Uniform Fraudulent Conveyance Act, retaining its substance and, as far as possible, its language." National Bankruptcy Conference, Analysis of H.R. 12889, 74th Cong., 2d Sess. 214 (Comm. Print 1936); see also In re Quaker Room, 90 F. Supp. 758, 762 (S.D. Cal. 1950); In re Vanity Fair Shoe Corp., 84 F. Supp. 533, 534 (S.D. N.Y. 1949), order aff'd, 179 F.2d 766 (2d Cir. 1950). See also 5 Collier on Bankruptcy ¶ 548.12 (16th 2021)

[68]Report of the Commission on the Bankruptcy Laws of the United States, H.R. Doc. No. 93-137, 93d. Cong., 1st Sess., Pt. I, at 179 (1973).

[69]Report of the Commission on the Bankruptcy Laws of the United States, H.R. Doc. No. 93-137, 93d. Cong., 1st Sess., Pt. I, at 180 (1973).

[70]Report of the Commission on the Bankruptcy Laws of the United States, H.R. Doc. No. 93-137, 93d. Cong., 1st Sess., Pt. I, at 180 (1973) (emphasis added).

[71]Bankruptcy Act of 1898, § 67a(3), 11 U.S.C.A. § 107(a)(3) (repealed 1979).

[72]Bankruptcy Act of 1898, § 70d(5), 11 U.S.C.A. § 110(d)(5) (repealed 1979).

[73]Report of the Commission on the Bankruptcy Laws of the United States, H.R. Doc. No. 93-137, 93d. Cong., 1st Sess., Pt. I, at 180 (1973) (citing 1 Garrard Glenn, Fraudulent Conveyances and Voidable Preferences § 259a, at 444-45 (Rev. ed. 1940)).

[74]1 Garrard Glenn, Fraudulent Conveyances and Voidable Preferences § 259a, at 445 (Rev. ed. 1940) (citing Restatement of Trusts § 298, cmt i. (1935)).

[75]H. Rep. No. 595, 95th Cong., 1st Sess. 375 (1977); S. Rep. 989, 95th Cong., 2d Sess. 90 (1978).

[76]UFTA § 8(a).

[77]11 U.S.C.A. § 548(c).

[78]UVTA § 8(a). The only difference between the UFTA provision and the UVTA provision is that the UVTA provision explicitly requires the value to be given to the debtor.

[79]R3RUE § 69, cmt. a (2011).

[80]1 Joseph Story, Commentaries on Equity Jurisprudence § 400, at 444 (13th ed. 1886).

[81]R2RUE § 69, cmt. f. See In re Otero County Hospital Association, Inc., 560 B.R. 551, 564, 76 Collier Bankr. Cas. 2d (MB) 1208 (Bankr. D. N.M. 2016) ("A person is on inquiry notice where a reasonably prudent person with knowledge of particular facts would make inquiry into the existence of other facts."). See also Cities Service Oil Co. v. Adair, 273 F.2d 673, 676 (10th Cir. 1959) (defining inquiry notice as "when a party has knowledge of facts which would lead an ordinarily prudent person to make inquiry which would disclose the existence of other facts, the knowledge amounts to notice of those other facts.").

[82]R3RUE § 67, cmt. f. ("The implicit standard of hypothetical, disinterested inquiry explains why this aspect of the law of notice is often described in terms of "good faith." Where the facts reveal a purchaser who has

acquired an interest without asking obvious questions, or without drawing inferences that would appear self-evident to a disinterested observer, it is natural to describe the ensuing contest (between purchaser and adverse claimant) by referring to the purchaser's lack of good faith.").

https://legal.thomsonreuters.com/

TAX SALE AS A FRAUDULENT TRANSFER

BY: MICHAEL W. HILE
JACOBSON HILE KIGHT LLC
The Elliott House
208 East 9th Street
Indianapolis, IN 46202
mhile@jhklegal.com

Seminar Materials for
The Sigmund J. Beck Advanced Bankruptcy Roundtable 2022
August 19-20, 2022
West Baden Springs Hotel/ French Lick Resort Casino
West Baden Springs, Indiana 47432

BACKGROUND

In the beginning (or close enough to it for our purposes), fraudulent transfer law as adopted by the Bankruptcy Code (11 U.S.C. 548), arguably applied to all transactions, including foreclosures and tax sales.[1] Initially, courts generally followed one of three analyses adopted by the various Courts of Appeals ruling on the issue of fraudulent transfer in the context of foreclosure sales. In its *Durrett v. Washington National Insurance Co*., 621 F.2d 201 (5th Cir. 1980), the Fifth Circuit Court of Appeals analyzed the fraudulent transfer aspect of a foreclosure sale under section 67(d) of the then applicable Bankruptcy Act and found that the foreclosure sale did not satisfy the "fair equivalent" test set forth in the Bankruptcy Act. In doing so, the Fifth Circuit had been "unable to locate a decision of any district or appellate court dealing only with a transfer of real property as the subject of attack under section 67(d) of the Act, which has approved the transfer for less than 70 percent of the market value of the property." 621 F.2d at 203. Based on the *Durrett* decision, many lawyers advised clients to bid at least 70% of appraised value at a foreclosure sale in order to meet the "Durrett Rule" to avoid a fraudulent transfer challenge to the purchase.

Two years later, the Ninth Circuit BAP, in deciding *Lawyers Title Ins. Corp. v. Madrid*, 21 B.R. 424 (B.A.P. 9th Cir. 1982), *aff'd on other grounds*, 725 F.2d 1197 (9th Cir. 1984), rejected the Durrett Rule, finding that the winning bid at a regularly conducted non-collusive foreclosure sale *always* constitutes reasonably equivalent value and thus, the related sale cannot be avoided as a fraudulent transfer.

Thereafter, in 1988, the Seventh Circuit Court of Appeals entered the fray in *Bundles v.*

---

[1] According to Justice Scalia, "Fraudulent transfer law and foreclosure law enjoyed over 400 years of peaceful coexistence in Anglo-American jurisprudence until the Fifth Circuit's unprecedented 1980 decision in *Durrett.* To our knowledge no prior decision had ever applied the 'grossly inadequate price' badge of fraud under fraudulent transfer law to set aside a foreclosure sale." *BFP v. Resolution Trust Corp*., 511 U.S. 531 (1994).

Baker, 856 F.2d 815 (7th Cir. 1988), rejecting both the *Durrett* and *Madrid* analyses as inappropriate constructions of Section 548 of the Bankruptcy Code. The Seventh Circuit concluded that "in defining reasonably equivalent value, the court should neither grant a conclusive presumption in favor of a purchaser at a regularly conducted, noncollusive foreclosure sale, nor limit its inquiry to a simple comparison of the sale price to the fair market value. Reasonable equivalence should depend on all the facts of each case." *Id.* at 824.

The United States Supreme Court resolved the Circuit conflict in *BFP v. Resolution Trust Corp.*, 511 U.S. 531 (1994), holding that a mortgage foreclosure sale conducted in compliance with the applicable state law conclusively produces reasonably equivalent value as a matter of law. 511 U.S. at 548-549. The Supreme Court rejected the Durrett and Bundles analyses because they read "fair market value" into section 548 of the Bankruptcy Code in contravention of Congress's specific use of the term "reasonably equivalent value." The Supreme Court concluded that "reasonably equivalent value" evidenced that "fair market value cannot - or at least cannot always - be the benchmark." *Id.* at 537. More specifically, fair market value has no applicability in the context of a sale conducted in accord with statutory requirements as such requirements specifically negate a negotiated price between a willing buyer and willing seller, which is implicit in the term "fair market value". *Id.* at 538. The Supreme Court noted that foreclosure sales are established by state laws and typically "require notice to the defaulting borrower, a substantial lead time before the commencement of foreclosure proceedings, publication of a notice of sale, and strict adherence to prescribed bidding rules and auction procedures." *Id.* at 542. These procedures have been adopted "to achieve what each [state] considers the proper balance between the needs of lenders and borrowers." *Id*. at 541-42. Therefore, a foreclosure sale conducted in compliance with the governing state procedure is protected from a 'fraudulent transfer challenge premised upon an inadequate sale price except where, and if, a state allows such a sale to be set aside due to a "shock the conscience" sale price or other facts raising a presumption of fraud or unfairness. *Id.*[2]

As the Court noted, a different ruling would upset the balance between foreclosure law and debtor-creditor law and place "title of every piece of realty purchased at foreclosure . . . under a federally created cloud." *Id.* at 544. The Court went on to state that "[s]urely Congress has the power pursuant to its constitutional grant of authority over bankruptcy . . . to disrupt the ancient harmony that foreclosure law and fraudulent conveyance law, those two pillars of debtor-creditor jurisprudence, have heretofore enjoyed. But absent clearer textual guidance than the phrase 'reasonably equivalent value' – a phrase entirely compatible with preexisting practice - we will not presume such a radical departure." *Id*. at 543. Thus, "[w]e deem, as the law has always deemed, that a fair and proper price, or a 'reasonably equivalent value,' for foreclosed property, is the price in fact received at the foreclosure sale, so long as all the requirements of the State's foreclosure law have been complied with." *Id*. at 545.[3]

However, and most relevant to discussion respecting avoidance of tax sales as a fraudulent transfer under section 548, the Supreme Court, in a footnote to its *BFP* decision, stated, "**[w]e emphasize that our opinion today covers only mortgage foreclosures of real estate. The considerations bearing upon other foreclosures and forced sales (to satisfy tax liens, for**

[2] Indiana has adopted the "shock the court's sense of conscience and justice" as a basis for setting aside a foreclosure sale. *Arnold v. Melvin R. Hall, Inc*., 496 N.E. 2d 63 (Ind. 1986).

[3]The Court's "conclusion does not render § 548(a)(2) superfluous, since the 'reasonable equivalent value' criterion will continue to have independent meaning (ordinarily a meaning similar to fair market value) outside the foreclosure contest. * * * Any irregularity in the conduct of the sale that would permit judicial invalidation of the sale under applicable law deprives the sale price of its conclusive force under § 548(a)(2)(A), and the transfer may be avoided if the price received was not reasonably equivalent to the property's actual value at the time of the sale (which we think would be the price that would have been received if the foreclosure sale had proceeded according to law)." *Id*. at 545.

example) may be different." *Id.* at 537, fn. 3 (*emphasis added*).

Forever in search of black letter law and notwithstanding the carveout in footnote 3 regarding tax sales and other forced sales, legal professionals and trial courts began adopting and adapting the *BFP* rule for foreclosure sales to tax sales even where the statutory procedures surrounding such sales were dissimilar to foreclosure. In doing so, the parties relied on the policy enunciated in *BFP* that a federal cloud over transfers of real property (which the parties assumed should include tax sale transfers of real property) should be avoided. Not all courts adopted this policy reasoning however and, when confronted with a forfeiture-type tax sale statute or one that did not require competitive bidding (for the property or related tax certificate), seized upon footnote 3 in *BFP* concluding that tax sales did not enjoy the same presumption of "reasonably equivalent value." Consequently, in certain jurisdictions, tax sales were found to be subject to fraudulent transfer challenges. Eventually, the tax sale/fraudulent transfer issue percolated to the Circuit Courts. As of today however, the issue has not been squarely addressed by the Supreme Court beyond its footnote in *BFP*.

I. CIRCUIT COURTS SPLIT OVER APPLICABILITY OF *RESOLUTION TRUST* TO TAX SALES

A. Fifth, Ninth, and Tenth Circuit Courts of Appeal Apply *BFP* to Tax Sales.

In *T.F. Stone Co. v. Harper (In re T.F. Stone Co.)*, 72 F.3d 466 (5th Cir. 1995), the Fifth Circuit extended *BFP* to an avoidance action under section 549 of the Bankruptcy Code (which uses the term '*fair* equivalent value' as opposed to '*reasonably* equivalent value' but of no consequence to the Fifth Circuit) finding that an Oklahoma tax sale subject to bidding resulted in fair equivalent value as a matter of law and therefore was not avoidable as a fraudulent transfer. The Fifth Circuit bolstered its holding by deference to state interests in ensuring security of title to real property.

Similarly, in *Kojima v. Grandote Int'l Ltd. Liab. Co. (In re Grandote Country Club Co.)*, 252 F.3d 1146 (10th Cir. 2001), the Tenth Circuit extended *BFP* to a Colorado tax sale where a trustee of a Japanese bankrupt entity in a case ancillary to the foreign proceedings (statute providing for such proceeding since repealed) sought to avoid a title transfer pursuant to Colorado tax sale under the Colorado Uniform Fraudulent Transfer Act ("CUFTA"). Looking to CUFTA's definition of value that "a person gives a reasonably equivalent value if the person acquires an interest of the debtor in an asset pursuant to a regularly conducted, noncollusive sale, foreclosing on assets subject to a lien," the Court also found that the *BFP* rule also applied to a Colorado state tax sale. Because Colorado's tax sale law required competitive bidding - the decisive factor in determining "reasonably equivalent value" - the tax sale in question conclusively obtained reasonably equivalent value.[4] The Tenth Circuit noted that its Bankruptcy Appellate Panel had declined to extend *BFP* to a Wyoming tax sale because Wyoming's statutory tax sale process did not include a competitive bidding procedure. *See Sherman v. Rose (In re Sherman)*, 223 B.R. 555 (B.A.P. 10th Cir. 1998). Thus, *Grandote* is best characterized as applying the *BFP* rule to tax sales that include competitive bidding. [5]

More recently, in *Tracht Gut, LLC v. L.A. County Treasurer & Tax Collector*, 836 F.3d 1146 (9th Cir. 2016), the Ninth Circuit held that *BFP's* holding should be extended to California tax sales because, by California state law, such sales have the same procedural safeguards as

---

[4] The Court also found that the transfer of the tax deed was not made by the debtor, but rather by the State of Colorado to whom the property forfeited upon failure to pay taxes due. Without any discussion, the Tenth Circuit appears to have assumed that the subsequent auction of the lien and transfer of title by Colorado to the winner baptized the prior forfeiture of the property for unpaid taxes. There is no discussion as to whom - Colorado or the former owner – was entitled to the any overage at the auction.

[5]The Court's finding respecting BFP is surplus to the ruling based on the finding respecting Colorado's CUFTA provisions and reasonably equivalent value.

regularly conducted foreclosure sales.

B. Second, Third, Sixth and Seventh Circuit Courts of Appeal Have Not Extended/Distinguished *BFP* to Tax Sales.

Other Circuits, however, have not extended *BFP* to tax sales or at least, have not done so where the legislated tax sale process limits or precludes an open bidding process.

Most recently, in *Gunsalus v. Cnty. Of Ontario*, 37 F.4th 859, 2022 U.S. App. LEXIS 17596 (2nd Cir. 2022), the Second Circuit Court of Appeals found that a tax sale conducted under the "strict foreclosure" provisions of New York State tax law, which do not require competitive bidding or permit the owner to recover any equity (overage) after tax sale, was not entitled to the *BFP* presumption of reasonably equivalent value. In that case, after Ontario County took title to a property upon tax payment default and despite selling the property at auction, all of which were in compliance with state law, because the County pocketed the difference (rather than the overage going to the owner) between the unpaid taxes and winning bid, the sale was not subject to the *BFP* presumption because the County received a windfall by forfeiture of the property worth more than the taxes due. In such case, the sale was subject to avoidance under section 548 as a fraudulent transfer. *Id.*; *see also Hampton v. Cnty. Of Ontario*, 2022 U.S. App. Lexis 18424*, 2022 WL 2443007 (2nd Cir. 2022) (similar holding).

The Third Circuit, in *Hackler v. Arianna Holdings Co., LLC In re Hackler)*, 938 F.3d 473 (3d Cir. 2019), distinguished fraudulent transfer law from preference law and overruled a tax purchaser's argument that *BFP* should preclude avoiding its tax sale purchase as a preference, albeit compliant with New Jersey procedures. There, the *Hackler* court found *BFP* inapplicable to section 547(b) where the tax sale auction was only as to the redemption interest rate and "the winning bid and the value of the underlying property [was] not merely attenuated but nonexistent."

Id. at 479. In looking at *BFP*, the Third Circuit summarized that "the circuit courts that have extended BFP to tax foreclosures under §548 involved state laws that subjected the property at issue to auction." *Id*. at 480. The Court found New Jersey's bid on the interest rate to be paid to redeem tax sale not an auction of the property and another reason to deny BFP protections to a preference analysis of the New Jersey tax foreclosure sale.

Similarly, in *Lowry v. Southfield Neighborhood Revitalization Initiative (In re Lowry)*, 2021 U.S. App. LEXIS 38533 (6th Cir. 2021) (unpublished), the Sixth Circuit declined to extend *BFP* to a Michigan tax foreclosure sale where, "Michigan foreclosure law here permitted the local government to purchase the property without a public auction, for a 'minimum bid . . . Michigan law also permitted the foreclosing government authority to retain the 'surplus proceeds' from a foreclosure sale which the Michigan Supreme Court recently held violated the takings clause of the state constitution. . . . The Michigan tax foreclosure system is thus distinguishable from the mortgage foreclosure process addressed in *BFP*, so the rule in *BFP* does not apply to the facts of this case." *Id*. at *11-12.

And here, notably, in *Smith v. SIPI, LLC (In re Smith)*, 811 F.3d 228 (7th Cir. 2016), *cert. den*., 580 U.S. 823 (2016), which involved an Illinois tax sale, the Seventh Circuit also answered the question of "whether compliance with state law for tax sales is sufficient to establish that the sale was for 'reasonably equivalent value' or whether the debtor may try to set aside the sale under § 548(a)(1)(B)." *Id*. at 234. In *SIPI,* the Seventh Circuit grabbed hold of *BFP's* footnote 3, concluding that "[b]ased on the fundamental differences between the bidding methods used, . . . the reasoning of *BFP* does not extend to Illinois tax sales of real property." *Id.* Because Illinois tax sales do not involve competitive bidding over the price of the property but only over the interest rate to be paid to the tax purchaser upon redemption of the property, the Court found that "the bid amounts bear no relationship to the value of the underlying real estate" and declined to extend the rule of *BFP* to Illinois tax sales. *Id.* at 234. The Court contrasted the Illinois "interest rate method" tax sale, where a party bids down the cost of the funds on redemption, to the "overbid method" adopted by other states where "the bidding price begins at the total amount of taxes and interest due, and potential buyers then offer higher bids up to the amount they are willing to pay in return for (eventual) fee simple title." *Id.* at 237 (internal citations omitted). While the Court noted that "[o]ther circuits have extended the reasoning of *BFP* from the mortgage foreclosure context to tax sales using the overbid method. Here, we are asked to take the different step of extending *BFP* to Illinois's interest rate methods as well. We decline to do so because of the fundamental differences between the overbid and interest methods." *Id.* at 238. Finally, because *BFP's* focus was on the "central role of competitive bidding in an auction for the value of the property itself" and the Illinois tax sale process was not similarly focused, it could not conclusively produce reasonably equivalent value. *Id.* at 239. However, it limited its holding "only to the interest-rate bidding system under Illinois law," stating that "[s]ale prices, by the very design of the overbid method, are likely to generate bids more reasonably equivalent to the value of the underlying property." *Id.* at 240-241.Therefore, where the overbid process is used in tax sales, "'deference to state regulatory interests' may warrant the application of *BFP* to those systems, as [the Fifth and Tenth Circuits in *Grandote* and *T. F. Stone*, respectively, have] held." *Id.* at 240.

II. <u>*SIPI* Applied to Indiana Tax Sales</u>.

There are no cases applying either *SIPI* or *BFP* to section 548 avoidance of Indiana tax sales. However, because Indiana tax sales generally follow the "overbid method," provide for redemption periods, and return the overage to the property owner, they likely would survive a section 548 challenge, and may, out of deference to state regulatory interests, warrant a BFP type conclusive presumption of reasonably equivalent value, provided that the tax sale procedure is followed and no other non-collusive facts exist..[6] Similar to Colorado in *Grandote* and other states that have adopted the Uniform Avoidable Transfer or Fraudulent Transfer acts, Indiana has legislated that, for the purposes of constructive fraud under avoidable transfer law, "a person gives reasonably equivalent value if the person acquires an interest of the debtor in an asset through a regularly conducted, noncollusive foreclosure sale . . ." I.C. 32-18-2-13(b). A tax sale in Indiana forecloses all rights of redemption of the property. I.C. 6-1.1-25-4 ("A tax deed executed under this chapter vests in the grantee an estate in fee simple absolute, free and clear of all liens and encumbrances created or suffered before or after the tax sale [with limited exceptions]").

Types of Indiana Tax Sales

i. Regular tax sale. Certificate representing lien for taxes due is sold to purchaser at overbid sale and property remains subject to redemption by owner for one year after which time the tax certificate purchaser may petition for a tax deed. I.C. 6-1.1-24-5(e)

ii. Tax Certificate Sale. These are properties that have not sold for the minimum bid (taxes due) at one prior tax sale for which the tax certificate has been issued to the County (and arguably properties not suitable for tax sale if included by the treasurer pursuant to general discretion to dispose of such property in accord with chapter 24 of I.C. 6-1.1). I.C. 6-1.1-24-6 and 6.1. The certificates are sold by overbid auction but the minimum bid begins at the property's proportionate cost of

---

[6] *See* I.C. 6-1.1-24-5(e); but see I.C. 6-1.1-24-1.7 (properties certified not suitable for tax sale are not sold at tax sale, but may be disposed of by the county authorities as provided by chapter 24 of I.C. 6-1.1. Abandoned/vacant property, certified as such by the County auditor and so determined by a court order, is still subject to a sale by overbid auction but title transfers upon sale of such property without redemption and no tax certificate is issued.

sale (not the taxes due.) Regular redemption periods apply. If the certificate does not sell, then they or the property may be disposed of as set forth in chapters 24 or 25 of I.C. 6-1.1 which includes transfers to a not for profit. In this type of sale, the property has been subjected to at least one overbid auction so claims that the subsequent transfer/disposition is avoidable may run in to a *SIPI/BFP* defense.

iii. Abandoned property. Property must be determined by court order to be vacant or abandoned. A tax sale certificate is sold at an overbid auction (where the minimum bid is the property's proportionate cost of the sale of such properties and the property remains subject to existing work and abatement orders). However, there is no right of redemption. I.C. 6-1.1-24-2.3. Proceeds first pay the costs of sale and remainder certified to the county treasurer to the county auditor for distribution to other taxiing units during settlement. I.C. 6-1.1-24-1.5.

iv. Property not suitable for tax sale. Property declared by court order as "not suitable for tax sale" because it "(1) contains hazardous waste or another environmental hazard; or (2) has unsafe building conditions; for which the cost of abatement or remediation will exceed the fair market value of the property." I.C. 6-1.1-24-4.7(i). Such property will not be disposed by regular tax sale but may be disposed of by the county executive under I.C. 6-1.1-24-4.7(k). Such sales contain a 120-day redemption period (reduced from one year). If the property is sold by the county within 3 years after the otherwise relevant tax sale date, any overage (exceeding minimum bid of original taxes due) will be disbursed as if the property had been sold at tax sale. If no bid for the property is received equaling at least the minimum bid, then the County may dispose of it as provided under I.C 6-1.1-24,

> including transferring the property to a not-for-profit. Consequently, such a ‘tax sale’ transfer to a not for profit may be subject to an avoidance challenge as the transfer was never subjected to an overbid process. Query whether a court’s decree that the property requires remediation/repairs which exceeds the property’s fair market value would be entitled to *res judicata* or other preclusive effect and save the transfer from avoidance.

Because Indiana tax sales generally are subject to competitive overbid auction, courts are likely to extend the *SIPI/BFP* presumption of reasonably equivalent value to sales conducted in conformity therewith. However, one must understand the type of tax disposition as certain types of tax sales may not subject the property to sale like the not suitable for tax sale transfer. Absent shenanigans in certifications/declarations of unsuitability for tax sale, it is difficult to see how such transfers are likely to be great candidates for avoidance because of their cost of their remediation or repair and likely limited value. However, governmental units are increasingly using such tax dispositions to take possession of properties for private developments that would be entitled to significantly more [150% of fair market value if residential property or 125% if agricultural land] if taken by eminent domain or otherwise subjected to the regular tax sale process. See I.C. 32-24-4.5-8. Avoidance in these circumstances may be available as such transfers have not been subjected to competitive overbidding as required by *SIPI*. Consequently, where a process of property aggregation has been undertaken by a governmental unit, shenanigans could be at play and a review of the *bona fides* of the sale/transfer are warranted.

Query: Do efforts to proscribe the bidder pool impact the determination that the sale should be entitled to a presumption of reasonably equivalent value? Surely, *SIPI’s* competitive bidding requirement envisions a reasonably open bidder pool. *See Sims v. SIPI, LLC*, 811 F.3d 228 (7th Cir. 2016), *cert. den*. *Smith v. SIPI, LLC*, 580 U.S. 823 (2016). In an effort to preclude tax scofflaws and ne'er-do-well property owners from purchasing/bidding at tax foreclosure sales. Indiana has adopted statutes that require that a tax sale bidder (or any affiliated entity) may not have unpaid and outstanding property taxes nor unpaid fines, pending work orders or judgments arising from property ownership and must so certify in order to participate in a tax sale with penalties for false certification. I.C. 6-1.1-24-5.1; 6-1.1-24-5.3; I.C. 6-1.1-24-5.4. Indiana also requires bidding business associations to obtain certificates of authority to do business in Indiana in order to bid/purchase at tax sales.[7] There are no empirical studies whether these restrictions on "eligible bidders" has impacted the Indiana tax sale marketplace. At one point, Indiana was considered an open marketplace and many investment firms bid due to a potential "great. Return" (approximately 10% after initial discounted redemption period). Whether requiring bidding entities to register to do business in Indiana will limit participation in the tax sale process is an unanswered question. In addition, disqualification of bidders (subject to work orders, etc.) likely has limited the number of tax sale bidders and discouraged participation by speculative investors as many counties have excluded their bulk tax sale purchasers. Policy reasons for excluding "bad actors" from tax sales is compelling but may open the process to challenge because it now seeks the highest bid only from a limited number of bidders rather than the universe of bidders generally. Evidence that a

[7] As of July 1, 2022, similar rules became effective respecting Indiana foreclosure sales as well. I.C. 32-29-7-4.5 - 4.7. Whether these regulations may be enough to distinguish an Indiana foreclosure sale from *BFP's* conclusive presumption of reasonably equivalent value is unclear. The 'reasonably equivalent value' presumption of *BFP* relies upon competitive bidding as a keystone. However, a limited pool of bidders due to ineligibility may not satisfy the *BFP* requirement of competitive bidding.

limited bidder pool at Indiana tax sale auctions could lead to denial of Indiana tax sales to a presumption of reasonably equivalent value.

Because Indiana tax sale auctions for the most part test the marketplace for property value and tax sale redemption periods generally permit owners and lenders to protect equity in property over and above property tax obligation, absent a total screw up respecting tax payment and/or timely redemption, it is difficult to imagine circumstances where avoidance of a tax sale would result in greater benefit to the bankruptcy estate than the cost to avoid it. The cases show it does occur, however.

User Name: Michael Hile

Date and Time: Monday, August 1, 2022 11:23:00 PM EDT

Job Number: 176456204

Document (1)

1. *Smith v. SIPI, LLC (In re Smith), 811 F.3d 228*

   Client/Matter: -None-

   Search Terms: Smith v. SIPI, LLC (In re Smith), 811 F.3d 228

   Search Type: Natural Language

   Narrowed by:

Content Type	Narrowed by
Cases	-None-

Smith v. SIPI, LLC (In re Smith)

United States Court of Appeals for the Seventh Circuit

September 11, 2015, Argued; January 20, 2016, Decided

No. 15-1166

Reporter
811 F.3d 228 *; 2016 U.S. App. LEXIS 934 **; Bankr. L. Rep. (CCH) P82,916; 62 Bankr. Ct. Dec. 13

IN RE: KEITH SMITH and DAWN SMITH, Debtors. KEITH SMITH and DAWN SMITH, Plaintiffs-Appellants, v. SIPI, LLC, and MIDWEST CAPITAL INVESTMENTS, LLC, Defendants-Appellees.

Subsequent History: US Supreme Court certiorari denied by *Smith v. SIPI, LLC, 137 S. Ct. 103, 196 L. Ed. 2d 40, 2016 U.S. LEXIS 4540 (U.S., Oct. 3, 2016)*

Prior History: [1]** Appeal from the United States District Court for the Northern District of Illinois, Eastern Division. No. 1:13-cv-06422 — Harry D. Leinenweber, Judge.

Smith v. SIPI, LLC, 526 B.R. 737, 2014 U.S. Dist. LEXIS 133625 (N.D. Ill., Sept. 22, 2014)
Smith v. SIPI, LLC (In re Smith), 501 B.R. 843, 2013 Bankr. LEXIS 3078 (Bankr. N.D. Ill., July 30, 2013)

Core Terms

tax sale, bidding, bankruptcy court, equivalent value, homestead exemption, fraudulent transfer, interest rate, fair market value, overbid, buyer, auction, foreclosure sale, good faith, competitive bidding, delinquent taxes, state law, tax lien, bidder, title to property, property value, fraudulent, exemption, mortgage foreclosure, federal bankruptcy, district court, real estate, insolvent, divorce, percent, redeem

Case Summary

Overview
HOLDINGS: [1]-A sale of bankruptcy debtors' real property at a tax sale did not provide reasonably equivalent value and thus was constructively fraudulent, even though the sale complied with state law for tax sales, since the tax sale procedure for bidding the lowest amount acceptable to pay the delinquent taxes in exchange for the tax lien bore no relationship to the value of the property; [2]-Both debtors had standing to seek avoidance of the fraudulent transfer since one debtor held title to the property at the time of the bankruptcy petition and the other debtor received the property in subsequent divorce proceedings; [3]-The debtors were entitled to an amount equivalent to only one homestead exemption upon avoidance of the fraudulent transfer since only one debtor held title to the property on the date of the bankruptcy petition.

Outcome
Judgment reversed and underlying bankruptcy court judgment affirmed.

LexisNexis® Headnotes

Bankruptcy Law > ... > Avoidance > Fraudulent Transfers > Value

HN1[] **Fraudulent Transfers, Value**

Federal bankruptcy law provides generally that a sale or other transfer of an insolvent bankruptcy debtor's property may be set aside as fraudulent if the transfer was for less than reasonably equivalent value. *11 U.S.C.S. § 548(a)(1)(B)*.

Bankruptcy Law > ... > Judicial Review > Standards of Review > Clear Error Review

Bankruptcy Law > ... > Judicial Review > Standards of Review > De Novo Standard of Review

HN2[] **Standards of Review, Clear Error Review**

An appellate court reviews de novo the legal conclusions of bankruptcy and district courts. Like the district court, the appellate court defers to the factual findings of the bankruptcy court, which must stand unless they are clearly erroneous.

Bankruptcy Law > Estate Property > Avoidance > Fraudulent Transfers

HN3[] Avoidance, Fraudulent Transfers

11 U.S.C.S. § 548(a)(1)(B) empowers a bankruptcy trustee to set aside a transfer of the bankruptcy debtor's property that occurred within two years before the bankruptcy petition was filed if the transfer amounted to either actual or constructive fraud. 11 U.S.C.S. § 548(a)(1)(B). And 11 U.S.C.S. § 522(h) allows the debtor to also set aside a fraudulent transfer if the trustee has not attempted to do so.

Bankruptcy Law > ... > Avoidance > Fraudulent Transfers > Value

HN4[] Fraudulent Transfers, Value

Reasonably equivalent value for an allegedly fraudulent transfer of a bankruptcy debtor's property is not defined in 11 U.S.C.S. § 548, but bankruptcy courts routinely make such determinations.

Tax Law > ... > Real Property Taxes > Collection of Tax > Methods & Timing

Tax Law > ... > Real Property Taxes > Collection of Tax > Tax Liens

HN5[] Collection of Tax, Methods & Timing

Under the interest rate method used by Illinois for collecting delinquent property taxes, at the county tax auction bidders vie to purchase the tax lien, not the property itself. They do so by bidding down. Bids are expressed not as a total price for the property but rather as decreasing interest percentages. These percentages are the penalty interest rates that the buyer may demand from the delinquent taxpayer (or mortgage lender) to redeem the property. In Illinois, the bids therefore work down from a statutory ceiling of eighteen percent. Zero percent is the floor. 35 ILCS 200/21-215 (2015). Under this system, the lowest bidder wins and is granted the lien and a certificate of purchase. And if the delinquent taxpayer and any mortgage lenders fail to redeem in the subsequent two years, the buyer takes the property free and clear.

Bankruptcy Law > Estate Property > Avoidance > Transferee Liabilities & Rights

HN6[] Avoidance, Transferee Liabilities & Rights

A good faith transferee of a bankruptcy debtor's property is granted a lien on the property for any improvements made and any resulting increase in property value. 11 U.S.C.S. § 550(e). And a subsequent good faith transferee who takes the property without knowledge of the fraudulent nature of the transfer is shielded from liability. 11 U.S.C.S. § 550(b).

Bankruptcy Law > Individuals With Regular Income > Debtor Duties & Powers

HN7[] Individuals With Regular Income, Debtor Duties & Powers

Chapter 13 bankruptcy grants bankruptcy debtors possession of the bankruptcy estate's property, which includes legal interests and the right to bring legal claims that could be prosecuted for benefit of the estate.

Civil Procedure > Parties > Substitution > Transfer of Interests

HN8[] Substitution, Transfer of Interests

See Fed. R. Civ. P. 25(c).

Real Property Law > Exemptions & Immunities > Homestead Exemptions

HN9[] Exemptions & Immunities, Homestead Exemptions

See 735 ILCS 5/12-901 (2015).

Real Property Law > Exemptions & Immunities > Homestead Exemptions

HN10[] Exemptions & Immunities, Homestead Exemptions

Illinois law is clear that the homestead exemption requires that an individual owned or rightly possessed by lease the delinquent property. Titled interest is required to sustain a homestead estate.

Real Property Law > Exemptions & Immunities > Homestead Exemptions

HN11[] Exemptions & Immunities, Homestead Exemptions

Title is required to support a homestead exemption. This is no less true for married couples where only one spouse has title to non-marital property.

Bankruptcy Law > Individuals With Regular Income > Debtor Duties & Powers

Bankruptcy Law > Estate Property > Avoidance > Fraudulent Transfers

HN12[] Individuals With Regular Income, Debtor Duties & Powers

Where a transfer is avoidable as fraudulent under 11 U.S.C.S. § 548 but the Chapter 13 bankruptcy trustee does not attempt to avoid it, the bankruptcy debtors themselves may avoid the transfer.

Bankruptcy Law > Estate Property > Avoidance > Transferee Liabilities & Rights

HN13[] Avoidance, Transferee Liabilities & Rights

Once a transfer is avoided as fraudulent, the Bankruptcy Code assigns the liability of the transferees under 11 U.S.C.S. § 550. It divides transferees into two categories: the initial transferee under § 550(a)(1) and any immediate or mediate transferee under § 550(a)(2). § 550. A transferee is one who exercises dominion over the money or other asset, the right to put the asset to one's own purposes. Accordingly, while an agent of a third party acting as an intermediary may not be a transferee, an entity that takes title or otherwise possesses the asset certainly is. The initial transferee, then, is simply the first transferee in the chain of title. And unlike an immediate or mediate transferee, the initial transferee has no defense against liability under § 550.

Bankruptcy Law > ... > Avoidance > Fraudulent Transfers > Constructively Fraudulent Transfers

Bankruptcy Law > ... > Avoidance > Fraudulent Transfers > Elements

HN14[] Fraudulent Transfers, Constructively Fraudulent Transfers

Under 11 U.S.C.S. § 548, a transfer from a bankruptcy debtor may be avoided as constructively fraudulent only within a narrow two-year window, and only if the debtor was insolvent and the conveyance was not for reasonably equivalent value.

Tax Law > ... > Real Property Taxes > Collection of Tax > Methods & Timing

Tax Law > ... > Real Property Taxes > Collection of Tax > Tax Deeds & Tax Sales

HN15[] Collection of Tax, Methods & Timing

Under Illinois law, the county acts as a facilitator of a tax sale to fulfill a delinquency judgment. The county collector merely offers the property for sale pursuant to the judgment. 35 ILCS 200/21-190 (2015). At no point in this transaction does the county take title. The purchaser of the property is the bidder at the sale offering to pay the amount due at the lowest penalty percentage interest. 35 ILCS 200/21-215 (2015).

Bankruptcy Law > Estate Property > Avoidance > Transferee Liabilities & Rights

HN16[] Avoidance, Transferee Liabilities & Rights

A subsequent transferee of a bankruptcy debtor's property may present a defense under 11 U.S.C.S. § 550(b) by showing that it took the property for value, in good faith, and without knowledge of the voidability of the transfer. Section 550(b) makes the policy decision to leave with the initial transferee the burden of inquiry and the risk if the conveyance is fraudulent. The subsequent transferee, conversely, is relieved of the responsibility to affirmatively monitor the initial transfer. For purposes of § 550(b), there is little difference between good faith and without knowledge of the voidability of the transfer. In combination, the two terms require that when facts strongly suggest the presence of other facts demonstrating fraud, a recipient that closes its eyes to the remaining facts may not deny knowledge. To be clear, this is not the same as a duty to investigate. Knowledge is a higher bar than inquiry notice. A subsequent transferee need not conduct extensive research into the chain of title of the property or pore through the financial statements of the debtor. Section 550(a) places the burden to investigate on the initial transferee. Section 550(b) is designed instead to ensure that a subsequent transferee with affirmative knowledge of a voidable transfer does not then quickly convey that property to an innocent third party to wash the transaction.

Bankruptcy Law > ... > Judicial Review > Standards of Review > Clear Error Review

HN17[] Standards of Review, Clear Error Review

A determination of good faith in a bankruptcy matter is a finding of fact; an appellate court reviews it only for clear error.

Counsel: For In the Matter of: KEITH SMITH, Debtor - Appellant: Arthur G. Jaros Jr., Attorney, Oak Brook, IL.

For Dawn Smith, Debtor - Appellant: Arthur G. Jaros Jr., Attorney, Oak Brook, IL.

For Sipi, Llc, Appellee: Harold Louis Moskowitz, Attorney, Chicago, IL.

For Midwest Capital Investments, Llc, Appellee: Michael Benjamin Bregman, Attorney, Ruff, Freud, Breems & Nelson, Ltd., Chicago, IL; Scott Curtis Nelson, Attorney, Ruff, Freud, Breems & Nelson, Ltd., Chicago, IL.

For National Association of Consumer Bankruptcy Attorneys, Amicus Curiae: Tara A. Twomey, Attorney, San Jose, CA.

For Legal Assistance Foundation, Amicus Curiae: David S. Yen, Attorney, Chicago, IL; Ainat Margalit, Attorney, Chicago, IL.

For National Tax Lien Association, Amicus Curiae: John William Stanko Jr., Attorney, Flamm Teibloom & Stanko, Ltd, Chicago, IL.

Judges: Before BAUER, WILLIAMS, and HAMILTON, Circuit Judges.

Opinion by: HAMILTON

Opinion

[*234] HAMILTON, *Circuit Judge*. **HN1**[] Federal bankruptcy law provides generally that a sale or other transfer of an insolvent debtor's property may be set aside as fraudulent if **[**2]** the transfer was for less than "reasonably equivalent value." 11 U.S.C. § 548(a)(1)(B). In this appeal, we apply this general rule to a lawfully conducted sale of real estate under Illinois property tax sale procedures. The principal question is whether compliance with state law for tax sales is sufficient to establish that the sale was for "reasonably equivalent value," or whether the debtor may try to set aside the sale under § 548(a)(1)(B).

In BFP v. Resolution Trust Corp., 511 U.S. 531, 114 S. Ct. 1757, 128 L. Ed. 2d 556 (1994), the Supreme Court held that a mortgage foreclosure sale that complies with state law is deemed for "reasonably equivalent value" as a matter of law. This rule applies even though the forced nature of the foreclosure sale will often result in a sale price well below a fair market price between a willing buyer and willing seller. Based on fundamental differences between the bidding methods used, however, we conclude that the reasoning of *BFP* does not extend to Illinois tax sales of real property.

Unlike mortgage foreclosure sales and some other states' tax sales, Illinois tax sales do not involve competitive bidding where the highest bid wins. Instead, bidders bid how *little* money they are willing to accept in return for payment of the owner's delinquent taxes. The *lowest* bid wins, **[**3]** and the bid amounts bear no relationship to the value of the underlying real estate. We therefore agree with the bankruptcy court, disagree with the district court, and apply the general rule of § 548(a)(1)(B). We affirm the judgment of the bankruptcy court.

I. *Factual and Procedural Background*

From about 1998 to 2009, debtors Keith and Dawn Smith lived in a home in Joliet, Illinois. Title to the property passed to Dawn Smith in 2004 as an inheritance. The inheritance came encumbered, however. The real estate taxes for the property had gone unpaid in 2000, resulting in a tax lien.

In 2001, acting under state law, the county auctioned the tax lien on the residence (but not the residence itself). The tax lien was purchased by appellee SIPI, LLC, which paid the amount of the delinquent taxes—$4,046.26—as well as miscellaneous costs. Thus, for a little over $5,000, SIPI was awarded a Certificate of Purchase that entitled SIPI to a number of rights. Dawn Smith could redeem her tax obligation, but only by paying SIPI the outstanding taxes plus interest as determined at the tax sale. And if she failed to redeem, SIPI could begin the process of taking unencumbered title to the property.

In the vast majority **[**4]** of such tax sales in Illinois, the owner of the property or a mortgage lender redeems the property by **[*235]** paying the delinquent taxes plus applicable interest to the buyer of the tax lien. This was the rare case, however, in which no one redeemed the property.

SIPI therefore applied for, obtained, and recorded its tax deed with the county on April 15, 2005. A few months later, in August 2005, SIPI sold the property to appellee Midwest Capital Investments, LLC for $50,000, ten times SIPI's purchase price. Midwest became and remains holder of the record title to the property in fee simple.

On April 13, 2007, the Smiths filed for bankruptcy relief under Chapter 13. At the same time they filed an adversary complaint against SIPI and Midwest seeking to avoid the tax sale of their property as a fraudulent transfer. In an earlier appeal in this case, we held that the Smiths filed within the proper two-year window to challenge the sale. *In re Smith, 614 F.3d 654, 660-61 (7th Cir. 2010)*. Upon remand, the bankruptcy court held a trial on the fraudulent transfer claim.

Bankruptcy Judge Black found that the Smiths had proven a fraudulent transfer because the property was not transferred for reasonably equivalent value. Analyzing the issue essentially **[**5]** as we do, he held that *BFP* does not apply to Illinois tax sales. The court limited the Smiths' recovery from SIPI to $15,000—the amount of one homestead exemption under Illinois law. The court also held in favor of Midwest on its defense to liability as a subsequent transferee in good faith.

On cross-appeals, the district court held that because the tax sale had complied with the requirements of state law, the reasoning of *BFP* applied so that the tax sale could not be set aside as a fraudulent transfer. The Smiths were entitled to no further recovery above the extinguishing of their $4,046.26 tax delinquency.

The Smiths have appealed to us. ***HN2***[] We review *de novo* the legal conclusions of the bankruptcy and district courts. *Freeland v. Enodis Corp., 540 F.3d 721, 729 (7th Cir. 2008)*. Like the district court, we defer to the factual findings of the bankruptcy court, which must stand unless they are clearly erroneous. *Id.*

We consider first the general question whether compliance with Illinois tax sale procedures protects the tax sale from the fraudulent transfer remedy under *§ 548(a)(1)(B)*. Our answer is no. We then address several case-specific issues, including the basis for the Smiths' standing, the proper amount of recovery, and finally the liability of Midwest. **[**6]**

II. *Fraudulent Transfers and Illinois Tax Sales*

States have a vital interest in collecting delinquent real estate taxes. See *BFP v. Resolution Trust Corp., 511 U.S. 531, 544, 114 S. Ct. 1757, 128 L. Ed. 2d 556 (1994)*. The outer limits of state law are prescribed by the federal Bankruptcy Code, which is intended to work in "peaceful coexistence" with state procedures. See *id. at 542*; see also 1 Garrard Glenn, *Fraudulent Conveyances and Preferences*, ch. V(B), §§ 62, 62a (2d ed. 1940) (explaining early attempts to harmonize state law with longstanding fraudulent transfer principles). Our task is to harmonize the specifics of Illinois tax sale law with one provision of federal bankruptcy law—protection under *§ 548(a)(1)(B)* against the fraudulent transfer of a debtor's property for less than reasonably equivalent value.

A. *Reasonably Equivalent Value*

HN3[] *Section 548(a)(1)(B)* empowers a trustee to set aside a transfer of the debtor's property that occurred within two years before the bankruptcy petition was **[*236]** filed if the transfer amounted to either actual or constructive fraud. *11 U.S.C. § 548(a)(1)(B)*. And *11 U.S.C. § 522(h)* allows a debtor to also set aside a fraudulent transfer if the trustee has not attempted to do so. The Smiths claim constructive fraud. The first requirement for constructive fraud, that the debtor either was insolvent on the date of the transfer or became **[**7]** insolvent as a result of the transfer, is not disputed. See *11 U.S.C. § 548(a)(1)(B)(ii)(I)*; see also *BFP, 511 U.S. at 535*. We focus here on the second requirement: that the debtor received "less than a reasonably equivalent value in exchange for such transfer." *11 U.S.C. § 548(a)(1)(B)*.

HN4[] "Reasonably equivalent value" is not defined in *§ 548*, but courts routinely make such determinations. See, e.g., *1756 W. Lake St. LLC v. American Chartered Bank, 787 F.3d 383, 387 (7th Cir. 2015)*; *Barber v. Golden Seed Co., 129 F.3d 382, 387 (7th Cir. 1997)* (*§ 548* equivalence inquiry is not a fixed mathematical formula but depends on all the facts of each case; an important element is fair market value).

In mortgage foreclosure sales forced pursuant to state law, a special rule applies under *§ 548*. In *BFP*, the Supreme Court held that where a foreclosure sale complied with the procedures of state law that allowed for competitive bidding for the value of the property, the sale could not be set aside under *§ 548* on the theory that the sale price was less than fair market value. *511 U.S. at 539-42*. Instead, the sale price reached through the state-law process was conclusively deemed reasonably equivalent value. *Id. at 545*.

BFP's special rule for "forced" mortgage foreclosure sales was not based on any textual clues in *§ 548* or other provisions of the bankruptcy laws. *Id.* It was based instead on practical concerns about how to let federal bankruptcy law work well with state **[**8]** mortgage foreclosure law. *Id. at 544-45*. The Court found that the "reasonably equivalent value" of a property was not necessarily the fair market value of the property. *Id. at 537-38*. Instead, a reasonably equivalent value for a foreclosed property "is the price in fact received at the foreclosure sale, so long as all the requirements of the State's foreclosure law have been complied with." *Id. at 545*.

The Court found that the standard market conditions required to make a "fair market value" determination simply do not apply in the forced sale context. *Id. at 538*. As the Court explained, a "fair market value" required a "fair market," with negotiations, mutual agreement, and lack of coercion. *Id.* A forced sale, conversely, changes these circumstances. "[P]roperty that *must* be sold within those strictures is simply *worth less." Id. at 539* (emphasis in original).

The *BFP* Court doubted that judges would be able to account accurately for the forced sale context in determining a hypothetical fair market value for property. *BFP* instructs that this would require judges to make "policy determinations that the Bankruptcy Code gives ... no apparent authority to make," especially since foreclosure systems are not uniform but vary considerably from state to state. **[**9]** *511 U.S. at 540*.

In reasoning that figures prominently in this case, the Court also said that relying on a hypothetical fair market value to determine reasonably equivalent value could have the effect of unsettling an "essential state interest ... in the security of the titles to real estate." *Id. at 544*, quoting *American Land Co. v. **[*237]** Zeiss, 219 U.S. 47, 60, 31 S. Ct. 200, 55 L. Ed. 82 (1911)*. State foreclosure systems are designed to ensure security in title and efficiency in debt collection. *Id.* An interpretation of *§ 548* that would expand judicial inquiry into foreclosure sales could have the effect of invalidating more legitimate transfers under state law and putting real estate titles under a "federally created cloud." *Id.*

BFP was limited in scope, however. The Court took care to note that its decision "covers only mortgage foreclosures of real estate. The considerations bearing upon other foreclosures and forced sales (to satisfy tax liens, for example) may be different." *Id. at 537 n.3*. This is such a case, so we turn to those considerations now.

B. *The Illinois Tax Sale System*

States generally choose one of three methods for collecting delinquent property taxes: the overbid method, the interest rate method, and the percentage ownership method. Georgette C. Poindexter, Lizabethann Rogovoy & Susan Wachter, **[**10]** *Selling Municipal Property Tax Receivables: Economics, Privatization, and Public Policy in an Era of Urban Distress*, *30 Conn. L. Rev. 157, 174 (1997)*. This case requires us to compare the overbid and interest rate methods, so we focus on them.[1]

The overbid method is probably the auction system more familiar to most readers: the bidding price begins at the total amount of taxes and interest due, and potential buyers then offer higher bids up to the total price they are willing to pay in return for (eventual) fee simple title. See, e.g., *Colo. Rev. Stat. Ann. § 39-11-115* (West 2015). The fair market value of the property is at

[1] In the percentage ownership method, the "successful purchaser bids to purchase the tax lien for the lowest percentage ownership in the underlying property." Poindexter et al., *Selling Municipal Property Tax Receivables*, *30 Conn. L. Rev. at 174-75*. For an example of Iowa's use of the percentage ownership method, see *Iowa Code Ann. § 446.16* (West 2015).

least in theory the ceiling for amounts that might be bid. The winner of this competitive bidding receives rights to the property. See In re Grandote Country Club Co., 252 F.3d 1146, 1152 (10th Cir. 2001) (explaining the competitive nature of the Colorado overbid system). A redemption period typically follows, during which the delinquent taxpayer or a mortgage lender may pay off the tax debt and **[**11]** reclaim the property. If the property is not redeemed, the winning bidder may bring an action for quiet title to the property. See, e.g., *Colo. Rev. Stat. Ann. § 39-11-120* (West 2015).

HN5[] The interest rate method used by Illinois is quite different. At the county tax auction, bidders vie to purchase the tax lien, not the property itself. They do so by bidding *down*. See BCS Services, Inc. v. Heartwood 88, LLC, 637 F.3d 750, 752-53 (7th Cir. 2011). Bids are expressed not as a total price for the property but rather as decreasing interest percentages. *Id.* These percentages are the penalty interest rates that the buyer may demand from the delinquent taxpayer (or mortgage lender) to redeem the property. *Id.* In Illinois, the bids therefore work *down* from a statutory ceiling of eighteen percent. Zero percent is the floor. 35 Ill. Comp. Stat. 200/21-215 (2015).

Under this system, the *lowest* bidder wins and is granted the lien and a certificate of purchase. In re LaMont, 740 F.3d 397, 400-01 (7th Cir. 2014). And if the delinquent taxpayer and any mortgage lenders fail to redeem in the subsequent two years, the buyer takes the property **[*238]** free and clear. *Id.*, citing 35 Ill. Comp. Stat. 200/21-350 (2015).

In the vast majority of tax sales in Illinois, the penalty percentage paid by the winning bidder is zero percent. BCS, 637 F.3d at 752 (almost 85 percent of the winning bids). The purchase price of the property, taking into account the **[**12]** risk of redemption, is therefore usually nothing more than the sum of the delinquent taxes.

C. *The Limits of BFP*

Other circuits have extended the reasoning of *BFP* from the mortgage foreclosure context to tax sales using the overbid method. Here, we are asked to take the different step of extending *BFP* to Illinois's interest rate method as well. We decline to do so because of the fundamental differences between the overbid and interest rate methods.

Illinois's tax sale method is not designed to produce bids that could fairly be called "reasonably equivalent value." For the reasons explained, in an Illinois tax sale, there is "no correlation between the sale price and the value of the property." In re McKeever, 166 B.R. 648, 650-51 (Bankr. N.D. Ill. 1994).

Competitive bidding is limited to only the penalty interest rate on the lien. There is no bidding on what the bidder would be willing to pay for the property itself, as with the overbid method. The Illinois sale method thus differs dramatically from the competitive bidding in *BFP*, which focused on "the context of [a] ... sale of real estate," 511 U.S. at 537, not the delinquent taxes attached to the title. Using the overbid method, the fair market value acts as a cap for the auction, testing at least in theory **[**13]** who is willing to pay the most for title to the property. Using the interest rate method, zero percent acts as a floor for the bidding, to determine who is willing to accept the least in penalty interest. Bidding using the interest rate method thus bears no relationship to the value of the property itself.

The Smiths' case reflects these dynamics. The debtors received a value of $4,046.26, the amount needed to extinguish the tax delinquency. They surrendered a property worth somewhere between $50,000 (the amount Midwest paid SIPI) and $110,000 (an appraiser's opinion of the property value). A purchase price between 3.8% and 8.8% of fair market value is not reasonably equivalent to the value of the property.

Because of the critical differences between the overbid auction used in *BFP* and the interest rate method used in Illinois tax sales, we therefore agree with Judge Black of the bankruptcy court that *BFP* does not extend to Illinois tax sales. The bankruptcy court correctly found that the tax sale of the Smiths' residence amounted to a fraudulent transfer avoidable under § 548.

This holding is true to § 548 and the broader purposes of the Bankruptcy Code and its fraudulent transfer provisions to **[**14]** ensure both a fair distribution of the debtor's assets among creditors and a fresh start for the debtor. A central concern of federal bankruptcy law is "[e]quality of distribution among creditors," Begier v. IRS, 496 U.S. 53, 58, 110 S. Ct. 2258, 110 L. Ed. 2d 46 (1990), which lies at the heart of fraudulent transfer law. 1 Glenn Garrard, *Fraudulent Conveyances and Preferences*, ch. I, § 1 (2d ed. 1940). If an insolvent debtor's asset worth between $50,000 and $110,000 can be transferred for about $5,000, a tax sale under the Illinois interest rate method can provide a windfall to one creditor at the expense of others. See Scott B. Ehrlich, *Avoidance of Foreclosure Sales as Fraudulent*

Conveyances: Accommodating **[*239]** *State and Federal Objectives*, 71 Va. L. Rev. 933, 935-36 (1985) (noting, in foreclosure context, that § 548 helps to protect against "an estate-depleting windfall to the purchaser at the expense of the debtor's creditors"); id. at 951-52 (§ 548 calls for an "inquiry into the adverse impact on the general creditors"); cf. BFP, 511 U.S. at 562-65 (Souter, J., dissenting) (noting that avoiding transfer of foreclosure properties for low prices "is plainly consistent" with policy of "maximum and equitable distribution for creditors ... at the core of federal bankruptcy law"). Fraudulent transfer remedies can also help provide a fresh start to **[**15]** debtors, at least in circumstances like this where the fraud is constructive. See Wetmore v. Markoe, 196 U.S. 68, 77, 25 S. Ct. 172, 49 L. Ed. 390 (1904); see also Local Loan Co. v. Hunt, 292 U.S. 234, 244, 54 S. Ct. 695, 78 L. Ed. 1230 (1934) (purpose of bankruptcy law to permit debtor "to start afresh"), quoting Williams v. U.S. Fidelity & Guaranty Co., 236 U.S. 549, 554, 555, 35 S. Ct. 289, 59 L. Ed. 713 (1915).

The strongest argument against our conclusion is based on the language in *BFP* on the need for stability and certainty in real estate titles and the fear of putting titles to properties bought in foreclosure sales "under a federally created cloud." 511 U.S. at 544-45. The district court focused on this policy consideration in deciding that the reasoning of *BFP* should extend to Illinois tax sales using the interest rate bidding system. Appellees endorse this reasoning and warn that applying the general rule of § 548 to tax sales will "wreak havoc" with Illinois's system for collecting delinquent property taxes.

We are not persuaded. First, we read *BFP* as depending not on a general concern about the stability of real estate transactions but on the central role of competitive bidding in an auction for the value of the property itself. The Court's opinion recognized the special circumstances of foreclosure sales, where the property must be sold for the highest bid, but the competitive bidding in foreclosure sales is based directly on the value of **[**16]** the underlying property. That simply is not true under the interest rate bidding system for Illinois tax sales.

Second, any fraudulent transfer remedy necessarily imposes some degree of uncertainty on all transfers of property, including real estate. The general rule of § 548 does so for all transfers of property. While *BFP* provided a special exception for foreclosure sales using auctions based on the value of the property, the general rule remains for essentially all other sorts of transfers of property, including property tax sales.

Third, the uncertainty is for a limited period of time, here, two years after the transfer. The tax sale process in Illinois already builds in significant delays through the time during which redemption is allowed. At the margins, applying § 548 to tax sales using the interest rate bidding system may reduce the already slim chances that a tax buyer will end up walking off with the fee simple title in return for having paid only the delinquent taxes. Those chances remain greater than zero, though. Tax buyers will still have incentives to bid, even though their incentives might lead them to bid a little more than zero percent to offset the diminished chances of a feesimple **[**17]** windfall.

Additional protection is provided by § 550 of the Bankruptcy Code. **HN6**[] A good faith transferee is granted a lien on the property for any improvements made and any resulting increase in property value. 11 U.S.C. § 550(e). And a subsequent good faith transferee who takes the property without knowledge of the fraudulent **[*240]** nature of the transfer is shielded from liability, as discussed below regarding defendant Midwest. See 11 U.S.C. § 550(b).

While applying § 548 may make purchases of Illinois tax liens marginally less attractive as investments, federal law mandates this result. We must enforce the federal bankruptcy remedy for fraudulent transfers where the reasoning of *BFP* does not apply, based on fundamental differences between the auction systems used in that case and this one. We agree with Judge Black that allowing application of § 548 to Illinois tax sales best heeds the challenge to interpret the Bankruptcy Code "in harmony with the 'state-law regulatory background.'" Smith v. SIPI, LLC, 526 B.R. 737, 743-44 (Bankr. N.D. Ill. 2014), quoting BFP, 511 U.S. at 539-40.

Accordingly, we apply to Illinois tax sales the same factors used to determine reasonably equivalent value in other § 548 cases, including the fair market value of what was transferred and received, whether the transaction took place at arm's length, and the good faith of the transferee. **[**18]** Barber v. Golden Seed Co., 129 F.3d 382, 387 (7th Cir. 1997); see also In re Williams, 473 B.R. 307, 313 (Bankr. E.D. Wis. 2012) (holding, in applying *Barber* factors, that a transfer was not for reasonably equivalent value), vacated on other grounds by *City of Milwaukee v.* Gillespie, 487 B.R. 916, 920-21 (E.D. Wis. 2013) (agreeing with application of *Barber* factors); In re Eckert, 388 B.R. 813, 835 (Bankr. N.D. Ill. 2008). The bankruptcy court correctly applied this approach, and we therefore affirm its holding that the transfer of the Smiths' property to SIPI for approximately $5,000 was not for reasonably equivalent value.

D. *Other Circuits' Approaches*

In reaching our decision, we note the different approaches taken by the Fifth and Tenth Circuits in other tax sale cases that differ from this one because of the different bidding systems used. Both circuits have held that *BFP* applies to the issue of reasonably equivalent value in Oklahoma and Colorado tax sales using the overbid method. *In re Grandote Country Club Co., 252 F.3d 1146, 1152 (10th Cir. 2001)*; *T.F. Stone Co. v. Harper, 72 F.3d 466, 471 (5th Cir. 1995)*. Both decisions were based on the particular state systems at issue, just as ours is here.

The overbid systems in both Oklahoma and Colorado use competitive bidding won by the highest bidder, similar to the bidding used in the foreclosure sale in *BFP*. Delinquent property is sold at an auction in which the sale price may rise well above the amount of the tax lien, toward the fair market value of the property subject **[**19]** to the forced sale. Accordingly, "deference to state regulatory interests" may warrant the application of *BFP* to those systems, as those courts held. See *T.F. Stone, 72 F.3d at 472*. Sale prices, by the very design of the overbid method, are likely to generate bids more reasonably equivalent to the value of the underlying property.

The Tenth Circuit took care to explain the narrow scope of its holding. It noted that "courts have not been unanimous in extending *BFP* to the tax sale context." *Grandote, 252 F.3d at 1152*. Critically, "the decisive factor in determining whether a transfer pursuant to a tax sale constitutes 'reasonably equivalent value' is a state's procedure for tax sales, in particular, statutes requiring that tax sales take place publicly under a competitive bidding procedure." *Id.* We have already explained why the Illinois interest rate method for tax sales is not similarly designed to produce higher bids approaching the value of the underlying property.

[*241] To make the point clear, *Grandote* went on to distinguish its ruling based on the Colorado "competitive bidding procedure," from a similar case from Wyoming, which did not require a public auction or competitive bidding. *Id.*, citing *Sherman v. Rose, 223 B.R. 555, 558-59 (B.A.P. 10th Cir. 1998)*, citing Wyo. Stat. Ann. § 39-3-105 (1998) (before relevant provision **[**20]** was repealed by statute, Wyoming property subject to tax lien was sold by random lottery for amount of delinquent taxes). The Tenth Circuit therefore limited its holding to Colorado's particular overbid system. *Grandote, 252 F.3d at 1152*. And it left in place the earlier holding of a bankruptcy appellate panel in *Sherman* that a property sold for one percent of its appraised value under Wyoming's old lottery tax sale system had not been sold for reasonably equivalent value. *Id.*, citing *Sherman, 223 B.R. at 559*. Our decision is similarly based on the differences between various state tax sale procedures and therefore applies only to the interest-rate bidding system under Illinois law.

III. *Additional Issues*

We now turn to several more case-specific issues. First is the logically prior question of whether the Smiths have standing to bring the meritorious claim for fraudulent conveyance. Second is the proper amount of recovery under Illinois homestead exemption law. Finally, we consider the affirmative defenses of SIPI and Midwest.

A. *Standing*

HN7[] Chapter 13 grants debtors "possession of the estate's property," which includes legal interests and the right to bring "legal claims that could be prosecuted for benefit of the estate." *Cable v. Ivy Tech State College, 200 F.3d 467, 472-73 (7th Cir. 1999)*, overruled **[**21]** on other grounds by *Hill v. Tangherlini, 724 F.3d 965, 967 n.1 (7th Cir. 2013)*. The debtors thus have standing to bring this claim to avoid the fraudulent transfer. This determination is complicated a bit by the Smiths' intervening divorce, but those details should not obscure a straightforward legal result.

Dawn Smith inherited the property in 2004 and therefore was the sole holder of record title. When both Dawn and Keith initially brought their claim before the bankruptcy court in 2012, only Dawn's claim was allowed to proceed. Keith, having no property interest, seemed not to have standing to assert this claim, or at least not to be a real party in interest. It was later revealed, however, that the Smiths had filed for and been granted a divorce in December 2011. The divorce decree granted Keith exclusive rights to the property in question. This revelation arose after discovery in the bankruptcy court had begun but before judgment was entered.

The Smiths agreed to determine their respective entitlements to any recovery in state court, removing the need for the bankruptcy court to decide whether and how to divide the recovery between Dawn and Keith.

Likewise, we need decide only whether either or both of the Smiths could bring this claim. **[**22]**

Keith Smith has standing to assert the fraudulent transfer claim based on his property interest granted in the divorce judgment. His agreement to resolve in the state divorce court the precise split of any potential recovery with Dawn Smith did not change the fact that he has a concrete interest in this case. The bankruptcy court did not err by reinstating him as a co-plaintiff in the fraudulent transfer action.

Dawn Smith also has standing. She arguably still has an interest in the outcome **[*242]** of the litigation by way of her agreement with Keith Smith to settle their potential recovery in state court. And even if the divorce judgment divested Dawn of any interest in the property or recovery, she may still bring this case under the rules of substitution of parties. See *Fed. R. Civ. P. 25(c)* (***HN8***[] "If an interest is transferred, the action may be continued by ... the original party ... ."); *Fed. R. Bankr. P. 7025*.

In any event, we are confident that the bankruptcy and district courts were correct to allow Dawn Smith to pursue this case as a co-plaintiff. We reject SIPI's argument that neither of the Smiths has standing.[2]

B. *Amount of Recovery*

Having determined that the transfer of the Smiths' residence was constructively fraudulent and that the Smiths have standing to assert this claim, we turn to the amount they may recover. The bankruptcy court held that the Smiths were entitled to $15,000—the amount of one homestead exemption under Illinois law. The Smiths argue for a larger recovery, but we agree with the bankruptcy court.

We begin with the Schedule C filed by the Smiths as part of their bankruptcy petition. Originally, the Smiths claimed one homestead exemption, in the amount of $15,000, reflecting Dawn Smith's interest in the property as the owner in fee simple. Over six years later, after the bankruptcy court had issued its decision, **[**24]** the Smiths filed an amended Schedule C, this time listing homestead exemptions for Dawn Smith, Keith Smith, and their four minor children. The Smiths now argue for a seventh exemption, for Dawn's cousin, a minor in the custody of the Smiths. In all, the Smiths ask for $105,000 (7 x $15,000) in aggregate homestead exemptions.

The Illinois homestead exemption statute provides:

> ***HN9***[] Every individual is entitled to an estate of homestead to the extent in value of $15,000 of his or her interest in a farm or lot of land and buildings thereon, a condominium, or personal property, owned or rightly possessed by lease or otherwise and occupied by him or her as a residence, or in a cooperative that owns property that the individual uses as a residence. ... If 2 or more individuals own property that is exempt as a homestead, the value of the exemption of each individual may not exceed his or her proportionate share of $30,000 based upon percentage of ownership.

735 Ill. Comp. Stat. 5/12-901 (2015). For purposes of argument, we assume that the Smiths properly and timely claimed all seven homestead exemptions they now seek, so the procedural propriety of the later-filed exemption claims does not matter. The Smiths still receive precisely **[**25]** the number of exemptions based on their amended filings and subsequent pleading that they would under their original Schedule C: one.

First, the four minor children of the Smiths, as well as the minor cousin, are not eligible for separate, independent homestead exemptions. ***HN10***[] Illinois law is clear that the homestead exemption requires that an individual "owned or rightly possessed by lease" the delinquent property. **[*243]** We have suggested that "titled interest is required to sustain a homestead estate." *In re Belcher, 551 F.3d 688, 691 (7th Cir. 2008)*, citing *De Martini v. De Martini, 385 Ill. 128, 52 N.E.2d 138, 142 (Ill. 1943)* ("The right of homestead ... can have no separate existence apart from the title on which it depends."); *First Nat'l Bank & Trust Co. v. Sandifer, 121 Ill. App. 2d 479, 258 N.E.2d 35, 37 (Ill. App. 1970)* (noting that a homestead exemption requires "Some title, no matter what its extent"). Debtors do not allege, nor could they, that the five children had title to the

[2] As SIPI views the issue, Dawn used to have standing and Keith did not. The divorce judgment then left Dawn with no property **[**23]** interest. Under SIPI's theory, the rather simple procedural device of reinstating Keith as a proper plaintiff would unsettle the "law of the case," i.e., that Keith did not have standing. The result of this line of thinking, which misunderstands the idea of the law of the case, would be that the private arrangements between Dawn and Keith as part of their divorce had the improbable result of preventing either one from asserting a meritorious claim for fraudulent transfer.

property.[3]

And though it is a closer issue, the Smiths may not claim two separate homestead exemptions on behalf of both Dawn and Keith Smith. ***HN11***[] As noted, title is required to support a homestead exemption. We have held this to be no less true for married couples where only one spouse has title to non-marital property. *Belcher, 551 F.3d at 690-93*. Whether or not an individual has title to property is measured at the time of the bankruptcy filing. *Id. at 690*. And, in April 2007 when the Smiths filed their bankruptcy petition, only Dawn had title by virtue of her inheritance.

We have recognized limited exceptions to this rule in the cases of married couples where only one spouse has listed title in the marital home. First, a divorced spouse at the time of the bankruptcy filing may have a potential interest in the family home despite a lack of title if the land was marital property. *Id.*, citing *750 Ill. Comp. Stat. 5/503(b)(1)* (2015). (This, of course, does not extend to property acquired during the marriage by way of "gift, legacy or descent." *750 Ill. Comp. Stat. 5/503(a)* (2015).) Second, a surviving spouse may be able **[**27]** to claim an interest where the titled spouse dies before the bankruptcy filing. *Belcher, 551 F.3d at 691*.

But where, as here, the spouses were "still married and alive at the time they filed the petition for bankruptcy," the exceptions do not apply and title controls the eligibility for homestead exemptions. *Id.* Dawn received the property by "gift, legacy or descent" and had sole title. Accordingly, the exceptions provide no support for an additional homestead exemption for the Smiths.

The fact that Keith later took title does not change the analysis. The homestead inquiry depends on the time of the filing. The "*future* or *potential* equitable interest" of a non-titled spouse is not sufficient to establish the formal title anticipated by Illinois exemption law. *Id.* (emphasis in original).

The Smiths also make an alternative argument that as both debtors and debtors in possession, they are both entitled to full trustee powers. Accordingly, they contend that they may set aside the transfer and are not bound by any limitations imposed by homestead exemptions. Rather, the Smiths seek to recover the entire amount of the value of their property.

We believe this argument misunderstands a key distinction between a debtor's **[**28]** **[*244]** power acting in place of a trustee to avoid a transfer and the entitlement to and amount of a debtor's recovery. It is true that the Smiths as debtors have the power to avoid the transfer just as their trustee would. See *11 U.S.C. § 522(h)*. As the bankruptcy court explained, ***HN12***[] where a transfer is avoidable under *§ 548* but the trustee does not attempt to avoid it (which the bankruptcy court found was the case here), the debtors themselves may avoid the transfer.

But the power to avoid is only the power to unwind the transfer. No authority would allow the Smiths themselves to recover the full value of the property simply because they can avoid the tax sale. The homestead exemption provides a safe haven for *some* recovery for parties in the Smiths' position. But any additional recovery would be for the benefit of the Smiths' estate and therefore for their other creditors.

The only authority the Smiths cite to support their claim for the entire value of the property is a footnote from *In re Einoder, 55 B.R. 319, 322 n.8 (Bankr. N.D. Ill. 1985)*. The Smiths contend that this footnote establishes that recovery is not limited to the amount of their exemptions, a proposition they claim was later adopted in *Gray-Mapp v. Sherman, 100 F. Supp. 2d 810, 812 (N.D. Ill. 1999)*.

The *Einoder* footnote said no such thing. Rather, it explained the ability **[**29]** of debtors to pursue Chapter 13 litigation in place of their trustees and later to collect the full value of their homestead exemption. *55 B.R. at 322 n.8* ("If the trustee has the power to help the debtors, they ought to be able to use that power to help themselves."). The *Einoder* footnote recognized that *§ 522(h)* empowers debtors to bring avoidance actions but did nothing to displace exemption law. *Gray-Mapp* said nothing to the contrary. See *100 F. Supp. 2d at 812* (determining that a debtor has "standing to bring this claim" in place of trustee). *Einoder* went on to apply the homestead exemption to the debtors. *55 B.R. at 325-26*

---

[3] The Smiths point to a concurring opinion in *First Nat'l Bank of Moline v. Mohr*, in which Justice Heiple mused that a ten-member household might well be entitled to an aggregate of ten homestead exemptions. *162 Ill. App. 3d 584, 515 N.E.2d 1356, 1359, 114 Ill. Dec. 85 (Ill. App. 1987)* (Heiple, J., concurring). But the 1994 amendments by the Illinois General Assembly added an explicit ownership requirement to the state homestead statute. See *Belcher, 551 F.3d at 692*, citing Act of Dec. 14, 1994, Pub. Act No. 88-672, § 25, 1994 Ill. Laws 2649. **[**26]** We noted in *Belcher* that the speculation in the *Mohr* concurrence about homestead-by-possession was blocked by the 1994 amendments. *Id.* That door remains shut.

("[D]ebtors can nevertheless avoid the Bank's lien under § 522(f)(1), at least to the extent it impairs their joint homestead exemption.").

Accordingly, the bankruptcy court was correct to award the Smiths precisely what they asked for in the first place: one homestead exemption for $15,000.

C. *Liability of SIPI*

HN13[] Once a transfer is avoided as fraudulent, the Bankruptcy Code assigns the liability of the transferees under § 550. It divides transferees into two categories: the "initial transferee" under § 550(a)(1) and "any immediate or mediate transferee" under § 550(a)(2). 11 U.S.C. § 550.

A transferee is one who exercises "dominion over the money or other asset, the right to put the [asset] **[**30]** to one's own purposes." *Bonded Financial Services v. European American Bank, 838 F.2d 890, 893 (7th Cir. 1988)*. Accordingly, while an agent of a third party acting as an intermediary may not be a transferee, an entity that takes title or otherwise possesses the asset certainly is. *Id.* ("When A gives a check to B as agent for C, then C is the 'initial transferee'; the agent may be disregarded.").

The initial transferee, then, is simply the first transferee in the chain of title. And unlike an immediate or mediate transferee, the initial transferee has no defense against liability under § 550.

The bankruptcy court correctly treated SIPI as the initial transferee and therefore liable to the Smiths. As the tax buyer, SIPI bought the tax lien at the tax **[*245]** sale, was awarded control over the tax lien, and then applied for and received title to the property in the transfer that was constructively fraudulent and thus avoidable.

SIPI makes two arguments against this conclusion. First, it asserts that Congress, in enacting § 550(a)(1), could never have meant it to apply to tax buyers like SIPI because that would render tax deeds unmerchantable and remove all incentives for tax buyers to purchase liens. This argument lacks a textual basis in the statute and overstates the consequences of this decision. **[**31]** This argument presents essentially the same concerns we addressed earlier in determining that applying § 548 to Illinois tax sales should not wreak havoc on Illinois tax sales. **HN14**[] Under § 548, a transfer may be avoided only within a narrow two-year window, and only if the debtor was insolvent and the conveyance was not for reasonably equivalent value. An Illinois tax deed should remain an attractive investment even though it will remain contingent for two more years.

SIPI also argues it was not the initial transferee because the county was technically the first to take title to the property so that the county was the initial transferee and SIPI a subsequent transferee entitled to assert a defense. In support, it cites the Fifth Circuit's decision in *T.F. Stone* where the county was determined to have taken title to property subject to an Oklahoma tax sale before it was later transferred. 72 F.3d at 471.

This argument does not work in this Illinois case. **HN15**[] Under Illinois law, the county acts as a facilitator of the tax sale to fulfill the delinquency judgment. The county collector merely "offer[s] the property for sale pursuant to the judgment." 35 Ill. Comp. Stat. 200/21-190 (2015). At no point in this transaction does the county take title. The "purchaser" **[**32]** of the property is the bidder at the sale offering to pay the amount due at the lowest penalty percentage interest. 35 Ill. Comp. Stat. 200/21-215 (2015). Here, that was SIPI.

At best, the county was an agent in the transfer of the property between the Smiths and SIPI much in the way that, in *Bonded Financial*, European American Bank was the intermediate agent between Michael Ryan and Bonded Financial Services. 838 F.2d at 893. As in that case, the county as agent never exercised dominion over the debtors' property. "In the case of an involuntary transfer of real estate through the tax sale procedure [in Illinois], the State is more like a conduit than a transferee." *In re Butler, 171 B.R. 321, 327 (Bankr. N.D. Ill. 1994)*. The county has "no ownership rights in the property," and is therefore "never a transferee." *Id. at 328*. We agree with that interpretation of Illinois law.

SIPI's view that the county was the initial transferee would produce improbable results. In all tax sales, the county would become the initial transferee, which would render the county, which recognized no profit from the transaction other than collecting delinquent property taxes, always liable for a constructively fraudulent transfer. And it would mean that tax buyers like SIPI—assuming they purchased in good faith—could capture substantial profits from the sales **[**33]** shielded from recovery by the debtor.

SIPI's reliance on *T.F. Stone* is not persuasive. As explained above, that decision depended on an entirely different Oklahoma tax sale method. But even setting that aside, SIPI misreads the opinion. In *T.F. Stone*, Bryan County "was forced to take title" at the original sale "because there were *no bids* on the Oklahoma property." *T.F. Stone Co. v. Harper, 72 F.3d 466, 471 (5th Cir. 1995)* (emphasis in original). The Fifth Circuit never suggested that the county took title before the transfer **[*246]** to the bidder. In this case there were bids for the Smiths' property, and SIPI came out the victor.

D. *Liability of Midwest*

We turn finally to appellee Midwest. As the eventual recipient of the property by way of a transfer from SIPI—the initial transferee—Midwest was the immediate subsequent transferee under *§ 550(a)(2)*.

HN16[] A subsequent transferee may present a defense under *§ 550(b)* by showing that it took the property for value, in good faith, and without knowledge of the voidability of the transfer. As we explained in *Bonded Financial*, *§ 550(b)* makes the policy decision to leave "with the initial transferee the burden of inquiry and the risk if the conveyance is fraudulent." *838 F.2d at 892*. The subsequent transferee, conversely, is relieved of the responsibility **[**34]** to affirmatively monitor the initial transfer.

For purposes of *§ 550(b)*, there is little difference between "good faith" and "without knowledge of the voidability of the transfer." *Id. at 897*; 5 *Collier on Bankruptcy P 550.03[3]*, at 550-28 (16th ed.) (noting that knowledge requirement is "surplusage to illustrate a transferee that could not be in good faith"). In combination, the two terms require that when "facts strongly suggest the presence of" other facts demonstrating fraud, "a recipient that closes its eyes to the remaining facts may not deny knowledge." *Bonded Financial, 838 F.2d at 898*.

To be clear, "this is not the same as a duty to investigate." *Id.* Knowledge is a higher bar than inquiry notice. A subsequent transferee need not conduct extensive research into the chain of title of the property or pore through the financial statements of the debtor. *Id.; In re Equipment Acquisition Resources, Inc., 803 F.3d 835, 840 (7th Cir. 2015)* ("If a reasonable inquiry would not have led to actual knowledge of voidability, a court cannot impute knowledge."). *Section 550(a)* places the burden to investigate on the initial transferee. *Section 550(b)* is designed instead to ensure that a subsequent transferee with affirmative knowledge of a voidable transfer does not then quickly convey that property to an innocent third party to "wash" the transaction. *Bonded Financial, 838 F.2d at 897*, quoting H.R. Rep. No. **[**35]** 95-595, 95th Cong., 2d Sess. 376 (1978).

Because *§ 550(b)* offers an affirmative defense, Midwest bore the burden of persuasion on the defense. *In re Commercial Loan Corp., 396 B.R. 730, 743 (Bankr. N.D. Ill. 2008)*. The bankruptcy court here determined after a trial that Midwest proved the elements of its defense, particularly that it took in good faith and without knowledge. ***HN17***[] A determination of good faith in a bankruptcy matter is a finding of fact; we review it only for clear error. See *Hower v. Molding Systems Engineering Corp., 445 F.3d 935, 938 (7th Cir. 2006)*; *In re Smith, 286 F.3d 461, 465-66 (7th Cir. 2002)*.

The bankruptcy court did not clearly err in its determination that Midwest proved its good faith and lack of knowledge under *§ 550(b)*. For Midwest to have had knowledge of the voidability of the transfer, it needed to have had some knowledge of a potential fraudulent conveyance: either that the Smiths were insolvent, or that the transfer was for less than reasonably equivalent value. The evidence at trial did not require the bankruptcy court to reject the defense.

The Smiths filed for bankruptcy well after both the initial transfer to SIPI and the later transfer to Midwest. Upon acquiring **[*247]** the property, Midwest thus had no affirmative knowledge of the insolvency of the Smiths.

Nor did the evidence require the bankruptcy court to find that Midwest knew the initial transfer was for less **[**36]** than reasonably equivalent value. At best, it knew that there was a tax deed in the chain of title, but the bankruptcy court did not clearly err by finding that was not enough to defeat Midwest's defense. As we hope we have made clear, not every tax sale is necessarily for less than reasonably equivalent value.

Further, the evidence did not compel a finding that Midwest intended in bad faith to collude with SIPI or subsequently to wash the property through a third party. There was evidence at trial that Midwest bought the property in an arm's length transaction after a lengthy negotiation with SIPI. Midwest bought the parcel as a rental property, not as an opportunity to launder the title quickly through another buyer. There were inspections of the property and review of title and the issuance of a warranty deed from SIPI. And Midwest, at the time of the bankruptcy court's decision, remained holder of record title.

We reject the Smiths' argument that the bankruptcy court was required to find that Midwest knew the transfer was avoidable simply because of the presence of a tax deed or because this was an occupied residence. We defer for a future case the issue of whether a bankruptcy court **[**37]** could have found knowledge of voidability or bad faith on a similar record.

* * *

To conclude, a tax sale lawfully conducted according to Illinois's interest rate auction system does not necessarily establish a transfer for reasonably equivalent value within the meaning of *11 U.S.C. § 548(a)(1)(B)*. The bankruptcy court correctly conducted a more substantive analysis of the fair market value of the property and other factors to determine that the Smiths' property was fraudulently conveyed. The debtors have standing to assert the claim; the bankruptcy court properly set the debtors' recovery at the value of one homestead exemption; SIPI is liable as the initial transferee; and the bankruptcy court did not err by finding that Midwest proved its defense to liability under *11 U.S.C. § 550(a)(2)*. Accordingly, the judgment of the district court is REVERSED and the judgment of the bankruptcy court is AFFIRMED in all respects.

End of Document

User Name: Michael Hile

Date and Time: Monday, August 1, 2022 11:12:00 PM EDT

Job Number: 176455977

Document (1)

1. Burns Ind. Code Ann. § 6-1.1-24-5.1

   Client/Matter: -None-

   Search Terms: I.C. 6-1.1-24-5.1

   Search Type: Natural Language

Burns Ind. Code Ann. § 6-1.1-24-5.1

Current with all legislation through the end of the Second Regular Session of the 122nd General Assembly

Burns' Indiana Statutes Annotated > Title 6 Taxation (Arts. 1 — 10) > Article 1.1 Property Taxes (Chs. 1 — 48) > Chapter 24 Real Property Tax Sales (§§ 6-1.1-24-1 — 6-1.1-24-17.5)

6-1.1-24-5.1. Applicability of section; limitations on tax sale purchases; forfeiture; certificate of good standing required to bid at tax sale.

(a) This section applies to the following:

(1) A business association that:

(A) has not obtained a certificate of authority from, or registered with, the secretary of state in accordance with the procedures described in IC 23, as applicable; or

(B) has obtained a certificate of authority from, or registered with, the secretary of state in accordance with the procedures described in IC 23, as applicable, but is not in good standing in Indiana as determined by the secretary of state.

(2) A person who is an agent of a person described in this subsection.

(b) A person subject to this section may not purchase a tract offered for sale under section 5 or 6.1 [IC 6-1.1-24-5 or IC 6-1.1-24-6.1] of this chapter. However, this section does not prohibit a person from bidding on a tract that is owned by the person and offered for sale under section 5 [IC 6-1.1-24-5] of this chapter.

(c) A business entity that seeks to register to bid at a tax sale must provide a certificate of good standing or proof of registration in accordance with IC 5-23 from the secretary of state to the county treasurer.

History

P.L.66-2014, § 9, eff. July 1, 2015; *P.L.247-2015, § 17*, emergency effective July 1, 2015; *P.L.66-2021, § 1*, effective July 1, 2021.

Annotations

Notes

Amendment Notes

The 2015 amendment rewrote the section, which formerly read: "A business entity that seeks to register to bid at a tax sale must provide a certificate of good standing or authority from the secretary of state to the county treasurer."

The 2021 amendment by P.L.66-2021 deleted former (c) through (e); and redesignated former (f) as (c).

End of Document

User Name: Michael Hile
Date and Time: Monday, August 1, 2022 11:13:00 PM EDT
Job Number: 176455988

Document (1)

1. *Burns Ind. Code Ann. § 6-1.1-24-5.3*
   Client/Matter: -None-
   Search Terms: I.C. 6-1.1-24-5.1
   Search Type: Natural Language

6-1.1-24-5.3. Persons prohibited from purchasing — Sale subject to forfeiture.

(a) This section applies to the following:

(1) A person who:

(A) owns a fee interest, a life estate interest, or the equitable interest of a contract purchaser in an unsafe building or unsafe premises; and

(B) is subject to an order issued under *IC 36-7-9-5(a)(2)*, *IC 36-7-9-5(a)(3)*, *IC 36-7-9-5(a)(4)*, or *IC 36-7-9-5(a)(5)* regarding which the conditions set forth in *IC 36-7-9-10(a)(1)* through *IC 36-7-9-10(a)(4)* exist.

(2) A person who:

(A) owns a fee interest, a life estate interest, or the equitable interest of a contract purchaser in an unsafe building or unsafe premises; and

(B) is subject to an order issued under *IC 36-7-9-5(a)*, other than an order issued under *IC 36-7-9-5(a)(2)*, *IC 36-7-9-5(a)(3)*, *IC 36-7-9-5(a)(4)*, or *IC 36-7-9-5(a)(5)*, regarding which the conditions set forth in *IC 36-7-9-10(b)(1)* through *IC 36-7-9-10(b)(4)* exist.

(3) A person who is the defendant in a court action brought under *IC 36-7-9-18*, *IC 36-7-9-19*, *IC 36-7-9-20*, *IC 36-7-9-21*, or *IC 36-7-9-22* that has resulted in a judgment in favor of the plaintiff and the unsafe condition that caused the action to be brought has not been corrected.

(4) A person who has any of the following relationships to a person, partnership, corporation, or legal entity described in subdivision (1), (2), (3), or (5):

(A) A partner of a partnership.

(B) A member of a limited liability company.

(C) An officer, director, or majority stockholder of a corporation.

(D) The person who controls or directs the activities or has a majority ownership in a legal entity other than a partnership or corporation.

(5) A person who owes:

(A) delinquent taxes;

(B) special assessments;

(C) penalties;

(D) interest; or

(E) costs directly attributable to a prior tax sale;

on a tract or an item of real property listed under section 1 [*IC 6-1.1-24-1*] of this chapter.

(6) A person who owns a fee interest, a life estate interest, or the equitable interest of a contract purchaser in a vacant or abandoned structure subject to an enforcement order under IC 32-30-6, IC 32-30-7, IC 32-30-8, or IC 36-7-9, or a court order under IC 36-7-37.

(7) A person who is an agent of the person described in this subsection.

(8) A person who:

(A) is delinquent in the payment of any personal property taxes; or

(B) is subject to an existing personal property tax judgment;

under *IC 6-1.1-22-9*.

(b) A person subject to this section may not bid on or purchase a tract offered for sale under section 5 or 6.1 [*IC 6-1.1-24-5* or *IC 6-1.1-24-6.1*] of this chapter. However, this section does not prohibit a person from bidding on a tract that is owned by the person and offered for sale under section 5 [*IC 6-1.1-24-5*] of this chapter.

(c) A business entity may not bid on or purchase a tract offered for sale under section 5 or 6.1 of this chapter if:

(1) a person subject to this section:

(A) formed the business entity;

(B) joined with another person or party to form the business entity; or

(C) joined the business entity as a proprietor, incorporator, partner, shareholder, director, employee, or member; or

(2) a person subject to this section:

(A) becomes an agent, employee, or board member of the business entity; or

(B) is not an attorney at law and represents the business entity in a legal matter.

History

P.L.98-2000, § 4; *P.L.1-2002, § 24*; *P.L.169-2006, § 22*; *P.L.88-2009, § 1*, eff. July 1, 2009; *P.L.247-2015, § 18*, emergency retroactive effective January 1, 2015; *P.L.251-2015, § 8*, effective July 1, 2015; *P.L.149-2016, § 26*, emergency effective March 23, 2016; *P.L.159-2020, § 45*, effective July 1, 2020; *P.L.66-2021, § 2*, effective July 1, 2021.

Annotations

Notes

Amendment Notes

The 2015 amendment by P.L.247-2015 deleted “in the county in which a sale is held under this; and chapter” at the end of (a)(1)(A) and (a)(2)(A); deleted “in the county in which a sale is held under this chapter” following “IC 36-7-9-22” in (a)(3); deleted “in the county in which a sale is held under this chapter” following “person who” in the introductory language of (a)(5); added “or a court order under IC 36-7-37” in (a)(6); in the second sentence of the second paragraph of (c), deleted “in this county” following “political subdivision,” substituted “county ordinance” for “ordinance, of this county,” and substituted “county health department” for “health department in this county”; and made a stylistic change.

The 2015 amendment, by P.L.251-2015, amending this section as amended by P.L.247-2015, in the second paragraph of (c), added “of a tract or item of real property listed under section 1 of this chapter” in the first sentence and substituted “by which my bid exceeds the minimum bid on the tract or item or real property under IC 6-1.1-24-5(e), if any” for “of my bid” in the last sentence.

The 2016 amendment substituted “IC 6-1.1-24-1” for “section 1 of this chapter” in the first sentence of the second paragraph of (c).

The 2020 amendment by P.L.159-2020 substituted “subdivision (1), (2), (3), or (5)” for “subdivision (1), (2), or (3)” in the introductory paragraph of (a)(4); added (a)(4)(B); redesignated former (a)(4)(B) and (a)(4)(C) as (a)(4)(C) and (a)(4)(D); added “director” in (a)(4)(C); added “controls or” in (a)(4)(D); added “bid on or” in the first sentence of (b); and in (c), added “bidding on or” in the first sentence and added the third sentence.

The 2021 amendment by P.L.66-2021 added (a)(8); added (c); and deleted former (c) through (f).

Notes to Decisions

Failure to Pay Delinquent Taxes.

Trial court did not err in denying appellants' request for injunctive relief and declaring the tax sale certificates they acquired forfeitable by the Lake County Treasurer because the Treasurer sent appellants a letter on September 11, 2019, indicating that the tax sale certificates issued to appellant company following the March 2019 tax sale were subject to forfeiture if certain delinquent taxes were not paid within 30 days; and neither of the appellants paid the full amounts due on the parcels identified in the Treasurer's September 11, 2019, forfeiture letter. *Broadway Logistics Complex, LLC v. Katona, 2021 Ind. App. LEXIS 330 (Ind. Ct. App. Oct. 29, 2021)*.

Research References & Practice Aids

Research References and Practice Aids

Indiana Law Review.

Taxation: Developments in Indiana Taxation, *34 Ind. L. Rev. 1003 (2001)*.

End of Document

LexisNexis

Document (1)

1. *Burns Ind. Code Ann. § 6-1.1-24-5.4*
   Client/Matter: -None-
   Search Terms: I.C. 6-1.1-24-5.1
   Search Type: Natural Language

Burns Ind. Code Ann. § 6-1.1-24-5.4

Current with all legislation through the end of the Second Regular Session of the 122nd General Assembly

Burns' Indiana Statutes Annotated > Title 6 Taxation (Arts. 1 — 10) > Article 1.1 Property Taxes (Chs. 1 — 48) > Chapter 24 Real Property Tax Sales (§§ 6-1.1-24-1 — 6-1.1-24-17.5)

6-1.1-24-5.4. Restrictions of purchases by foreign business association.

(a) This section applies to the following:

(1) A foreign business association that:

(A) has not obtained a certificate of authority from, or registered with, the secretary of state in accordance with the procedures described in IC 23, as applicable; or

(B) has obtained a certificate of authority from, or registered with, the secretary of state in accordance with the procedures described in IC 23, as applicable, but is not in good standing in Indiana as determined by the secretary of state.

(2) A person who is an agent of a person described in this subsection.

(b) As used in this section, "foreign business association" means a corporation, professional corporation, nonprofit corporation, limited liability company, partnership, or limited partnership that is organized under the laws of another state or another country.

(c) A person subject to this section may not purchase a tract offered for sale under section 5 or 6.1 [IC 6-1.1-24-5 or IC 6-1.1-24-6.1] of this chapter. However, this section does not prohibit a person from bidding on a tract that is owned by the person and offered for sale under section 5 [IC 6-1.1-24-5] of this chapter.

History

P.L.66-2014, § 10, eff. July 1, 2015; *P.L.66-2021, § 3*, effective July 1, 2021.

Annotations

Notes

Amendment Notes

The 2021 amendment by P.L.66-2021 deleted former (d) through (f).

End of Document

Sigmund J. Beck Advanced Bankruptcy Roundtable
West Baden Springs Resort
West Baden Springs, Indiana
August 19-20, 2022

For a Consummated Sale Under Section 363(m), is an Appellate Court Divested of Jurisdiction or Does It Just Lack Power to Set the Sale Aside – A Distinction That Makes a Difference

Edward M. ("Ted") King
Frost Brown Todd LLC
Louisville, Kentucky

Materials –

> *In re Sears Holdings Corp.*, 616 B.R. 615 (S.D.N.Y. 2020), *reh'g denied* 2020 WL 3050554 (S.D.N.Y. June 5, 2020), *aff'd,* 2021 WL 5986997 (2d Cir. Dec. 17, 2021), *cert. granted sub nom. MOAC Mall Holdings LLC v. Transform Holdco LLC,* 2022 WL 2295163 (U.S. June 27, 2022).
>
> *In re Sears Holdings Corp.*, 2021 WL 5986997 (2d Cir. Dec. 17, 2021), *cert. granted sub nom. MOAC Mall Holdings LLC v. Transform Holdco LLC*, 2022 WL 2295163 (U.S. June 27, 2022).

Section 363(m). Section 363 is one of the most highly discussed sections of the Bankruptcy Code. And one of the most important provisions in section 363 is section 363(m), which provides as follows:

> The reversal or modification on appeal of an authorization under subsection (b) or (c) of this section of a sale or lease of property does not affect the validity of a sale or lease under such authorization to an entity that purchased or leased such property in good faith, whether or not such entity knew of the pendency of the appeal, unless such authorization and such sale or lease were stayed pending appeal.

Recognizing that parties who have consummated a sale must be able to rely upon the order authorizing the sale, section 363(m) provides that if an appellate court reverses or modifies a sale authorized under section 363(b) or (c), that reversal or modification does not affect the validity of the sale unless the sale had been stayed pending appeal. The provision encourages section 363 sales because a purchaser may be less willing to acquire property from a debtor (or at a higher price) if the purchaser were forced to take the risk of an appeal. It is not uncommon for an appellate court to rely on section 363(m) when dismissing an appeal that attacks the authorization of a section 363 sale.

When interpreting section 363(m), some appellate courts have gone so far as to say that section 363(m) is jurisdictional – that is, section 363(m) actually strips an appellate court from jurisdiction. They believe that section 363(m) statutorily moots a sale appeal.

In prior Sig Beck conferences, we have learned about another flavor of mootness - equitable mootness – which is where an appellate court exercises discretion to determine that an appeal is moot based on policy. But if an appellate court determines that 363(m) deprives the appellate court of subject matter jurisdiction, it never even reaches a policy decision. If there really is subject matter jurisdiction, the appellate court has too narrowly construed its jurisdiction and bankruptcy court sale decisions that deserve scrutiny will instead never be reviewed at all. Further, painting 363(m) with too broad a brush can preclude review on issues that are merely tangential to a sale. This results in inconsistent rulings and can unfairly leave a party with a winning claim at the court's doorstep.

<u>The Mall of America/Sears Appeal.</u>

In Sears Holdings Corp.'s (the "<u>Debtor</u>") bankruptcy, the Mall of America (the "<u>Mall</u>") objected to the assignment of a lease, but Judge Drain took the Debtor's side, authorizing the Debtor's sale of assets and assumption and assignment of that lease. The sale was consummated, as there was no stay in place. The Mall appealed the decision to the United States District Court, and the purchaser of Sears ("<u>New Sears</u>") and the Debtor were appellees. The District Court initially ruled for the Mall, reversing the Bankruptcy Court. Neither the Debtor nor New Sears raised the issue of whether section 363(m) deprived the District Court of jurisdiction to hear the appeal.

Then, two weeks later, New Sears moved the District Court for a rehearing. After the District Court had decided to reverse the Bankruptcy Court, New Sears contended that the appeal must be dismissed because the Mall had not obtained a stay pending appeal. The District Court then reversed itself, noting that the Second Circuit in two cases had held that section 363(m) is a "jurisdiction-depriving statute." *MOAC Mall Holdings LLC v. Transform Holdco LLC (In re Sears Holdings Corp.)*, 616 B.R. 615, 626 (S.D.N.Y. 2020). The Mall asked the District Court to reconsider its decision reversing itself, which was denied before New Sears or the Debtor even responded, chiding the Mall for not having requested a stay pending appeal. *In re Sears Holdings Corp.*, 2020 WL 3050554, at *5 (S.D.N.Y. June 5, 2020), *aff'd*, 2021 WL 5986997 (2d Cir. Dec. 17, 2021), *cert. granted sub nom. MOAC Mall Holdings LLC v. Transform Holdco LLC*, 2022 WL 2295163 (U.S. June 27, 2022). The Mall then appealed to the Second Circuit Court of Appeals.

Late last year, the Second Circuit issued a per curium summary decision affirming the District Court. Initially, the Second Circuit performed a four corners analysis of section 363(m), noting that section 363(m) "limits appellate review of any transaction that is integral to a sale authorized under section 363(b)." *In re Sears Holdings Corp.*, 2020 WL 3050554, at *5. Here, the Second Circuit found that an appellate court lacks the power to overturn a sale, which is consistent with section 363(b). But the Second Circuit went further by holding that the Mall's appeal "is foreclosed by our binding precedent . . . under which § 363(m) deprived the District Court of appellate jurisdiction." *In re Sears Holdings Corp.*, 2020 WL 3050554, at *8.

The Mall had argued that New Sears waived the right to argue section 363(m), because it raised the issue only after the District Court ruled against it on the merits. However, the Second Circuit disagreed, noting that in the *WestPoint Stevens* case, the Second Circuit "held in no ambiguous terms that section 363(m) is a limit on our jurisdiction and that, absent an entry of a stay of the Sale Order, we only retain authority to review challenges to the 'good faith' aspect of the sale." *Id.* at *2 (internal citations and quotations omitted). Having built the jurisdictional straw man, the Second Circuit easily dispensed with the Mall's waiver argument, because of course a challenge to subject matter jurisdiction cannot be waived and can be raised for the first time on appeal.

The Mall petitioned for certiorari and noted that the Second and Fifth Circuits represent the minority view, with the Third, Sixth Seventh, Ninth, Tenth, and Eleventh Circuits comprising the majority, having rejected the argument that section 363(m) is a jurisdictional bar to an appellate court even hearing an appeal. As may have been given away by the prior case citations, the Supreme Court granted certiorari on June 27, 2022, so stay tuned for that decision. *MOAC Mall Holdings LLC v. Transform Holdco LLC*, 2022 WL 2295163, at *1 (U.S. June 27, 2022).[1]

Discussion Questions:

1) Do you think that section 363(m) is jurisdictional or merely a limitation on the relief that an appellant or other party may obtain?

2) Did the Second Circuit inappropriately conflate the terms jurisdiction and authority?

[1] It is worth noting that the Supreme Court has recently declined to take up two cases on equitable mootness, so it is interesting that the justices have chosen a case on statutory mootness. *KK-PB Fin., LLC v. 160 Royal Palm, LLC*, 142 S. Ct. 2778 (2022); *Hargreaves v. Nuverra Env't Sols., Inc.*, 142 S. Ct. 337 (2021).

3) Does this encourage gamesmanship or a wait and see approach by a party to see if it loses on appeal?

4) Could a court dismiss an appeal that does not affect the validity of a sale, such as an appeal over the distribution of proceeds?

5) Section 363(m) contains an exception for an appellate court to consider whether the assignee acted in good faith. Section 550(b) concerns the ability to recover a transfer from a transferee that takes for value in good faith. Would an appellate court have jurisdiction to hear a case where section 550(b) protected a good faith transferee?

6) Given this decision, should an appellant of a sale or transfer order always push hard for a stay?

0000000.700030 4892-6492-2662v2

IN RE: SEARS HOLDINGS CORPORATION, et al., Debtors.

MOAC Mall Holdings LLC, Appellant,

v.

Transform Holdco LLC and Sears Holdings Corporation, et al., Appellees.

No. 19 Civ. 09140 (CM)

United States District Court,
S.D. New York.

Signed May 11, 2020

Background: Chapter 11 debtor, a retailer that was one of well-known shopping mall's original anchor tenants, proposed assigning its shopping center lease to affiliate of company formed by debtor's former chief executive officer (CEO) and other former executives. Mall's owner, which wanted the lease to revert to it, objected. The United States Bankruptcy Court for the Southern District of New York, Robert D. Drain, J., denied owner's objections and approved debtor's assumption of the lease and its assignment. Owner appealed. The United States District Court for the Southern District of New York, Colleen McMahon, Chief Judge, 613 B.R. 51, vacated and remanded, and designated assignee moved for rehearing.

Holdings: The District Court, Colleen McMahon, Chief Judge, held that:

(1) waiver or judicial estoppel did not apply to prevent entity designated by purchaser of Chapter 11 debtor's assets as intended assignee of debtor's shopping mall lease from asserting that statutory mootness doctrine applied, and

(2) assignment of Chapter 11 debtor's shopping mall lease to party designated by purchaser of debtor's assets was in nature of transfer of property or title for consideration, and thus qualified as a "sale," for purpose of statutory mootness provision.

Motion granted; dismissed.

1. Federal Civil Procedure ⚿613.11

Generally, party's failure to raise a known argument while case is under adjudication precludes the granting of motion for rehearing/reargument.

2. Bankruptcy ⚿3781

Equitable mootness is prudential doctrine, whereby district courts may dismiss a bankruptcy appeal as moot when effective relief would be inequitable.

3. Bankruptcy ⚿3781

Equitable mootness doctrine applies to avoid unraveling underlying reorganization plans that have been substantially consummated.

4. Bankruptcy ⚿3789.1

Party moving for rehearing must state with particularity each point of law or fact that it believes the court overlooked or misapprehended. Fed. R. Bankr. P. 8022.

5. Bankruptcy ⚿3789.1

Strict standard for grant of rehearing does not allow movant to reargue its case but rather is intended to direct court's attention to any material matter of law or fact which it overlooked in deciding the case, and which, had it been considered, would probably have brought about different result. Fed. R. Bankr. P. 8022.

6. Estoppel ⚿68(2)

Waiver or judicial estoppel did not apply to prevent entity designated by purchaser of Chapter 11 debtor's assets, as intended assignee of debtor's shopping mall lease, from asserting that statutory mootness doctrine applied to prevent shopping mall owner, which had failed to obtain a stay of bankruptcy court's assignment order pending appeal, from pursuing appeal to challenge assignment of shopping mall lease to designee, though designee had previously argued, as basis for denial of stay pending appeal, that statutory mootness provision did not apply and had disclaimed any intent to rely on statutory mootness provision, belatedly changing its position only after district court, unaware of any mootness problem with its bankruptcy appellate jurisdiction, purported to vacate assignment order. 11 U.S.C.A. § 363(m).

7. Bankruptcy ⚷3781

Statutory mootness of appeal from certain unstayed orders of bankruptcy court is jurisdictional, and neither waiver nor judicial estoppel can be relied upon to overcome it. 11 U.S.C.A. § 363(m).

8. Federal Courts ⚷3251

Waiver and forfeiture cannot be relied upon to create appellate jurisdiction where none exists.

9. Bankruptcy ⚷3764

Parties cannot waive a defect in district court's bankruptcy appellate jurisdiction.

10. Bankruptcy ⚷3781

Statutory mootness furthers the policy of finality in bankruptcy sales and assists bankruptcy court in securing the best price for debtor's assets. 11 U.S.C.A. § 363(m).

11. Bankruptcy ⚷3776.5(5), 3781

Even if an appeal from bankruptcy court's sales order is not moot in constitutional sense, because court can provide a remedy, the policy favoring finality in bankruptcy sales reflected in statutory mootness provision requires that certain appeals nonetheless be treated as moot absent a stay. 11 U.S.C.A. § 363(m).

12. Estoppel ⚷68(2)

Judicial estoppel is equitable doctrine, that is to be exercised in sound discretion of court.

13. Estoppel ⚷68(2)

Judicial estoppel is designed to prevent a party who plays fast and loose with the courts from gaining unfair advantage through the deliberate adoption of inconsistent positions.

14. Estoppel ⚷68(2)

Judicial estoppel typically applies when: (1) a party's later position is clearly inconsistent with its earlier position; (2) the party's former position has been adopted in some way by the court in earlier proceeding; and (3) the party asserting the two positions would derive an unfair advantage against the party seeking estoppel.

15. Estoppel ⚷68(2)

Application of judicial estoppel is limited to situations in which the risk of inconsistent results with their impact on judicial integrity is certain.

16. Federal Courts ⚷2076

Lack of subject matter jurisdiction may be raised at any time, even by a party who originally asserted jurisdiction.

17. Federal Courts ⚷2073

Federal courts have independent obligation to ensure that federal jurisdiction is not extended beyond its proper limits.

18. Estoppel ⚷68(2)

Judicial estoppel applies to inconsistent factual positions, not alternative legal theories of case.

19. Bankruptcy ⚷3776.5(5), 3781

Assignment of Chapter 11 debtor's shopping mall lease to party designated by purchaser of debtor's assets was in nature of transfer of property or title for consideration, and thus qualified as a "sale," for purpose of statutory mootness provision; accordingly, shopping mall owner, in order to cut off later mootness challenge to its appeal from assignment order, had to obtain a stay pending appeal. 11 U.S.C.A. § 363(m).

See publication Words and Phrases for other judicial constructions and definitions.

20. Bankruptcy ⚷3776.5(5), 3781

Not every assignment of debtor's unexpired lease or executory contract qualifies as a "sale," for purposes of statutory mootness provision; party need obtain a stay pending appeal only when debtor receives authorization to assign and sell executory contracts or leases under both the Bankruptcy Code's sales provision and the Code section governing executory contracts and unexpired leases. 11 U.S.C.A. §§ 363(m), 365.

Daniel Abraham Lowenthal, III, David Wayne Dykhouse, Patterson, Belknap, Webb & Tyler LLP, New York, NY, Tom Flynn, Alexander J. Beeby, Larkin, Hoffman, Daly & Lindgren, Ltd., Minneapolis, MN, for Appellant.

Garrett Avery Fail, Jacqueline Marcus, Sunny Singh, Ray C. Schrock, Weil, Gotshal & Manges LLP, New York, NY, for Appellee Sears Holdings Corporation.

Rachel Ehrlich Albanese, Alana M. Friedberg, DLA Piper US LLP, New York, NY, Richard A. Chesley, DLA Piper LLP, Chicago, IL, Robert Craig Martin, DLA Piper LLP, Wilmington, DE, for Appellee Transform Holdco LLC.

ORDER GRANTING TRANSFORM HOLDCO LLC'S MOTION FOR REHEARING, AND ON REHEARING VACATING THE COURT'S ORIGINAL DECISION ON APPEAL

McMahon, C.J.:

Appellant MOAC Mall Holdings LLC ("MOAC") took an appeal to this court from an order of the United States Bankruptcy Court for the Southern District of New York (Drain, B.J.), which approved the assignment and assumption of the certain lease (the "Lease") of the Sears store at the Mall of America in Minneapolis, Minnesota to an entity known as Transform Leaseco LLC.[1] The parties filed lengthy briefs discussing the complicated issue raised by the appeal; they held an oral argument at which the court questioned them closely on contested points of law.

At no point in this entire process – through briefing and oral argument – did either side suggest that the court might lack jurisdiction over the appeal. MOAC did not seek a stay pending appeal in this court, and Transform did not move to dismiss MOAC's appeal for want of jurisdiction. Everyone behaved as though that were a foregone conclusion.

1. Transform Leaseco LLC ("Leaseco") is wholly owned by Transform Holdco LLC ("Holdco"). They are represented by the same counsel who have filed only one set of briefs and motions throughout the appeal. These two entities were referred to as "Transform" throughout the appellate opinion. However, as a technical matter relevant to this opinion on rehearing, it was Leaseco who was the designated assignee of the Sears lease, and Holdco who made the designation, and it turns out to be necessary to refer to them as separate entities, rather than collectively as "Transform," in critical portions of this opinion. Therefore, in this opinion references to "Transform" reflect arguments made in the one set of papers filed on behalf of both Leaseco and Holdco.

It took several weeks of concentrated work to write the forty-three-page decision disposing of the appeal. In the end, the court vacated the order of the Bankruptcy Court, concluding that the assignment of the Mall of America Lease to Leaseco violated § 365(b)(3)(A) of the Bankruptcy Code.

Transform has not appealed that decision to the United States Court of Appeals for the Second Circuit. Instead, Transform filed the instant motion, in which is asserts for the first time – albeit on the basis of facts known to it throughout the pendency of the appeal, but never revealed to this court – that this court lacked jurisdiction over the appeal all along, because the order appealed from was not stayed pending appeal.

[1] Ordinarily, the failure to raise a known argument while a case is under adjudication precludes the granting of a motion for rehearing/reargument. *In re Soundview Elite Ltd.*, No. 14-cv-7666, 2015 WL 1642986, at *1 (S.D.N.Y. Apr. 13, 2015), *aff'd*, 646 F. App'x 1 (2d Cir. 2016). As Transform did not raise the appellate implications of Judge Drain's denial of MOAC's motion for a stay pending appeal under § 363(m) of the Bankruptcy Code, under the traditional rules applicable to such motions, its motion for rehearing would be summarily denied.

Transform insists, however, that the court must entertain the motion, because the issue it raises is both "jurisdictional" – that is, it goes to the court's power to hear the appeal in the first instance – and non-waivable. Transform also argues that it cannot be estopped to raise the issue of the court's jurisdiction belatedly, even though – as I now know – its counsel flatly stated to the bankruptcy judge that § 363(m) had no applicability to the assignment of the Mall of America Lease to Leaseco, *and that Transform did not intend to argue otherwise*, in order to induce him to deny MOAC's motion for a stay.

Transform's motion for rehearing is granted. The court has examined its appellate jurisdiction for the first time. Having done so, I conclude, with great regret, that this court lacked the power to hear and decide MOAC's appeal.

The decision on appeal is vacated, and MOAC's appeal is dismissed as statutorily moot.

BACKGROUND

The Original Sale Order and the Asset Purchase Agreement

Though I have no wish to rehash details discussed in the opinion I am now vacating, Transform's latest gambit needs to be contextualized.

Sears, Roebuck and Co. ("Sears"), Sears Holdings Corporation and its affiliated debtors (collectively, the "Debtors") filed for bankruptcy in October 2018. Former Sears executives formed Transform – a group of entities including, for our purposes, a parent company known as Holdco and an affiliate called Leaseco – to try to recapture and market Sears' assets. Transform, through the vehicle Holdco, submitted the best bid to purchase substantially all of Sears' assets.

The Debtors and Holdco entered into an Asset Purchase Agreement (the "APA") to memorialize Holdco's purchase. Pursuant to the APA, Holdco paid Sears over $1.4 billion to purchase all of Sears' assets, properties and rights related to its business,[2] which included all of the following:

- Assigned Agreements and the Designation Rights

2. Property excluded from the asset sale is not relevant to this appeal and rehearing motion.

- Lease Rights
- Owned real property
- Inventory, receivables, equipment and improvements
- Intellectual Property
- Goodwill
- Data
- Books and records
- Marketing materials (including Sears iconic catalogs, its original marketing innovation)
- Claims
- Actions
- Contracts related to the business
- Store cash

In February 2019, the Bankruptcy Court approved the APA in a § 363(b) sale order (the "Sale Order"). (Bankr. Dkt. No. 2507, APX87.)[3] In the Sale Order, the Bankruptcy Court held that Holdco had purchased Sears' assets for "fair consideration." (*Id.* at 7, ¶ J.)

Among the bundle of assets purchased by Transform pursuant to the APA were (1) certain specifically Assigned Agreements, and (2) Designation Rights for contracts identified as "Designatable Leases." (*Id.* at 3.) "Designation Rights" are the right to designate to whom a lease between Sears (or an affiliate, such as Kmart) and some landlord should be assigned. Because Holdco had purchased Designation Rights, once it identified an assignee, Sears was required, per the terms of the APA, to assign the lease to Holdco's chosen assignee, as long as Holdco satisfied certain conditions that were specified in the APA. ("APA," Ex. B. to the Sale Order, APX184, as amended by Ex. F to Bankr. Dkt. No. 2599, APX3593, at § 2.6).

All told, there were hundreds of "Designatable Leases," one of which was Sears' lease at the Mall of America in Minneapolis. As this court noted in the decision on appeal, Transform intended to continue to operate about 425 of those properties as Sears or Kmart stores. It planned to use its Designation Rights to bring about the assignment of the rest of the Designatable Leases to itself (through an affiliate, such as Transform Leaseco), and then to sublease the spaces covered by those leases to new tenants at what it hoped would be a handsome profit.

Pursuant to § 2.6 of the APA, Transform Holdco purchased the Designation Rights for all Designatable Leases on the closing date. (*Id.*) Its right to designate assignees under the leases vested at the closing of the APA. (*Id.* at §§ 2.6, 5.2(a).) But the APA made clear, "For the avoidance of doubt, the sale ... of the Designation Rights provided for herein on the Closing Date *shall not effectuate a sale, transfer, assignment or conveyance of any Designatable Lease to Buyer [Holdco] or any other Assignee*...." (*Id.* at § 2.6 (emphasis added).) Any such "sale, transfer, assignment or conveyance" would only occur on something called the "Designation Assignment Date" – defined in the APA as the date of the "sale, transfer, assignment, conveyance and delivery" of the designated lease by Sears to Holdco's designee. (*See id.* at §§ 2.6, 5.2(d).) The APA also set out precisely when and how Sears' interest in any individual Sears would pass to Holdco's designee:

> On each Assumption Effective Date,[4] pursuant to section 365 of the Bankrupt-

3. "Bankr. Dkt." refers to the proceedings before Judge Drain in *In re Sears Holdings Corp., et al.,* No. 18-23538 (RDD) (Bankr. S.D.N.Y) and "APX" refers to the record on appeal to this court.

4. With respect to designatable leases to which objections to designation were lodged – such

> cy Code and the Approval Order, Sellers shall assume and assign to the applicable Assignee any Designatable Lease so designated by Buyer for assumption and assignment in accordance with the terms of this Agreement, and Buyer shall pay all or be responsible for Cure Costs with respect to such Designatable Leases.

(*Id.* § 2.7(c).)

Certain leases were assigned to Holdco as designee simultaneously with the closing of the APA and Holdco's acquisition of Designation Rights. (*See id.* § 2.7(b).) Those leases are listed in Exhibit A to the Sale Order. (APX170.) The Mall of America-Sears Lease that was the subject of the appeal to this court is not one of those leases.

The Subsequent Designation of the Mall of America Lease, The Objection, and The Appeal

On April 2, 2019, Judge Drain entered an order establishing a procedure for Holdco to designate additional contracts for assumption and assignment to its desired assignees. (Bankr. Dkt. No. 3008, APX1290.) Once Holdco identified an additional lease to be designated for assumption and assignment, the Debtors were to file a notice with the court. Any party objecting to such an assignment had to serve and file a written objection with the Bankruptcy Court eight days after the filing of (i) the notice, or (ii) evidence of adequate assurance of future performance pursuant to 11 U.S.C. § 365(b)(3) – whichever was later. (*Id.*)

Two weeks later, on April 19, 2019, Holdco filed a notice of "additional designatable leases" for assignment to itself or an affiliated entity (the "Notice"). (Bankr. Dkt. No. 3298, APX1331.) Among the additional designated leases was the Mall of America Lease. Holdco designated its affiliate, Leaseco, as the assignee of that particular lease.

MOAC objected to the Notice on the ground, among others, that the Debtors had not demonstrated that Leaseco met the qualifications for assignment of a shopping center lease as set forth in § 365(b)(3). (Bankr. Dkt. No. 3501, APX1344.) Over the course of the next few months, MOAC filed supplemental objections to the designation. Many other parties also filed objections to other lease assignments proposed in the April 19 Notice; all such objections except MOAC's were resolved.

As one might surmise from the name of Holdco's designee, the Mall of America Lease was intended to be marketed to a new tenant or tenants not yet identified. The parties stipulated that Holdco had no intention of operating a Sears store at the Mall of America, but rather intended to sublease the premises to a third-party tenant at a profit to Transform. (Bankr. Dkt. No. 4865 ¶¶ 11-14, APX1783.) In fact, this was MOAC's major motivation for fighting the assignment – it did not want to see Sears' anchor tenant space divided or occupied by whoever would pay Transform the highest price. MOAC wanted another big box retailer to take over the space – even if it (like Sears) paid little or no rent – both to "preserve the character" of Mall of America (a concept discussed at length in this court's opinion disposing of the appeal) and to ward off the possibility that MOAC might find itself in default on co-tenancy provisions in the leases of other Mall tenants.

as the lease before this court – this date is defined as "the fifth (5th) Business Day following the date of resolution of any objection to assumption and assignment of such Lease." (*Id.* § 1.1.) In the case of the Mall of America Lease, the Designation Assignment Date and the Assumption Effective Date were the same day.

Judge Drain conducted an evidentiary hearing on MOAC's objections on August 23, 2019. At that hearing, Leaseco – the proposed assignee – presented evidence that it met the requirements of § 365(b)(3)(A)-(D), as required by law and by the APA. It also offered two additional "concessions" that were intended to assuage MOAC's objections. It agreed (i) to put $1.1 million (effectively one year's rent, which the assignee would have had to pay in any event) into escrow; and (ii) to guarantee that it would sublet at least portion of the premises within two years. Leaseco also expressly agreed to operate in full compliance with the Lease (including the "Uses" section of the Lease and the REA), and to honor MOAC's buy-back rights under Article 6.3 of the Lease.

At the conclusion of the hearing, the Bankruptcy Court overruled MOAC's objections in an oral opinion read into the record. On September 5, Judge Drain signed a final order (the "Assignment Order") authorizing the assumption and assignment of the Mall of America Lease to Leaseco. (Bankr. Dkt. No. 5074, APX1947.) In that order, the Bankruptcy Court found that Leaseco met all the requirements for assignment of a shopping center lease, as set forth in 11 U.S.C. § 365. The Assignment Order imposed on Leaseco, as a condition of the assignment, the obligation to undertake the concessions it had offered during the hearing, and specifically ordered Leaseco to comply with the "Uses" section and to honor MOAC's buy-back rights.

The Assignment Order is the official bankruptcy court order by which the objections to the assignment were resolved. It is the order from which an appeal was taken to this court – the appeal that was disposed of by this court's decision dated February 27, 2020. (Dkt. No. 26.)

The Stay Proceedings

MOAC moved to stay the Assignment Order pending appeal on September 6, the day after it was filed. (Bankr. Dkt. No. 5083, Ex. A. to "Reh'g Resp.," Dkt. No. 33; Bankr. Dkt. No. 5110.) On September 18, Judge Drain held a hearing on MOAC's stay motion. (*See* "Stay Tr.," Bankr. Dkt. No. 5413; Ex. A to "Mot. for Reh'g," Dkt. No. 29-1.)

MOAC argued that, in light of 11 U.S.C. § 363(m), it needed a stay in order to protect its right to appellate review of the Bankruptcy Court's September 5 Assignment Order. That section of the Code provided as follows:

> The reversal or modification on appeal of an authorization under subsection (b) or (c) of this section of a sale or lease of property does not affect the validity of a sale or lease under such authorization to an entity that purchased or leased such property in good faith, whether or not such entity knew of the pendency of the appeal, unless such authorization and such sale or lease were stayed pending appeal.

The Bankruptcy Court was skeptical that any stay was necessary. While noting that the assignment was being made in accordance with the original § 363 Sale Order, Judge Drain said, "I can't imagine 363(m) as far as the sale is concerned applying here." (Stay Tr. at 8:4-5.) He reasoned that MOAC was appealing the Assignment Order only insofar as it related to only one of the roughly 600 Sears leases Holdco had the right to designate throughout the bankruptcy proceeding, while the authorization for the transfer of property that was the subject of the Sale Order – the sale of the Designation Rights – applied to all the leases. (*Id.*)

While it was in the happy position of having prevailed in the Bankruptcy Court, Transform agreed that no stay was necessary. At the stay hearing, counsel for Transform represented to the Bankruptcy Court that § 363(m) did not apply to MOAC's challenge to the Assignment Order. He stated, "in effect, because we do not have a transaction, I think we couldn't rely on 363(m) for the purposes of arguing mootness *because we have not closed on a transaction to assume and assign this to a sub-debtor* [sic]." (*Id.* at 8:14-18 (emphasis added).)[5] In other words, Transform argued to the Bankruptcy Court that an assignment to an intermediary entity such as Leaseco, without a subsequence transfer to some as-yet unidentified third party or parties that would occupy the Sears space, was not a § 363(b) or (c) "sale or lease" for the purposes of § 363(m).

The Bankruptcy Court ultimately concluded that no stay was necessary to preserve MOAC's right to appeal, finding, "This is not -- this is a 365 order. It's an outgrowth of the sale. It's not a 363(m), *and they're not going to rely on 363(m)*, which [Transform's counsel]'s just reiterated for the second time." (*Id.* at 9:23-25, 10:1 (emphasis added).) Judge Drain believed that the only "sale or lease of property" that was authorized pursuant to § 363(b) or (c) – which is a prerequisite for the applicability of § 363(m) – was the sale of Sears' assets (including the specific leases assigned directly to Holdco and the right to designate assignees for additional but as-yet-unidentified "designatable" leases), as memorialized in the original Sale Order. He also plainly relied on Transform's representation that § 363(m) would not moot the appeal in the absence of a stay when he rejected MOAC's principal argument for irreparable harm and concluded that it had not made a substantial showing of the need for a stay on the merits. In response to MOAC's concern that the district court might independently deem the appeal moot, Judge Drain stated that Transform would be estopped from so arguing. (*Id.* at 10:2-16.)

On September 27, Judge Drain entered an order denying MOAC's stay motion. (Bankr. Dkt. No. 5246.) The order clearly stated that the Assignment Order was "immediately enforceable and effective as of its entry on September 5, 2019." (*Id.*) Per the terms of the APA and the Assignment Order, the transaction closed five business days later, and the Mall of America Lease was assumed by Sears and then assigned to Leaseco.

Proceedings in the District Court

[2, 3] On October 2, MOAC filed the instant appeal, challenging the Assignment Order under § 365. (Dkt. No. 1.) At the September 18 hearing before the Bankruptcy Court, MOAC had reserved its right to seek leave for a stay in the event "equitable mootness" became an issue (Stay Tr. at 10:20-25, 11:1-7),[6] but it neither appealed from Judge Drain's order denying a stay pending appeal nor sought a stay pending appeal from this court. I have little doubt this was because Transform had represented to Judge Drain that

5. As the parties were discussing the subleasing of the Sears premises at Mall of America, Transform's counsel must have said "subletter," which was mistranscribed as "subdebtor."

6. Equitable mootness is a prudential doctrine whereby district courts may dismiss a bankruptcy appeal as moot when effective relief would be inequitable. This doctrine applies to avoid unraveling underlying plans that have been substantially consummated. Here, Transform has not argued for equitable mootness; it only argues for statutory mootness. Moreover, to the extent the doctrine may apply to Transform's consummation of its plan to sublease the Mall of America Lease to an actual tenant, based on a stipulation entered in this court – *see infra.*, at page 623 – it can do no such thing.

the appeal would not be moot under § 363(m).

As a result, this court – which does not pretend to expertise in bankruptcy law – was unaware of the possibility that the appeal might be moot because of Judge Drain's refusal to enter a stay pending appeal. I read the briefs and the record; I heard oral argument; and I worked for over a month on what turned out to be a very complicated appeal, relying on the arguments raised by the parties.

Ultimately, this court concluded that the Bankruptcy Court had erred in finding that Transform satisfied § 365(b)(3)(A) – a section of the Code that requires, in connection with the assignment of a lease for premises in a shopping center, that the proposed assignee's financial condition and operating performance be similar to the financial condition and operating performance of the debtor at the time the debtor became the lessee under the lease. The bankruptcy judge had expressly found that Leaseco's financial condition and operating performance were not similar to that of Sears when its Mall of America lease commenced back in 1991. In light of that finding (which was amply supported by the record), this court did not believe that any judicially-created performance guarantees, such as those sanctioned by the Bankruptcy Court [7] could be substituted for the standard expressly written into law by Congress.

As a result, this court vacated the Assignment Order to the extent it had authorized the assumption and assignment of the Sears Lease to Leaseco – i.e., it modified the Assignment Order – and remanded the case to the Bankruptcy Court. (Dkt. No. 26); *In re Sears Holdings Corp.*, 613 B.R. 51 (S.D.N.Y. 2020).

Subsequently, this Court so-ordered a stipulation between the parties that allowed both parties to market the Lease pending further appeal, but forbade either party from entering into any sublease or similar agreement for the Sears space. (Dkt. No. 28.)

The following day, Transform filed the instant motion for rehearing, arguing for the first time that this Court lacked appellate jurisdiction over MOAC's appeal under 11 U.S.C. § 363(m), because MOAC had not obtained a stay of the Assignment Order. (Dkt. No. 29.)

ANALYSIS

[4, 5] Transform moves for rehearing pursuant to Bankruptcy Rule 8022. "The standard for granting such a motion, derived from Rule 40 of the Federal Rules of Appellate Procedure, requires the movant to state with particularity each point of law or fact that the movant believes the district court or BAP has "overlooked or misapprehended." *Soundview Elite*, 2015 WL 1642986, at *1 (internal quotations and citations omitted). This strict standard does not allow the movant to reargue its case, but rather is intended to "direct the court's attention to a material matter of law or fact which it has overlooked in deciding the case, and which, had it been given consideration, would probably have brought about a different result." *Id.*

This court has admitted complete unawareness of the possibility that the appeal it so laboriously considered and decid-

7. The Bankruptcy Court concluded that Transform/Leaseco did not have to abide by the literal terms of § 365(b)(3)(A) because (i) it seemed (by virtue of its fundraising capabilities) to have a net worth of at least $50 million (the justification for that number is explained in the opinion on the appeal), and (ii) it had agreed to abide by all terms of the Lease. This court concluded that things could not be substituted for the very different requirements set forth in the statute.

ed might well be moot. I cannot say that I "overlooked" the issue, because both sides were aware that 11 U.S.C. § 363(m) had been raised in the Bankruptcy Court, but neither side called it to my attention during the pendency of the appeal. I would certainly not have "overlooked" this issue if it had been raised, since lack of appellate jurisdiction would have foreclosed me from deciding the appeal as argued (not to mention, saved me a great deal of work). I would instead have been limited me to whether Leaseco's assumption of the lease in the absence of a stay was done "in good faith" – an issue not briefed or argued to this court. That certainly would have "brought about a different result" on the appeal.

Having lost on the appeal, Transform has apparently thought better of the position it took before Judge Drain. It now argues that § 363(m) renders MOAC's appeal of the unstayed Assignment Order moot, thus precluding appellate review by this court.

[6] MOAC responds that Transform has waived any rights it might have had under § 363(m) and is judicially estopped from relying on any protection the statute might otherwise have afforded it. MOAC also argues that Transform was correct when it represented to Judge Drain that § 363(m) did not apply to the Assignment Order.[8]

[7] After deliberation, I must reject MOAC's arguments. Because the Second Circuit takes the position that § 363(m) is "jurisdictional," neither waiver nor judicial estoppel can be relied on to overcome it. And, regrettably, § 363(m) does protect the assignment of the Mall of America Lease from appellate review in the absence of a stay, because the assignment of that lease was a "sale" within the meaning of that section.

Accordingly, MOAC's appeal is, and always was, statutorily moot.

I. Because Section 363(m) is "Jurisdictional," Waiver and Estoppel Cannot Be Relied On to Create Appellate Jurisdiction Where None Exists.

District courts have jurisdiction to hear bankruptcy appeals pursuant to 28 U.S.C. § 158. However, § 363(m) imposes a limitation on the exercise of that jurisdiction:

> The reversal or modification on appeal of an authorization under subsection (b) or (c) of this section of a sale or lease of property does not affect the validity of a sale or lease under such authorization to an entity that purchased or leased such property in good faith, whether or not such entity knew of the pendency of the appeal, unless such authorization and such sale or lease were stayed pending appeal.

11 U.S.C. § 363.

The Second Circuit has "held in no ambiguous terms that section 363(m) *is a limit on our jurisdiction* and that, absent an entry of a stay of the Sale Order, we only retain authority to review challenges to the 'good faith' aspect of the sale. Specifically, we held in *Gucci I* that we *lack jurisdiction* to review the 'unstayed *sale order*,' of a sale subject to the protections of section 363(m) and concluded that 'we may neither reverse *nor modify* the judicially-authorized sale.' " *In re WestPoint Stevens, Inc.*, 600 F.3d 231, 248 (2d Cir. 2010) (emphasis added) (quoting *In re Gucci*, 105 F.3d 837, 838–840 (2d Cir. 1997)). Moreover, the statute makes it plain that knowledge of the pendency of an appeal does not in and of itself constitute

8. I am not insensible to the fact that MOAC took exactly the opposite position when it moved before Judge Drain for a stay pending appeal.

"bad faith." Whether Transform's behavior before the Bankruptcy Court would qualify as bad faith is not a question that anyone has suggested I answer; it was certainly not raised on the appeal.

The Court of Appeals in *WestPoint* left open the possibility for, "A narrow exception . . . for challenges to the Sale Order that are so divorced from the overall transaction that the challenged provision would have affected none of the considerations on which the purchaser relied." *Id.* at 249. No one has pointed this court to any case in which such an exception has been found.

MOAC nonetheless insists that Transform's representations to the bankruptcy judge render the appeal not moot under the doctrines of waiver and judicial estoppel. While this court is appalled by Transform's behavior, I must disagree that either doctrine confers jurisdiction over an appeal where Congress has expressly removed it.

Waiver

MOAC contends that § 363(m) should be treated like any other statute, such that a party can knowingly waive its protection. Transform's counsel's representation to the Bankruptcy Court that the statute was inapplicable, and that Transform could not and would not rely on § 363, was, MOAC contends, a waiver of Transform's right to rely on the statute.

[8, 9] While waiver and forfeiture are applicable to many procedural conditions – for example, the "final decision" requirement for appeals, Title VII's exhaustion requirement, and the forum defendant rule in diversity cases, *see Williams v. KFC Nat. Mgmt. Co.*, 391 F.3d 411, 416 n.1 (2d Cir. 2004) (collecting cases)[9] – they cannot be relied on to create appellate jurisdiction where there is none. Given the Second Circuit's recognition of a clear distinction between limits on jurisdiction and waivable procedural conditions, I find it difficult to believe that the Court of Appeals would deem a statutory requirement to be "jurisdictional" – that is, one conferring or denying jurisdiction – and yet conclude that jurisdiction could attach via waiver, which is tantamount to by consent of the parties. If § 363(m) is a jurisdiction-depriving statute, then its requirements cannot be waived; "Parties cannot waive a defect in the Court's appellate jurisdiction." *In re Bucurescu*, 282 B.R. 124, 130 n.19 (S.D.N.Y. 2002) (citing *Kamerling v. Massanari*, 295 F.3d 206, 212–13 (2d Cir. 2002); *Goldberg v. Cablevision Sys. Corp.*, 261 F.3d 318, 323 (2d Cir. 2001)).

[10, 11] Of course, the language of the statute does not exactly suggest that an appellate court lacks the power to reverse or modify an unstayed bankruptcy court order (it does, after all, presume that a district or appellate court has entered just such an order). But it does say that any such order will, in the absence of bad faith, be ineffective to undo a sale or lease already consummated in the absence of a stay. This, of course, means that an appellate court cannot fashion effective relief in the absence of a stay, which is what renders the appeal moot. Such "statutory" or "bankruptcy" mootness "furthers the policy of finality in bankruptcy sales and assists the bankruptcy court to secure the best price for the debtor's assets." *Gucci*, 105 F.3d at 840 (citing *United States v. Salerno*, 932 F.2d 117, 123 (2d Cir. 1991)).

9. Recently, the Second Circuit determined in *In re Indu Craft, Inc.*, 749 F.3d 107, 113, 116 (2d Cir. 2014) that Rule 6(b)(1) of the Federal Rules of Appellate Procedure (Appeal in a Bankruptcy Case) "is a nonjurisdictional rule" subject to waiver and forfeiture, emphasizing the difference between court-promulgated rules and jurisdictional limits enacted by Congress.

As explained by the Sixth Circuit, § 363(m):

> reflects the more general constitutional consideration that an appeal must be dismissed as moot when, by virtue of intervening events, the court of appeals cannot fashion effective relief. Though reflective of the general prohibition against advisory opinions undergirding the constitutional mootness doctrine, bankruptcy mootness under § 363(m) is broader. Even if the appeal is not moot as a constitutional matter because a court could provide a remedy, the policy favoring finality in bankruptcy sales reflected in § 363(m) requires that certain appeals nonetheless be treated as moot absent a stay.

Weingarten Nostat, Inc. v. Serv. Merch. Co., 396 F.3d 737, 742 (6th Cir. 2005) (internal citations omitted).

The Second Circuit has quite clearly interpreted § 363(m) as a jurisdiction-depriving statute – that is, a statute that removes the appellate court's power to decide any issue except the issue of bad faith. I sit as a district court in the Second Circuit, so I am constrained by the words used by my Court of Appeals to describe my power. And if I lack all power to grant effective relief by congressional command, the parties are not free to agree otherwise, whether by consent or by waiver.

Significantly, MOAC calls the court's attention to no case in which an appellate court's order overturning an unstayed and fully consummated Bankruptcy Court order authorizing a § 363 sale was deemed effective by virtue of waiver. In the only case it cites, *In re Paige*, 443 B.R. 878, 908 (D. Utah 2011), *aff'd in part, rev'd in part*, 685 F.3d 1160 (10th Cir. 2012), the district court considered the possibility that § 363(m) could be waived, but ultimately rejected the proposition that any waiver occurred. *See id.*

Estoppel

With respect to estoppel, MOAC argues that, at the stay hearing, Judge Drain relied on Transform's representations that § 363(m) would not moot MOAC's appeal, which led him to conclude that MOAC would not suffer irreparable harm if he denied the stay. Now Transform seeks to benefit from a complete reversal of that representation.

[12–15] Judicial estoppel is an equitable doctrine to be exercised in the sound discretion of the Court. *New Hampshire v. Maine*, 532 U.S. 742, 750, 121 S.Ct. 1808, 149 L.Ed.2d 968 (2001). It is "designed to prevent a party who plays fast and loose with the courts from gaining unfair advantage through the deliberate adoption of inconsistent positions." *Wight v. BankAmerica Corp.*, 219 F.3d 79, 89 (2d Cir. 2000). Judicial estoppel typically applies when "1) a party's later position is 'clearly inconsistent' with its earlier position; 2) the party's former position has been adopted in some way by the court in the earlier proceeding; and 3) the party asserting the two positions would derive an unfair advantage against the party seeking estoppel." *In re Adelphia Recovery Tr.*, 634 F.3d 678, 695–96 (2d Cir. 2011). The Second Circuit has "further limit[ed] judicial estoppel to situations where the risk of inconsistent results with its impact on judicial integrity is certain." *Intellivision v. Microsoft Corp.*, 484 F. App'x 616, 619 (2d Cir. 2012) (internal citations omitted).

All the conditions for application of judicial estoppel would seem to be met here. Transform has taken different positions that are clearly inconsistent. Judge Drain plainly relied on Transform's representations – both that § 363(m) did not apply to this situation and that Transform had no intention of arguing otherwise – when he concluded that MOAC had failed to demonstrate that it would suffer irreparable injury in the absence of a stay. In response to Judge Drain's question, "So you're not relying on -- you wouldn't -- you're not going to go to the district and say 363(m) applies here. This is over," Transform's counsel replied:

> MR CHESLEY: "Well, we -- in effect, because we do not have a transaction, I think we couldn't rely on 363(m) for the purposes of arguing mootness because we have not closed on a transaction to assume and assign this to a sub debtor [sic].
>
> THE COURT: The specific assign.
>
> MR. CHESLEY: Correct, Your Honor."

(Stay Tr. at 8:11-20.) Judge Drain then reiterated his understanding of Transform's comments: "It's not a 363(m), and they're not going to rely on 363(m), which Mr. Chesley's just reiterated for the second time." (*Id.* at 9:24-25, 10:1.)

Finally, Transform has derived an unfair advantage from its switch in position, because MOAC appears to have been lulled into not seeking a stay before this court.

The question is whether that gets MOAC past § 363(m).

[16, 17] Although the Second Circuit has "never held . . . that judicial estoppel can never apply to matters affecting subject matter jurisdiction," it has cautioned that " 'special care' should be taken in considering whether judicial estoppel should apply 'to matters affecting federal subject matter jurisdiction.' " *Intellivision*, 484 F. App'x at 621 (quoting *Wight*, 219 F.3d at 89). This special care is warranted because, "It is axiomatic that a *lack of subject matter jurisdiction may be raised at any time* even by a party who originally asserted jurisdiction." *Wight*, 219 F.3d at 90 (emphasis added) (internal quotation and citations omitted). Although Transform represented that it could not and would not rely on § 363(m), when it comes to "jurisdictional" considerations, "The bottom line is that irrespective of how the parties conduct their case, the courts have an independent obligation to ensure that federal jurisdiction is not extended beyond its proper limits." *Id.*

[18] Moreover, as a bankruptcy judge in this district recently pointed out, "Judicial estoppel applies to inconsistent factual positions, not alternative legal theories of the case." *In re DeFlora Lake Dev. Assocs., Inc.*, 571 B.R. 587, 599 (Bankr. S.D.N.Y. 2017). Transform's representation to Judge Drain that § 363(m) did not apply to the instant appeal, because there had not yet been a "sale" of Sears' Mall of America Lease as that term is used in § 363(m) is at best a mixed question of law and fact, if not a pure question of law. The assertion that a particular statute does not apply to undisputed facts is not, it seems to me, an "inconsistent factual position" – it is an inconsistent legal position.

Therefore, as much as I hate to say it, judicial estoppel appears to me inapplicable. And I do hate to say it, for if ever there were an appropriate situation for the application of judicial estoppel, this would be it.

II. *Weingarten* is not Outcome Determinative.

Transform argues that the Sixth Circuit's opinion in *Weingarten Nostat, Inc. v. Service Merchandise Co.*, 396 F.3d 737 (6th Cir. 2005) compels the conclusion that MOAC's appeal is mooted by the absence of a stay of the Assignment Order. (*See* Mot. for Reh'g at 5.)

Weingarten is the only case known to this court in which the assignment of a lease pursuant to designation rights was deemed a protected transaction under § 363(m). Its facts are so nearly identical to those in this case as to render it deceptively appealing as a precedent. But I do not believe that it controls the outcome of this motion – and not simply because it was decided in a different circuit.

In *Weingarten*, the debtor, Service Merchandise, sold the designation rights to most of its real property and retail leases to KLA (the equivalent of Holdco) for \$116.4 million. *See* 396 F.3d at 739. KLA's parent corporation, Kimco, then partnered with Schottenstein Stores Corporation to form an entity known as JLPK (the Leaseco equivalent), which was designated by KLA as the assignee of the Service Merchandise lease in a mall known as Argyle Village Square Shopping Center. *See id.* at 739, n. 1. JLPK, like Leaseco, had no intention of operating a business on the site; it intended to sublease the space. The difference between that case and ours is that, in *Weingarten*, the sublessees had already been identified and the premises were to be subleased at roughly the same time as the assignment. *See id.* at 739–40.

Weingarten, the landlord at Argyle Village, objected to both prongs of the transaction. It objected to the assignment to JLPK, because JLPK did not meet the "similarity" requirements required by § 365(b)(3)(A). And it objected to the sublease of a portion of the premises to Michaels, an arts and crafts store, because having Michaels in the mall would both (i) place Weingarten in breach of its lease with Jo-Ann's, a competing crafts store, in violation of § 365(b)(3)(C), and (ii) disrupt the tenant mix or balance of Argyle Village under § 365(b)(3)(D). *See id.* at 740.

After first siding with the landlord – ironically, on the very ground on which MOAC prevailed in this court on the appeal (namely, that JLPK, the intermediate assignee did not meet the similarity in "financial condition and operating performance" criteria of § 365(b)(3)(A)) – the Bankruptcy Court reversed field and approved the transaction, pursuant to both §§ 363 and 365. It did so after Kimco and Schottenstein's – neither of whom was ever the assignee of Service Merchandise's lease – agreed to guarantee a year's base rent on the leased premises.

Weingarten "vigorously" sought a stay pending appeal, from both the district court and the Sixth Circuit. However, its many applications were denied, and the transactions closed. Although the aggrieved landlord pursued its appeal in the absence of a stay, the Sixth Circuit dismissed Weingarten's appeal as moot under § 363(m). It reasoned that (1) lease assignments for consideration were "sales" within the meaning of that statute; and (2) the two-part transaction in question was actually a single transaction, pursuant to which Service Merchandise had "sold" its lease to the ultimate subtenant, Michaels. *See id.* at 742–43.

There are two important factual distinctions between this case and *Weingarten*.

First, as MOAC correctly points out, in *Weingarten* "the assignee paid *separate consideration* for the assignment." (Reh'g Resp. at 16 (emphasis added).) JLPK, the party in Leaseco's position in the *Weingarten* transaction, paid \$300,000 in order to be designated as the assignee of the lease. *See* 396 F.3d at 743. Of course, JLPK paid that money to its affiliate, KLA – not to Service Merchandise's bankruptcy estate. But at least it paid something to someone in the transactional chain. There is no suggestion in the record before me that Leaseco paid anything to anyone who controlled the Lease – not to Sears, the assignor; not to Holdco, the designator; and not to ESL Investments, Inc., their mutual parent – in order to procure the assignment of the Mall of America Lease from

Sears. But for reasons discussed below, I think this first factual distinction irrelevant.

It is the second reason that causes me to conclude that the Sixth Circuit's opinion, while interesting and informative, does not necessarily control the outcome of Transform's motion. The *Weingarten* court ultimately blessed the transaction because the assignment to intermediate assignee JLPK (the party in Leaseco's shoes) was but the first half of a two-step but ultimately unitary transaction, whereby Service Merchandise (the debtor) assigned (sold) its lease to the ultimate subtenant, Michaels. To the Sixth Circuit, that was a critically important factor – one that caused it to "discount" the intermediate assignment to JLPK, and overlook Weingarten's argument that JLPK did not meet the requirements of § 365(b)(3)(A):

> Service Merchandise's assignment of the lease to JLPK pursuant to the designation-of-rights agreement with KLA constitutes a single transaction *if we consider the overall result of the transaction.* If the details of the transaction are discounted, it is clear that *Service Merchandise sold the Argyle Village lease to Michaels* pursuant to §§ 363(b) and 365. The relevant case law demonstrates that *a stay pending appeal is required when the sale and assignment are part of a single transaction*, and there is no reason that this protection should be lost merely because the transaction has been separated into two steps.

Id. (emphasis added).

In our case, we have no second step – none has occurred, and none is anticipated in the foreseeable future. No ultimate subtenant had been identified at the time the Assignment Order was approved and entered; none has been identified to date. That this made a difference to the outcome below could not be clearer; Transform's counsel represented to Judge Drain that the absence of a second-step transaction took the assignment of Sears' Mall of America lease to Leaseco out of the purview of § 363(m). (*See* Stay Tr. at 8:14-18.) Put otherwise, Transform essentially argued to Judge Drain that *Weingarten* did not preclude MOAC's appeal.

Because the Sixth Circuit's "unitary transaction" analysis ultimately dictated the outcome in *Weingarten*, I cannot accept Transform's invitation to hold that *Weingarten* is outcome-determinative here, or to conclude that its reasoning would necessarily apply to the intermediate step in a two-step transaction in a case, like this one, where the assignee has not closed on the ultimate sublease.

If Transform is to prevail, it must be because the intermediate step, the assignment of the lease from Sears to Leaseco, was a "sale" within the meaning of § 363(m) – an issue never discussed by the Sixth Circuit in *Weingarten*. It is to that issue that I now turn.

III. The Assignment Order is Protected by § 363(m).

Section 363(m) applies to the "sale or lease of property."

[19] A sale, per Black's Law Dictionary, is the transfer of property or title for a price. *Sale*, Black's Law Dictionary (11th ed. 2019). The Second Circuit has never opined on whether an assignment of an interest in property is tantamount to a "sale" for purposes of § 363(m). However, other courts that have faced this issue have concluded that such assignments are sales, because either (1) they were assignments for valuable consideration, or (2) the bankruptcy court authorized the § 365 assignment under § 363 as well.

Applying either criterion, the intermediate assignment of the Mall of America

Lease to Leaseco qualifies as a § 363(m) sale.

The Sixth and Fourth Circuits, as well as one of my colleagues in this District, have expressly held that a lease assignment for valuable consideration is a § 363 sale. *See Weingarten*, 396 F.3d at 742 (The Sixth Circuit holds that "the assignment of a lease for a valuable consideration" is a sale for § 363(m) purposes); *In re Adamson Co. Inc.*, 159 F.3d 896, 898 (4th Cir. 1998) (same); *see also In re Cooper*, 592 B.R. 469, 480 (S.D.N.Y. 2018), *appeal dismissed* (Mar. 1, 2019) ("This Court sees no meaningful distinction between a sale, on the one hand, and a transfer of property in exchange for valid consideration, on the other."). The Third and Ninth circuits have similarly treated assignments for consideration as § 363(m) "sales." *See Krebs Chrysler-Plymouth, Inc. v. Valley Motors, Inc.*, 141 F.3d 490, 493 (3d Cir. 1998) (buyer purchased franchise agreement for $230,000); *In re Exennium, Inc.*, 715 F.2d 1401, 1404 (9th Cir. 1983) (buyer purchased four of debtor's leases for over $78,000); *see also In re Am. Banknote Corp.*, No. 99 B 11577, 2000 WL 815910, at *2 (S.D.N.Y. June 22, 2000) (debtor received $380,000 for assuming lease); *but c.f. In re Joshua Slocum Ltd.*, 922 F.2d 1081, 1085 (3d Cir. 1990) (appellee conceded that § 363(m) did not apply to mere lease assignments).

I can see no reason not to reach the same conclusion, and to hold that an assignment for consideration constitutes a "sale" as that word is used in the Code.

(i) The Assignment of the Lease Was a Sale Because It Was a Transfer of an Interest in Property for Consideration.

The Assignment Order authorized a transfer of Sears' interest in the Lease to Leaseco. And I must reject MOAC's contention that this particular assignment cannot be a "sale" within the meaning of these cases because it was not supported by independent consideration.

The Assignment Order directs Holdco to pay all cure costs due to MOAC under the Lease. (Assignment Order ¶ 11.) As noted above, this was the bargain struck in the APA; when a specific lease was designated for assignment, five business days after the resolution of any objections thereto (the Assumption Effective Date), Sears would assume the lease and assign the lease to Holdco's designee -- but only after Holdco paid cure costs for that lease. (APA § 2.7(c).)

Under the Bankruptcy Code, a debtor that assumes an unexpired ease is responsible for paying cure costs when the debtor assumes an unexpired lease. *See* 11 U.S.C. § 365(b)(1)(A). Sears did not become responsible for cure costs until is assumed the Mall of America Lease, which occurred on the Assumption Effective Date. Holdco's satisfaction of Sears' obligation to pay those cure costs constitutes valid consideration for the assignment of the Mall of America Lease itself. *See Thales Alenia Space France v. Thermo Funding Co., LLC*, 959 F. Supp. 2d 459, 467 (S.D.N.Y. 2013) (citing *Mencher v. Weiss*, 306 N.Y. 1, 8, 114 N.E.2d 177 (1953)). And because Sears had no obligation to pay cure costs until the Assumption Effective Date, the payment of those costs by Holdco constitutes new consideration – not simply the carrying out of a preexisting obligation to which Holdco agreed in the APA. Indeed, Sears would not have incurred the statutory obligation to pay cure costs if the Bankruptcy Court's had not approved Sears' assumption of the MOAC Lease.

I thus have no difficulty concluding that the assignment to Leaseco was a "sale," because Sears transferred its interest in the Mall of America lease to Holdco's designee for consideration.

(ii) The Assignment Was a Sale Pursuant to Both §§ 363 and 365.

[20] That said, not every assignment under § 365 is *per se* a "§ 363(m) sale." Only assignments/sales that fall within § 363(b) or (c) of the Code qualify as "sales" for the purposes of § 363(m). As the Third Circuit put it, "[A] party need only obtain a stay pending appeal when the debtor receives authorization to assign and sell executory contracts or leases under *both* § 363 and § 365." *Cinicola v. Scharffenberger*, 248 F.3d 110, 124 (3d Cir. 2001) (emphasis added).

So the question becomes whether this particular assignment was authorized under both statutes, or was merely an assignment under § 365. The answer is: both.

Cases in other Circuit Courts of Appeal have attached great importance to whether the bankruptcy court "purported to authorize a section 363 sale" to distinguish such sales from cases where the debtor "merely assigns a lease under section 365." *In re Rickel Home Ctrs., Inc.*, 209 F.3d 291, 302 (3d Cir. 2000); *see also Weingarten*, 396 F.3d at 743; *Krebs*, 141 F.3d at 498. Numerous courts have applied § 363(m) to transactions where the bankruptcy court invoked § 363 as well as § 365 in order to authorize a transaction.

In *Krebs*, for example, the debtor moved to assume and assign three franchise agreements to the highest bidder at auction. 141 F.3d at 493. The court distinguished its case from *Slocum* (in which the Third Circuit had concluded that a "mere assignment" pursuant to § 365 was not a § 363(m) "sale") because, in *Krebs*, "the bankruptcy judge in this case authorized both an assumption under section 365 and a subsequent sale under section 363." *Id.* at 498. Similarly, in *Rickel*, the debtor sold and assigned 41 leases to the buyer or its affiliate. 209 F.3d at 295. Once again, the court distinguished the case from *Slocum* because, "the District Court explicitly authorized a sale of the leases pursuant to section 363, despite [the appellant]'s contention that section 363 was inapplicable to this transaction." *Id.* at 302. I note also that the Sixth Circuit in *Weingarten* authorized the transaction under both § 363 and § 365. *Weingarten, supra.*, 396 F.3d at 743.

And so we turn to the language of the Assignment Order in this case. Its text answers the question. The assignment of the Mall of America Lease is a sale for purposes of § 363(m) because the assignment of this particular designatable lease – which I have found to be a sale, a transfer of an interest in property for consideration) – repeatedly references § 363 as well as § 365 as providing authority for the assignment. Despite Judge Drain's on-the-record statement that the Assignment Order would be "only" a "365," the text of the Assignment Order provides that, "*Pursuant to sections 105, 363, and 365* of the Bankruptcy Code, the Debtors ... are authorized to take any and all actions as may be: (i) reasonably necessary or desirable to implement the assumption and assignment of the Designated Lease pursuant to and in accordance with the terms and conditions of the Asset Purchase Agreement, the Related Agreements, the Sale Order, and this Order ..." (Assignment Order ¶ 5 (emphasis added)); and "*Pursuant to sections 105(a), 363(b), 363(f), and 365* of the Bankruptcy Code, the Debtors are authorized to transfer the Designated Lease in accordance with the terms of the Asset Purchase Agreement and the Sale Order" (*id.* ¶ 6 (emphasis added)). These references alone are enough to bring the assignment of the

Mall of America lease within the ambit of § 363(m).

Furthermore, the integrity of Assignment Order has to be protected by § 363(m), because the Assignment Order is "inextricably intertwined" with the Sale Order. *See Cinicola*, 248 F.3d at 126. As Judge Drain recognized at the hearing, the assignment to Leaseco was an "outgrowth" of the Sale Order. (Stay Tr. at 9:24.) Nothing could be more patent. The "sale" by assignment of leases to be designated in the future was originally authorized by the Sale Order, which was itself entered pursuant to § 363(b) of the Code. The Sale Order adopted the APA between Sears and Holdco – with all of its terms and conditions of sales of the designatable leases, as explained above – and incorporated the terms of that agreement into the Sale Order. The APA, as incorporated into the Sale Order, specifically provided that the "sale" of any designatable lease would take place only when an assignee is designated and the assignment is authorized

It is difficult to see how the Assignment Order effectuating a "sale" authorized pursuant to the Sale Order could be anything but "inextricably intertwined" with that Sale Order – an order that, while expressly stating that it did not bring about the "sale" of any particular lease, specifies when that sale would take place and sets out all the steps needed to effectuate the actual sale of any designated lease. The two orders could not operate more closely "in conjunction" with each other.

Cinicola is persuasive authority for this proposition. There, the debtor's trustee asked the bankruptcy court to approve a settlement agreement that involved the sale of assets and the assignment of executory contracts to a buyer for over $25 million. *Cinicola*, 248 F.3d at 116. The executory contracts included certain physicians' employment contracts, and the physicians objected to the assignment. *See id.* at 116–17. The bankruptcy court, invoking §§ 363 and 365, authorized the settlement agreement, but deferred action on the assignment of the physicians' contracts in order to address their objections. *See id.* at 117, 122. After a hearing on the physicians' objections, the bankruptcy court entered a second order authorizing the assignment of the contracts under § 365. *See id.* at 125. The trustee assigned the contracts and subsequently closed on the settlement agreement. *See id.* at 117.

Notwithstanding the fact that the second order invoked only § 365, the Third Circuit determined it was "clear the Bankruptcy Court intended its Second Order to operate in conjunction with its First Order," such that the assumption and assignment of the employment contracts were "inextricably intertwined" with the debtor's sale of assets to the buyer in the settlement agreement. *Id.* at 125–26. Its reasoning is reminiscent of the Sixth Circuit's determination, in *Weingarten*, that a transaction carried out in two steps should be viewed from the perspective of the ultimate result.

Here, even if the Assignment Order itself were only a § 365 order (as Judge Drain obviously believed it to be), it was certainly an "outgrowth of the sale" (as he also believed), such that the two orders are inextricably intertwined. The transaction could not have been carried out without reference to both orders.

MOAC's arguments to the contrary are unconvincing.

First, MOAC argues that, unlike the Sale Order, the Assignment Order does not explicitly reference § 363(m). But in none of the cases discussed above did the court expressly reference subsection (m), as opposed to § 363 generally. *See, e.g.*, *Rickel*, 209 F.3d at 302; *Krebs*, 141 F.3d at 498.

MOAC also urges that, because it has a right to object as part of the designation process, its objection cannot be deemed "finally resolved" until its appeal is decided. Unfortunately, the language of § 363(m) is unforgiving: "Although an appellant's challenge to a sale authorization might raise meritorious arguments . . . denial of a requested stay has the effect of precluding this Court from reviewing those issues, other than the good faith of the purchaser, if the sale has closed in the interim." *Gucci*, 105 F.3d at 840. The assignment of the Lease to Leaseco has taken place; the unstayed transaction has closed. Section 363(m) would be meaningless if "final resolution" of an objection were deemed delayed until a decision is rendered on appeal even in the absence of a stay. Indeed, the entire § 363(m) jurisprudence that has (finally) been called to the attention of this court consists of cases in which the objection was not "finally resolved" on MOAC's reading, because the landlord took an appeal. Yet appeal after appeal from consummated transaction has been dismissed for statutory mootness because of a desire to give "finality" to the judgments of the Bankruptcy Court – judgments that would be interlocutory in nature if they did not "finally resolve" objections. When it comes to statutory mootness under § 363(m), there are "special consequences of denying a stay of a bankruptcy sale" such that I may not review even the most meritorious arguments on appeal if the sale has closed in the interim. *See id.* at 840.

Next, MOAC argues that Transform provided no more or less consideration based on the approval or denial of the assignment of the Mall of America Lease. But as explained above (*see supra*, pp. 630–31), that is simply not so; Holdco made a separate and independent payment, in satisfaction of an obligation imposed by law on Sears, in order to bring about the assignment.

Finally, I have considered the possibility that this case presents the never-before-found and possibly mythical "exception" to the usual rule of statutory mootness that was mentioned in passing in *WestPoint*, 600 F.3d at 249. The *WestPoint* court speculated that there might be "challenges to the Sale Order that are so divorced from the overall transaction that the challenged provision would have affected none of the considerations on which the purchaser relied, thereby allowing a higher court to entertain an appeal from a consummated transaction in the absence of a stay. *Cf. Krebs Chrysler–Plymouth, Inc. v. Valley Motors, Inc.*, 141 F.3d 490, 499 (3d Cir. 1998) (stating that an appeal is not moot under § 363(m) unless the party failed to obtain a stay and reviewing courts can fashion a remedy "that will not affect the validity of the sale")." *Id.*

Unfortunately for MOAC, I cannot conclude that this case would fall within any such exception. Judge Drain did say (also in passing) that § 363(m) probably would not apply to the Assignment Order because MOAC was appealing from just one assignment among 600 that were authorized by the Sale Order. But nothing in the record supports a conclusion that losing the opportunity to sublease the Mall of America space "would have affected none of the considerations on which [Transform/Holdco] relied" in making the deal enshrined in the APA. If, as MOAC insists, Mall of America is a very special mall in the pantheon of American malls, then the opportunity to sublease Sears' very valuable space at this very special mall might well have been integral to any deal Transform was willing to enter. Any "finding" that Transform would have agreed to the same deal, on the same terms memorialized in the Sale Order, without gaining the ability to sublease the Mall of America space would be pure conjecture on my part. There was no hearing at which evidence was adduced on that issue; and it is not a conclusion one can reach simply because the Mall of America lease is but one among 600.

So either the Assignment Order brought about a § 363(m) sale, or it is protected by virtue of its connection to the APA and the Sale Order. Either way, Transform wins.

I am not suggesting that MOAC needed to obtain a stay of the actual Sale Order at the time it was entered. It could not possibly have done so, since at that point no one knew to whom the Mall of America Lease might be designated, so there would have been no basis on which to object. But Sears' assignment of the Mall of America Lease to Leaseco in the Assignment Order is protected by § 363(m), because, per the terms of the APA, the Assignment Order effected a sale (a transfer for consideration) of that lease, as authorized by the Sale Order. If MOAC had obtained a stay of the Assignment Order from Judge Drain, we would not be here today. And if MOAC had asked this court to impose a stay prior to the consummation of the assignment, we might not be here today.[10] But it did not.

It is, therefore, with deep regret that I grant the motion for rehearing and, on rehearing, dismiss MOAC's appeal as statutorily moot. That necessitates the vacatur of this court's decision on appeal.

CONCLUSION

For the reasons stated above, Transform's motion for rehearing is GRANTED. On rehearing, this Court concludes that it lacks appellate jurisdiction over MOAC's appeal because it is statutorily moot under § 363(m). Therefore, this court's decision on appeal at Dkt. No. 26 is VACATED and MOAC's appeal at Dkt. No. 1 is DISMISSED.

This constitutes a written opinion and order of the court. The Clerk of Court is directed to close the motion at Dkt. No. 29.

In the MATTER OF: PACIFIC DRILLING S.A., et al., Reorganized Debtors.

Case No. 17-13193 (MEW)

United States Bankruptcy Court, S.D. New York.

Signed 04/02/2020

Background: Debtor and certain of its affiliates in jointly administered Chapter 11 cases objected, on timeliness grounds, to proof of claim filed by creditor against debtor in connection with creditor's arbitration involving contract with one affiliate that was guaranteed by second affiliate.

Holdings: The Bankruptcy Court, Michael E. Wiles, J., held that:

(1) creditor did not act with "excusable neglect" in belatedly filing its proof of claim against debtor;

(2) creditor's earlier claims against two affiliates were not "informal" claims against debtor, and so, as to debtor, the objected-to proof of claim was an entirely new claim, not an amendment to or clarification of an existing claim; and

10. Obviously, I cannot go back in time and say with certainty what ruling would have issued if MOAC had sought a stay pending appeal back in September of last year. Other landlords, such as the landlord in Weingarten, have tried and failed to obtain stays pending appeal in similar circumstances. For all I know, it was already too late by the time MOAC filed its notice of appeal. However, I certainly cannot say that I absolutely would have denied any such application.

2021 WL 5986997
United States Court of Appeals, Second Circuit.

IN RE: SEARS HOLDINGS CORPORATION, Debtor.
Moac Mall Holdings LLC, Appellant-Cross-Appellee,
v.
Transform Holdco LLC, Appellee-Cross-Appellant,
Sears Holdings Corporation, Debtor-Appellee.

Nos. 20-1846-bk, 20-1953-bk
|
December 17, 2021

Appeal from a judgment of the United States District Court for the Southern District of New York (Colleen McMahon, *Judge*).

UPON DUE CONSIDERATION, IT IS HEREBY ORDERED, ADJUDGED, AND DECREED that the judgment of the District Court is AFFIRMED.

Attorneys and Law Firms

FOR APPELLANT-CROSS-APPELLEE:Alexander J. Beeby (Thomas J. Flynn, on the brief), Larkin Hoffman Daly & Lindgren Ltd., Minneapolis, MN; David W. Dykhouse, Daniel A. Lowenthal, Patterson Belknap Webb & Tyler LLP, New York, NY.

FOR APPELLEE-CROSS-APPELLANT:Richard A. Chesley (Rachel Ehrlich Albanese, on the brief), DLA Piper LLP, New York, NY; Craig Martin, DLA Piper LLP, Wilmington, DE.

PRESENT: RAYMOND J. LOHIER, JR., JOSEPH F. BIANCO, Circuit Judges, RONNIE ABRAMS, District Judge. [*]

SUMMARY ORDER

***1** Appellant-Cross-Appellee MOAC Mall Holdings LLC ("MOAC") appeals from a judgment of the United States District Court for the Southern District of New York (McMahon, J.), which (1) dismissed as moot under 11 U.S.C. § 363(m) MOAC's appeal from a September 5, 2019 assignment order (the "Assignment Order") issued by the United States Bankruptcy Court for the Southern District of New York (Drain, B.J.), and (2) denied MOAC's motion for rehearing. Appellee-Cross-Appellant Transform Holdco LLC ("Transform") conditionally appeals the District Court's initial order of February 27, 2020, which reversed the Bankruptcy Court's judgment entered in Transform's favor. We assume the parties' familiarity with the underlying facts and procedural history, to which we refer only as necessary to explain our decision to affirm. Because we conclude that MOAC's appeal was properly dismissed as moot, we do not address the merits of Transform's conditional cross-appeal.

"A district court's order in a bankruptcy case is subject to plenary review, meaning that this Court undertakes an independent examination of the factual findings and legal conclusions of the bankruptcy court." D.A.N. Joint Venture v. Cacioli (In re Cacioli), 463 F.3d 229, 234 (2d Cir. 2006) (quotation marks omitted). A bankruptcy court's conclusions of law are reviewed de novo and its findings of fact for clear error. Id. We review de novo questions about whether an appeal relating to a bankruptcy court decision is moot. See Contrarian Funds LLC v. Aretex LLC (In re WestPoint Stevens, Inc.), 600 F.3d 231, 247 (2d Cir. 2010).

Two provisions of the Bankruptcy Code, 11 U.S.C. § 363(b)(1) and 11 U.S.C. § 363(m), are principally at issue in this case, which arises from a Chapter 11 bankruptcy proceeding involving Sears Holding Corporation ("Sears"). Sears formerly occupied space in the Mall of America in Minneapolis under a lease with MOAC.

By order dated February 8, 2019 (the "Sale Order"), the Bankruptcy Court authorized a sale under 11 U.S.C § 363(b), which, with exceptions not pertinent here, permits a trustee, after notice and a hearing, to use, sell, or lease property of the estate outside of the ordinary course of business. 11 U.S.C. § 363(b)(1). [1] Through the Sale Order, Transform, among other things, purchased from Sears the right to designate which assignee would assume Sears's lease. The parties do not dispute that the Sale Order was authorized under § 363(b). After the sale closed, the Bankruptcy Court entered the Assignment Order, which authorized Transform to assign the lease to its wholly-owned subsidiary, Transform Leaseco LLC ("Leaseco"), and permitted Leaseco to assume the lease. MOAC moved to stay Transform's assignment of the lease, but the Bankruptcy Court entered an order denying the motion. MOAC then appealed the Assignment Order to the District Court, but it is undisputed that it did so without first obtaining from the District Court a stay of the assignment pending resolution of the appeal.

***2** Relying on § 363(m), Transform — at the latest possible stage in the District Court proceedings — challenged the District Court's review on appeal of the Bankruptcy Court's Assignment Order. Section 363(m) "creates a rule of statutory mootness ... which bars appellate review of any sale authorized by 11 U.S.C. § 363(b) ... so long as the sale was made to a good-faith purchaser and was not stayed pending appeal." In re WestPoint Stevens, Inc., 600 F.3d at 247 (quotation marks omitted). The text of § 363(m) provides as follows:

> The reversal or modification on appeal of an authorization under subsection (b) or (c) of this section of a sale or lease of property does not affect the validity of a sale or lease under such authorization to an entity that purchased or leased such property in good faith, whether or not such entity knew of the pendency of the appeal, unless such authorization and such sale or lease were stayed pending appeal.

11 U.S.C. § 363(m). Thus, as the text makes clear, in the absence of a stay, § 363 limits appellate review of a final sale to "challenges to the 'good faith' aspect of the sale" without regard to the merits of the appeal. In re WestPoint Stevens, Inc., 600 F.3d at 247; see also Licensing by Paolo, Inc. v. Sinatra (In re Gucci), 105 F.3d 837, 838 (2d Cir. 1997). The provision reflects Congress's "uniquely important interest in assuring the finality of a sale that is completed pursuant to 11 U.S.C. § 363(b)" and protecting good faith purchasers. In re WestPoint Stevens, Inc., 600 F.3d at 248.

We have held that § 363(m) also limits appellate review of any transaction that is integral to a sale authorized under § 363(b) — for example, where removing the transaction from the sale would prevent the sale from occurring or otherwise affect its validity. See id. at 250 (citing In re Stadium Mgmt. Corp., 895 F.2d 845, 849 (1st Cir. 1990)); see also Cinicola v. Scharffenberger, 248 F.3d 110, 125 (3d Cir. 2001). The Bankruptcy Court concluded that § 363(m) does not apply to the assignment in this case. But we note that the parties before it did not raise the legal question that is before us — namely, whether the assignment is integral to the Sale Order such that § 363(m) applies to the assignment. The parties elected instead to focus the Bankruptcy Court's attention on whether MOAC would suffer irreparable harm in the absence of the stay.

The District Court, however, was squarely presented with the issue of whether the assignment in this case was integral to the Sale Order and determined that it was. We agree that the assignment of the lease to Leaseco was integral to the sale of Sears's assets to Transform, especially since both the Sale Order and the Assignment Order expressly state that the latter is integral to the former. Specifically, the Sale Order states that "[t]he assumption and assignment of the Assigned Agreements are integral to the Asset Purchase Agreement" pursuant to which the sale was accomplished. Joint App'x 28. "Assigned Agreements" is defined in the Asset Purchase Agreement to include "Designatable Leases" like the Mall of America lease. Supp. App'x 11. The Assignment Order contains language nearly identical to the Sale Order. It provides that "[t]he assumption and assignment of the Designated [Mall of America] Lease is integral to the Asset Purchase Agreement." Special App'x 72.[2] Taken together, this language supports the conclusion that the successful assignment of the leases, including the Mall of America lease at issue here, was integral to the Sale Order. The District Court thus correctly found that § 363(m)'s threshold requirement was satisfied.

***3** Urging a contrary conclusion, MOAC argues that the term "integral" is ambiguous and that the assignment of the lease here is not integral to the § 363(b) sale because the Sale Order does not guarantee that Transform's designated assignee would be approved. According to MOAC, the Sale Order provides that the parties must adhere to the designation-of-rights procedure contained in the Sale Order and Asset Purchase Agreement, and that while failure to abide by the procedure might scuttle the sale, an unsuccessful assignment could not.

We are not persuaded. Under the designation-of-rights procedure, Transform's designated assignee must be approved if (1) the assignee satisfied certain contractual and statutory conditions, and (2) either no one objected to the assignment or the Bankruptcy Court resolved any objections in Transform's favor. See Joint App'x 71–72; see also Special App'x 42. Here, the Bankruptcy Court resolved MOAC's challenge to the assignment in Transform's favor and approved the Assignment Order after finding that Leaseco had complied with all necessary contractual and statutory requirements. In the absence of a stay of the assignment, reversing or modifying the Bankruptcy Court's approval of the assignment after the court has made such a finding would negate the parties' agreement. Reversing or modifying the Bankruptcy Court's approval would also run contrary to § 363(m)'s rule limiting appellate jurisdiction over an unstayed sale order to the narrower issue of whether the sale was entered in good faith. See In re Gucci, 105 F.3d at 840 (recognizing "that a rule limiting appellate jurisdiction over unstayed sale orders to the issue of good faith furthers the policy of finality in bankruptcy sales").

MOAC next argues that Transform has waived its ability to rely on § 363(m), or is estopped from doing so, because it raised its jurisdictional argument only after the District Court ruled against it on the merits and because it insisted before the Bankruptcy Court that § 363(m) was not applicable under the circumstances of this case. At most, MOAC acknowledges, the statute's limitations on available appellate relief can render an affected appeal moot, but MOAC contends that these limitations are not "truly jurisdictional" and are therefore subject to waiver and judicial estoppel.

But that argument is foreclosed by our binding precedent in In re WestPoint Stevens, Inc., under which § 363(m) deprived the District Court of appellate jurisdiction, and which followed the Supreme Court's warning in Arbaugh v. Y & H Corp., 546 U.S. 500, 514 (2005), that we not conflate jurisdictional and nonjurisdictional statutory limitations. "We have held in no ambiguous terms that section 363(m) is a limit on our jurisdiction and that, absent an entry of a stay of the Sale Order, we only retain authority to review challenges to the 'good faith' aspect of the sale." In re WestPoint Stevens, Inc., 600 F.3d at 248; see also In re Gucci, 105 F.3d at 838 (holding that, pursuant to § 363(m), appellate courts "have no jurisdiction to review an unstayed sale order once the sale occurs, except on the limited issue of whether the sale was made to a good faith purchaser"). Thus, absent the entry of a stay (and excepting challenges to a purchaser's good faith), the District Court had no authority to reverse or modify a sale order in a way that affects the validity of a § 363 sale, regardless of the merit of the petitioner's appeal. See In re WestPoint Stevens, Inc., 600 F.3d at 247; In re Gucci, 105 F.3d at 840; cf. Bowles v. Russell, 551 U.S. 205, 213–14 (2007).

***4** Relying primarily on Arbaugh, MOAC also argues that § 363(m) cannot be jurisdictional because it is not phrased in clearly jurisdictional terms and because viewing the statute as imposing a jurisdictional limitation conflates threshold requirements bearing on a statute's applicability, such as elements of a claim, with jurisdictional requirements. In advancing this argument, MOAC suggests that we did not mean to hold in In re WestPoint Stevens, Inc. that, under circumstances that also exist in this case, § 363(m) divests appellate courts of jurisdiction to grant relief. In urging a contrary conclusion, moreover, MOAC mistakenly relies in part on cases that relate to a district court's original subject-matter jurisdiction rather than, as here, appellate jurisdiction. MOAC's argument ignores that, in the absence of a stay, the District Court, on appeal, was unable to grant effective relief without impacting the validity of the sale at issue, thus rendering the case moot by operation of a clear limit on its appellate review that is imposed by Congress, not by rule. Moreover, in a summary order issued earlier this year, a panel of this Court reaffirmed that § 363(m) is jurisdictional because it "creates a rule of statutory mootness." In re Pursuit Holdings (NY), LLC, 845 F. App'x 60, 62 (2d Cir. 2021) (quoting In re WestPoint Stevens, Inc., 600 F.3d at 247). For these reasons, we are unpersuaded by MOAC's argument that statutory mootness under § 363(m) is subject to waiver or judicial estoppel, or that the statute conferred jurisdiction upon the District Court under the circumstances of this case.

Finally, the District Court did not abuse its discretion when it dismissed MOAC's alternative good-faith purchaser argument — raised for the first time in MOAC's own motion for a rehearing — as untimely. As previously noted, under the circumstances here, the reviewing courts "only retain authority to review challenges to the 'good faith' aspect of the sale." In re WestPoint Stevens, Inc., 600 F.3d at 248 (emphasis added). In other words, appellate review is available only when the parties challenge the good-faith aspect of a sale. Here, neither party raised the good-faith issue on Transform's motion for a rehearing, and the District Court did not err in declining to address the issue sua sponte, as a court is not required to review the issue sua sponte before dismissing an appeal as moot under § 363(m). The District Court therefore neither overlooked nor misapprehended a point of law or fact previously raised, as is required to grant a motion for a rehearing under Bankruptcy Rule 8022.

In sum, because MOAC failed to obtain a stay of the Assignment Order, we agree with the District Court that it lacked jurisdiction to review that order.

***5** We have considered MOAC's remaining arguments and conclude that they are without merit. For the foregoing reasons, the judgment of the District Court is AFFIRMED. [3]

All Citations

Not Reported in Fed. Rptr., 2021 WL 5986997, 71 Bankr.Ct.Dec. 35

Footnotes

* Judge Ronnie Abrams, of the United States District Court for the Southern District of New York, sitting by designation.

1 Section 363(b)(1) provides:

> (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.

11 U.S.C. § 363(b)(1).

2 "Integral" is not defined in the contracts or the orders, so the word is defined by its ordinary meaning and means "essential to completeness." MERRIAM-WEBSTER'S COLLEGIATE DICTIONARY (11th ed. 2020).

3 The District Court's May 11, 2020 order granting Transform's motion for rehearing and vacating the court's original decision in favor of MOAC, and its June 8, 2020 order denying MOAC's motion for rehearing and directing the district clerk of court in effect to close the case, together constitute a final decision that "end[ed] the litigation on the merits and [left] nothing for the court to do but execute the judgment." Hall v. Hall, 138

S. Ct. 1118, 1123–24 (2018); see 28 U.S.C. § 1291 (providing appellate jurisdiction over "appeals from all final decisions of the district courts"). We appreciate that, on March 11, 2020, the District Court entered a stay of what it described as its initial judgment in favor of MOAC. The District Court may well have thought that the stay remained in place after it later granted Transform's motion for rehearing. We note, however, that no judgment of the District Court was ever actually set forth in a separate document at any point. Of course, in the absence of a separate document, judgment is deemed entered 150 days after the order from which the appeal lies is entered. Fed. R. Civ. P. 58(c)(2)(B). But we will repeat our strong suggestion that "where the District Court makes a decision intended to be 'final,' the better procedure is to set forth the decision in a separate document called a judgment." Elfenbein v. Gulf & W. Indus., Inc., 590 F.2d 445, 449 (2d Cir. 1978), abrogated on other grounds by Espinoza ex rel. JPMorgan Chase & Co. v. Dimon, 797 F.3d 229 (2d Cir. 2015).

Sigmund J. Beck Advanced Bankruptcy Roundtable
Indiana Continuing Legal Education Forum
August 19 and 20, 2022

Kayla Britton & Yusuf Qureshi
Faegre Drinker Biddle & Reath LLP
Indianapolis, Indiana
kayla.britton@faegredrinker.com
yusuf.qureshi@faegredrinker.com

Archer-Daniels-Midland Company v. Country Visions Cooperative: Failure to Provide Notice Deprives a Buyer of a Good Faith Purchase Status

I. Introduction

Section 363(m) provides protection for a good faith purchaser of real property from reversal or modification on appeal of the sale order. A recent Seventh Circuit opinion demonstrated a buyer's failed attempt to portray itself as a good faith purchaser and provides a good reminder about the importance of ensuring all parties receive adequate notice of a potential sale. The bankruptcy court ruled that a buyer was not a good faith purchaser because the buyer knew that a holder of a right of first refusal (ROFR) did not receive proper notice of the sale of that land in which it had an interest.

II. Statutory Framework

The purpose of §363(m) is to give "a purchaser or lessee of property of the estate [protection] from the effects of a reversal or modification on appeal of the authorization to sell or lease as long as the purchaser acted in good faith and the appellant failed to obtain a stay of the sale." [1] The statute states:

> (m) The reversal or modification on appeal of an authorization under subsection (b) or (c) of this section of a

[1] 3 *Collier on Bankruptcy* 363.11 (16th 2022).

> sale or lease of property does not affect the validity of a sale or lease under such authorization to an entity that purchased or leased such property in good faith, whether or not such entity knew of the pendency of the appeal.

III. Background

In 2007, Olsen Brothers Enterprises LLP granted an ROFR on a parcel of land (the Ripon Property) to Country Visions Cooperative (CVC). [2] The ROFR "provided that for a period of ten years, Olsen Brothers Enterprises would give the holder of the ROFR notice and an opportunity to match any third party's written offer to purchase the Ripon Property." [3] In July 2010, Olsen Brothers Enterprises dissolved and distributed the business assets (including the Ripon Property) to the partners (Paul and David Olsen). [4]

In 2010, Paul and David Olsen filed for bankruptcy and filed an agreed plan of reorganization in 2011. [5] The bankruptcy court, believing all interested parties consented to the plan, approved the plan, and scheduled a hearing and auction on August 30, 2011 to bid on the parcel with "title free and clear." [6]

However, none of the parties, including ADM, served CVC with the bankruptcy sale notice or any other notices or pleadings in the bankruptcy case. [7] Instead, a week before the auction, CVC informally learned the Ripon Property was being sold. [8]

In August 2011, CVC attempted to contact the debtors to discuss the sale. [9] For example, CVC left a voicemail with one of the major creditors to discuss the sale, but the call was never returned. CVC sent a letter to the debtors informing the debtors of CVC's ROFR, and one of the

[2] *Archer-Daniels-Midland Company v. Country Visions Cooperative*, 628 B.R. 315, 318 (E.D. Wis. 2021).
[3] *Id*.
[4] *Id*.
[5] *Id*.
[6] *Id*. at 325.
[7] *Id*. at 318.
[8] *Id*.
[9] *Id*. at 319.

debtor's attorneys called CVC informing them that the Ripon Property *might* be sold but never served CVC a notice of the proceedings. [10] CVC did not appear at the confirmation hearing and the bankruptcy court approved the sale to ADM. [11]

CVC ultimately sued ADM four years later when ADM tried to sell the parcel. [12] In 2015, ADM arranged to sell the Ripon and three other parcels to United Cooperative for $25 million (approximately $14.57M allocated to intangible rights and $10.42M allocated to the four properties including the Ripon Property). [13]

CVC contacted ADM to discuss its ROFR on the parcel. [14] In response, ADM separated the transaction into two sales: one transaction valued just the Ripon property at $20M, and the other covering the remaining assets valued at $5M. [15] ADM forwarded the offer to CVC to allow CVC the opportunity to exercise the ROFR, but CVC sued ADM in state court arguing the transaction was a "sham designed to impede the exercise of CVC's ROFR." [16]

In response to the state court litigation, ADM returned to the bankruptcy court and filed a "Motion to Enforce the Confirmation Order Under Which It Purchased Property Free and Clear and Under Which It Is Not a Successor to the Debtors' Obligations" to confirm ADM purchased the property without any obligations under the ROFR. [17]

IV. Buyer's Argument

ADM presented two arguments in their brief. First, CVC's due process rights were not violated because CVC had "actual notice" of the sale. [18] CVC "consulted with eight attorneys

---

[10] *Id.*
[11] *Id.*
[12] *Id.*
[13] *Id.*
[14] *Id.*
[15] *Id.*
[16] *Id.*
[17] *Id.* at 320.
[18] Brief for Appellant Archer-Daniels-Midland Company at 42, *Archer-Daniels-Midland Company v.*

about the bankruptcy, monitored the docket for more than a month, downloaded and printed the bankruptcy court's order setting bidding procedures and the hearing date, and spoke directly with debtor's counsel." [19] Second, ADM argued it was a good faith purchaser because ADM purchased the property with "explicit assurance" that the parcel had an "unrestricted title," and the buyer should not be responsible for providing notice to the creditor. [20]

V. Creditor's Argument

In CVC's reply brief, it argued CVC's constitutional right to due process was violated because "without notice to [CVC], the Debtors and ADM obtained [a] bankruptcy court authority to conduct a sale that purported to be free and clear of [CVC's] ROFR." [21] Also, ADM is not a good faith purchaser because ADM had "actual and constructive knowledge" of CVC's ROFR, and ADM failed to disclose the ROFR to the bankruptcy court or to provide actual notice to CVS of the sale. [22]

VI. Bankruptcy Court

The bankruptcy court ruled CVC did not have notice of the sale and ADM was not a good faith purchaser because it knew about CVC's right of first refusal and failed to inform the bankruptcy court. [23]

The court reasoned CVC lacked notice because neither the timing nor specificity requirements of the Bankruptcy Rule were met. [24] CVC had "general knowledge" of the debtor's

---

Country Visions Cooperative, 628 B.R. 315 (E.D. Wis. 2021), No. 21-1400.

[19] *Id*.

[20] *Id*.

[21] Response Brief for Appellee Country Visions Cooperative at 29, *Archer-Daniels-Midland Company v. Country Visions Cooperative*, 628 B.R. 315 (E.D. Wis. 2021), No. 21-1400.

[22] *Id*.

[23] *Archer-Daniels-Midland Company*, 628 B.R. at 326.

[24] *Id*. at 325.

bankruptcy because CVC spoke with the debtor's attorney, however, the information provided to CVC was "ambiguous." [25] The conversation only discussed a "potential sale," and it was "clear from the telephone conversation" that CVC had not received service of notices in the bankruptcy, such as notices related to the sale, the disclosure statement or plan. [26] Additionally, CVC was not "listed as a creditor, party to an executory contract or interested party in the [d]ebtors' bankruptcy schedules, and CVC's name was not on the mailing matrix used to send notices to creditors in the case." [27]

The bankruptcy court reasoned ADM was not a good faith purchaser because ADM had actual and constructive knowledge of the right of first refusal. [28] CVC's right of first refusal was recorded in local real estate records. [29] ADM had a copy of the records and knew CVC was not listed as a creditor or party of interest in the bankruptcy case. [30] Also, before the confirmation hearing, ADM was informed by email that the Ripon Property was subject to a right of first refusal. [31]

The court rejected ADM's argument that this case is like *Edwards*, a Seventh Circuit Court of Appeals case decided on May 4, 1992. [32] There, notice never reached the creditor because the debtor provided the bankruptcy court with the creditor's old address. [33] Unlike the purchaser in *Edwards*, who did not know the creditor had not received notice, ADM should have known CVC

[25] *Id.*
[26] *Id.*
[27] *Id.*
[28] *Id.* at 326.
[29] *Id.*
[30] *Id.*
[31] *Id.*
[32] *Id.*
[33] *Id.*

had not received notice of the sale. [34] Therefore, the bankruptcy court ruled ADM cannot be a good faith purchaser "when it ignored information" that suggested CVC's rights were not considered in the sale. [35]

VII. District Court and Court of Appeals

The district court and court of appeals affirmed the bankruptcy ruling that ADM was not a good faith purchaser. The district noted that CVC's ROFR was properly and timely recorded, ADM knew or should had known CVC was not included in the service list, and ADM knew about CVC's ROFR for four years. [36]

The district court added that the bankruptcy court did not have personal jurisdiction over CVC because ADM and the debtors failed to provide "any notice" to CVC. [37] The court rejected ADM's (citing a Supreme Court Case [38] and 7th Circuit Case [39]) argument that "procedural failings can be wiped clean because CVC had notice of the potential sale." [40] However, neither case cited by ADM attempted to bind a party over whom the bankruptcy court did not have personal jurisdiction. And neither case argues that "some informal notice always satisfies due process." [41]

The court of appeals noted that "it is impossible to disagree with the bankruptcy and district [court] judges" that ADM acted with bad faith because ADM had actual and constructive

---

[34] *Id.*
[35] *Id.*
[36] *Archer-Daniels-Midland Company*, 628 B.R. 315, 326.
[37] *Id.* at 322.
[38] *UNITED STUDENT AID FUNDS, INC. v. ESPINOSA*: Ruling a creditor was bound to the bankruptcy court confirmation order even though the debtor had procedural failings because the creditor had notice.
[39] *Matter of Pence*: Ruling a creditor that had notice was bound to the bankruptcy court confirmation even though the creditor did not receive a formal written notice of the confirmation hearing.
[40] *Id.*
[41] *Id.*

knowledge of the ROFR. [42] Also, CVC did not have notice so the bankruptcy court could not "resolve competing claims to debtors' assets [or] extinguish them." [43]

VIII. Conclusion

Section 363(m) serves to protect good faith purchaser. The *Archer-Daniels-Midland Company v. Country Visions Cooperative* case serves as another cautionary tale to both buyer and debtor's counsel. The bankruptcy, district and appellate court all concluded that ADM was not a good faith purchaser.

IX. Discussion Points/Questions

1. Does it matter that Country Visions Cooperative waited until four year to sue Archer-Daniels-Midland?

2. Would the case be decided differently if Country Visions Cooperative, still without notice, knew of the auction a year in advance?

3. Is the presumption that a purchaser acted in "good faith" unless the creditor can prove otherwise?

[42] *Archer-Daniels-Midland Co. v. Country Visions Coop*., 29 F.4th 956, 959 (U.S. 7th Cir. 2022).
[43] *Id*.

Sigmund J. Beck Advanced Bankruptcy Roundtable
West Baden Springs Resort, West Baden Springs, Indiana
August 19-20, 2022

Melissa M. Root
JENNER & BLOCK LLP
Chicago, Illinois

Make Me Whole, Part II

---

11 U.S.C. § 502(b)(2)

"(b) Except as provided in subsections (e)(2), (f), (g), (h) and (i) of this section, if such objection to a claim is made, the court, after notice and a hearing, shall determine the amount of such claim in lawful currency of the United States as of the date of the filing of the petition, and shall allow such claim in such amount, except to the extent that—

…

(2) such claim is for unmatured interest;"

We last discussed make-whole provisions in 2016, when we covered the *Momentive* and *Energy Futures Holdings* cases. Since then, the enforceability of make-whole provisions continues to be a hot topic. Most recently, in *Ultra Petroleum* and *Hertz* (among other cases), courts have considered whether make-whole payments are claims for "unmatured interest" subject to section 502(b)(2); whether, if so, disallowance of such a claim renders a creditor "impaired;" and whether, where post-petition interest is allowed, the federal judgment rate or the contract default rate is the appropriate rate of post-petition interest.

So, what is the genesis of this issue? The common law "perfect tender in time" rule requires the payment of loans only *upon* maturity--not before—and is the default rule in many states. An extension of this rule, and common features in loan agreements—particularly complex indentures— are provisions that either bar prepayments altogether ("no-call" provisions) or provisions that condition prepayments upon the payment of a "make-whole" amount.

Supposedly, make-whole provisions are intended to compensate holders for the lost income stream from future interest that they would have received had the loan stayed in place through the initial maturity date. Outside of bankruptcy, make-whole provisions kick in to protect noteholders and lenders when a borrower might be inclined to prepay the loan to take advantage of declining market interest rates. Make-whole amounts are commonly determined by a fixed percentage of the principal amount to be repaid or as a formula-based premium that measures the difference between the lender's expected return through the maturity date versus the return the lender received through the early repayment date.

Ultra Petroleum

- **Background**

Ultra Petroleum filed for bankruptcy in 2016. Although the debtors were insolvent at the time of filing, rising commodity prices quickly resulted in the debtors becoming solvent during the bankruptcy case, and they proposed a plan that paid off all creditors in full and in cash. The plan provided for payment of the outstanding $1.5 million of unsecured notes plus post-petition interest at the federal judgment rate and treated the noteholders as unimpaired.

The master note purchase agreement (the "MNPA") pursuant to which the notes were issued included a prepayment provision that permitted the debtors to repay the notes before maturity by repaying the principal amount of the notes *and* the make-whole amount. The MNPA defined the make-whole amount as the amount by which the amount of principal that is accelerated or repaid in advance is less than the discounted value of all future scheduled payments, including all future unaccrued interest on the unpaid principal. The MNPA also provided that upon a bankruptcy filing, the notes are accelerated, the make-whole amount becomes immediately due and payable, and that if that amount is not immediately paid, it accrues interest at a contractual default rate of interest.

In light of the MNPA's make-whole provision, the acceleration, and the default interest rate, the noteholders disagreed with the plan's treatment of them as unimpaired. They argued that because the plan did not provide for the payment of the make-whole amount ($201 million) as well as post-petition interest at the contractual default rate ($186 million), they were impaired and entitled to vote. They also argued that section 502(b)(2) did not disallow the make-whole payment and that—in the case of a solvent debtor—post-petition interest must be paid at the contract default rate, not the federal judgment rate.

- **The Bankruptcy Court's 2017 Opinion**

The bankruptcy court agreed with the noteholders. In a 2017 opinion, it held that even if the make-whole amount were the economic equivalent of "unmatured interest" and thus disallowed by section 502(b)(2), the noteholders' claim was still impaired because the noteholders were not paid the full amount permitted under applicable non-bankruptcy law. It also held that the make-whole amount was not an unenforceable liquidated provision under state law. Last, relying on the solvent-debtor exception—that interest continues to accrue after the bankruptcy filing at the contract rate if the bankruptcy estate is sufficiently solvent to pay the contract rate of interest and other creditors—the bankruptcy court held that to treat the noteholders' claims as "unimpaired," they must receive postpetition interest at the contractual default rate.

- **The Fifth Circuit's Two 2019 Opinions**

In January 2019, the Fifth Circuit reversed in part and vacated in part. It held that when a creditor's claim is impaired by the Code, rather than the plan, the creditor is not "impaired" under section 1124(1). In reaching this conclusion, the court focused on the plain language of section 1124(1)—"a class of claims or interests" is not impaired if "*the plan* … leaves unaltered the [claimant's] legal, equitable, and contractual rights." The Court relied on *In re PPI Enterprises (U.S.), Inc.*, 324 F.3d 197 (2003), in which the Third Circuit held that a landlord's claim was not "impaired" by section 502(b)(6)'s cap on leasehold damages: "[a]t the end of the day, 'a creditor's claim outside of bankruptcy is not the relevant barometer for impairment; we must examine whether the plan itself is a source of limitation on a creditor's legal, equitable, or contractual rights.'"

The Court was unpersuaded by the noteholders' counter-arguments: (1) that section 1124(1) refers to a "claim" not an "allowed claim" as is used in other places in the Code; (2) that Congress' intent in repealing section 1124(3) was to require solvent debtors to make creditors whole (1124(3) provided that a creditor was unimpaired if the creditor received cash equal to the "allowed amount of such claim" and had been construed to permit a solvent debtor to pay allowed claims of unsecured creditors in full, but excluding post-petition interest, without causing impairment); and (3) that it is the plan itself that effectuates the Code's disallowance provisions.

The Fifth Circuit then addressed the issue not reached by the bankruptcy court—whether the noteholders' claims for the make-whole amount and the contractual default rates were disallowed by the Code. Although it remanded the question to the bankruptcy court, the Fifth Circuit strongly suggested that the make-whole amount should be disallowed, finding that the make-whole amount was "the economic equivalent" of interest, and that, notwithstanding the acceleration clause, the make-whole amount remained "unmatured" because the acceleration clause was an unenforceable *ipso facto* clause. Addressing the noteholders' argument that the debtors' solvency was a relevant factor, the court considered the effect of the solvent-debtor exception, which required that a solvent debtor pay creditors in full—including a "right to interest wherever there is a contract for it," before its equity holders could receive a distribution. It remanded the question to the bankruptcy court, but not without previewing its own view: "the creditors can recover the Make-Whole Amount if (but only if) the solvent-debtor exception survives Congress's enactment of § 502(b)(2). We doubt it did."

And with regard to postpetition interest at the contract rate, it found the issue "even murkier." "To the extent the creditors seek post-petition interest *as part of* their claims, they run into the same issues that affect the Make-Whole Amount. To the extent they seek post-petition interest *on* their claims, the pre-Code solvent-debtor exception does not countenance it. And the Code itself says nothing about post-petition interest on unimpaired claims for Chapter 11 cases." Because this issue also had not been addressed by the bankruptcy court, the court remanded it to the bankruptcy court to determine the appropriate rate of interest, suggesting two possibilities—the federal judgment rate of interest, or an equitably determined rate of interest.

The noteholders petitioned for rehearing *en banc*, arguing that the Fifth Circuit should not have reached the issue of whether the make-whole payment was the "economic equivalent" of unmatured interest under section 502(b)(2) because the bankruptcy court did not decide that issue, and also because the remanded issue of whether the bankruptcy court's decision should be affirmed under the solvent debtor exception could obviate the need to resolve the section 502(b)(2) question. The noteholders also argued that *en banc* consideration or rehearing was necessary on the Fifth Circuit's section 1124(1) holding.

In November 2019, the Fifth Circuit withdrew its January 2019 opinion and issued an amended opinion that included its prior holding on impairment but excluded the Court's discussion of whether the make-whole amount was the economic equivalent of unmatured interest and whether the noteholders were entitled to post-petition interest at the contractual default rate.

- **The Bankruptcy Court's 2020 Opinion**

On remand, the bankruptcy court held that the make-whole amount was not disallowed, and that the noteholders were entitled to the contract default rate of interest. The debtors' solvency was key to the court's holding:

> Bankruptcy relief is intended for the honest, but unfortunate debtor. Although no one questions Ultra's honesty, a post-petition uptick in natural gas prices made Ultra and its shareholders quite fortunate. As a result, Ultra became massively solvent. The question becomes whether an honest but fortunate solvent debtor may use bankruptcy to discharge validly owed debt, while its shareholders retain value. Sensibly, the answer is 'no.' Ultra must pay its creditors before it pays its shareholders.

First, addressing the make-whole amount, the court held that the make-whole amount was not disallowed because it represented liquidated damages, not unmatured interest under section 502(b)(2) because it "does not compensate for the use or forbearance of money, and it does not accrue over time."

Second, with regard to interest, although the court noted that the Code disallows unmatured interest as *part* of a claim, "it is ambiguous" as to unimpaired unsecured creditors' right to post-petition interest *on* a claim. Finding that Congress did not "silently abandon" the solvent-debtor exception when it passed the Bankruptcy Code, and finding support in section 1124(1)'s "equitable" language, the bankruptcy court held that the solvent-debtor exception entitled the noteholders to post-petition interest at the contractual default rates.

- **The Fifth Circuit Appeal**

Ultra's appeal of the bankruptcy court's 2020 decision is currently pending before the Fifth Circuit. The Fifth Circuit held oral argument in October 2021. Following the *Hertz* decision (below) both parties supplemented their briefing (noteholders arguing that *Hertz* was correct to focus on the nature of the make-whole amount and whether it was a "simple present value of unmatured interest," and arguing that in the case of *Ultra*, it was not, and Ultra arguing that *Hertz* "followed [the Fifth Circuit's] lead, both with respect to the make-whole issue and post-petition interest).

Hertz

In December 2021, a Delaware bankruptcy court issued its opinion in *In re The Hertz Corp.*, 2021 WL 6068390 (Bankr. D. Del. Dec. 22, 2021). As was the case in *Ultra Petroleum*, the plan provided for payment of unsecured creditors in "full." The noteholders similarly argued that payment in "full" required the payment of $147 million in make-whole premiums and interest at the contract default rate in the amount of $125 million.

Addressing similar issues but ruling on a motion to dismiss the noteholders' adversary proceeding, the bankruptcy court stated that it was "not prepared to conclude, as a legal matter, that make-wholes cannot be disallowed as unmatured interest [—] [c]alling a make-whole a contract right or a liquidated damages provision does not answer the question of whether it is unmatured interest." The court noted that whether a make-whole premium is the economic equivalent of unmatured interest is fact-specific and turns on whether it is calculated based on the present value of the unmatured interest due on the redemption date.

On the question of impairment, the court followed the Fifth Circuit, holding that even if the make-whole premiums were disallowed under section 502(b)(2), that would not render the noteholders impaired within the meaning of section 1124(1).

As to interest, the court held that the post-petition interest at the federal judgment rate, not the contract default rate, applied. The court rejected the noteholders' argument that by repealing section 1124(3) Congress intended to require unimpaired creditors in a solvent case to receive the contract rate of interest. Had Congress wanted to do so, it could have done so by explicit amendment to section 1124(3) or by including a solvent debtor exception to 502(b)(2), but it did neither. The court found that the "solvent-debtor" exception" survived the Bankruptcy Code only to a limited extent—for oversecured creditors, it is codified in section 506(b), and for undersecured creditors, it is codified in sections 726(a)(5) and 1129(a)(7). Noting that "[a] bankruptcy court cannot use equitable principles to modify express language of the Code," the court rejected the *Ultra Petroleum* bankruptcy court's holding that unimpaired creditors in a solvent chapter 11 case should receive post-petition interest at the default rate.

Discussion Questions:

1. Plan impairment v. Code impairment—a "false dichotomy"? (This one's for you, Professor Markell!). Economic equivalent of unmatured interest v. liquidated damages—a false dichotomy?

2. The obligation to pay the make-whole amount in *Ultra Petroleum* was triggered by the acceleration upon default. So, is the amount still "unmatured"? Is it an unenforceable *ipso facto* clause?

3. Did the "solvent debtor exception" survive the Code in full or part? In the pending *Ultra Petroleum* appeal, the Noteholders argue that "Congress ensured that the exception survived, including by providing in 11 U.S.C. § 1124(1) that, for a creditor to be 'unimpaired' (and thus deprived of the right to vote on the plan), the creditor's 'equitable rights' must be left unaltered."

4. Should equity require that unimpaired creditors in a solvent chapter 11 case receive post-petition interest at the default rate?

5. Can parties draft around this issue?

Appendix

1. *Ultra Petroleum Corporation v. Ad Hoc Committee of Unsecured Creditors of Ultra Resources, Incorporated (In re Ultra Petroleum Corporation)*, 943 F.3d 758 (5th Cir. 2019)

2. *Ultra Petroleum Corporation v. Ad Hoc Committee of Unsecured Creditors of Ultra Resources, Incorporated (In re Ultra Petroleum Corporation)*, 624 B.R. 178 (Bankr. S.D. Tex. 2020)

3. *In re The Hertz Corp.*, 2021 WL 6068390 (Bankr. D. Del. Dec. 22, 2021)

worked at the Galveston Bay jobsite without a skiff. Excel crew members worked above and below the dock, using ladders to move between the areas of the scaffolding system. The top of the dock was thirty feet from the water, and the water around the docks was eighteen feet deep, with conditions ranging from calm to choppy. The ALJ also found that there was no evidence that it would have been difficult to navigate a skiff "if an employee fell from the dock or the ladder into an area of the water that was not underneath the dock"—a proposition Excel does not refute. Given these circumstances, there was substantial evidence to support the ALJ's conclusion that the absence of a skiff exposed Excel's employees to a substantial probability of death or serious injury.

VI.

For the foregoing reasons, the petition for review is DENIED.

IN RE: ULTRA PETROLEUM CORPORATION; Keystone Gas Gathering, L.L.C.; Ultra Resources, Incorporated; Ultra Wyoming, Incorporated; Ultra Wyoming LGS, Incorporated; UP Energy Corporation; UPL Pinedale, L.L.C.; UPL Three Rivers Holdings, L.L.C., Debtors,

Ultra Petroleum Corporation; Keystone Gas Gathering, L.L.C.; Ultra Resources, Incorporated; Ultra Wyoming, Incorporated; Ultra Wyoming LGS, Incorporated; UP Energy Corporation; UPL Pinedale, L.L.C.; UPL Three Rivers Holdings, L.L.C., Appellants,

v.

Ad Hoc Committee of Unsecured Creditors of Ultra Resources, Incorporated; OPCO Noteholders, Appellees.

No. 17-20793

United States Court of Appeals,
Fifth Circuit.

FILED November 26, 2019

Background: In surplus case, Chapter 11 debtors objected to noteholders' claim for make-whole premium and postpetition interest at contractual default rate. The United States Bankruptcy Court for the Southern District of Texas, Marvin P. Isgur, J., 575 B.R. 361, denied objection, and subsequently certified a direct appeal to the Court of Appeals, 2017 WL 4863015.

Holdings: The Court of Appeals, Andrew S. Oldham, Circuit Judge, held that as a matter of first impression, a creditor is not "impaired" by a reorganization plan simply because it incorporates the Bankruptcy Code's disallowance provisions.

Reversed in part, vacated in part, and remanded.

Opinion, 913 F.3d 533, superseded.

1. Bankruptcy 🔑3544

"Unimpaired" creditors cannot object to Chapter 11 plans. 11 U.S.C.A. § 1126(f).

2. Bankruptcy 🔑3782

On appeal from a bankruptcy court decision, the Court of Appeals reviews legal questions anew.

3. Bankruptcy 🔑3536.1

A creditor is not "impaired" by a reorganization plan simply because it incorporates the Bankruptcy Code's disallowance provisions; when a plan refuses to pay funds disallowed by the Code, the Code, not the plan, is doing the impairing. 11 U.S.C.A. §§ 502, 1124(1).

4. Bankruptcy ⚷3541.1

Because discharge effected by confirmation of a Chapter 11 plan affects a creditor's rights, the Bankruptcy Code generally requires a debtor to vie for the creditor's vote first. 11 U.S.C.A. §§ 1129(a)(8), 1141(d)(1).

5. Bankruptcy ⚷3544

Although a creditor generally may vote to accept or reject a Chapter 11 plan, the creditor's right to vote disappears when the plan doesn't actually affect his rights; that is, if the creditor is not impaired under the plan, he is conclusively presumed to have accepted it. 11 U.S.C.A. §§ 1126(a), 1126(f).

6. Bankruptcy ⚷3536.1

A creditor is "impaired" within the meaning of the Bankruptcy Code only if the plan itself alters the creditor's legal, equitable, or contractual rights; the creditor's claim outside of bankruptcy is not the relevant barometer for impairment. 11 U.S.C.A. § 1124(1).

7. Bankruptcy ⚷2014
Courts ⚷96(7)

Court of Appeals is always chary to create a circuit split, especially in the context of bankruptcy, where uniformity is sufficiently important that the Constitution authorizes Congress to establish uniform laws on the subject of bankruptcies throughout the United States. U.S. Const. art. 1, § 8, cl. 4.

8. Bankruptcy ⚷3536.1

Under the Bankruptcy Code, courts judge Chapter 11 creditor's impairment after considering everything that defines the scope of the right or entitlement, such as a contract's language or state law. 11 U.S.C.A. § 1124.

9. Bankruptcy ⚷2021.1

Bankruptcy Code itself is a statute which, like other statutes, helps to define the legal rights of persons.

10. Bankruptcy ⚷3790

Questions of whether the Bankruptcy Code disallowed creditors' claims for the make-whole amount and creditors' request for post-petition interest at the contractual default rates specified in note agreement and revolving credit facility would be determined by bankruptcy court, rather than Court of Appeals, in surplus Chapter 11 case, as bankruptcy court never reached either question but was best equipped to understand the individual dynamics pertinent to post-petition interest question. 11 U.S.C.A. § 502(b)(2).

11. Bankruptcy ⚷2125, 3101

Absent compelling equitable considerations, when a debtor is solvent, it is the role of the bankruptcy court to enforce the creditors' contractual rights.

12. Bankruptcy ⚷2126

Equitable powers that remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code.

Appeal from the United States Bankruptcy Court for the Southern District of Texas, Marvin P. Isgur, U.S. Bankruptcy Judge

ON PETITION FOR REHEARING

Paul D. Clement, George W. Hicks, Jr., C. Harker Rhodes, IV, Kirkland & Ellis, L.L.P., Washington, DC, for Appellant.

Andrew M. Leblanc, Esq., Milbank, Tweed, Hadley & McCloy, L.L.P., Washington, DC, Lauren Doyle, Dennis F. Dunne, Evan R. Fleck, Milbank, Tweed, Hadley & McCloy, L.L.P., New York, NY, William Richard Greendyke, Norton Rose Fulbright US, L.L.P., Houston, TX, for Appellee AD HOC COMMITTEE OF UNSECURED CREDITORS OF ULTRA RESOURCES, INCORPORATED.

David Bruce Salmons, Esq., Morgan, Lewis & Bockius, L.L.P., Washington, DC, Peter Sabin Willett, Esq., Amelia C. Joiner, Boston, MA, Andrew J. Gallo, Morgan, Lewis & Bockius, L.L.P., New York, NY, for Appellee OPCO NOTEHOLDERS.

David Andrew Baay, Garrett Gibson, Mark David Sherrill, Bankruptcy Counsel, Houston, TX, Edward P. Christian, Eversheds Sutherland (US), L.L.P., Atlanta, GA, Houston, TX, for Intervenors.

Before DAVIS, ENGELHARDT, and OLDHAM, Circuit Judges.

ANDREW S. OLDHAM, Circuit Judge:

Treating the Appellees' and Intervenors' Joint Petition for Rehearing En Banc as a Petition for Panel Rehearing, it is GRANTED. The prior opinion, *In re Ultra Petroleum Corporation*, 913 F.3d 533 (5th Cir. 2019), is withdrawn, and the following opinion is substituted:

These bankruptcy proceedings arise from exceedingly anomalous facts. The debtors entered bankruptcy insolvent and now are solvent. That alone makes them rare. But second, the debtors accomplished their unlikely feat by virtue of a lottery-like rise in commodity prices. The combination of these anomalies makes these debtors as rare as the proverbial rich man who manages to enter the Kingdom of Heaven.

The key legal question before us is whether the rich man's creditors are "impaired" by a plan that paid them everything allowed by the Bankruptcy Code. The bankruptcy court said yes. In that court's view, a plan impairs a creditor if it refuses to pay an amount the Bankruptcy Code independently disallows. In reaching that conclusion, the bankruptcy court split from the only court of appeals to address the question, every reported bankruptcy court decision on the question, and the leading treatise discussing the question. We reverse and follow the monolithic mountain of authority holding the Code—not the reorganization plan—defines and limits the claim in these circumstances.

Because the bankruptcy court saw things differently, it did not consider whether the Code disallows certain creditors' contractual claims for a Make-Whole Amount or post-petition interest. Instead, it ordered the debtors to pay both amounts in full. We vacate and remand those determinations for reconsideration.

I.

Ultra Petroleum Corporation ("Petroleum") is an oil and gas exploration and production company. To be more precise, it's a holding company. Petroleum's subsidiaries—UP Energy Corporation ("Energy") and Ultra Resources, Inc. ("Resources")—do the exploring and producing. Resources took on debt to finance its operations. Between 2008 and 2010, Resources issued unsecured notes worth $1.46 billion to various noteholders. And in 2011, it borrowed another $999 million under a Revolving Credit Facility. Petroleum and Energy guaranteed both debt obligations.

In 2014, crude oil cost well over $100 per barrel. But then Petroleum's fate took a sharp turn for the worse. Only a year and a half later, a barrel cost less than $30. The world was flooded with oil; Petroleum and its subsidiaries were flooded with debt. On April 29, 2016, the companies voluntarily petitioned for reorganization under Chapter 11. *See* 11 U.S.C. § 301(a). No one argues the companies filed those petitions in bad faith. *See id.* § 1112(b).

[1] During bankruptcy proceedings, however, oil prices rose. Crude oil approached $80 per barrel, and the Petroleum companies became solvent again. So, the debtors proposed a rare creature in bankruptcy—a reorganization plan that (they said) would compensate the creditors in full. As to creditors with claims under the Note Agreement and Revolving Credit Facility (together, the "Class 4 Creditors"), the debtors would pay three sums: the outstanding principal on those obligations, pre-petition interest at a rate of 0.1%, and post-petition interest at the federal judgment rate. *In re Ultra Petroleum Corp.*, No. 4:16-bk-32202, ECF No. 1308-1 at 25–26 (Bankr. S.D. Tex. 2017). Accordingly, the debtors elected to treat the Class 4 Creditors as "unimpaired." Therefore, they could not object to the plan. 11 U.S.C. § 1126(f).

The Class 4 Creditors objected just the same. They insisted their claims *were* impaired because the plan did not require the debtors to pay a contractual Make-Whole Amount and additional post-petition interest at contractual default rates.

Under the Note Agreement, prepayment of the notes triggers the Make-Whole Amount. That amount is designed "to provide compensation for the deprivation of" a noteholder's "right to maintain its investment in the Notes free from repayment." A formula defines the Make-Whole Amount as the amount by which "the Discounted Value of the Remaining Scheduled Payments with respect to the Called Principal" exceeds the notes' "Called Principal." Remaining scheduled payments include "all payments of [the] Called Principal and interest ... that would be due" after prepayment (if the notes had never been prepaid). And the discounted value of those payments is keyed to a "Reinvestment Yield" of 0.5% over the total anticipated return on comparable U.S. Treasury obligations.

Under the Note Agreement, petitioning for bankruptcy automatically renders the outstanding principal, any accrued interest, and the Make-Whole Amount "immediately due and payable." Failure to pay immediately triggers interest at a default rate of either 2% above the normal rate set for the note at issue or 2% above J.P. Morgan's publicly announced prime rate, whichever is greater.

The Revolving Credit Facility does not contain a make-whole provision. But it does contain a similar acceleration clause that made the outstanding principal and any accrued interest "automatically ... due and payable" as soon as Resources petitioned for bankruptcy. And it likewise provides for interest at a contractual default rate—2% above "the rate otherwise applicable to [the] Loan"—if Resources delayed paying the accelerated amount.

Under these two agreements, the creditors argued the debtors owed them an additional $387 million—$201 million as the Make-Whole Amount and $186 million [1] in post-petition interest. Both sides chose to kick the can down the road. Rather than force resolution of the impairment issue at the plan-confirmation stage, the parties stipulated the bankruptcy court could resolve the dispute by deeming the creditors unimpaired and confirming the proposed

1. This amount includes $106 million in interest on the outstanding principal under the notes, $14 million in interest on the Make-Whole Amount, and $66 million in interest on the outstanding principal under the Revolving Credit Facility, all accruing after the debtors filed their petitions.

plan. Meanwhile, the debtors would set aside $400 million to compensate the Class 4 Creditors if necessary "to render [the creditors] Unimpaired." The bankruptcy court agreed and confirmed the plan.

After confirmation, the parties (and the bankruptcy court) turned back to the question of impairment. The debtors acknowledged the plan did not pay the Make-Whole Amount or provide post-petition interest at the contractual default rates. But they insisted the Class 4 Creditors were not "impaired" because federal (and state) law barred them from recovering the Make-Whole Amount and entitled them to receive post-petition interest only at the federal judgment rate.

The Bankruptcy Code provides that a class of claims is not impaired if "the [reorganization] plan . . . leaves unaltered the legal, equitable, and contractual rights to which such claim . . . entitles the holder." 11 U.S.C. § 1124(1). Elsewhere the Code states that a court should disallow a claim "to the extent that [it seeks] unmatured interest." *Id.* § 502(b)(2). The debtors argued the Make-Whole Amount qualified as unmatured interest. But even if it didn't, they said, it was an unenforceable liquidated damages provision under New York law. In either case, something *other than* the reorganization plan itself—the Bankruptcy Code or New York contract law—prevented the Class 4 Creditors from recovering the disputed amounts.

The debtors' argument as to post-petition interest was much the same: The Bankruptcy Code entitles creditors, at most, to post-petition interest at the "legal rate," not the rates set by contract. 11 U.S.C. § 726(a)(5). And the legal rate, they said, is the federal judgment rate under 28 U.S.C. § 1961. Once again, the Code—not the plan—limited the Class 4 Creditors' claims.

The bankruptcy court rejected the premise that it must bake in the Code's provisions before asking whether a claim is impaired. Instead it concluded unimpairment "requires that [creditors] receive all that they are entitled to under state law." *In re Ultra Petroleum Corp.*, 575 B.R. 361, 372 (Bankr. S.D. Tex. 2017). In other words, if a plan does not provide the creditor with all it would receive under state law, the creditor is impaired even if the Code disallows something state law would otherwise provide outside of bankruptcy. So, the bankruptcy court asked only whether New York law permits the Class 4 Creditors to recover the Make-Whole Amount (concluding it does), and whether the Code limits the contractual post-petition interest rates (concluding it does not). *Id.* at 368–75. It never decided whether the Code disallows the Make-Whole Amount as "unmatured interest" under § 502(b)(2) or what § 726(a)(5)'s "legal rate" of interest means. It ordered the debtors to pay the Make-Whole Amount and post-petition interest at the contractual rates to make the Class 4 Creditors truly unimpaired.

[2] The debtors sought a direct appeal to this Court (rather than the district court) because the case raises important and unsettled questions of law. *See* 28 U.S.C. § 158(d)(2)(A). The bankruptcy court agreed, and so did we. *In re Ultra Petroleum Corp.*, No. 16-32202, 2017 WL 4863015, at *1 (Bankr. S.D. Tex. Oct. 26, 2017). On appeal, we review those legal questions anew. *In re Positive Health Mgmt.*, 769 F.3d 899, 903 (5th Cir. 2014).

II.

[3] We consider first whether a creditor is "impaired" by a reorganization plan simply because it incorporates the Code's disallowance provisions. We think not.

A.

[4, 5] Chapter 11 lays out a framework for proposing and confirming a reorganization plan. Confirmation of the plan "discharges the debtor from any debt that arose before the date of such confirmation." 11 U.S.C. § 1141(d)(1). Because discharge affects a creditor's rights, the Code generally requires a debtor to vie for the creditor's vote first. *Id.* § 1129(a)(8). And when it does, the creditor may vote to accept or reject the plan. *Id.* § 1126(a). But the creditor's right to vote disappears when the plan doesn't actually affect his rights. If the creditor is "not impaired under [the] plan," he is "conclusively presumed to have accepted" it. *Id.* § 1126(f). The question, then, is whether the Class 4 Creditors were "impaired" by the plan.

[6] Let's start with the statutory text. Section 1124(1) says "a class of claims or interests" is not impaired if "the plan ... leaves unaltered the [claimant's] legal, equitable, and contractual rights." The Class 4 Creditors spill ample ink arguing their rights have been altered. But that's both undisputed and insufficient. The plain text of § 1124(1) requires that "the plan" do the altering. We therefore hold a creditor is impaired under § 1124(1) only if "*the plan*" itself alters a claimant's "legal, equitable, [or] contractual rights."

The only court of appeals to address the question took the same approach. In *In re PPI Enterprises (U.S.), Inc.*, a landlord (creditor) argued the reorganization plan of his former tenant (debtor) impaired his claim because it did not pay him the full $4.7 million of rent he was owed over the life of the lease. 324 F.3d 197, 201–02 (3d Cir. 2003). The Third Circuit disagreed. Because the Bankruptcy Code caps lease-termination damages under § 502(b)(6), the plan merely reflected the *Code's* disallowance. *Id.* at 204. At the end of the day, "a creditor's claim outside of bankruptcy is not the relevant barometer for impairment; we must examine whether the plan itself is a source of limitation on a creditor's legal, equitable, or contractual rights." *Ibid.* It simply did not matter the landlord "might have received considerably more if he had recovered on his leasehold claims before [the debtor] filed for bankruptcy." *Id.* at 205. The debtor's plan gave the landlord everything the law entitled him to once bankruptcy began, so he was unimpaired.

Decisions from bankruptcy courts across the country all run in the same direction. *See, e.g.*, *In re Tree of Life Church*, 522 B.R. 849, 861–62 (Bankr. D.S.C. 2015); *In re RAMZ Real Estate Co.*, 510 B.R. 712, 717 (Bankr. S.D.N.Y. 2014); *In re K Lunde, LLC*, 513 B.R. 587, 595–96 (Bankr. D. Colo. 2014); *In re Mirant Corp.*, No. 03-46590, 2005 WL 6440372, at *3 (Bankr. N.D. Tex. May 24, 2005); *In re Coram Healthcare Corp.*, 315 B.R. 321, 351 (Bankr. D. Del. 2004); *In re Monclova Care Ctr., Inc.*, 254 B.R. 167, 177 (Bankr. N.D. Ohio 2000), *rev'd on other grounds*, 266 B.R. 792 (N.D. Ohio 2001); *In re Am. Solar King Corp.*, 90 B.R. 808, 819–22 (Bankr. W.D. Tex. 1988). All agree that "[i]mpairment results from what the *plan* does, not what the [bankruptcy] statute does." *Solar King*, 90 B.R. at 819.

[7] The creditors cannot point to a single decision that suggests otherwise. That's presumably why Collier's treatise states the point in unequivocal terms: "Alteration of Rights by the Code Is Not Impairment under Section 1124(1)." 7 Collier on Bankruptcy ¶ 1124.03[6] (16th ed. 2018). "We are always chary to create a circuit split." *United States v. Graves*, 908 F.3d 137, 142 (5th Cir. 2018) (quotation omitted). That's especially true "in the context of bankruptcy, where uniformity is sufficiently important that our Constitution authorizes Congress to establish 'uniform laws on the subject of bankruptcies throughout the United States.' " *In re Marciano*, 708 F.3d 1123, 1135 (9th Cir. 2013) (Ikuta, J., dissenting) (quoting U.S. CONST. art. I, § 8, cl. 4). We refuse to create one today.

B.

The Class 4 Creditors' counterarguments do not move the needle. First, they focus on § 1124(1)'s use of the word "claim." They note the Code elsewhere speaks of "*allowed* claims." *See, e.g.*, 11 U.S.C. §§ 506(a)(1), 506(a)(2), 510(c)(1), 1126(c). Then they suggest the absence of "allowed" in § 1124(1) means "claim" there refers to the claim *before* the Code's disallowance provisions come in and trim its edges.

[8, 9] But the broader statutory context cuts the other way. Section 1124 is not just (or even primarily) about the allowance of claims. It is about rights—the "legal, equitable, and contractual rights to which [the] claim ... entitles the holder." *Id.* § 1124(1). That means we judge impairment after considering everything that defines the scope of the right or entitlement—such as a contract's language or state law. *See In re Energy Future Holdings Corp.*, 540 B.R. 109, 121 (Bankr. D. Del. 2015); 11 U.S.C. § 502(b)(1). Even the bankruptcy court recognized this to some extent because it asked whether New York law permitted the Noteholders to recover the Make-Whole Amount. *See Ultra Petroleum*, 575 B.R. at 368–72. "The Bankruptcy Code itself is a statute which, like other statutes, helps to define the legal rights of persons." *Solar King*, 90 B.R. at 819–20.

Finding no help in § 1124(1)'s statutory text, the Class 4 Creditors turn to the legislative history of a different provision. In 1994, Congress repealed § 1124(3), which provided that a creditor's claim was not impaired if the plan paid "the *allowed amount* of such claim." 11 U.S.C. § 1124(3) (1988) (emphasis added). This proves, they say, that disallowance should now play no role in the impairment analysis.

Even for those who think legislative history can be relevant to statutory interpretation, this particular history is not. It does not say that every disallowance causes impairment. Rather, Congress repealed § 1124(3) in response to a specific bankruptcy court decision. *See In re New Valley Corp.*, 168 B.R. 73 (Bankr. D.N.J. 1994). That decision held unsecured creditors who received their allowed claims from a solvent debtor, but who did not receive post-petition interest, were unimpaired. *Id.* at 77–80. In debating the proposed repeal of § 1124(3), the House Judiciary Committee singled out *New Valley* by name as the justification for the repeal. *See* H.R. Rep. No. 103-835, at 47–48 (1994) (citing *New Valley* and explaining the intent to repeal § 1124(3) "to preclude th[e] unfair result" of "den[ying] the right to receive postpetition interest"). It is noteworthy the committee report does not cite other bankruptcy cases—such as *Solar King*—that addressed Code impairment under § 1124(1). That is why the Third Circuit rejected appellees' legislative-history argument in *PPI* and held the repeal of § 1124(3) "does not reflect a sweeping intent by Congress to give impaired status to creditors more freely outside the post-petition interest context." 324 F.3d at 207 (noting the committee report cited *New Valley* but not *Solar King*).

Next, the Class 4 Creditors attempt to distinguish *PPI*. True, that case involved disallowance under § 502(b)(6), not § 502(b)(2). But that's a distinction without a difference. *See In re W.R. Grace & Co.*, 475 B.R. 34, 161–62 (Bankr. D. Del. 2012); *Energy Future*, 540 B.R. at 122. Section 502 states that "the court ... *shall allow*

[a] claim in [the requested] amount, *except to the extent that*" any one of nine conditions apply. If any of the enumerated conditions applies, the court shall not allow the relevant portion of the claim. *PPI* reasoned that where one of those conditions applies, the Code—not the plan—impairs the creditors' claims. *See* 324 F.3d at 204. That reasoning applies with equal force to § 502(b)(2).

The Class 4 Creditors (like the bankruptcy court) also point to the mechanics of Chapter 11 discharge to suggest the plan itself, not the Code, is doing the impairing. They note the Code's disallowance provisions are carried into effect only if the plan is confirmed, and "confirmation of the plan ... discharges the debtor from any debt that arose before" confirmation. 11 U.S.C. § 1141(d). In one sense, plan confirmation limits creditors' claims for money by discharging underlying debts. But in another sense, the Code limits the creditors' claims for money and imposes substantive and procedural requirements for plan confirmation. The Class 4 Creditors' argument thus begs the critical question: What is doing the work here? We agree with *PPI*, every reported decision identified by either party, and Collier's treatise. Where a plan refuses to pay funds disallowed by the Code, the Code—not the plan—is doing the impairing.

III.

That leaves the questions of whether the Code disallows the creditors' claims for the Make-Whole Amount and the creditors' request for post-petition interest at the contractual default rates specified in the Note Agreement and the Revolving Credit Facility. The creditors say their contracts entitle them to both amounts, and that their contracts should be honored under bankruptcy law's longstanding "solvent-debtor" exception. The debtors argue no such exception exists in modern bankruptcy law. And the debtors further argue both claims are governed by the Bankruptcy Code, not the pre-Code law or the parties' contracts.

[10] The bankruptcy court never reached either question. The issue of make-whole premiums, like the Make-Whole Amount, has become "[a] common dispute" in modern bankruptcy. Douglas G. Baird, Elements of Bankruptcy 84 (6th ed. 2014). Sometimes it is "comparatively easy to tell" whether such premiums are effectively unmatured interest, and therefore disallowed under § 502(b)(2). *Id.* at 84–85. Other times, "it is much harder." *Id.* at 85. Accordingly, "much depends on the dynamics of the individual case." *Ibid.* The bankruptcy court is often best equipped to understand these individual dynamics—at least in the first instance. *Cf. U.S. Bank Nat'l Ass'n ex rel. CWCapital Asset Mgmt. LLC v. Village at Lakeridge, LLC*, — U.S. ——, 138 S. Ct. 960, 968 n.6, 200 L.Ed.2d 218 (2018) (noting a bankruptcy court is often best equipped to consider "multifarious, fleeting, special, narrow facts that utterly resist generalization"). So too is the bankruptcy court best able to consider the postpetition interest question. *See ibid.*

[11, 12] Our review of the record reveals no reason why the solvent-debtor exception could not apply. As other circuits have recognized, "absent compelling equitable considerations, when a debtor is solvent, it is the role of the bankruptcy court to enforce the creditors' contractual rights." *In re Dow Corning Corp.*, 456 F.3d 668, 679 (6th Cir. 2006); *see also In re Chicago, Milwaukee, St. Paul and Pac.*

R.R. Co., 791 F.2d 524, 528 (7th Cir. 1986). That might be the case here.[2] But "mindful that we are a court of review, not of first view," we will not make the choice ourselves or weigh the equities on our own. *Cutter v. Wilkinson*, 544 U.S. 709, 718 n.7, 125 S.Ct. 2113, 161 L.Ed.2d 1020 (2005).

Accordingly, the bankruptcy court should consider the Make-Whole Amount, the appropriate post-petition interest rate, and the applicability of the solvent-debtor exception on remand.

* * *

As we have explained, Code impairment is not the same thing as plan impairment. Because the bankruptcy court found otherwise, it did not address whether the Code disallows the Make-Whole Amount or post-petition interest, and if not, how much the debtors must pay the Class 4 Creditors. The bankruptcy court, therefore, must consider these issues on remand. For that reason and others explained above, we REVERSE in part, VACATE in part, and REMAND for further proceedings consistent with this opinion.

Rosa Alba MARTINEZ-LOPEZ; Josafat Nahum Sierra-Martinez, Petitioners

v.

William P. BARR, U.S. Attorney General, Respondent

No. 18-60393

United States Court of Appeals, Fifth Circuit.

FILED December 4, 2019

Background: Alien and son, who were natives of Honduras, filed petition for review of Board of Immigration Appeals (BIA) decision affirming immigration judge's (IJ) denial of their requests for asylum, withholding of removal, and protection under the Convention Against Torture (CAT).

Holdings: The Court of Appeals held that:

(1) IJ had jurisdiction over removal proceedings;

(2) finding that alien did not suffer past persecution, as required for asylum and withholding of removal, was supported by substantial evidence; and

(3) substantial evidence supported IJ's denial of alien's application for protection under CAT.

Petition denied.

1. Aliens, Immigration, and Citizenship ⚷403(2)

The Court of Appeals reviews an immigration judge's (IJ) factual determinations for substantial evidence, overturning

2. Of course, we follow the Supreme Court's command that any "equitable powers [that] remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code." *Law v. Siegel*, 571 U.S. 415, 421, 134 S.Ct. 1188, 188 L.Ed.2d 146 (2014) (quotation omitted). While we express no view on the matter, it is possible a bankruptcy court's equitable power to enforce the solvent-debtor exception is moored in 11 U.S.C. § 1124's command that a "plan leave[ ] unaltered ... equitable ... rights." *See, e.g., In re Energy Holdings*, 540 B.R. 109, 123–24 (Bankr. D. Del. 2015).

to which it was rightfully entitled, [against] the losing party's right to litigate a bona fide legal dispute." *Tech. & Supply Mgmt., LLC v. Johnson Controls Bldg. Automation Sys., LLC*, Civ. Action No. 1:16-cv-303, 2017 WL 3219281, at *20 (E.D. Va. July 28, 2017) (citing *Wells Fargo Equip. Fin., Inc. v. State Farm Fire & Cas. Co.*, 823 F. Supp. 2d 364, 366 (E.D. Va. 2011)).

[52] Here, Planet has been deprived of the funds it expended for the renovations for several years. At the same time, there was a substantial and bona fide dispute regarding Dawn's liability to Planet for the renovations. Litigation of this issue began in the state court in 2017. The uncertainty regarding Dawn's liability arises directly from the fact that the parties never came to an express written agreement with respect to the cost or other essential terms of the project that would define the parties' obligations. The right to payment is instead grounded in equity, which requires a judicial determination of the reasonable value of the services provided. Thus, not only were the damages unliquidated at the time of the dispute, but Dawn's liability was essentially nonexistent until judicially determined herein. Upon weighing the equities and considering the circumstances of this case, the Court concludes, in its discretion, that making Planet whole requires no more than the awarded damages and that awarding prejudgment interest is not appropriate.

III. Conclusion

For the reasons stated in this Memorandum Opinion, the Court concludes that Planet has proven by a preponderance of the evidence that it is entitled to an award of damages against Dawn in the amount of $74,429.23. The Amended Claim is therefore allowed in the unsecured amount of $74,429.23, and all amounts claimed in excess of $74,429.23, including prejudgment interest, are disallowed. Accordingly, the Objection is overruled in part and sustained in part. The Court will enter a separate Order consistent with the findings and conclusions contained in this Memorandum Opinion.

The Clerk shall deliver copies of this Memorandum Opinion to Barry W. Spear, counsel for Dawn Elaine Reed; Todd D. Rothlisberger, counsel for Planet Plumbing, LLC; and Michael P. Cotter, Chapter 13 Trustee.

IN RE: ULTRA PETROLEUM CORP., et al.

Ultra Resources, Inc.

Ultra Wyoming, Inc.

Ultra Wyoming LGS, LLC

UP Energy Corporation

UPL Pinedale, LLC

UPL Three Rivers Holdings, LLC, Debtors.

CASE NO: 16-32202, CASE NO: 16-03272, CASE NO: 16-32204, CASE NO: 16-32205, CASE NO: 16-32206, CASE NO: 16-32207, CASE NO: 16-32208, CASE NO: 16-32209

United States Bankruptcy Court,
S.D. Texas, Houston Division.

Signed 10/26/2020

Background: In surplus case, Chapter 11 debtors objected to noteholders' claim for make-whole premium and postpetition interest at contractual default rate. The United States Bankruptcy Court for the

Southern District of Texas, Marvin P. Isgur, J., 575 B.R. 361, denied objection, and subsequently certified a direct appeal to the Court of Appeals, 2017 WL 4863015. The Court of Appeals, Andrew S. Oldham, Circuit Judge, 943 F.3d 758, reversed in part, vacated in part, and remanded.

Holdings: On remand, the Bankruptcy Court, Marvin Isgur, Chief Judge, held that:

(1) make-whole amount that Chapter 11 debtor was contractually obligated to pay upon prepayment was neither unmatured interest nor functional equivalent of unmatured interest, and thus a claim for this make-whole amount did not need to be disallowed;

(2) "solvent debtor" exception to general prohibition against the continued accrual of interest on claims postpetition continues to apply following enactment of the Bankruptcy Code; and

(3) postpetition interest to which unimpaired creditors were entitled in Chapter 11 case of a massively solvent natural gas exploration and production company had to be calculated, not at federal judgment rate, but at contractual default rate.

Ordered accordingly.

1. Bankruptcy ⚷3563.1

Bankrupt natural gas exploration and production company, which had become massively solvent as result of postpetition uptick in natural gas prices, could not use its Chapter 11 filing in order to discharge validly owed debt, while its shareholders retained any value; rather, debtor had to pay its creditors before paying its shareholders.

2. Bankruptcy ⚷3536.1

In order for note claimants to be unimpaired in debtor's Chapter 11 case, they had to receive a distribution of all amounts validly owed under state law, minus any amounts disallowed by the Bankruptcy Code.

3. Bankruptcy ⚷2836

Bankruptcy statute disallowing claims for unmatured interest also disallows claims for the economic equivalent of unmatured interest. 11 U.S.C.A. § 502(b)(2).

4. Bankruptcy ⚷2826

Absent controlling federal law, determination of a creditor's allowed claim necessarily references state law; calculating a creditor's allowed claim based on state law prevents party from receiving a windfall merely by reason of the happenstance of bankruptcy.

5. Bankruptcy ⚷2831, 2836

Make-whole amount that Chapter 11 debtor was contractually obligated to pay upon prepayment was neither unmatured interest nor functional equivalent of unmatured interest, and thus a claim for this make-whole amount did not need to be disallowed pursuant to bankruptcy statute; make-whole amount was not in compensation for use or forbearance of money, and did not accrue over time, and rather than being in nature of interest, was actually liquidated damages for debtor's prepayment. 11 U.S.C.A. § 502(b)(2).

6. Damages ⚷76

Under New York law, make-whole provisions in contracts are enforceable liquidated damages clauses.

7. Damages ⚷74

Under New York law, "liquidated damages" are, in effect, an estimate, made by the parties at time that they enter into their agreement, of extent of injury that would result from a breach of the agreement.

See publication Words and Phrases for other judicial constructions and definitions.

8. Bankruptcy ⚷2021.1

Undefined words found in the Bankruptcy Code should be given their ordinary meaning.

9. Bankruptcy ⚷2021.1

Undefined terms in Bankruptcy Code provision are generally interpreted in accordance with state law. 11 U.S.C.A. § 101 et seq.

10. Interest ⚷9

"Interest" is consideration for the use or forbearance of another's money accruing over time.

See publication Words and Phrases for other judicial constructions and definitions.

11. Interest ⚷9

"Unmatured interest" is consideration for the use or forbearance of another's money, which has not yet accrued or been earned as of a reference date; in bankruptcy, this reference date is date of the order for relief.

See publication Words and Phrases for other judicial constructions and definitions.

12. Bankruptcy ⚷2835.1

Key distinction between matured and unmatured interest is whether interest has been earned; under the Bankruptcy Code, interest that has accrued as of petition date is matured, because lender has earned that interest as a result of debtor's prepetition use of its funds.

13. Interest ⚷10

Interest matures under loan agreement when it is earned and owing to lender.

14. Bankruptcy ⚷2836

Whether interest is matured as of the time of debtor's bankruptcy filing, so as to be allowable, is determined without reference to acceleration clauses triggered by a bankruptcy petition. 11 U.S.C.A. § 502(b)(2).

15. Bankruptcy ⚷2836

Claim is for the economic equivalent of unmatured interest, so as not to be allowable in bankruptcy, if, in economic reality, it is the economic substance of unmatured interest. 11 U.S.C.A. § 502(b)(2).

16. Bankruptcy ⚷2836

Economic substance, rather than party labels, determines whether a claim is for unmatured interest, so as not to be allowable. 11 U.S.C.A. § 502(b)(2).

17. Bankruptcy ⚷2123, 2125

Absent compelling equitable considerations, when a debtor is solvent, it is the role of bankruptcy court to enforce the creditors' contractual rights.

18. Bankruptcy ⚷2836

While, as general rule, interest ceases to accrue as part of a claim upon filing of bankruptcy petition, there are some circumstances in which creditors may demand postpetition interest on their claims. 11 U.S.C.A. §§ 502(b)(2), 506.

19. Bankruptcy ⚷2836

"Solvent debtor" exception to general prohibition against the continued accrual of interest on claims postpetition continues to apply following enactment of the Bankruptcy Code, but must be applied within the parameters of the Code.

20. Bankruptcy ⚷2125

Bankruptcy court may not exercise its equitable powers in contravention of the Bankruptcy Code. 11 U.S.C.A. § 105(a).

21. Bankruptcy ⚷2836, 3563.1

Impaired creditors in a solvent Chapter 11 case must receive at least their full allowed claims, plus interest at the legal rate, and because unimpaired creditors can be treated no less favorably than impaired creditors, they also have a right to postpetition interest in a solvent Chapter 11 case. 11 U.S.C.A. § 1124.

22. Bankruptcy ⟹3560

Postpetition interest to which unimpaired creditors were entitled in Chapter 11 case of a massively solvent natural gas exploration and production company had to be calculated, not at federal judgment rate, but at contractual default rate.

23. Bankruptcy ⟹3560

In solvent Chapter 11 case, creditors have right to have their contractual rights fully enforced.

Paul D. Clement, George W. Hicks, Michael A. Petrino, C. Harker Rhodes, IV, Kirkland & Ellis LLP, Washington, DC, Matthew C. Fagen, Christopher T. Greco, Kirkland & Ellis LLP, New York, NY, Gregory F. Pesce, David R. Seligman, Kirkland and Ellis LLP, Chicago, IL, Joseph G. Thompson, III, Porter Hedges LLP, Matthew D. Cavenaugh, Jackson Walker LLP, T. Brooke Farnsworth, Farnsworth & vonBerg, Houston, TX, for Debtors.

MEMORANDUM OPINION

Marvin Isgur, UNITED STATES BANKRUPTCY JUDGE

The Court answers two questions:

- Does the Bankruptcy Code disallow a contractual claim for "make-whole" liquidated damages when an interest-bearing obligation is prepaid?
- Does the Bankruptcy Code permit a solvent debtor to forego contractual obligations to an unimpaired class of unsecured creditors, but still pay a distribution to its shareholders?

Ultra Petroleum argues that the Bankruptcy Code allows a solvent debtor to avoid paying unimpaired unsecured creditors a contractual liquidated damages claim and to avoid paying postpetition interest at contractual default rates. The Bankruptcy Code permits neither.

[1] Bankruptcy relief is intended for the honest, but unfortunate debtor. Although no one questions Ultra's honesty, a post-petition uptick in natural gas prices made Ultra and its shareholders quite fortunate. As a result, Ultra became massively solvent. The question becomes whether an honest but fortunate solvent debtor may use bankruptcy to discharge validly owed debt, while its shareholders retain value. Sensibly, the answer is "no." Ultra must pay its creditors before it pays its shareholders.

BACKGROUND

The particulars of the Ultra Make-Whole litigation are well chronicled in the Federal and Bankruptcy Reporters. *Ultra Petroleum Corp. v. Ad Hoc Comm. Of Unsecured Creditors (In re Ultra Petroleum Corp.)*, 913 F.3d 533 (5th Cir. 2019) *withdrawn and superseded*, 943 F.3d 758 (5th Cir. 2019); *In re Ultra Petroleum Corp.*, 575 B.R. 361 (Bankr. S.D. Tex. 2017). The Court provides a brief history for clarity.

This dispute stems from Ultra's 2016 chapter 11 bankruptcy case and focuses on the amount owed to unimpaired Noteholders under Ultra's confirmed plan. Ultra Resources ("OpCo"), Ultra Petroleum Corp. ("HoldCo"), and UP Energy Corp. ("MidCo") (collectively, "Ultra") engaged in natural gas exploration and production. *Ultra*, 943 F.3d at 760. Due to a precipitous decline in natural gas prices, Ultra found itself unable to pay its debts as they came due. (*See* ECF No. 30 at 18). Accordingly, the Ultra entities filed voluntary chapter 11 petitions on April 29, 2016. (ECF No. 1). After the petition date, commodity prices rose sharply, allowing Ultra to propose and confirm a chapter 11 plan paying its creditors in full.[1] *Ultra*, 943 F.3d at 761.

Among the creditors deemed unimpaired by Ultra's plan were the Class 4 Creditors. (ECF No. 1308-01 at 25-26). Class 4 of the plan set out the treatment of the "OpCo Funded Debt Claims." (ECF No. 1308-01 at 25-26). The plan defined "OpCo Funded Debt Claims" as "the OpCo Note Claims and the OpCo RCF Claims." (ECF No. 1308-01 at 16). The OpCo Note Claimants held $1.46 billion in unsecured notes, issued between 2008 and 2010. *Ultra*, 943 F.3d at 760. The OpCo RCF Claimants were owed $999 million, which OpCo borrowed under a Revolving Credit Facility ("RCF") in 2011. *Id.* HoldCo and MidCo each guaranteed the OpCo Funded Debt. *Ultra*, 575 B.R. at 363.

Ultra issued the OpCo Notes pursuant to a Master Note Purchase Agreement ("MNPA"). (ECF No. 1834 at 2). The MNPA contains a number of provisions relevant to this dispute. Under the MNPA, Ultra could repay the Notes ahead of the Notes' maturity date, so long as Ultra also paid a Make-Whole Amount. (ECF No. 1215-1 at 27). The Make-Whole Amount could be calculated using a formula designed to compensate a Noteholder for deprivation of the "right to maintain its investment in the Notes free from repayment." (ECF No. 1834 at 11).

The MNPA defines the Make-Whole Amount as "an amount equal to the excess, if any, of the Discounted Value of the Remaining Scheduled Payments with respect to the Called Principal of such fixed rate Note over the amount of such Called Principal . . . ." (ECF No. 1215-1 at 27). "Called Principal" is "the principal of such Note that . . . has become or is declared to be immediately due and payable pursuant to Section 12.1." (ECF No. 1215-1 at 27). "Remaining Scheduled Payments" include "all payments of such Called Principal and interest thereon that would be due after the Settlement Date," which is "the date on which such Called Principal . . . has become or is declared to be immediately due and payable pursuant to Section 12.1." (ECF No. 1215–1 at 28). The "Discounted Value" of such Remaining Scheduled Payments is comprised of "the amount obtained by discounting all Remaining Scheduled Payments with respect to such Called Principal from their respected scheduled due dates to the Settlement Date . . . . in accordance with accepted financial practice and at a discount factor . . . equal to the Reinvestment Yield" of 0.5% over the yield to maturity of specified United States Treasury obligations. (ECF No. 1215–1 at 27).

The MNPA also contained various events of defaults, the occurrence of which accelerated the Notes and caused them to become immediately due and payable. (ECF No. 1215-1 at 38). After an event of default, the entire unpaid principal, accrued but unpaid interest, and the Make-Whole Amount came due for each Note. *Ultra*, 575 B.R. at 364. One event of default was the filing of a bankruptcy petition. *Id.* Thus, Ultra's bankruptcy filing accelerated the Notes and triggered the Make-Whole Amount. *Id.*

"Failure to pay immediately trigger[ed] interest at a default rate of either 2%

1. Although the rebound in commodity prices made Ultra "as rare as the proverbial rich man who manages to enter the Kingdom of Heaven," Ultra's stay beyond the Pearly Gates was short-lived. *See Ultra*, 943 F.3d at 760. Ultra filed a second voluntary chapter 11 petition on May 14, 2020. (Case No. 20-32631, ECF No. 1).

above the normal rate set for the note at issue or 2% above J.P. Morgan's publicly announced prime rate, whichever [was] greater." *Ultra*, 943 F.3d at 761. While the RCF did not include a Make-Whole provision, it contained a similar acceleration clause, with a default interest rate of 2% above the contractual RCF rate. *Id.*

The proposed plan distribution to Class 4 Creditors did not include the Note Claimants' Make-Whole Amount. (*See* ECF No. 1308-01 at 25-26). Nor did the plan pay Class 4 Creditors post-petition interest at the MNPA and RCF default interest rates. (*See* ECF No. 1308-01 at 25-26). Instead, the plan only proposed to pay the Class 4 Creditors the outstanding principal under the Notes and RCF, pre-petition interest at the rate of 0.1%, and post-petition interest at the federal judgment rate. (ECF No. 1308-01 at 25-26). Despite restricting the contractual amounts due, the plan deemed Class 4 unimpaired, prohibiting Class 4 Creditors from voting on the plan. 11 U.S.C. § 1126(f).

The Class 4 Creditors objected to confirmation, citing an entitlement to the Make-Whole Amount and post-petition default interest. *Ultra*, 943 F.3d at 761. Ultra objected to the Class 4 Creditors' claims. *Id.* The Court confirmed Ultra's plan after the parties stipulated that a decision determining the amounts necessary to leave the Class 4 Creditors unimpaired could be reached after confirmation. *Id.*

On September 21, 2017, this Court issued an opinion allowing the Make-Whole Amount and post-petition interest at the default rates. *Ultra*, 575 B.R. at 361. Following a direct appeal, the Fifth Circuit reversed, holding that a creditor is not impaired when a plan incorporates the Bankruptcy Code's disallowance provisions. *Ultra*, 943 F.3d at 758. The Fifth Circuit remanded and directed this Court to consider whether the Make-Whole Amount is disallowed by the Bankruptcy Code, "the appropriate post-petition interest rate, and the applicability of the solvent-debtor exception." *Id.* at 766. The Court now determines those issues.

It is also important to place the dispute in context. The plan in this case was confirmed on March 14, 2017. (ECF No. 1324). The confirmation order reserved to the Court whether the treatment of these claims left the holders "unimpaired." The Court's sole role is to determine the amount that must be paid to leave the Class 4 Claimants unimpaired.

JURISDICTION

The district court has jurisdiction over this proceeding pursuant to 28 U.S.C. § 1334. The allowance or disallowance of a proof of claim against the estate, as well as the "estimation of claims or interests for the purposes of confirming a plan under chapter 11," are core matters as defined in 28 U.S.C. § 157(b)(2)(B). This case was referred to the Bankruptcy Court pursuant to 28 U.S.C. § 157(a).

DISCUSSION

This Memorandum Opinion addresses two primary questions:

- Does the Bankruptcy Code disallow a contractual claim for make-whole liquidated damages when an interest-bearing obligation is prepaid?
- Does the Bankruptcy Code permit a solvent debtor to forego contractual obligations to an unimpaired class of unsecured creditors, but still pay a distribution to its shareholders?

The first question focuses on whether the amounts due under the contractual Make-Whole constitute unmatured interest. If the amounts due under the Make-Whole are unmatured interest, they would be disallowed under § 502(b)(2). Because the Fifth Circuit held that failure to pay amounts disallowed by the Bankruptcy Code does not result in impairment, the classification of the Make-Whole as unmatured interest would permit non-payment while leaving the holders of the claims "unimpaired." If the Make-Whole Amount is not unmatured interest, it is allowed under the Bankruptcy Code.

The answer to the first question is "yes." Section 502(b)(2) disallows claims for the economic equivalent of unmatured interest. The Make-Whole Amount represents liquidated damages and should not be characterized as unmatured interest, or its economic equivalent. The Make-Whole Amount is not compensation for the use or forbearance of money, and it does not accrue over time. It is not interest. The Bankruptcy Code allows the Make-Whole Amount.

The second question focuses on whether the Bankruptcy Code requires that an unimpaired unsecured creditor of a solvent debtor be paid post-petition interest at contractual rates. While the Bankruptcy Code disallows unmatured interest as part of a claim, it is ambiguous as to an unimpaired unsecured creditor's right to post-petition interest on a claim. The parties agree that the Class 4 Claimants are entitled to some post-petition interest, but dispute whether the proper amount is the federal judgment rate or the contractual default rates.

The answer to the second question, is also "yes." The solvent-debtor exception has been widely recognized, both before and after adoption of the Bankruptcy Code. The exception is rooted in the principle that the solvent debtor must pay its creditors in full before the debtor may recover a surplus. Congress did not silently abandon that fundamental equitable principle when it passed the Bankruptcy Code. The solvent-debtor exception entitles the Class 4 Claimants to post-petition interest. The proper rates of interest are the contractual default rates. Awarding the contractual default rates is consistent with the underlying principle of the solvent-debtor exception, that creditors must be paid what they are owed under the contract before the debtor may receive a windfall. Further, limiting the Class 4 Claimants to the federal judgment rate would treat an unimpaired class worse than an impaired class of unsecured creditors.

a. Make-Whole Amount is Allowed Under the Bankruptcy Code

[2] Ultra's confirmed plan left the Note Claimants unimpaired. The Fifth Circuit made clear that an unimpaired creditor is entitled to the full amount of his claim allowed under the Bankruptcy Code. *See Ultra*, 943 F.3d at 765. Ultra is obligated to distribute to the Note Claimants all amounts validly owed under state law, minus any amounts disallowed by the Bankruptcy Code. *See id.* at 765.

[3] Section 502 of the Bankruptcy Code sets out categories of debts which Congress disallowed in bankruptcy. Among other categories, § 502 disallows a claim if "such claim is for unmatured interest." 11 U.S.C. § 502(b)(2). Section 502(b)(2) also encompasses a claim to the extent that it seeks "the economic equivalent of unmatured interest." *Tex. Commerce Bank, N.A. v. Licht (In re Pengo Indus., Inc.)*, 962 F.2d 543, 546 (5th Cir. 1992).

Although the Code does not define the term unmatured interest, interest is widely understood as consideration for the use or forbearance of another's money accruing over time. *See Love v. State of New York*, 78 N.Y.2d 540, 544, 577 N.Y.S.2d 359, 583 N.E.2d 1296 (N.Y. 1991); *Interest*, Black's

Law Dictionary, (11th ed. 2019). The Make-Whole Amount is an enforceable liquidated damages provision which compensates the Note Claimants for any actual loss suffered due to prepayment of the notes. The Make-Whole Amount is not interest because it does not compensate the Note Claimants for OpCo's use or forbearance of the Note Claimants' money, it compensates the Note Claimants for OpCo's breach of a promise to use money. Because the Make-Whole Amount is not interest, it is also not unmatured interest. Because the Make-Whole Amount is not unmatured interest, it forms part of the Note Claimants' allowed claims.

Section 502(a) of the Bankruptcy Code states that "a claim or interest, proof of which is filed under § 501 of this title, is deemed allowed, unless a party in interest . . . objects." Section 502(b) mandates that a claim is allowed, unless the claim (or a portion thereof) falls into one of nine disallowed categories. *See* 11 U.S.C. § 502(b); *In re Today's Destiny, Inc.*, No. 05-90080, 2008 WL 5479109, at *2 (Bankr. S.D. Tex. Nov. 26, 2008).

[4] Section 502(b)(2) "flows from the legal principle that 'interest *stops accruing* at the date of the filing of the petition.' " *In re Pengo*, 962 F.2d at 546 (emphasis added) (quoting S. Rep. No. 989, 95th Cong., 2d Sess. 63, reprinted in 1978 U.S.S.C.A.N. 5787, 5849). When determining if an amount falls within § 502(b)(2), "much depends on the dynamics of the individual case." *Ultra*, 943 F.3d at 765. Absent controlling federal law, a determination of a creditor's allowed claim necessarily references state law. *E.g.*, *Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156, 161, 67 S.Ct. 237, 91 L.Ed. 162 (1946) ("[W]hat claims of creditors are valid and subsisting obligations against the bankrupt at the time a petition in bankruptcy is filed, is a question which, in the absence of overruling federal law, is to be determined by reference to state law."). Calculating a creditor's allowed claim based on state law "prevent[s] a party from receiving 'a windfall merely by reason of the happenstance of bankruptcy.' " *Butner v. United States*, 440 U.S. 48, 55, 99 S.Ct. 914, 59 L.Ed.2d 136 (1979) (quoting *Lewis v. Mfrs. Nat'l Bank*, 364 U.S. 603, 609, 81 S.Ct. 347, 5 L.Ed.2d 323 (1961)). No one disputes that the MNPA is governed by New York law. To form part of an allowed claim, the Make-Whole Amount must be both enforceable under New York law, and not unmatured interest under § 502(b)(2).

1. The Make-Whole Amount is Enforceable Under New York Law

[5] This Court previously held that the Make-Whole Amount is a valid liquidated damages clause, and not a disproportionate penalty, under New York law. *Ultra*, 575 B.R. at 369 ("Debtors fail to rebut the Noteholders' claim for the Make-Whole Amount because they fail to prove that the damages resulting from prepayment were readily ascertainable at the time the parties entered into the Note Agreement or that they were conspicuously disproportionate to foreseeable damage amounts."). The Fifth Circuit did not disturb that holding. *See Ultra*, 943 F.3d at 764.

[6, 7] New York courts hold that make-whole provisions are enforceable liquidated damages clauses. *JMD Holding Corp. v. Cong. Fin. Corp.*, 4 N.Y.3d 373, 795 N.Y.S.2d 502, 828 N.E.2d 604, 609 (2005). Liquidated damages are "[i]n effect . . . an estimate, made by the parties at the time they enter into their agreement, of the extent of the injury that would be sustained as a result of breach of the agreement." *Truck Rent-A-Ctr. v. Puritan Farms 2nd*, 41 N.Y.2d 420, 424, 393 N.Y.S.2d 365, 361 N.E.2d 1015 (N.Y. 1977).

The Make-Whole Amount is enforceable under New York law.

Ultra argues that the Make-Whole Amount can be both liquidated damages under New York law and unmatured interest under the Bankruptcy Code. The Note Claimants believe that liquidated damages and unmatured interest are mutually exclusive terms in New York. Ultra correctly notes that it is the Bankruptcy Code, not New York law, which determines the scope of amounts disallowed as unmatured interest. However, because the Bankruptcy Code leaves unmatured interest undefined, the Note Claimants' reference to state law is appropriate.

The Court need not decide whether liquidated damages and unmatured interest are mutually exclusive *per se* because this Make-Whole Amount is not the economic equivalent of unmatured interest. Black's Law Dictionary defines a "liquidated-damages clause" as "[a] contractual provision that determines in advance the measure of damages if a party breaches the agreement." *Liquidated-damages clause*, Black's Law Dictionary, (11th ed. 2019). The Court need not speculate whether some hypothetical liquidated damages clause conceivably compensates a creditor for unmatured interest under section 502(b)(2). This Make-Whole does not. This Make-Whole Amount is enforceable under New York law. For the reasons that follow, it represents neither interest, unmatured interest, nor the economic equivalent of unmatured interest.

2. Defining Interest

[8, 9] Having determined that the Make-Whole Amount is recoverable under applicable nonbankruptcy law, the Court must determine whether the Make-Whole Amount constitutes the "economic equivalent of unmatured interest." *See Pengo*, 962 F.2d at 546. The Bankruptcy Code defines neither interest nor unmatured interest. *See* 11 U.S.C. § 101. Without Congressional instruction to the contrary, undefined words found in the Bankruptcy Code should be given their ordinary meaning. *Lamar, Archer & Cofrin LLP v. Appling*, ––– U.S. ––––, 138 S. Ct. 1752, 1759, 201 L.Ed.2d 102 (2018) ("Because the Bankruptcy Code does not define the words 'statement,' 'financial condition,' or respecting,' we look to their ordinary meanings."). Further, bankruptcy courts generally interpret undefined terms in accordance with state law. *See Butner*, 440 U.S. at 54, 99 S.Ct. 914.

To decide whether the Make-Whole Amount is allowed, the Court must define the "economic equivalent of unmatured interest." *Pengo*, 962 F.2d at 546. The definition is formed in three steps. First, the Court defines interest. Second, the Court defines unmatured interest. Third, the Court identifies the characteristics which make a debt the 'economic equivalent' of unmatured interest.

The Court begins by defining interest. The Senior Creditors' Committee and the OpCo Noteholders provide substantially similar definitions of interest. According to the Note Claimants, interest can be defined as consideration for the use or forbearance of another's money accruing over time. (ECF No. 1859 at 6 ("'*Interest*' means consideration that accrues over time for the use or forbearance of another's money.") (emphasis in original)); (ECF No. 1862 at 9 ("'Interest' means consideration for the use or forbearance of another's money over a period of time.")).[2]

2. In its supplemental brief, Ultra did not provide a specific definition of interest. (*See generally* ECF No. 1860 at 7-12).

The Note Claimants' definition is consistent with the ordinary meaning of interest and with state law interpretations of the term. Black's Law Dictionary defines "interest" as "[t]he compensation fixed by agreement or allowed by law for the use or detention of money, or for the loss of money by one who is entitled to its use; especially the amount owed to a lender in return for the use of borrowed money." *Interest*, Black's Law Dictionary, (11th ed. 2019). Webster's Dictionary notes that interest accrues as a percentage over time. *See Interest*, Webster's New World Dictionary, (2d coll. ed. 1970) ("[M]oney paid for the use of money [and/or] the rate of such payment, expressed as a percentage per unit of time."). New York courts similarly recognize that interest is a cost associated with the use or nonpayment of another's money. *Love*, 78 N.Y.2d at 544, 577 N.Y.S.2d 359, 583 N.E.2d 1296 (describing interest as "the cost of having the use of another's money for a specified period"); *Becker v. Huss Co.*, 43 N.Y.2d 527, 543, 402 N.Y.S.2d 980, 373 N.E.2d 1205 (N.Y. 1978) ("[I]nterest is intended to compensate for the use or nonpayment of money."). Applying Texas law, the Fifth Circuit has acknowledged the same general definition. *See Achee Holds., LLC v. Silver Hill Fin., LLC*, 342 F. App'x 943, 944 (5th Cir. 2009) ("Specifically a fee will not be considered interest if it is not for the use, forbearance or detention of money.").

[10] The Court adopts the Note Claimants' definition of interest. Interest means *consideration for the use or forbearance of another's money accruing over time*. The New York Court of Appeals, the Fifth Circuit, and Black's Law Dictionary expressly recognize the principle that interest is a cost associated with the use or forbearance of another's money. Webster's Dictionary adds to that principle the fact that interest is normally expressed as a percentage accruing over time. The Note Claimants' definition appropriately incorporates each element of interest.

3. Defining Unmatured Interest

[11] If interest is consideration for the use or forbearance of another's money accruing over time, unmatured interest is interest that has not accrued or been earned as of a reference date. *See In re Sadler*, No. 14-CV-2312, 2015 WL 9474174, at *6 (N.D. Ohio Dec. 29, 2015) (noting bankruptcy court defined unmatured interest as "interest that is not yet due and payable or is not yet earned at the time of the filing of the petition"). Stated more fully, unmatured interest is *consideration for the use or forbearance of another's money, which has not accrued or been earned as of a reference date*. In a bankruptcy case, the reference date is the order for relief. *E.g., In re X-Cel, Inc.*, 75 B.R. 781, 788-89 (N.D. Ill. 1987) ("Unmatured interest is defined in this context as interest which was not yet due and payable at the time the petition was filed."). This Court slightly refines the *X-Cel* court's definition. "Unmatured" is more indicative of whether the interest has accrued and been earned; the due date for payment of the interest should not be considered.

[12, 13] The key distinction between matured and unmatured interest is whether such interest has been earned. Interest matures when it is earned and owing to the lender. *See In re Sadler*, 2015 WL 9474174, at *6. An amount is due when it is either immediately enforceable or owing. *Due*, Black's Law Dictionary (11th ed. 2019). Under the Bankruptcy Code, interest that has accrued as of the petition date is matured. The lender has earned that compensation because his money was used pre-petition.

Because interest accrues, or is earned, steadily over time, some interest may be owed on a given date even though it is not immediately payable. In other words, on any given date between contractual installments, a portion of the interest has come due and is owing, despite the fact that the next installment is not immediately payable. Such interest is 'earned' because the borrower, looking backwards, used the lender's money. The Bankruptcy Code allows such interest, even if it is not immediately payable as of the petition date. Unmatured interest is prospective. It is compensation for the future use of another's money.

[14] The Note Claimants argue that the Make-Whole Amount matured due to acceleration of the Notes. (ECF No. 1831 at 26). While interest can also mature when it becomes immediately payable due to acceleration, acceleration occurred post-petition in this case. Acceleration is "the advancing of a loan agreement's maturity date so that payment of the entire debt is due immediately. *NML Capital v. Republic of Arg.*, 17 N.Y.3d 250, 928 N.Y.S.2d 666, 952 N.E.2d 482, 491 (2011) (citing Black's Law Dictionary (9th ed. 2009)). Obligations can become due for payment through acceleration. *Id.* (" '[A]cceleration' of a repayment obligation in a note or bond changes the date of maturity from some point in the future . . . to an earlier date based on the debtor's default under the contract."). However, whether interest is matured at the moment of filing is determined without reference to acceleration clauses triggered by a bankruptcy petition. *See In re ICH Corp.*, 230 B.R. 88, 94 (N.D. Tex. 1999). The Make-Whole Amount came due because the Notes accelerated when Ultra filed its chapter 11 petition. Because the Notes did not accelerate prior to the petition, the Make-Whole Amount's status under § 502(b)(2) is determined without reference to the acceleration clause.

4. The Make-Whole Amount is not Unmatured Interest

The Make-Whole Amount is neither interest nor unmatured interest. The Make-Whole Amount is not consideration for the use or forbearance of the Note Claimants' money, which had not accrued or been earned as of the petition date. Although the Make-Whole Amount is "consideration," it is not consideration for the use or forbearance of the Note Claimants' money. The Make-Whole Amount compensates the Note Claimants for the cost of reinvesting in a less favorable market. If the market is substantially more favorable at the time of prepayment, the Make-Whole Amount could equal zero dollars. Instead of compensating the Note Claimants for the use or forbearance of their money, the Make-Whole Amount compensates the Note Claimants for Ultra's decision not to use their money. In an unfavorable market, that decision causes the Note Claimants to suffer damages. The Make-Whole Amount liquidates those damages.

The Make-Whole Amount became payable because on the petition date, the Called Principal of the Notes was less than the "Discounted Value" of the principal and interest payments scheduled to come due after the petition date. (ECF No. 1831 at 10). Under the MNPA, "Discounted Value" was calculated by discounting the remaining payments to their net present value on the petition date, "using a discount factor equal to the applicable 'Reinvestment Yield.' " (ECF No. 1831 at 11). The applicable "Reinvestment Yield" was 0.5% higher than the yield for similar U.S. Treasury securities reported two days prior to the petition date. (ECF No. 1831 at 11).

The Make-Whole formula incorporates both the timing of prepayment and the applicable Treasury rates just prior to prepayment. The earlier prepayment occurs, the higher the Called Principal. At lower

Treasury rates, the Discounted Value becomes higher. On the other hand, higher Treasury rates equate to lower Discounted Values. A Make-Whole is owed when the Discounted Value exceeds the Called Principal, and the Make-Whole equals the difference between those two sums. The combination of the timing of prepayment and the applicable reinvestment rates approximate the damages suffered due to prepayment.

Other courts have reached the conclusion that similar make-wholes are compensate for liquidated damages. *E.g.*, *In re Trico Marine Servs. Inc.*, 450 B.R. 474, 481 (Bankr. D. Del. 2011) ("Th[e] Court is persuaded by the soundness of the majority's interpretation of make-whole obligations, and therefore finds that the Indenture Trustee's claim on account of the Make-Whole Premium is akin to a claim for liquidated damages, not for unmatured interest."); *see, e.g.*, *C.C. Port, Ltd. v. Davis-Penn Mortg. Co.*, 61 F.3d 288, 289 (5th Cir. 1995) ("Where the contract grants the borrower the right to prepay, a prepayment premium is not compensation for the use, forbearance, or detention of money, rather it is a charge for the option or privilege of prepayment.").

The Make-Whole Amount is not unmatured interest simply because it could equal zero when reinvestment rates are high. Nor would the Make-Whole Amount be unmatured interest merely because it might equal the unmatured interest due at the time of prepayment. The issue is not the final sum of the Make-Whole Amount. Rather, the issue is what the Make-Whole Amount compensates the Note Claimants for. Like a grade school math student, answering the problem requires showing the work. The arithmetic here demonstrates that the Make-Whole Amount does not compensate the Note Claimants for the use or forbearance of their money.

The Make-Whole Amount does not accrue over time. Rather, it is a one-time charge which fixes the Note Claimants' damages when it is triggered. *See Parker Plaza W. Partners v. UNUM Pension & Ins. Co.*, 941 F.2d 349, 352 (5th Cir. 1991) (noting under Texas law "a prepayment premium is a charge for the option or privilege of prepayment . . . and, as such, the charge is not 'interest' "); *Feldman v. Kings Highway Savs. Bank*, 278 A.D. 589, 102 N.Y.S.2d 306, 307 (2d Dep't 1951) (applying New York usury law and finding prepayment premium "was not in consideration of the making of a loan or of forbearance of money. It was the converse, that is, for the making of a new and separate agreement, the termination of the indebtedness. Accordingly, it was not a payment of interest"). Interest accrues over time. Even payment in kind interest, where no interest becomes due for payment until a maturity date, accrues over the life of a note for the purposes of § 502(b)(2). *See In re Energy Future Holdings Corp.*, 540 B.R. 109, 111 (Bankr. D. Del. 2015) (characterizing portion of interest on payment in kind notes as accrued as of the petition date).

Unlike interest, the Make-Whole Amount fixes the damages sustained by the Noteholders' at the time of prepayment. While the timing of prepayment plays a significant role in calculating the damages suffered, nothing about the formula suggests the Make-Whole accrues over time. The Note Claimants do not earn the Make-Whole Amount over the life of the Notes. Instead, time is utilized in the Make-Whole formula to determine the Called Principal and remaining payments. Significantly, the time relevant to the Make-Whole formula is the date at which Ultra *ceased* to use or forbear the Note Claimants' money. The Make-Whole Amount is not earned over time.

Ultra relies on the Court of Appeals for the Second Circuit's decision in *In re MPM Silicones, LLC*, as suggesting that a make-whole is unmatured interest. 874 F.3d 787, 801-02 (2d Cir. 2017) ("The make-whole premium was intended to ensure that the Senior-Lien Note holders received additional compensation to make up for the interest they would not receive if the Notes were redeemed prior to the maturity date."). However, the Second Circuit was not presented with the question of whether a make-whole is unmatured interest. *See id.* In fact, the make-whole in *MPM Silicones* was not disallowed by the Bankruptcy Code at all. *See id.* Instead, that make-whole never became due under the relevant terms of the notes. *Id.* at 803. The make-whole in *MPM Silicones* came due if the debtor opted to prepay the notes ahead of the maturity date. *Id.* Under the acceleration clause of the notes, the debtor's bankruptcy filing automatically accelerated the notes. *Id.* The maturity date became the petition date. Because the make-whole only became due if the debtors paid those notes ahead of the maturity date, the debtor's postpetition decision to redeem the notes was not a prepayment and did not trigger the make-whole. *Id.* Any statement by the Second Circuit about the characterization of the make-whole was dicta.

To illustrate whether the Make-Whole Amount is akin to unmatured interest, during the May 19, 2020 oral argument, the Court posed a brokerage fee hypothetical that envisioned the make-whole as a three-party transaction. The Court then requested further briefing regarding whether any portion of the brokerage fee constitutes unmatured interest. The hypothetical began with a loan, providing for a fixed 6% interest rate, prepaid exactly one year prior to maturity. Prepayment of the loan triggers a reinvestment fee equal to the amount that the lender would be required to pay to make a loan in the same industry as the original loan, with cash flows that match the remaining payments had the original loan not been prepaid. (ECF No. 1856 at 1). Following the borrower's prepayment, the lender locates a broker who will find a new borrower and replace the loan with a 6% loan in exchange for a 2.25% fee. The market interest rate at the time of prepayment is 4%. The Court asked whether any portion of the 2.25% fee is unmatured interest.

The fee is equal to the amount the lender would have to pay to a broker in order to reinvest the prepaid funds with cash flows mirroring the remaining original loan payments. The fee cannot be interest because it does not provide consideration for the use or forbearance of the lender's money, and it does not accrue over time. Just like the Make-Whole Amount, the fee represents a negotiated cost to compensate the lender for making a new loan on comparable terms in a changed market. The hypothetical is no different than the Make-Whole at issue here. Instead of a Make-Whole that directly compensates the lender for the difference in interest rates compared to the outstanding principal, the hypothetical reinvestment fee involves a third-party broker and compensates the lender for the actual cost of making a new loan. There is no credible argument that the reinvestment fee could be considered unmatured interest under the Bankruptcy Code. Nor is there reason to believe that the Bankruptcy Code disallows the Make-Whole Amount, despite allowing a functionally identical transaction executed through a third-party. Both the Make-Whole Amount and the reinvestment fee represent damages to the lender, not interest.

The OpCo Noteholders and the Senior Creditors Committee provided substantially similar answers to the hypothetical.

Both creditor groups recognized that the reinvestment fee was not for the use or forbearance of money. (ECF No. 1859 at 11 ("It is a remedy imposed upon the borrower when it no longer borrows money, after having promised to do so for a fixed term."); ECF No. 1862 at 17 ("[The fee] compensates the lender for its actual damages by obligating the initial borrower to reimburse the lender for the cost of relending the funds that the borrower had agreed to borrow for a specified period.")). Further, the fee is unlike interest because it does not grow as a function of time. (ECF No. 1859 at 11). The reinvestment fee becomes due upon the closing of the replacement loan. (ECF No. 1862 at 18). The fee is entirely contingent on future market events.

Ultra also acknowledged that the reinvestment fee would be allowed under § 502. (ECF No. 1860 at 15 ("That brokerage fee plainly does not qualify as unmatured interest under § 502(b)(2).")). Ultra noted that because the hypothetical lender has not borrowed money from the broker, the fee does not qualify as unmatured interest. (ECF No. 1860 at 15). Rather, Ultra characterizes the fee as the transaction cost of finding a new borrower. (*See* ECF No. 1860 at 15-16). Ultra also raised concerns that the hypothetical would be economically impractical and would potentially subject the borrower to "unlimited liability upon prepayment." (ECF No. 1860 at 14). Qualms about the practicality of the hypothetical aside, Ultra's characterization of the reinvestment fee is a mere transaction cost does not distinguish the fee from the Make-Whole Amount.

The sole economic difference between the hypothetical and the Make-Whole in this case is that the Make-Whole in this case eliminates the broker. Rather than paying the broker to find the alternative borrower, the Make-Whole recipients accept the identical amount of funds. The compensation to the borrower represents liquidated damages stemming from prepayment, whether it is structured as a Make-Whole or a reinvestment fee. The hypothetical illustrates an economic equivalent of the make whole, and it is apparent that neither the hypothetical nor the Make-Whole is unmatured interest.

5. The Make-Whole Amount is not the Economic Equivalent of Unmatured Interest

[15] Ultra argues that the Make-Whole is the economic equivalent of unmatured interest. This is incorrect. Applying the Court's definitions, the economic equivalent of interest must be the economic equivalent of consideration for the use or forbearance of another's money accruing over time. A claim is the economic equivalent of unmatured interest if, in economic reality, it is the economic substance of unmatured interest. *Pengo*, 962 F.2d at 546. If it is the economic equivalent of interest, the claim must be disallowed regardless of the parties' labels. *See id.* The Make-Whole Amount is not an economic equivalent of unmatured interest.

[16] Economic substance, rather than party labels, determines whether an amount is unmatured interest. *In re Chateaugay Corp.*, 109 B.R. 51, 57 (Bankr. S.D.N.Y. 1990) ("[T]he essential factor guiding this Court in making its determination . . . is the underlying economic substance of the transaction."). If a debt fits within the definition of unmatured interest, it is disallowed by § 502(b)(2), regardless of its superficial label. *See id.*

The Fifth Circuit expressly adopted that understanding in *Pengo*, 962 F.2d at 543. In *Pengo*, the Fifth Circuit held that an unamortized original issue discount ("OID") is disallowed by § 502(b)(2) because it is the economic equivalent of unmatured interest. *Id.*

OID notes are issued for less than face value. For example, an issuer might receive $90 for a note with a face value of $100. The issuer receives $90 up front, but agrees to repay $100 over the life of the note. That $10 difference would, in economic fact, be compensation "for the delay and risk involved in the ultimate repayment of monies loaned." *Id.* at 546. The difference is earned over the note's term as it amortizes, and in the event of a bankruptcy petition, unearned amounts are the economic equivalent of unmatured interest. *Id.*

In deciding that unamortized OID fell within the scope of unmatured interest, the Fifth Circuit followed an analysis similar to what this Court applies here. First, it explained the mechanics of OID loans, noting that OID "is in the nature of additional interest," and that it amortizes over time. *See id.* at 546 (internal quotations omitted). Next, while the Fifth Circuit did not define unmatured interest, it stated that OID compensates a lender for "the delay and risk involved" with lending money. *Id.* Because the economic facts showed that unamortized OID fit within the meaning of unmatured interest, it was disallowed under § 502(b)(2). *Id.* ("The 'unmatured interest' bankruptcy rule and the economic notion of 'original issue discount' intersect to form the legal nexus for our decisionmaking."). Put simply, the Fifth Circuit compared the mechanics of OID to a common understanding of unmatured interest. Because OID's round peg fit within unmatured interest's round hole, OID was the economic equivalent of unmatured interest. *See id.*

The *Pengo* court also noted that both the Senate and House Reports describe OID as a form of unmatured interest disallowed under § 502(b)(2). *Id.* (citing S. Rep No. 989, 95th Cong., 2d Sess. 62, *reprinted in* 1978 U.S.C.C.A.N. 5787, 5848 (noting § 502 disallows "any portion of prepaid interest that represents an original discounting of the claim, yet that would not have been earned on the date of bankruptcy"); H.R. Rep. No. 595, 95th Cong., 2d Sess. 352, *reprinted in* U.S.C.C.A.N. 5963, 6308).

Applying *Pengo* to the case at hand, the Make-Whole Amount is distinguishable from OID and is not an economic equivalent of unmatured interest. The Make-Whole Amount does not compensate the Note Claimants for "the delay and risk involved" with lending money. *Id.* Rather than compensating for delay or risk, the Make-Whole Amount compensates for actual pecuniary loss. Further, while the timing of prepayment affects damages suffered, the Make-Whole Amount does not amortize or accrue over time. Unlike OID, the Make-Whole Amount is a square peg, one which cannot be shoved into a round hole. The Make-Whole Amount is not the economic equivalent of unmatured interest.

In re Doctors Hospital of Hyde Park, Inc., 508 B.R. 697 (Bankr. N.D. Ill. 2014), which Ultra relies on, provides an unpersuasive comparison of OID and make-wholes. There, the bankruptcy court held that a make-whole (described as a "Yield Maintenance Premium") was both a liquidated damages clause and unmatured interest. *Id.* Without further explanation, *Doctors Hospital* stated that "[n]othing about the nature of liquidated damages necessarily excludes interest, or vice versa." *Id.* The court likened the make-whole to OID. *Id.* at 705 (citing *In re Chateaugay*, 961 F.2d at 380). However, that comparison was based on the understanding that "[b]oth OID and yield maintenance premiums are one-time charges to compensate the lender for lending ...." *Id.*

The Court respectfully disagrees with *Doctors Hospital* for two reasons. First, as discussed, this Make-Whole Amount is distinguishable from OID. Contrary to the *Doctors Hospital* court's assertion, OID is not a one-time charge. OID is amortized and, like interest, it is earned over the term of the loan. *See Pengo*, 962 F.2d at 546. The Make-Whole Amount is distinguishable from interest because it does not accrue over time. Second, while "[n]othing about the nature of liquidated damages *necessarily* excludes interest," *Doctors Hospital* fails to explain how this Make-Whole Amount could be considered interest. *See Doctors Hosp.*, 508 B.R. at 706. Beyond the false parallel between make-wholes and OID as one-time charges, *Doctors Hospital* provides no persuasive explanation why make-wholes "serve the purpose of interest in economic reality." *Id.* at 705. The law in this circuit is that § 502(b)(2) disallows amounts seeking the economic equivalent of unmatured interest. The Make-Whole Amount does not compensate for the use or forbearance of money, and it does not accrue over time. It is not the economic equivalent of unmatured interest.

Ultra argues that the Make-Whole Amount merely compensates the Note Claimants for a portion of the unmatured interest owed on the petition date. In Ultra's view, the Note Claimants were owed a certain amount of unmatured interest under the Notes as of the petition date, and the Make-Whole Amount is equivalent to a slice of that unmatured pie. Therefore, according to Ultra, the Make-Whole Amount must be disallowed. Section 502(b)(2) disallows a claim "to the extent that" it is for unmatured interest. Ultra is correct that any claim for unmatured interest must be disallowed, whether that claim represents the full amount of unmatured interest owed under nonbankruptcy law or only a portion thereof. However, the Fifth Circuit noted that when analyzing whether a make-whole is unmatured interest, "much depends on the dynamics of the individual case. *Ultra*, 943 F.3d at 765. Resolution of those dynamics requires consideration of "multifarious, fleeting, special, narrow facts that utterly resist generalization." *U.S. Bank Nat'l Ass'n ex rel. CWCapital Asset Mgmt. LLC v. Vill. at Lakeridge, LLC*, ––– U.S. ––––, 138 S. Ct. 960, 968 n.6, 200 L.Ed.2d 218 (2018); *see Ultra*, 943 F.3d at 765. Ultra's view oversimplifies the Make-Whole Amount and fails to engage with the economic reality that the Make-Whole Amount does not compensate the Note Claimants for the use or forbearance of money.

As discussed, the Make-Whole Amount compensates the Note Claimants for damages based on the prepayment or acceleration of the Notes. Absent the Make-Whole, if Ultra prepaid the Notes, the Note Claimants would be deprived of the interest expected to accrue between the date of prepayment and the original maturity date of the Notes. That amount would undoubtedly be unmatured interest. It also equals the maximum amount of compensable damages under the Make-Whole. Ultra believes that fact leads to the conclusion that the Make-Whole Amount is the economic equivalent of unmatured interest. That conclusion is incorrect.

The Make-Whole Amount does not become the economic equivalent of unmatured interest merely because the Make-Whole formula references interest rates. The differential between the contractual interest rate and the reinvestment interest rate is the logical measure of a noteholder's damages. Courts recognize that reference to an interest rate differential does not transform a make-whole into unmatured interest. *See In re Sch. Specialty, Inc.*, No. 13-10125 (KJC), 2013 WL 1838513, at *4 (Bankr. D. Del. Apr. 22,

2013) (allowing claim for make whole "calculated by discounting future interest payments using an interest rate tied to Treasury Note performance").

It is neither surprising nor dispositive that the high-water mark of damages a lender may suffer when a loan is paid off ahead of schedule is equal to the expected interest lost. From a lender's perspective, interest is the benefit of the bargain. However, contrary to Ultra's argument, the Make-Whole formula does not provide the Note Claimants with a portion of the full amount owed for the use or forbearance of the Note Claimants' money. Rather, the Make-Whole builds the upper limit of unmatured interest into a formula designed to compensate the Note Claimants for actual damages. The Make-Whole does not give the Note Claimants a slice of the unmatured interest pie. Unmatured interest is merely an ingredient in the liquidated damage pie.

The Make-Whole formula is also not an example of clever attorneys drafting around the provisions of § 502. The Make-Whole measures the Note Claimants potential economic loss based on the remaining principal at the time of acceleration and a comparison between the interest rates under the Notes and available reinvestment rates. The resulting Make-Whole Amount is not a cost for the use or forbearance of the Noteholders' money, which had not yet accrued on the petition date. Nor is it the economic equivalent of that amount. It is a principled economic estimation of the damages suffered by the Note Claimants after Ultra defaulted on the Notes.

Ultra advances a theory where the economic equivalent of unmatured interest equates to anything Ultra believes is similar to unmatured interest. The parameters of Ultra's broad view of an economic equivalent are uncertain. What is certain is that Congress disallowed claims for "unmatured interest" in bankruptcy. 11 U.S.C. § 502(b)(2). Just as a federal court cannot narrow the scope of § 502(b)(2) by allowing some forms of unmatured interest, a court cannot widen the scope by disallowing claims that are not for unmatured interest. *Pengo* teaches that unmatured interest is determined based on economic reality, not by contractual labels. 962 F.2d at 546 ("For OID constitutes a 'method of providing for and collecting what in economic fact is interest to be paid to compensate for the delay and risk involved in the ultimate repayment of monies loaned.' "). Despite this, Ultra reads *Pengo* as expanding § 502(b)(2) to disallow unmatured interest *and* other amounts that (in its view) seem similar to unmatured interest. (*See* ECF No. 1860 at 10 (arguing unmatured interest includes "its economic substitutes")). Yet, Congress was clear that § 502(b)(2) disallows only unmatured interest.

Ultra resists defining unmatured interest because "much depends on the dynamics on the individual case." (ECF No. 1860 at 7 (quoting *Ultra*, 943 F.3d at 765)). Ultra argues that because "[t]he Make-Whole Amount was expressly intended to serve as an *economic substitute* for the Creditors' expected future interest payments," the Make-Whole Amount is the economic equivalent of unmatured interest. (ECF No. 1860 at 11 (emphasis added)). However, without a workable definition of unmatured interest, it is impossible to determine whether a make-whole is the economic equivalent of unmatured interest.

Notably, Ultra frequently stressed that *Pengo* disallows claims for the *economic equivalent* of unmatured interest. Yet, at various points in its briefing, Ultra's reading of *Pengo* shifts. At times, Ultra suggests that *Pengo* disallows claims for the *economic substitute* of unmatured interest.

(*E.g.*, ECF No. 1860 at 10 ("In short, the critical lesson of *Pengo* is that 'unmatured interest' under § 502(b)(2) must be defined to include not only amounts traditionally labeled as 'interest,' but also amounts that represent an economic substitute for traditional interest."); ECF No. 1834 at 16 ("[T]he Make-Whole Amount in the MNPA was expressly designed to serve as an economic substitute for unmatured interest . . . .")). An *equivalent* and a *substitute* are not, for lack of a better word, equivalent.

The reason for this subtle shift in terminology is clear: the Make-Whole Amount cannot be categorized as the equivalent of interest. The Make-Whole Amount does not compensate the Note Claimants for the use or forbearance of their money. It is not interest and it is not the economic equivalent of interest. Ultra attempts to avoid this issue by framing *Pengo* as disallowing substitutes for unmatured interest. Whether or not the Make-Whole Amount is a "substitute" for unmatured interest, *Pengo* says nothing about substitutes. *Pengo* disallows equivalents because an equivalent to unmatured interest is economically identical to unmatured interest. That is what Congress chose to disallow. A substitute is not an equivalent. When a restaurant diner substitutes a $10.00 slice of salmon for $10.00 of chopped grilled chicken on a Caesar salad, it is not because salmon and grilled chicken (even at the equivalent price) are the same. She does so because they are different. Section 502(b)(2) disallows claims for unmatured interest, not amounts that parties contract to pay instead of interest. The Make-Whole Amount is allowed under § 502 of the Bankruptcy Code.

b. The Solvent-Debtor Exception

[17] The second question before the Court is whether the "solvent-debtor exception" survived the enactment of the Bankruptcy Code, and if so, whether the exception entitles the Class 4 Creditors to post-petition interest at the MNPA and RCF default rates.[3] The answer to both questions is yes. The parties agree that Ultra was "massively solvent" at confirmation, and that the Class 4 Claimants are entitled to receive some amount of post-petition interest. Ultra argues that post-petition interest should be limited to the federal judgment rate. However, "absent compelling equitable considerations, when a debtor is solvent, it is the role of the bankruptcy court to enforce the creditors' contractual rights." *In re Dow Corning Corp.*, 456 F.3d 668, 679 (6th Cir. 2006). For the reasons that follow, this Court upholds the Class 4 Claimants' contractual rights.

1. The Historical Basis of the Solvent-Debtor Exception

[18] Under § 502(b)(2), interest as part of a claim ceases to accrue upon the filing of a bankruptcy petition. However, in some circumstances, creditors may demand post-petition interest on their claims. *See* 11 U.S.C. § 506. Historically, one such circumstance allowed unsecured creditors of a solvent debtor to receive post-petition interest on their claims.

Courts have heard disputes between solvent debtors and their creditors over the

3. Because the Make-Whole Amount is allowed under § 502 of the Bankruptcy Code, the Court does not decide whether the solvent-debtor exception also permits recovery of the Make-Whole Amount. While the solvent-debtor exception is rooted in a court's duty to enforce creditors' contractual rights, the exception has traditionally been utilized only to award post-petition interest. Because the Make-Whole Amount is not interest, it is unclear whether the solvent-debtor exception provides an alternative basis for the Note Claimants to recover the Make-Whole Amount.

right to post-petition interest for nearly three hundred years. Over the centuries, courts developed a solvent-debtor exception to the general bankruptcy rule that interest stops accruing on the petition date. The rationale for the exception is as obvious as it is uncontroversial: an individual with the means to pay his debts in full should be required to do so. *See Johnson v. Norris*, 190 F. 459, 466 (5th Cir. 1911) ("The bankrupts should pay their debts in full, principal and *interest to the time of payment*, whenever the assets of their estates are sufficient." (emphasis added)).

The solvent-debtor exception, rooted in English bankruptcy law, long predates the Bankruptcy Code. Lorde Chancellor Hardwicke first recognized the exception in *Bromley v. Goodere*, (1743) 1 Atkyns 75. There, certain creditors held notes with an entitlement to interest. Following a thirty-year bankruptcy proceeding, a surplus remained after the creditors were paid the full principal of the notes, as well as contractual interest up to the date of the bankruptcy. *Id.* at 79. Lord Chancellor Hardwicke held that, due to the surplus assets, the creditors were entitled to recover post-bankruptcy interest before any distribution could be made to the debtor's heirs. *Id.* Subsequent English cases adopted this solvent-debtor exception. *E.g.*, *Ex parte Mills*, 2 Vesey, Jr., 295; *Ex parte Clarke*, 4 Vesey, Jr., 676.

Congress exercised its Constitutional power to adopt uniform bankruptcy law in 1898, when it passed the Bankruptcy Act.[4] U.S. Const. Art. I. § 8, cl. 4; Bankruptcy Act of 1898, ch. 541, 30 Stat. 544. Interpreting the Bankruptcy Act, the Supreme Court "naturally assume[d] that the fundamental principles upon which [England's bankruptcy system] was administered were adopted by [the United States] when we copied th[at] system." *Sexton v. Dreyfus*, 219 U.S. 339, 344, 31 S.Ct. 256, 55 L.Ed. 244 (1911). One fundamental principle of English bankruptcy adopted in the Bankruptcy Act was the suspension of interest accrual as of the petition date. *City of New York v. Saper*, 336 U.S. 328, 330-31, 69 S.Ct. 554, 93 L.Ed. 710 (1949); *see also Dreyfus*, 219 U.S. at 344, 31 S.Ct. 256 (stating "[n]o one doubts interest on unsecured debt stops" accruing on the petition date).

The Bankruptcy Act expressly disallowed unmatured interest as part of a claim. Section 63 of the Bankruptcy Act dealt with claims allowance, and provided:

> Debts of the bankrupt may be proved and allowed against his estate which are founded upon (1) a fixed liability . . . owing at the time of the filing of the petition by or against him, whether then payable or not, with *any interest thereon which would have been recoverable at that date* . . . (5) provable debts reduced to judgments after the filing of the petition . . . *less costs incurred and interest accrued after the filing of the petition* and up to the time of the entry of such judgments.

Bankruptcy Act of 1938, ch. 575, § 63, 52 Stat. 840 (repealed) (emphasis added). Section 63 disallowed post-petition on both secured and unsecured claims. *See id.*; *In re Al Copeland Enters., Inc.*, 133 B.R. 837, 840 (Bankr. W.D. Tex. 1991).

Despite that fundamental principle, the solvent-debtor exception entitled creditors of a solvent debtor to recover post-petition interest. Courts consistently applied the solvent-debtor exception under the Bank-

4. Prior to passage of the Bankruptcy Act of 1898, Congress passed three short-lived bankruptcy statutes: The Bankruptcy Act of 1800, the Bankruptcy Act of 1841, and the Bankruptcy Act of 1867. Those Acts were repealed after three, two, and eleven years, respectively.

ruptcy Act. *Am. Iron & Steel Mfg. Co. v. Seaboard Air Line Ry.*, 233 U.S. 261, 266-67, 34 S.Ct. 502, 58 L.Ed. 949 (1914) ("Even in bankruptcy . . . it has been held, in the rare instances where the assets ultimately proved sufficient for the purpose, that creditors were entitled to interest accruing after adjudication."); *see also Sword Line, Inc. v. Indus. Comm'r of N.Y.*, 212 F.2d 865, 870 (2d Cir. 1954) ("[I]nterest ceases upon bankruptcy in the general and usual instances noted and unless the bankruptcy bar proves eventually nonexistent by reason of the actual solvency of the debtor.").

The Bankruptcy Act's treatment of unmatured interest was nearly identical to § 502(b)(2). Prior to Congresses' adoption of the Bankruptcy Code, courts understood that "in the case of a solvent bankrupt the bankruptcy court should be guided by the contract between the bankrupt and its creditors rather than by the distinct principles of equity jurisprudence." *In re Chicago, Milwaukee, St. Paul & Pac. R.R. Co.*, 791 F.2d 524, 531 (7th Cir. 1986).

In *Johnson v. Norris*, the Fifth Circuit squarely held that creditors of a solvent debtor may recover post-petition interest, notwithstanding the plain text of § 63 of the Bankruptcy Act. 190 F. at 460 ("The rule in bankruptcy for the computation of interest on claims to the date of filing the petition *has no application* to a solvent estate." (emphasis added)). The trustee in *Norris* had $88,432 on hand after paying all creditors in full, including pre-petition interest. *Id.* at 461. The debtors contended that the creditors were "entitled to collect only the principal of their claims and interest to the date of the filing of the voluntary petition, and that therefore the entire surplus should be returned to the bankrupts." *Id.*

The Fifth Circuit noted that in a typical case there is no dispute that § 63 disallows postpetition interest. *Id.* ("Ordinarily no question as to subsequently accruing interest can arise, for it is a very rare occurrence that a surplus is left after paying the principal and interest to the date of the filing of the petition."). However, that general rule promoted equitable distribution of limited assets, a consideration that was inapplicable to a solvent estate. *Id.* at 462 ("It was not intended to be applied to a solvent estate. It was not in the contemplation of Congress that a solvent estate would be settled in the bankruptcy courts."). Thus, the Fifth Circuit applied the solvent-debtor exception and held that "[w]hether we are governed by the apparent intention of Congress as shown by the general purpose of the bankruptcy law, or by the general principles of equity, the result would be the same. The bankrupts should pay their debts in full, principal and interest to the time of payment, whenever the assets of the estate are sufficient." *Id.* at 466.

Multiple circuit courts followed *Norris*' lead. *E.g.*, *Littleton v. Kincaid*, 179 F.2d 848, 852 (4th Cir. 1950) ("Ordinarily interest on claims against a bankrupt estate runs to the filing of the petition in bankruptcy . . . [pursuant to] Section 63 . . . . [But] when [solvency] . . . occurs interest is payable out of this surplus to the date of payment." (citations omitted)); *Brown v. Leo*, 34 F.2d 127, 127 (2d Cir. 1929) ("[T]he time when interest stops . . . has already been fixed as a matter of law as the date of the filing of the petition . . . . But this estate will be solvent, and neither the rule nor the reason for stopping interest at the date of the filing of the petition applies to an estate which turns out to be solvent." (citations omitted)). Some courts went further and held that there is an *obligation* to enforce the solvent-debtor exception in cases where a claim included a contractual right to post-petition interest. *See Ruskin* *v. Griffiths*, 269 F.2d 827, 832 (2d Cir. 1959) ("[W]here there is no showing that the creditor entitled to the increased interest caused any unjust delay in the proceedings, it seems to us the opposite of equity to allow the debtor to escape the expressly-bargained-for" contractual interest provision); *In re Int'l Hydro-Elec. Sys.*, 101 F. Supp. 222, 225 (D. Mass. 1951) ("Fairness requires that the debenture holders who were compelled to wait for their interest payments should receive the compensation which the indenture provided they should be paid in such an eventuality.").

2. Adoption of the Bankruptcy Code did not Abrogate the Solvent-Debtor Exception

There is no doubt that courts recognized a solvent-debtor exception to § 63 of the Bankruptcy Act. When Congress enacted the Bankruptcy Code, Congress confirmed that section 502(b)(2) incorporated the principle that "interest stops accruing at the date of the filing of the petition." S. Rep. No. 95-989, at 63 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, at 6309. In fact, § 502(b)(2) is "closely analogous" to § 63 of the Bankruptcy Act. *In re Dow Corning Corp.*, 244 B.R. 678, 684 (Bankr. E.D. Mich. 1999). The primary change from pre-Code practice was the adoption of § 506(b), which allows over-secured creditors to recover postpetition interest up to the value of the collateral in all cases. *Rake v. Wade*, 508 U.S. 464, 471, 113 S.Ct. 2187, 124 L.Ed.2d 424 (1993). Absent clear Congressional intent, provisions of the Bankruptcy Code did not abrogate universally recognized legal principles under the Bankruptcy Act. *E.g.*, *Gladstone v. U.S. Bancorp*, 811 F.3d 1133, 1139-40 (9th Cir. 2016). Nothing in the legislative history of the Bankruptcy Code or § 502(b)(2) suggests that Congress intended to defang the solvent-debtor exception.

Parsing legislative history is always a murky business. However, if Congress intended to abandon the universal principle that a capable individual must fully repay his debts, Congressional silence on the issue would be curious. The Supreme Court has made clear that it "will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure." *Cohen v. de la Cruz*, 523 U.S. 213, 221, 118 S.Ct. 1212, 140 L.Ed.2d 341 (1998); *see also Midlantic Nat'l Bank v. N.J. Dep't of Envtl. Prot.*, 474 U.S. 494, 501, 106 S.Ct. 755, 88 L.Ed.2d 859 (1986) ("The normal rule of statutory construction is that if Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific."). Congress gave no indication that it intended to erode the solvent debtor exception.

Equitable considerations support the solvent-debtor exception. Limiting claims to prepetition interest is of overwhelming consequence when creditors must share a limited pool of assets, but that limitation is without cause when the debtor can afford to pay all of its debts. *UPS Cap. Bus. Credit v. Gencarelli (In re Gencarelli)*, 501 F.3d 1, 7 (1st Cir. 2007); *In re Chemtura Corp.*, 439 B.R. 561, 605 (Bankr. S.D.N.Y. 2010) ("With a solvent debtor, issues as to fairness amongst creditors, in sharing a limited pie, no longer apply."). Instead, when the debtor is solvent, the equitable tug exists between unsecured creditors and the debtor's equity holders. The solvent-debtor exception ensures that the debtor does not receive a windfall at the expense of its creditors. *See In re Carter*, 220 B.R. 411, 416-17 (Bankr. D.N.M. 1998) ("[I]f the Court were to modify the originally contracted for [default] interest rate . . ., it would result in a windfall to the Debtor . . . at the [creditors'] expense.").

Norris recognized that rationale over one hundred years ago, and it remains persuasive to this day. Nothing in the legislative history surrounding the adoption of the Bankruptcy Code suggests that Congress intended to eliminate the solvent-debtor exception. This may be unsurprising given the *Norris* court's recognition that bankruptcy law "was not intended to be applied to a solvent estate. It was not in the contemplation of Congress that a solvent estate would be settled in the bankruptcy courts." 190 F. at 462. That observation applies as persuasively to Congresses' deliberation of the Bankruptcy Code as it did to deliberations of the Bankruptcy Act. There is no reason why Congress would allow solvent debtors to wield bankruptcy as a sword to slash valid debts. The solvent-debtor exception was "sufficiently widespread and well recognized" under the Bankruptcy Act to survive adoption of the Bankruptcy Code, absent a clear legislative intent to the contrary. *See Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 10, 120 S.Ct. 1942, 147 L.Ed.2d 1 (2000). No such intent was present when Congress passed the Bankruptcy Code. Elimination of the solvent-debtor exception would allow solvent debtors to realize windfalls by virtue of bankruptcy, while reneging on valid contractual debt. *Id.* Neither legal, equitable, or contractual principles favor such an outcome.

Numerous courts recognize that the solvent-debtor exception survived enactment of the Bankruptcy Code. *See, e.g.*, *In re Gencarelli*, 501 F.3d at 7 ("[T]he equities strongly favor holding the [solvent] debtor to his contractual obligations as long as those obligations are legally enforceable under applicable nonbankruptcy law."); *In re Dow Corning Corp.*, 456 F.3d 668, 679 (6th Cir. 2006) (holding solvent debtor must pay post-petition interest and remanding to determine whether contractual default rate or contractual non-default rate applied); *In re Schoeneberg*, 156 B.R. 963, 972 (Bankr. W.D. Tex. 1993) (in a solvent debtor case the "weight of prior case law . . . convinces this Court that, when there was a prepetition contract between the parties that provided for interest, it is that contract rate which should be applied"); *In re Beck*, 128 B.R. 571, 573 (Bankr. E.D. Okla. 1991) ("The scale balancing the equities . . . is overwhelmingly tilted toward restoring the creditor to as near a position as the creditor would have occupied absent bankruptcy before benefitting the Debtors with surplus funds.").

Legislative history after the adoption of the Bankruptcy Code also shows that the solvent-debtor exception enjoys continued vitality. The history of § 1124 of the Bankruptcy Code indicates that Congress intended that a solvent debtor's creditors should receive post-petition interest. Section 1124 sets out the conditions that must be satisfied for a class of claims to be unimpaired in a chapter 11 plan. Before 1994, § 1124(3) stated that a claim was unimpaired where "the holder of such claim . . . receive[d] . . . cash equal to . . . the allowed amount of such claim." 11 U.S.C. § 1124(3) (1988). Congress removed that provision in direct response to a bankruptcy court's decision in *In re New Valley Corp.*, 168 B.R. 73 (Bankr. D.N.J. 1994).

In *New Valley*, the court confirmed a solvent debtor's chapter 11 plan. The plan left a class of unsecured creditors unimpaired, despite limiting the class' claims to prepetition interest while providing a recovery to a junior class. The debtor's argued that because § 1124(3) only required that unimpaired creditors receive the *allowed* amount of their claims, paying post-petition interest was not necessary. The bankruptcy court agreed and confirmed the plan.

Congress quickly rejected that result by removing § 1124(3) from the Bankruptcy Code. The House Reporter states that:

> The principal change in this section ... relates to the award of postpetition interest. In a recent Bankruptcy Court decision in *New Valley*, unsecured creditors were denied the right to receive postpetition interest on their allowed claims even though the debtor was liquidation and reorganization solvent. The *New Valley* decision applied section 1124(3) of the Bankruptcy Code literally by asserting ... that a class that is paid the allowed amount of its claims in cash on the effective date of a plan is unimpaired under section 1124(3), therefore is not entitled to vote, and is not entitled to receive postpetition interest .... In order *to preclude this unfair result in the future*, the Committee finds it appropriate to delete section 1124(3) from the Bankruptcy Code.

H.R. Rep No. 103-835, at 47-48 (1994), reprinted in 1994 U.S.C.C.A.N. 3340. The repeal of § 1124(3) illustrates that, by adopting the Bankruptcy Code, Congress did not intend to eliminate the solvent-debtor exception. The principle that unsecured creditors of a solvent debtor are entitled to post-petition interest continues to exist under the Bankruptcy Code. Congress expressly recognized that the amendment after *New Valley* was meant to "preclude" the "unfair result" of depriving such creditors of post-petition interest "in the future." *Id.*

The Class 4 Claimants here find themselves in an identical situation as the creditors in *New Valley*. Depriving the Class 4 Claimants of their bargained for interest would allow Ultra's equity holders to realize an unjust windfall. Congress did not intend such a result. Moreover, depriving the Class 4 Claimants of post-petition interest would run counter to a "monolithic mountain of authority," developed over nearly three hundred years in both English and American courts, holding that a solvent debtor must make its creditors whole. *See Ultra*, 943 F.3d at 760. Congresses' amendment to the Bankruptcy Code after the *New Valley* decision supports the conclusion that the solvent-debtor exception remains.

3. *The Solvent-Debtor Exception is not Rooted in § 105(a)*

This review of competing statutes, legislative history, amendments to the Code, and case law may appear both sprawling and technical. These are the tools available to interpret the Bankruptcy Code. The task is delicate. The mechanics of the solvent-debtor exception and the precise manner of its incorporation into the Bankruptcy Code is similarly nuanced. However, it is crucial to remember that the exception's reason for existence is plain: a "fortunate" debtor must repay its creditors.

[19, 20] While the solvent-debtor exception survives, it must be applied within the parameters of the Bankruptcy Code. *See Gencarelli*, 501 F.3d at 7. A bankruptcy court is undoubtedly forbidden from exercising equitable powers "in contravention of the Code." *Law v. Siegel*, 571 U.S. 415, 423, 134 S.Ct. 1188, 188 L.Ed.2d 146 (2014); *see* 11 U.S.C. § 105(a). Any explanation of the exception as a gloss to § 502(b)(2), allowing unmatured interest as part of a claim, is foreclosed by *Law v. Siegel*. Such an understanding plainly contravenes the Bankruptcy Code. Thus, the Court must look to other provisions of the Bankruptcy Code to understand the solvent-debtor exception's operation.

This Court is mindful of the Supreme Court's admonishment of bankruptcy courts using roving equity to disregard provisions of the Bankruptcy Code. *Id.*

However, the Fifth Circuit has "caution[ed] against an overly literal interpretation of the Bankruptcy Code," instead encouraging interpretations based on "careful review of the statutory language, legislative history, and public policy considerations . . . ." *CompuAdd Corp. v. Tex. Instruments Inc. (In re CompuAdd Corp.)*, 137 F.3d 880, 882 (5th Cir. 1998). *Law v. Siegel* dealt with a bankruptcy court's use of its equitable powers to rewrite the Code based on what that court thought was fair. 571 U.S. at 423, 134 S.Ct. 1188. The solvent-debtor exception, while equitable in nature, does not lend itself to whimsical application by courts. It is triggered when one concrete fact exists: the estate's assets exceed its liabilities. Its application is similarly straightforward: creditors are paid the postpetition interest to which they are legally or contractually entitled.

4. The Best Interest of Creditors Test is not the Source of the Exception

Ultra suggests that Congress codified some aspects of the solvent-debtor exception in § 1129(a)(7) of the Bankruptcy Code, but that suggestion lacks merit. Ultra's vision of the solvent-debtor exception under the Bankruptcy Code is that unimpaired creditors are simply entitled to the same post-petition interest as impaired creditors. There is neither a textual nor historical basis for that assertion.

Section 1129(a)(7), commonly known as the best interest of creditors test, prohibits confirmation of a chapter 11 plan if a dissenting impaired class would receive less than it would in a chapter 7 liquidation. Because an unsecured creditor in chapter 7 is entitled to receive postpetition "interest at the legal rate" before funds may be distributed to the debtor, Ultra argues that Congress incorporated the solvent-debtor exception into the best interest of creditors test. *See* 11 U.S.C. § 726(a)(5).

One problem with Ultra's argument is that the best interest of creditors test already existed in the Bankruptcy Act. Section 366(2) of the Bankruptcy Act provided that "[t]he court shall confirm an arrangement if satisfied that . . . it is for the best interests of the creditors." Bankruptcy Act of 1938, ch. 575, § 366, 52 Stat. 840, 911. Section 366(2) was "broadly interpreted to require a comparison between what creditors would receive under the composition offer and what they would receive in liquidation of the estate. Where the composition offer would pay creditors considerably less than they might reasonably expect to realize in liquidation, the composition . . . was not for the best interest of creditors." *In re Gilchrist Co.*, 410 F. Supp. 1070, 1074 n.2 (E.D. Pa. 1976) (citations omitted).

Section 1129(a)(7) of the Bankruptcy Code restates the test found in § 366 of the Bankruptcy Act. *See In re SM 104 Ltd.*, 160 B.R. 202, 219 (Bankr. S.D. Fla. 1993) ("Section 1129(a)(7) sets out the financial minimum that assenting creditors in an assenting class can impose on dissenting creditors within that class. This minimum was drawn from the best interests test that came to the Bankruptcy Code from the old [Bankruptcy Act].").

Again, the solvent-debtor exception was widely recognized under the Bankruptcy Act. The best interest of creditors test also existed under the Bankruptcy Act. Section 502(b)(2) and § 1129(a)(7) of the Bankruptcy Code closely mirror their predecessor provisions in the Bankruptcy Act. Nothing in the legislative history suggests Congress intended to eliminate the solvent-debtor exception or that Congress incorporated it into § 1129(a)(7) of the Bankruptcy Code. *See In re Dow Corning*, 244 B.R. at

684 (citing H.R. Rep. No. 95-595, at 353 (1977)).

A second problem with Ultra's argument is based upon the plain text of the Bankruptcy Code. Section 1129(a)(7) expressly applies only to impaired creditors in a cramdown scenario. Nothing in the text of the Bankruptcy Code applies § 1129(a)(7) to unimpaired creditors. Nor does any provision of the Bankruptcy Code give unimpaired creditors a right to interest at the legal rate under § 726(a)(5). Instead, the Bankruptcy Code is silent regarding an unimpaired creditor's right to post-petition interest.

5. The Fair and Equitable Test is not the Source of the Exception

The Class 4 Claimants' argument that the solvent-debtor exception is rooted in the fair and equitable test under § 1129(b)(1) faces a similar issue as Ultra's argument regarding the best interest of creditors test. Section 1129(b)(1) requires a plan to be "fair and equitable" before a court may allow confirmation. 11 U.S.C. § 1129(b)(1). " 'Fair and equitable' (a redundant term) should be pictured vertically, as it 'regulates priority among classes of creditors having higher and lower priorities.' " *In re Tribune Co.*, 972 F.3d 228, 232 (3d Cir. 2020) (quoting Markell, *A New Perspective on Unfair Discrimination in Chapter 11*, 72 Am. Bankr. L.J. 227, 228 (1998)). Thus, a plan must be fair and equitable as between interest holders of higher and lower priorities. *Id.*

As with the best interest of creditors test, the fair and equitable test only applies "with respect to each class of claims or interests that is impaired under, and has not accepted, the plan." 11 U.S.C. § 1129(b)(1). Nothing in the Bankruptcy Code applies the fair and equitable test to unimpaired classes of creditors. For that reason, a bankruptcy court cannot apply the test to determine whether a plan that limits or denies post-petition interest to unimpaired creditors, but awards a recovery to equity holders, is fair and equitable.

6. The Solvent-Debtor Exception Entitles the Class 4 Claimants to Post-Petition Interest

No single provision of the Bankruptcy Code explains the solvent-debtor exception on its own. However, piecing these Bankruptcy Code provisions together, the solvent-debtor exception works as follows. Section 1124 sets out what the Class 4 Claimants are entitled to receive under Ultra's plan. Section 1124 requires that the plan leaves the Claimants' "legal, equitable, and contractual rights" unaltered. 11 U.S.C. § 1124(1). This encompasses a panoply of rights, derived from a number of different sources. The starting points are the MNPA and RCF, without which the Class 4 Claimants would have no contractual rights, and thus, no legal or equitable rights in this bankruptcy case. The MNPA gives the Note Claimants a contractual right to the Make-Whole Amount and interest at the default rate. The RCF gives the RCF Claimants a right to interest at the default rate. New York law provides the Class 4 Claimants with a legal right to those contractual rights. The full amount of the Make-Whole Amount and interest at the default rates represent the Class 4 Claimants maximum limit that the plan would distribute.

Of course, § 502(b)(2) supersedes New York law and the parties' contract by restricting the legal right to receive unmatured interest in bankruptcy. The Fifth Circuit made clear that any limitation on the Class 4 Claimants' claims imposed by the Bankruptcy Code does not result in impairment. *Ultra*, 943 F.3d at 762. In other words, § 502(b)(2) subtracts unmatured interest from the ceiling of recovery provided by New York law, the MNPA, and the RCF. At the very least, the Class 4 Creditors must receive their full allowed claims in order to be unimpaired.

[21] However, the Class 4 Creditors possess two important equitable rights as well. First, they have an equitable right, based within the Bankruptcy Code, to be treated better than similarly situated impaired creditors. *See In re Energy Future Holdings*, 540 B.R. at 119 (quoting *In re PPI Enters. (U.S.), Inc.*, 324 F.3d 197, 202-203 (3d Cir. 2003)). Impaired creditors in a solvent chapter 11 must receive at least their full allowed claim plus interest at the legal rate. *See id.* The Bankruptcy Code is silent as to whether unimpaired creditors have a right to post-petition interest. This creates ambiguity because equity dictates that unimpaired creditors be treated no less favorably than impaired creditors.

Second, the Class 4 Claimants have an equitable right to be paid the full amount they are validly owed before Ultra's equity holders receive any recovery. *See Norris*, 190 F. at 466. This equitable right is the root of the solvent-debtor exception. In a typical case, the right vanishes because other creditors must share a limited pot of assets. That is not so when the debtor is solvent. *Id.* at 462. When the struggle is between creditors and equity holders, as opposed to creditors and creditors, the equitable right is critical.

The Bankruptcy Code's ambiguity leaves an unimpaired unsecured creditor's right to post-petition interest uncertain. Because an unimpaired creditor has equitable rights to be treated no less favorably than an impaired creditor and to be paid in full before the debtor realizes a recovery, a plan denying post-petition interest in a solvent debtor case alters the equitable rights of an unimpaired creditor under § 1124(1).

Viewed in this light, the solvent-debtor exception is not simply a judicial gloss allowing courts to bypass § 502(b)(2). Instead, the exception recognizes that the equitable prong of § 1124 applies differently when the debtor is solvent. *In re Energy Future Holdings*, 540 B.R. at 111 ("The receipt of post-petition interest, thus, does not arise as part of the allowed amount of the claim but, rather, as a requirement to confirmation."). The solvent-debtor exception has existed throughout the history of bankruptcy law and § 1124 provides a means to implement the exception within the plan confirmation framework of the Bankruptcy Code. Because impaired creditors are expressly entitled to post-petition interest, unimpaired creditors of a solvent chapter 11 debtor, who must be no worse off than impaired creditors, should also receive post-petition interest. Further, because creditors in a solvent case need not share limited assets, there is no equitable reason to deny unimpaired creditors post-petition interest.

7. The Class 4 Claimants Must Receive Interest at the Default Rates

[22] The final question is what post-petition interest rate the Class 4 Claimants are entitled to receive. The Claimants argue that they must be paid interest at the MNPA and RCF default rates. On the other hand, Ultra believes the Claimants must be limited to interest at the federal judgment rate. Courts are split as to whether the reference to interest "at the legal rate" under § 726(a)(7) means the federal judgment rate or a contractual rate. *Compare In re Cardelucci*, 285 F.3d 1231 (9th Cir. 2002), *with In re Carter*, 220 B.R. 411 (Bankr. D.N.M. 1998).

[23] The Court need not pin down the meaning of the "legal rate" at this time because the Class 4 Claimants have a right to receive interest at the contractual default rates even if interest "at the legal" rate means the federal judgment rate. As discussed, the Class 4 Claimants' right to post-petition interest is based on two key equitable rights. First, the right to receive no less favorable treatment than impaired creditors. And second, the right to have their contractual rights fully enforced. *See In re Dow Corning*, 456 F.3d at 679 ("When a debtor is solvent, the presumption is that a bankruptcy court's role is merely to enforce the contractual rights of the parties, and the role that equitable principles play in the allocation of competing interest is significantly reduced.").

Assuming that the legal rate under § 726(a)(7) is the federal judgment rate, the Class 4 Claimants may nevertheless recover interest at the contractual default rates. If the legal rate is the federal judgment rate, then impaired creditors of a solvent chapter 11 debtor must receive interest at least at the federal judgment rate. The Court cannot adopt a reading of the Bankruptcy Code which places impaired creditors in a more advantageous position than unimpaired creditors. If the Class 4 Creditors are limited to the federal judgment rate, they are worse off than if they were impaired under Ultra's plan. This is because even though the Class 4 Creditors would receive identical interest as a hypothetical impaired class, as an unimpaired class the Claimants were deprived of the right to vote for or against the plan.

Additionally, limiting the Class 4 Claimants to interest at the federal judgment rate contravenes the purpose of the solvent-debtor exception. The underlying purpose of the exception, recognized for nearly three hundred years, is that a debtor must repay its debts in full when it has the means to do so. This means that when a debtor is solvent, "a bankruptcy court's role is merely to enforce the contractual rights of the parties." *In re Dow Corning*, 456 F.3d at 679. Limiting post-petition interest to the federal judgment rate would not enforce the contractual rights of the parties in this case. Instead, it would curtail the Class 4 Claimants' recovery, while allowing Ultra and its equity holders to escape bankruptcy with a windfall.

The solvent-debtor exception is based on the critical public policy consideration that a debtor cannot walk away from bankruptcy with a windfall while creditors walk away with depleted pockets. This Court will not upset three hundred years of established law. The Class 4 Claimants are entitled to post-petition interest at the MNPA and RCF default rates.

CONCLUSION

The Court will issue an order consistent with this Memorandum Opinion.

State of WISCONSIN, Appellant,

v.

Brian A HANSEN, Amie R Hansen, Appellees.

Case No. 17-cv-1635-bhl

United States District Court, E.D. Wisconsin.

Signed 01/08/2021

Background: In individual Chapter 11 cases of couple who were "responsible persons" of company that failed to maintain workers' compensation insurance coverage for its employees, the State of Wisconsin Department of Workforce Development (DWD) moved for injunctive relief from provisions of debtors' con-

IN RE: The HERTZ CORP., et al., Debtors.

Wells Fargo Bank, N.A., as Indenture Trustee, Plaintiffs,

and

US Bank, as Indenture Trustee, Intervenor-Plaintiff,

v.

The Hertz Corp., et al., Defendants.

Case No. 20-11218 (MFW)
Jointly Administered
Adv. No. 21-50995 (MFW)

United States Bankruptcy Court,
D. Delaware.

Signed December 22, 2021

Background: Indenture trustee brought adversary complaint on behalf of unsecured noteholders, seeking declaratory judgment that Chapter 11 debtors, which had issued notes prepetition, were required to pay redemption premium and/or postpetition interest allegedly due under notes. Debtors filed motion to dismiss for failure to state claim.

Holdings: The Bankruptcy Court, Mary F. Walrath, J., held that:

(1) whether debtors were required to pay redemption premium depended on terms of redemption provision, not acceleration clause;

(2) debtors' redemption of notes was optional, as required for liability for redemption premium;

(3) term "maturity," as used in redemption provision, referred to acceleration caused by bankruptcy filing;

(4) notes were redeemed after "maturity," so that debtors were not required to pay redemption premium;

(5) debtors were required to pay premium for second set of notes for which governing redemption provision did not mention "maturity";

(6) noteholders plausibly alleged that claim for redemption premium was not economic equivalent of unmatured interest disallowed by Code; and

(7) noteholders were not "impaired" creditors within meaning of Code.

Motion granted in part and denied in part.

1. Bankruptcy ⚷2162

In weighing motion to dismiss for failure to state claim, bankruptcy court should undergo three-part analysis: first, court must take note of elements needed for plaintiff to state claim; second, court must separate factual and legal elements of claim, accepting complaint's well-pled facts as true and disregarding any legal conclusions; third, court must determine whether facts alleged are sufficient to show that plaintiff has plausible claim for relief. Fed. R. Civ. P. 12(b)(6).

2. Bankruptcy ⚷2162

In ruling on motion to dismiss for failure to state claim, bankruptcy court may consider documents to which complaint refers if they are central to claim and no party questions their authenticity. Fed. R. Civ. P. 12(b)(6).

3. Commercial Paper ⚷674(1), 687

Chapter 11 debtors' liability for redemption premium purportedly owed to unsecured noteholders pursuant to terms of notes that debtors had issued prepetition depended on terms of redemption provision rather than on terms of acceleration clause in notes, which made no mention of payment of redemption premium upon acceleration even, i.e., filing of bankruptcy petition.

4. Commercial Paper ⚷687

Chapter 11 debtors' redemption of notes it had issued prepetition to unsecured noteholders, which redemption was triggered by acceleration event caused by bankruptcy filing, was optional, as required for debtors to be liable for redemption premium purportedly owed under terms of notes; even if debtors did not file for strategic purposes, and even if filing was brought on by business hardships due to the COVID-19 pandemic, petition itself was voluntary, and debtors had option, once in bankruptcy, to reinstate notes.

5. Commercial Paper ⚷687

"Maturity," as used in redemption provision of notes that Chapter 11 debtors had issued prepetition, which required payment of premium if notes were redeemed before maturity, meant acceleration caused by bankruptcy filing; redemption provision used term "maturity" standing alone, whereas notes elsewhere used phrase "stated maturity" to refer to specific date that notes became due, and so "maturity," as used in redemption provision, had to reference something broader than specific date.

6. Commercial Paper ⚷687

Notes that Chapter 11 debtors had issued prepetition were redeemed, by virtue of acceleration event triggered by debtors' filing of bankruptcy petition, after "maturity" within meaning of redemption provision, and thus, under terms of provision, debtors were not liable to unsecured noteholders for redemption premium; under redemption provision, "maturity" referred to acceleration event, not specific date on which obligation under notes became due.

7. Commercial Paper ⚷687

Chapter 11 debtors were liable to unsecured noteholders for redemption premium under express terms of redemption provision in notes that were issued prepetition; provision made no mention of maturity and instead stated that, at any time prior to specified date on which obligation became due, notes could be redeemed at specific redemption price which included redemption premium.

8. Bankruptcy ⚷2835.1

Commercial Paper ⚷687

Unsecured noteholders plausibly alleged that their claim for redemption premium, purportedly due under notes that Chapter 11 debtors had issued prepetition, was not economically equivalent to unmatured interest that would be disallowed under Bankruptcy Code; noteholders alleged that redemption provision was much less than present value of unmatured interest, and that provision was very favorable to debtors since it was tied to treasury rate, not contract rate. 11 U.S.C.A. § 502(b)(2).

9. Bankruptcy ⚷2835.1

In deciding whether charge is unmatured interest, for purposes of claim allowance, courts look to economic substance of transaction to determine what counts as interest. 11 U.S.C.A. § 502(b)(2).

10. Bankruptcy ⚷3536.1

Claim by unsecured noteholders, for unmatured interest and/or redemption premium purportedly due under notes that Chapter 11 debtors had issued prepetition, was modified by Bankruptcy Code's disallowance of claims for unmatured interest, rather than modified by operation of Chapter 11 plan itself, and thus noteholders were not "impaired" creditors within meaning of Code. 11 U.S.C.A. §§ 502(b)(2), 1124(1).

11. Bankruptcy ⚷2836

Both impaired and unimpaired creditor should receive same treatment in event of solvent Chapter 11 debtor: payment of allowed claim plus post-petition interest at federal judgment rate in accordance with Bankruptcy Code. 11 U.S.C.A. §§ 726(a)(5), 1129(a)(7).

12. Bankruptcy ⚷2125

Bankruptcy court cannot use equitable principles to modify express language of Bankruptcy Code.

Edmon L. Morton, Joseph M. Mulvihill, Young Conaway Stargatt & Taylor, LLP, Wilmington, DE, for Plaintiff.

Ricardo Palacio, Esq., Ashby & Geddes, P. A., Wilmington, DE, for Defendant.

Michael L. Vild, Cross & Simon LLC, Wilmington, DE, Richard C. Pedone, Nixon Peabody LLP, Boston, MA, Christopher Fong, Nixon Peabody LLP, New York, NY, for Intervenor-Plaintiff.

Rel. Docs. 5, 15, 16, 17

MEMORANDUM OPINION [1]

Mary F. Walrath, United States Bankruptcy Judge

Before the Court is the Debtors' Motion to Dismiss the complaint filed by the Indenture Trustees, on behalf of the holders of a series of unsecured notes issued by the Debtors pre-petition (the "Noteholders"), for recovery of a redemption premium and/or post-petition interest allegedly due under the Notes. For the reasons stated below, the Court will grant in part and deny in part the Debtors' Motion to Dismiss the redemption premium count and grant the Debtors' Motion to Dismiss the post-petition interest count.

I. BACKGROUND

On May 22, 2020, the Hertz Corporation and its affiliates (collectively "the Debtors") filed voluntary petitions under chapter 11 of the Bankruptcy Code. The filing was due in large part to the disruption caused to travel and its business operations by the Covid-19 pandemic. (D.I. 28 ¶¶ 3-9.)[2] After a downsizing of their fleet and a sale of a non-core part of their business, the Debtors obtained an offer from a proposed plan sponsor. After designating a stalking horse bidder and conducting an auction process, the Debtors selected a winning bidder and filed the Second Modified Third Amended Plan of Reorganization ("the Plan") to effectuate a reorganization in accordance with that bid. (D.I. 5178.) The Plan provided generally for payment in full in cash on the effective date to creditors plus post-petition interest to the effective date at the federal judgment rate or in the amount necessary to render them unimpaired and a distribution to shareholders of cash and new warrants or subscription rights. (Id. at Art. III.B.) The Plan was accepted by the shareholders. (D.I. 5181.) On June 10, 2021, the Court confirmed the Plan. (D.I. 5261.) The Confirmation Order preserved the rights of the Noteholders to assert entitlement to a make-whole premium and additional interest and other claims as necessary to render their claims unimpaired, as well as the Debtors' right to object to those claims. (Id. at ¶¶ 26 & 27.) The Plan went effective on June 30, 2021 (the "Effective Date"). (D.I. 5477.)

On July 1, 2021, Wells Fargo Bank, N.A. ("Wells Fargo"), as Indenture Trustee for a series of unsecured notes issued by the Debtors pre-petition (the "Senior Notes"), filed a complaint seeking a declaratory

1. The Court is not required to state findings of fact or conclusions of law pursuant to Rule 7052 of the Federal Rules of Bankruptcy Procedure. Instead, the facts recited are those averred in the Complaint, which must be accepted as true for the purposes of the Motion to Dismiss. Ashcroft v. Iqbal, 556 U.S. 662, 678, 129 S.Ct. 1937, 173 L.Ed.2d 868 (2009).

2. References to the docket in this adversary proceeding are to "Adv. D.I. #" while references to the docket in the main case are to "D.I. #."

judgment that, in addition to the principal and pre-petition interest paid to the Senior Noteholders on the Effective Date (in excess of $2.7 billion), the Debtors must pay approximately $272 million consisting of (1) a make-whole premium due under the Senior Notes (totaling approximately $147 million) and (2) post-petition interest on their claims at the contract default rate in excess of the federal judgment rate (approximately $125 million). (Adv. D.I. 1 at Ex. A.) US Bank, N.A. ("US Bank"), as Indenture Trustee for the 7% Unsecured Promissory Noteholders, intervened as a plaintiff seeking relief only on the second claim. (Adv. D.I. 14.)

On August 2, 2021, the Debtors filed a Motion to Dismiss both counts for failure to state a claim. The Motion was fully briefed and oral argument was held on November 9, 2021. The matter is ripe for decision.

II. JURISDICTION

The Court has subject matter jurisdiction over this adversary proceeding. 28 U.S.C. §§ 157, 1334. The Court has the power to enter a final judgment in this adversary because it concerns the allowance of claims against the estate. 28 U.S.C. § 157(2)(A) & (O). Stern v. Marshall, 564 U.S. 462, 499, 131 S.Ct. 2594, 180 L.Ed.2d 475 (2011). In addition, the parties have consented to entry of a final order by this Court. (Adv. D.I. 1 at ¶ 39, 5 at ¶12 & 14 at ¶ 15.) Wellness Int'l Network, Ltd. v. Sharif, 575 U.S. 665, 135 S.Ct. 1932, 191 L.Ed.2d 911 (2015) (holding that even where Article III concerns would preclude the bankruptcy court from entering final judgment over a party's opposition, a court may do so if the parties consent).

III. DISCUSSION

A. Standard of Review

A Rule 12(b)(6) motion challenges the sufficiency of the factual allegations in the complaint. Kost v. Kozakiewicz, 1 F.3d 176, 183 (3d Cir. 1993). To survive a motion to dismiss, the complaint must contain sufficient factual matter, accepted as true, "to state a claim to relief that is plausible on its face." Bell Atl. Corp. v. Twombly, 550 U.S. 544, 570, 127 S.Ct. 1955, 167 L.Ed.2d 929 (2007). A claim is facially plausible when "the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." Ashcroft v. Iqbal, 556 U.S. 662, 678, 129 S.Ct. 1937, 173 L.Ed.2d 868 (2009) (citing Twombly, 550 U.S. at 556, 127 S.Ct. 1955). The court must draw all reasonable inferences in favor of the plaintiff. E.g., Alpizar-Fallas v. Favero, 908 F.3d 910, 914 (3d Cir. 2018).

[1] In weighing a motion to dismiss, the court should undergo a three-part analysis. "First, the court must take note of the elements needed for a plaintiff to state a claim." Santiago v. Warminster Twp., 629 F.3d 121, 130 (3d Cir. 2010) (citing Iqbal, 556 U.S. at 675, 129 S.Ct. 1937). Second, the court must separate the factual and legal elements of the claim, accepting all of the complaint's well-pled facts as true and disregarding any legal conclusions. Id.; Fowler v. UPMC Shadyside, 578 F.3d 203, 210 (3d Cir. 2009) (citing Iqbal, 556 U.S. at 679, 129 S.Ct. 1937). Third, the court must determine whether the facts alleged in the complaint are sufficient to show that the plaintiff has a plausible claim for relief. Santiago, 629 F.3d at 130.

[2] The Court may consider documents to which the complaint refers if they are central to the claim and no party questions their authenticity. Marder v. Lopez, 450 F.3d 445, 448 (9th Cir. 2006). See also Chambers v. Time Warner, Inc., 282 F.3d 147, 153 n.3 (2d Cir. 2002).

B. Redemption Premium

In Count 1 of the Complaint, Wells Fargo seeks a declaratory judgment that the Debtors must pay the redemption premium provided in the Senior Notes because they were redeemed prior to their maturity.

The Debtors seek to dismiss this count for failure to state a claim asserting that (a) no redemption premium is allowed under the express language of the Indentures or (b) the redemption premium is unmatured interest which must be disallowed under the Bankruptcy Code. Wells Fargo disputes both of these contentions.

1. Terms of the Indentures [3]

a. Acceleration Clause

[3] The Debtors rely initially on section 602 of the Indentures which provides that upon the filing of a bankruptcy petition the Senior Notes are automatically accelerated and "the principal of and accrued but unpaid interest on all Outstanding Notes of such series will ipso facto become immediately due and payable without any declaration or other act on the part of the Trustee or any Holder." Because section 602 does not provide for the payment of any redemption premium on acceleration, the Debtors contend that none is due.

Wells Fargo responds that the Debtors' argument must be rejected based on controlling Third Circuit precedent. In re Energy Future Holdings Corp., 842 F.3d 247 (3d Cir. 2016) (hereafter "EFH"). In EFH, Wells Fargo contends, the Third Circuit considered similar language in acceleration clauses under New York law [4] and concluded that the issue of whether a redemption premium was due depended not on the terms of the acceleration clause, but on the terms of the redemption provision. 842 F.3d at 257-60.

The Debtors seek to distinguish EFH by noting that the language in the two series of notes at issue in that case provided that on acceleration all "outstanding Notes" were due or all "principal, interest, and applicable premium" were due. Id. at 254, 257. Therefore, they assert that the Third Circuit held that the acceleration clause and the redemption provision were not in conflict. Id. at 256. In contrast, they contend that the acceleration clause in this case, which provides for payment only of "the principal of and accrued but unpaid interest," cannot be read in harmony with the redemption provision which requires payment of an additional premium.

The Court finds that argument is a distinction without significance. While the Third Circuit rejected the EFH debtor's argument that the acceleration and redemption provisions in that case were in conflict, it concluded that the two sections "simply address different things: § 6.02 causes the maturity of EFHI's debt to accelerate on its bankruptcy, and § 3.07 causes a make-whole to become due when there is an optional redemption before" the maturity date. Id. The Third Circuit concluded that the redemption provision "is the only provision that specifically addresses redemption." Id. That conclusion applies to the Senior Notes in this case, as well. Therefore, the Court concludes that the acceleration clause in the Indentures is not the operative provision in determining whether the redemption premium is due.

b. Redemption Provision

The Debtors argue that, even under the language of the redemption provision, no

3. The Indentures and Supplemental Indentures for the Senior Notes contain substantially identical terms for purposes of the issues at bar. (Adv. D.I. 5 at Exs. A-H.)

4. The Indentures in this case are also governed by New York law. (Adv. D.I. 5, Exs. A & C, § 115, Exs. E & G, § 113.)

redemption premium is due on the Senior Notes for several reasons.

i. At the Debtors' Option

[4] The Debtors argue, initially, that for any redemption premium to be due, the redemption must have been "at the [Debtors'] option."[5] They contend that the Senior Notes were not redeemed at the Debtors' option. They assert that they were forced to file bankruptcy because of the collapse of their business due to the pandemic. The Debtors argue that, upon the bankruptcy filing, the Senior Notes were automatically accelerated and required to be paid in full. E.g., In re MPM Silicones, L.L.C., 874 F.3d 787, 803 (2d Cir. 2017) (holding that payment was mandated by acceleration of the notes on the filing of bankruptcy and therefore that payment was not a voluntary redemption by the debtor).

Wells Fargo disagrees, arguing that the MPM case on which the Debtors rely is contrary to the decision in EFH which is binding on this Court. It argues that the Third Circuit in EFH specifically concluded that the automatic acceleration caused by a bankruptcy filing did not make any later redemption nonvoluntary. EFH, 842 F.3d at 255.

The Court agrees with Wells Fargo. The Third Circuit in EFH expressly held that the mere acceleration of notes as a result of a bankruptcy filing does not mean that the debtor in that case could not be liable for a redemption premium upon subsequently redeeming the notes. Id. Although MPM is to the contrary, it is not the law in this Circuit. The Third Circuit in EFH disagreed with the bankruptcy court's decision which was upheld in MPM and distinguished the AMR decision (on which the Second Circuit relied in MPM). 842 F.3d at 258-60 (citing In re AMR Corp., 730 F.3d 88 (2d Cir. 2013)).

The Debtors assert, nonetheless, that EFH is distinguishable because, unlike the debtor in that case, they did not file bankruptcy in a strategic effort to avoid the payment of a redemption premium. Id. at 251.[6]

Wells Fargo disagrees, noting that there is nothing in EFH requiring an intent to avoid the make-whole obligation in order to find that a redemption of notes is voluntary. Wells Fargo argues that no court has held that if an issuer does not have an intent to avoid the redemption provision, its action is not voluntary. Instead, Wells Fargo asserts that the cases which find a redemption involuntary are predominately cases where the acceleration was at the lenders' option.[7]

The Court agrees with Wells Fargo. The EFH Court did not conclude that the voluntariness of the redemption was dependent on a finding that the debtor filed bankruptcy to avoid the obligation to pay the noteholders a redemption premium. Instead, the Third Circuit found that the debtor had filed a voluntary petition in bankruptcy and once in bankruptcy, had the option to reinstate the notes. EFH, 842

5. Adv. D.I. 5, Exs. B, D, F, H at § 6.

6. See also Sharon Steel Corp. v. Chase Manhattan Bank, N.A., 691 F.2d 1039, 1053 (2d Cir. 1982) (enforcing make-whole where debtor filed a voluntary plan of liquidation in an attempt to substitute the buyer for the debtor as obligor under low interest debentures); Wilmington Sav. Fund Soc'y v. Cash Am. Int'l, Inc., No. 15-CV-5027 (JMF), 2016 WL 5092594, at *7 (S.D.N.Y. Sept. 19, 2016) (enforcing make-whole where issuer breached indenture in connection with a spin-off).

7. E.g., In re Granite Broad. Corp., 369 B.R. 120, 144 (Bankr. S.D.N.Y. 2007) (citing In re LHD Realty Corp., 726 F.2d 327, 330 (7th Cir. 1984)). See also EFH, 842 F.3d at 260 (noting that "by electing to accelerate the debt, a lender forgoes its right to a stream of payments in favor of immediate repayment" and cannot claim a redemption premium).

F.3d at 255. The other cases cited by the Debtors are similarly distinguishable.[8] In fact, several cases have found a redemption voluntary even where the issuer acted in the utmost good faith.[9]

Finally, the Debtors argue that any option to reinstate the Senior Notes was hypothetical at best. They contend that they could not continue to operate without filing bankruptcy because they lost over 90% of their revenues as a result of the pandemic. Further, they argue that they had no ability to formulate a plan that reinstated the Senior Notes because they received no offers that allowed that option. Rather, the Debtors assert that, once in bankruptcy, they had a fiduciary duty to accept the highest and best bid they received at the auction, which precluded the reinstatement of the Senior Notes. Therefore, the Debtors argue that the repayment of the Senior Notes pursuant to the terms of the Plan was not a redemption "at the Company's option" which is necessary to trigger the requirement to pay the redemption premium.

Wells Fargo argues that the Debtors' bankruptcy filing was a strategic, voluntary decision and that the Debtors had many options for restructuring their obligations once in bankruptcy, including specifically the choice to reinstate the Senior Notes. 11 U.S.C. § 1124(2). It, therefore, contends that the Plan which was filed by the Debtors and ultimately confirmed was a redemption of the Senior Notes at the Debtors' option.

The Court agrees with Wells Fargo. The Third Circuit found, in concluding that the redemption of notes in EFH was voluntary, that the debtor there "filed for Chapter 11 protection voluntarily. Once there, it had the option, per its plan of reorganization, to reinstate the accelerated notes' original maturity date under Bankruptcy Code § 1124(2) rather than paying them off immediately. It chose not to do so." EFH, 842 F.3d at 255.

Similarly, in this case the Debtors filed a voluntary petition in bankruptcy. It was perhaps the best option for the Debtors in light of the drastic effects on their business caused by the pandemic, but it was not the only option. Further, while the Debtors chose to conduct an auction for a plan sponsor and ultimately selected the highest and best offer, that too was not the Debtors' only option. At numerous junctures in any bankruptcy case, a debtor in possession has multiple paths from which to choose. That the Debtors here chose a path that resulted in a fantastic result for all of their creditors and shareholders does not mean that it was not a voluntary choice. Even though the Debtors acted in good faith and in the fulfillment of their fiduciary duties, the Court concludes that their actions were voluntary. As noted above, courts have found that even actions taken in good faith and in fulfillment of a

8. E.g., Sharon Steel, 691 F.2d at 1053 (simply holding that where issuer breached the indenture, the trustee had the option to enforce the redemption provision rather than accelerate the notes); WSFS, 2016 WL 5092594, at *7 (concluding that cases interpreting Sharon Steel as requiring bad faith intent to avoid redemption premium were incorrect and no such intent was necessary to allow enforcement of redemption clause).

9. E.g., Chesapeake Energy Corp. v. Bank of N.Y. Mellon Tr. Co. N.A., 837 F.3d 146 (2d Cir. 2016) (enforcing redemption provision even though company acted in good faith, in reliance on a declaratory judgment, later reversed on appeal, that its actions would not trigger the provision); In re Imperial Coronado Partners, Ltd., 96 B.R. 997, 1000 (9th Cir. BAP 1989) (concluding that decision to sell property was voluntary even though debtor did not have the financial means to reinstate the note and the sale made good business sense).

debtor's fiduciary duty can be voluntary resulting in liability for a redemption premium. See cases discussed in note 9, supra.

Therefore, the Court concludes that Wells Fargo has alleged sufficient facts which, accepted as true, state a facially plausible claim that the redemption of the Senior Notes was at the Debtors' option. Twombly, 550 U.S. at 570, 127 S.Ct. 1955.

ii. Applicability of Section 6(a)

The Debtors further argue that, even if the redemption is determined to be voluntary, no redemption premium is due under the express terms of the Indentures because they were redeemed after they matured upon the bankruptcy filing. The Debtors rely preliminarily on section 6(a) of the Supplemental Indentures which provides that the "[Senior] Notes will be redeemable, at the Company's option, in whole or in part, at any time and from time to time on or after [a specified date] and prior to maturity thereof at the applicable redemption price set forth below." (Adv. D.I. 5, Exs. B, D, E & G (emphasis added).)

a. 2022/2024 Senior Notes

[5, 6] Wells Fargo concedes that section 6(a) is the provision applicable to the 2022/2024 Senior Notes. It argues, however, that the term "prior to maturity" in section 6(a) means prior to the original maturity date of the Senior Notes in 2022 and 2024. Because the Debtors redeemed the Senior Notes before the date that they were due to mature, Wells Fargo contends that the redemption premium is due.

The Debtors respond that the Indentures contained a defined term (the "Stated Maturity") for the date when each of the series of Senior Notes was originally due. They argue that the failure to use that defined term in section 6(a) establishes that the phrase "prior to maturity" must mean something broader than that specific date. They cite several other sections of the Indentures which distinguish Stated Maturity from maturity arising "on acceleration" or "otherwise." (Adv. D.I. 5, Exs. A, C, E, G at §§ 1301(a), 601(ii), 301(6).) The Debtors also argue that if "prior to maturity" simply meant the Stated Maturity date, that it would have been unnecessary (and mere surplusage)[10] to include the term at all because the chart in section 6(a) makes reference to what premium is due at all times prior to the Stated Maturity date.

The Court agrees with the Debtors' analysis. The date when the Senior Notes are due is a defined term, Stated Maturity. If section 6(a) was meant to apply only to redemptions before the Stated Maturity date, rather than prior to a maturity caused by some other event, such as a bankruptcy filing, it would have used the term Stated Maturity. Further, if the phrase simply meant redemption prior to the Stated Maturity it would have been surplusage, because the chart included in that section stated what needed to be paid at any time before the Stated Maturity date.

Accordingly, the Court concludes that the undefined term "maturity" in section 6(a) must refer to the common meaning of maturity, which under the terms of the Senior Notes includes upon the acceleration caused by a bankruptcy filing. E.g., Sapp v. Indus. Action Servs., LLC, C.A. No. 19-912-RGA, 2020 WL 2813176, at *3 (D. Del. May 29, 2020) ("[W]hen the same term appears in different sections of the agreement and is capitalized in one section but not the other, the non-capitalized term will have its 'ordinary, plain meaning.' ") (citing Derry Finance N.V. v. Christiana

10. E.g., Burlington Ins. Co. v. NYC Transit Auth., 29 N.Y.3d 313, 57 N.Y.S.3d 85, 79 N.E.3d 477, 482 (2017) (holding that courts should interpret contracts in a manner that does not render a portion of a provision superfluous or meaningless).

Cos., 797 F.2d 1210, 1214 (3d Cir. 1986)). This interpretation is confirmed by sections 601(ii) and 301(6) of the Indentures which use the lower case term "maturity" in reference to acceleration of the Senior Notes on bankruptcy or a default.

Therefore, under the express terms of section 6(a) of the redemption provision, the Court concludes that Wells Fargo has failed to state a plausible claim that a redemption premium is due on the 2022/2024 Senior Notes because they were redeemed after the initial period stated therein but not prior to the maturity arising as a result of the bankruptcy filing. Therefore, the Court will grant the Motion to Dismiss Count 1 as to the 2022/2024 Senior Notes.

b. 2026/2028 Senior Notes

[7] The Debtors argue that the same result applies to the Senior Notes originally due to mature in 2026 and 2028.

Wells Fargo responds that section 6(a) is not applicable to those Senior Notes because they were not redeemed "on or after" the date specified in that section. Instead, it contends that section 6(c) governs, which provides that "At any time prior to [the specified date], the [Senior Notes] may also be redeemed (by the Company or any other person) in whole or in part, at the Company's option, at ... the Redemption Price ...."

The Debtors assert, however, that section 6(a) is incorporated in full into section 6(c) because the latter provides circumstances under which the Senior Notes may "also" be redeemed.

Wells Fargo responds that if "also" meant that all of section 6(a) was incorporated into section 6(c) then there would have been no need to repeat provisions from section 6(a) in section 6(c) such as "at the Company's option" and "in whole or in part."

The Court agrees with Wells Fargo that the use of "also" in section 6(c) does not mean that all of section 6(a) is incorporated into section 6(c). If it did, section 6(c) would contain surplusage, which is to be avoided in contract interpretation. E.g., Burlington Ins., 57 N.Y.S.3d 85, 79 N.E.3d at 482. It would also create an internal contradiction: section 6(a) is only applicable if redemption occurs after a specified date, while section 6(c) applies only if redemption occurs before that date, and each section provides a different redemption price. Rather than accept the Debtors' tortured reading, the Court reads section 6(c) as simply providing the Debtors with the ability to redeem under the circumstances in that section, in addition to their redemption rights under section 6(a). While redemption under section 6(a) requires that it occur before maturity, section 6(c) contains no such requirement.

Therefore, the Court concludes that Wells Fargo has stated a plausible claim, under the express terms of section 6(c) of the redemption provision, that a premium would be due on the 2026/2028 Senior Notes because they were redeemed before the initial period stated therein.

2. Economic Equivalent of Interest

[8] The Debtors argue that, even if the redemption premium is due under the terms of the 2026/2028 Senior Notes, however, it cannot be an allowed claim because section 502(b)(2) of the Bankruptcy Code expressly provides that any claim for unmatured interest must be disallowed. Although that term is not defined in the Code, the Debtors assert that courts look to substance over form and have disallowed claims that are the "contractual equivalent" of future interest.[11] The Debt-

11. E.g., In re Chateaugay Corp., 961 F.2d 378, 380 (2d Cir. 1992) (concluding that unamortized portion of original issue discount was unmatured interest disallowed by § 502(b)(2)); In re Doctors Hosp. of Hyde ors also note that, although the Third Circuit did not directly address this issue in EFH, it characterized a redemption premium as the "contractual substitute for interest lost on Notes redeemed before their expected due date." 842 F.3d at 251.[12]

Wells Fargo argues that the redemption premium is not interest. It contends that interest is a payment for the "use" of money, while the redemption premium is being paid to the Senior Noteholders for the Debtors' "failure to use" their money. Wells Fargo asserts that, unlike interest, the redemption premium does not accrue over time but is a fixed one-time charge upon redemption, and, unlike interest, the redemption premium is contingent: it is only due if the Debtors redeem the Senior Notes in accordance with the terms of the redemption provision. Wells Fargo contends that the redemption premium is intended to compensate the Senior Noteholders for the uncertainty and potential losses incurred in reinvesting that money in a different market environment, which implicates numerous factors beyond simply the periodic payment of interest. It argues that the majority of courts agree, holding that redemption premiums are not unmatured interest.[13]

While the cases cited by Wells Fargo are useful, the Court notes that there is a minority of courts who disagree.[14] Further, although the Third Circuit in EFH described a redemption premium as the "contractual substitute for interest lost on Notes redeemed before their expected due date," it was not addressing the issue of whether it could be characterized as such to preclude its payment under section 502(b)(2). 842 F.3d at 251, 253 n.1. Similarly, while the Fifth Circuit in Ultra Petroleum suggested that some make-wholes may be the equivalent of unmatured interest, it did not decide whether the ones in that case were, instead remanding the is-

Park, Inc., 508 B.R. 697, 705-06 (Bank. N.D. Ill. 2014) (holding that yield maintenance premium was a liquidated damages provision in the nature of disallowable unmatured interest); In re Ridgewood Apts., 174 B.R. 712, 721 (Bank. S.D. Ohio 1994) (prepayment penalty could be disallowed as unmatured interest because it was meant to compensate lender for loss of interest income). See also In re Ultra Petroleum Corp., 943 F.3d 758, 765 (5th Cir. 2019) (noting that make-whole premium could be unmatured interest and remanding to bankruptcy court for determination based on the unique dynamics of the case).

12. See also MPM, 874 F.3d at 802 (noting that a make-whole premium "was intended to ensure that the Senior-Lien Note holders received additional compensation to make up for the interest they would not receive if the Notes were redeemed prior to the maturity date.")

13. E.g., In re Ultra Petroleum Corp., 624 B.R. 178, 188-95 (Bankr. S.D. Tex. 2020) (on remand, concluding that make–whole premium was not the economic equivalent of unmatured interest and not disallowed under § 502(b)(2)); In re School Specialty, Inc., Bank. No. 13-10125 (KJC), 2013 WL 1838513, at *5 (Bank. D. Del. 2013) (agreeing with Trico and holding that make-whole premium should not be disallowed as unmatured interest); In re Trico Marine Servs. Inc., 450 B.R. 474, 481 (Bank. D. Del. 2011) (reviewing cases and concluding that "Th[e] Court is persuaded by the soundness of the majority's interpretation of make-whole obligations, and therefore finds that the Indenture Trustee's claim on account of the Make-Whole Premium is akin to a claim for liquidated damages, not for unmatured interest."). See also 4 Collier on Bankruptcy ¶ 502.03 (16th ed 2021) (collecting cases).

14. E.g., Doctors Hosp., 508 B.R. at 706 (disagreeing with the Trico analysis because liquidated damages may well include unmatured interest); In re MPM Silicones LLC, Bankr. No. 14-22503 (RDD), 2014 WL 4436335, at *17-18 (Bankr. S.D.N.Y. Sept. 9, 2014) (concluding that noteholders claim to a make-whole based on debtor's breach of no call provision was unmatured interest disallowed under § 502(b)(2)), aff'd in part and rev'd in part on other grounds, 874 F.3d 787 (2d Cir. 2017).

sue to the bankruptcy court. 943 F.3d at 765.[15]

[9] The Court is not prepared to conclude, as a legal matter, that make-wholes cannot be disallowed as unmatured interest as Wells Fargo, the cases it cites, and academics [16] suggest. Calling a make-whole a contract right or a liquidated damages provision does not answer the question of whether it is unmatured interest.[17] In deciding whether a charge is unmatured interest "courts look to the economic substance of the transaction to determine what counts as interest." Doctors Hosp., 508 B.R. at 705. If it were enough to just label a make-whole claim liquidated damages, damages for breach of contract, or a "separate contract right" from the obligation to pay interest, then a contract providing that on default or redemption "all unmatured interest" would be immediately due and payable could avoid the effect of section 502(b)(2) completely. This is contrary to the express provisions of the Code and, consequently, the Court concludes that the characterization of a make-whole as a contract right or liquidated damages is not dispositive.

Instead, the Court concludes that the determination of whether the redemption premium that Wells Fargo seeks in this case is, in fact, the economic equivalent of unmatured interest is not a legal question, but is instead a factual one: namely whether the redemption provision in the 2026/2028 Senior Notes is actually the economic equivalent of unmatured interest.

In considering the actual language of the redemption premium in this case, the Court finds it significant that it is calculated, in large part, on the present value of the unmatured interest due on the Senior Notes as of the Redemption Date.[18] At oral argument, Wells Fargo presented a powerpoint that appeared to suggest, however, that the redemption provision was much less than a simple present value of the unmatured interest and very favorable to the Debtors because it is tied to the Treasury rate. That was, of course, merely

15. Although the Bankruptcy Court held on remand that make-whole premium was not unmatured interest, that decision is currently on appeal. Ultra Petroleum Corp. v. Ad Hoc Comm. of OpCo Unsecured Creditors, Case No. 21-20008 (oral argument was held before the Fifth Circuit on 10/04/2021).

16. See Douglas Baird, Making Sense of Make-Wholes, 94 Am. Bankr. L.J. 567 (2020).

17. In re Long John Silver's Rests., Inc., 230 B.R. 29, 33 n.4 (Bankr. D. Del. 1999) (quoting William Shakespeare, Romeo & Juliet, Act II, scene ii).

18. The Supplemental Indenture provides in relevant part that prior to the stated date, the Debtors may redeem the 2028 Senior Notes for a price "equal to 100.0% of the principal amount thereof plus the Applicable Premium (as defined below) as of, and accrued but unpaid interest, if any, to, but not including, the Redemption Date." (Adv. D.I. 5, Ex. H, § 6(c)). That section further defines the Applicable Premium to mean

> with respect to a 2028 Note at any Redemption Date, the greater of (i) 1.00% of the principal amount of such 2028 Note and (ii) the excess of (A) the present value at such Redemption Date, calculated as of the date of the applicable redemption notice, of (1) the redemption price of such 2028 Note on January 15, 2023 (such redemption price being that described in Section 6(a)), plus (2) all required remaining scheduled interest payments due on such 2028 Note through such date (excluding accrued and unpaid interest to the Redemption Date), computed using a discount rate equal to the Treasury Rate plus 50 basis points, over (B) the principal amount of such 2028 Note on such Redemption Date, as calculated by the Company in good faith (which calculation shall be conclusive) or on behalf of the Company by such Person as the Company shall designate; provided that such calculation shall not be a duty or obligation of the Trustee.

(Id. (emphasis added)).

argument and no evidence was presented to support that assertion. Nor did the Debtors have an opportunity to rebut the assertion with any evidence. Instead, the Debtors argued that the test is not whether the redemption premium equals the unpaid interest but whether it is the economic equivalent of the interest which the Senior Noteholders will not receive because of the early redemption of the Senior Notes. Doctors Hosp., 508 B.R. at 705-06.

The presentation by Wells Fargo (and the language of the redemption provision itself), however, are sufficient to convince the Court that Wells Fargo has stated a plausible claim for relief. Santiago, 629 F.3d at 130. While the redemption premium clearly was not due until the redemption occurred on the Effective Date of the Plan and, therefore, was "unmatured" as of the petition date, the Court concludes that Wells Fargo may be able to present evidence that the redemption premium in the 2026/2028 Senior Notes is not, in fact, the economic equivalent of unmatured interest due under those Senior Notes.

Accordingly, the Court concludes that Count 1 of the Complaint states a claim that is plausible on its face that the Debtors must pay the redemption premium on the 2026/2028 Senior Notes but does not state a plausible claim that the Debtors must pay the redemption premium on the 2022/2024 Senior Notes. Accordingly, the Court will grant the Debtors' Motion to Dismiss Count 1 as to the 2022/2024 Senior Notes but deny the Debtors' Motion as to the 2026/2028 Senior Notes.

3. Other Arguments

Wells Fargo also contends, however, that regardless of how the redemption provision is characterized, that portion of the Senior Noteholders' claim cannot be disallowed because the Debtors treated their class as unimpaired in the Plan, thereby precluding them from voting on the Plan. As a result, Wells Fargo contends that the Debtors cannot impair any of the Senior Noteholders' legal, contractual, or equitable rights and must pay the Senior Noteholders all that they are entitled to receive under the Indentures and under equity. 11 U.S.C. § 1124(1). The failure to pay the Senior Noteholders their contractual entitlement to the redemption premium, Wells Fargo contends, impairs the Senior Noteholders' contractual and equitable rights. It also argues that, because the Debtors were "wildly solvent" (returning in excess of $ 1.5 billion to equity holders), the Senior Noteholders are entitled to all of their contract rights (including the make-whole even if it is unmatured interest) under the "solvent debtor exception."

The Debtors argue that the "impairment" and the "solvent debtor exception" arguments are relevant only if the make-whole is determined to be unmatured interest. If it is not unmatured interest, then the Debtors apparently concede that it is not impaired by the Code or by the Plan and is due to the Senior Noteholders.

The Court agrees with the Debtors that it is only if the redemption premium is determined to be the economic equivalent of unmatured interest that Wells Fargo's other arguments would be relevant. However, if it is unmatured interest, then the claim would be subject to the same analysis as the claims of all Noteholders' to post-petition interest. Therefore, the Court considers the parties' arguments on impairment and the solvent debtor exception together below.

C. Unmatured Interest

In Count 2 of the Complaint, Wells Fargo and US Bank (collectively, the "Indenture Trustees") seek a declaratory judgment that the Noteholders are entitled to post-petition interest on their claims, from the petition date to the date they were paid in full, at the contract rate. As noted above, Wells Fargo also asserts that to the extent the Court concludes that the make-whole claim is unmatured interest, the Senior Noteholders are nonetheless entitled to it under the express terms of the Indentures.

The Debtors seek to dismiss both the claim for post-petition interest and any claim for the redemption premium that is properly characterized as unmatured interest, contending that general unsecured claims for unmatured interest are disallowed under the Bankruptcy Code. 11 U.S.C. § 502(b). They contend that at most the Noteholders are entitled to interest from the petition date to the date the claims were paid in full only at the federal judgment rate as allowed in section 726(a)(5).

1. Unimpaired

[10] The Indenture Trustees contend, however, that the Noteholders were treated as unimpaired under the Plan and, therefore, their claims for post-petition interest and/or the redemption premium must be paid in accordance with the terms of the Indentures. They rely on section 1124(1) which provides in relevant part that

> a class of claims or interests is impaired under a plan unless, with respect to each claim or interest of such class, the plan -
>
> (1) leaves unaltered the legal, equitable, and contractual rights to which such claim or interest entitles the holder of such claim or interest . . . .

11 U.S.C. § 1124(1).

The Debtors disagree. Because any claim for unmatured interest is disallowed by operation of the Bankruptcy Code, rather than the Plan, the Debtors argue that the Noteholders' claims are not impaired. In re PPI Enters. (US), Inc., 324 F.3d 197, 204 (3d Cir. 2003) (holding that a creditor is unimpaired if it is the effect of the Bankruptcy Code that modifies its rights, not the debtor's plan).

The Indenture Trustees argue that PPI is distinguishable because it dealt with the effect of section 502(b)(6) rather than section 502(b)(2). They assert that section 502(b)(6) imposes an absolute cap on a landlord's claim, while section 502(b)(2) is not absolute and, in fact, is not effective where the debtor is solvent as it is here (pursuant to sections 726(a)(5) and 1129(a)(7)).

The Court finds the distinction illusory. Section 502(b) addresses the allowance of claims; sections 1129(a)(7) and 726(a)(5) address the treatment of claims where the debtor is solvent. The Indenture Trustees are conflating the allowance of claims with the treatment of claims. If one considers only the allowance issue, the Court concludes that section 502(b)(2) is as absolute as section 502(b)(6), because it disallows all unmatured interest on general unsecured claims.

It is true that in the rare solvent chapter 11 debtor case, some claims may be entitled to post-petition interest under sections 1129(a)(7) and 726(a)(5).[19] However, those sections do not reinstate the creditors' contract or state law rights to unmatured interest that has been disallowed by section 502(b)(2). Instead as discussed below, sections 1129(a)(7) and 726(a)(5) require the treatment of claims in accordance with the mandates of those sections which courts have concluded require the payment of post-petition interest only at the federal judgment rate.[20]

19. United Sav. Ass'n of Texas v. Timbers of Inwood Forest Assocs., 484 U.S. 365, 379, 108 S.Ct. 626, 98 L.Ed.2d 740 (1988).

20. E.g., In re Cardelucci, 285 F.3d 1231, 1234 (9th Cir. 2002) (concluding that post-petition interest on general unsecured claims is payable under sections 726(a)(5) and 1129(a)(7) only at the federal judgment rate, not at the contract rate); In re PG&E Corp., 610 B.R. 308, 315 (Bank. N.D. Cal. 2019)

In Ultra Petroleum, the creditors made the same argument as the Indenture Trustees do in this case. They contended that they were impaired because the debtor's plan did not pay their make-whole amount or post-petition interest at their contract rate. The Bankruptcy Court agreed. In re Ultra Petroleum Corp., 575 B.R. 361, 373 (Bank. S.D. Tex. 2017). On direct appeal, the Fifth Circuit reversed, concluding that "[w]e agree with PPI, every reported decision identified by either party, and Collier's treatise. Where a plan refuses to pay funds disallowed by the Code, the Code - not the plan - is doing the impairing." Ultra Petroleum, 943 F.3d at 762-64.

Following binding precedent in this Circuit (and the analysis of the Fifth Circuit with respect to claims similar to the Noteholders' claims), the Court concludes that any modification of the Noteholders' claim to unmatured interest or to the redemption premium (if it is the economic equivalent of unmatured interest) is an impairment of the Noteholders' contract claims by operation of section 502(b)(2) of the Bankruptcy Code, not the Debtors' Plan. Consequently, the Noteholders' claims are not impaired within the meaning of section 1124(1). E.g., PPI, 324 F.3d at 204; Ultra Petroleum, 943 F.3d at 765; PG&E, 610 B.R. at 315.

2. Solvent Debtor Exception

[11] The Indenture Trustees argue, nonetheless, that they are entitled to their contract rate of interest under the equitable doctrine known as the "solvent debtor exception." They contend that the Bankruptcy Code incorporated that equitable concept which arose under the Bankruptcy Act and provided that creditors were entitled to their full contract rights, if a debtor was solvent. The Indenture Trustees assert that the equities of this case clearly support their claims: the Debtors are awash in cash, paid all creditors in full, and provided a substantial return on investment to equity (in cash and warrants).

a. Express Terms of the Code

The Debtors argue that equitable principles cannot override express provisions of the Code, such as section 502(b)(2) which disallows all unmatured interest on general unsecured claims, without regard to whether a debtor is solvent. They contend that, while sections 726(a)(5) and 1129(a)(7)[21] require the payment of post-petition interest on general unsecured claims where the debtor is solvent, courts have held that the interest is set at the federal judgment rate, not at the contract rate.[22]

The Indenture Trustees respond that section 1129(a)(7) only incorporates section 726(a)(5) in chapter 11 cases with respect to impaired claims. Because the Noteholders' claims are unimpaired under the Debtors' Plan, they assert that any limitation of post-petition interest to the federal judgment rate contained in those sections is not applicable to them.

The Court agrees with the Indenture Trustees, in part. By their express terms, sections 1129(a)(7) and 726(a)(5) provide

(same); In re Washington Mutual, Inc., 461 B.R. 200, 242 (Bank. D. Del. 2011) (same), vacated on other grounds, 2012 WL 1563880 (Bank. D. Del. Feb. 24, 2012).

21. 11 U.S.C. §§ 726(a)(5) (providing payment of postpetition interest at "the legal rate" to creditors, before any distribution to the debtor (or equity), in the event there are funds left after paying all other claims in a chapter 7 liquidation case), & 1129(a)(7) (providing that with respect to each impaired class of claims or interests, each holder of such claim has either accepted the plan or will receive at least what it would have received in a liquidating chapter 7 case).

22. E.g., Cardelucci, 285 F.3d at 1234; PG&E, 610 B.R. at 315; Washington Mutual, 461 B.R. at 242.

what treatment impaired creditors are entitled to receive, not what treatment unimpaired claims are entitled to receive in a solvent chapter 11 debtor case. In essence, the Code is silent on what treatment unimpaired creditors must receive in a solvent chapter 11 debtor case.

b. Repeal of § 1124(3)

The Indenture Trustees argue, however, that Congress has made it clear that unimpaired creditors are entitled to receive post-petition interest at their contract rate by its repeal of section 1124(3). Before it was repealed, section 1124(3) had provided that a creditor is unimpaired if "the holder of such claim . . . receive[s] . . . cash equal to the allowed amount of such claim" on the effective date of the plan. 11 U.S.C. § 1124(3) (1988). Its repeal was prompted by the decision of a Bankruptcy Court that because sections 726(a)(5) and 1129(a)(7) were only applicable to impaired creditors and because section 1124(3) required only the payment of the allowed amount of their claims, unimpaired creditors were not entitled to post-petition interest. In re New Valley Corp., 168 B.R. 73, 79-81 (Bankr. N.J. 1994). The Indenture Trustees contend that the Legislative History makes it clear that denial of post-petition interest to unimpaired creditors in the New Valley case was "unfair."[23] Thus, the Indenture Trustees conclude that the repeal of section 1124(3) makes it clear that unimpaired creditors must receive interest at their contract rate.

The Debtors argue that the repeal of section 1124(3) is irrelevant to the issue at hand. They note that the repeal occurred before the Third Circuit's decision in PPI and did not affect its conclusion that creditors are unimpaired if their rights are altered by the Bankruptcy Code rather than the plan. PPI, 324 F.3d at 206-07. Thus, they contend that the repeal of section 1124(3) does not alter the fact that section 502(b)(2) does not permit the payment of post-petition interest on the Noteholders' claim.

The Court disagrees with the Debtors' analysis of PPI. The Third Circuit in PPI agreed with the bankruptcy court's conclusion in that case that the repeal of section 1124(3) meant that unimpaired creditors were entitled to the payment of postpetition interest if the debtor was solvent. Id. However, the Court does not read the repeal of section 1124(3) as expansively as the Indenture Trustees to mandate that unimpaired creditors must receive their contract rate of interest. Congress explained the repeal's effect, as follows:

> The principal change in this section is set forth in subsection (d) and relates to the award of postpetition interest. In a recent Bankruptcy Court decision in In re New Valley Corp., 168 B.R. 73 (Bankr. D.N.J. 1994), unsecured creditors were denied the right to receive postpetition interest on their allowed claims even though the debtor was liquidation and reorganization solvent. . . . In order to preclude this unfair result in the future, the Committee finds it appropriate to delete section 1124(3) from the Bankruptcy Code.
>
> As a result of this change, if a plan proposed to pay a class of claims in cash in the full allowed amount of the claims, the class would be impaired, entitling creditors to vote for or against the plan of reorganization. If creditors vote for the plan of reorganization, it can be confirmed over the vote of dissenting class of creditors only if it complies with the "fair and equitable" test under section 1129(b)(2) of the Bankruptcy Code

23. H.R. Rep. No. 103-835, at 48 (1994) (emphasis added), reprinted in 1994 U.S.C.C.A.N. 3340, 3356-57.

> and it can be confirmed over the vote of dissenting individual creditors only if it complies with the "best interests of creditors" test under section 1129(a)(7) of the Bankruptcy Code.
>
> The words "fair and equitable" are terms of art that have a well established meaning under the case law of the Bankruptcy Act as well as under the Bankruptcy Code. Specifically, courts have held that where an estate is solvent, in order for a plan to be fair and equitable, unsecured and undersecured creditors' claims must be paid in full, including postpetition interest, before equity holders may participate in any recovery.

H.R. Rep. No. 103-835, at 48 (1994) (emphasis added), reprinted in 1994 U.S.C.C.A.N. 3340, 3356-57.

Thus, in its repeal of section 1124(3), Congress did express its belief that the Bankruptcy Code contained an exception in cases where the debtor is solvent to the principle that creditors are not entitled to post-petition interest. The Legislative History, however, suggests that Congress believed that this solvent debtor exception is embodied in the "fair and equitable" and "best interests of creditors" tests contained in sections 1129(b) and 1129(a)(7).

While Congress stated that it would be unfair in a solvent chapter 11 debtor case for unimpaired creditors to receive no interest, it did not point to any provision of the Code that would allow interest to be paid to unimpaired creditors. Instead, it suggested that the failure to pay any interest to unsecured creditors in a solvent chapter 11 debtor would make them impaired and thus eligible to be paid interest by application of sections 1129(a)(7) and 1129(b)(2).

The Indenture Trustees argue, however, that Congress made it clear that unimpaired creditors under section 1124(1) would not be limited to the interest due under sections 1129(a)(7) and 726(a)(5).[24] While the Court agrees that Congress did state that the repeal of section 1124(3) was not meant to modify the 1984 amendment to section 1129(a)(7) which excluded unimpaired creditors, the Court does not conclude that it was intended to suggest that any interest due to unimpaired creditors cannot be capped at the federal judgment rate applicable under section 726(a)(5). Id. The 1984 amendment to section 1129(a)(7) was made in conjunction with an amendment of section 1129(a)(10) to require the vote of "impaired" claims, rather than all claims.[25] The Legislative History to those amendments reveals that they were meant to require that debtors only need obtain the requisite vote (or satisfaction of the best interest of creditors test) with respect to "real" creditors, i.e., those impaired by the plan, rather than intended to assure that unimpaired creditors get more than the federal judgment rate in the case of the debtor's solvency. See S. Rep. No. 98-65, at 80 (1983) ("Paragraph (10) makes clear the intent of section 1129(a)(10) that one "real" class of creditors must vote for the plan of reorganization.")

Nowhere in the repeal of section 1124(3) or its Legislative History did Congress state what the Indenture Trustees argue, namely that unimpaired creditors must be

24. H.R. Rep. 103-835, 48 (1994), reprinted in 1994 U.S.C.C.A.N. 3340, 3357 ("With respect to section 1124(1) and (2), subsection (d) would not change the beneficial 1984 amendment to section 1129(a)(7) of the Bankruptcy Code, which excluded from application of the best interests of creditors test classes that are unimpaired under section 1124.").

25. See An Act to amend title 28 of the United States Code regarding jurisdiction of bankruptcy proceedings, to establish new Federal judicial positions, to amend title 11 of the United States Code, and for other purposes, Pub. L. 98-353, § 512(a)(7) & (10), 98 Stat. 333 (1984) (amending 11 U.S.C. § 1129(a)(7) & (10)).

paid their contract rate of interest in a solvent chapter 11 debtor case. Congress could have so provided (1) by amending section 1124(3) to require that unimpaired creditors receive their contract rate of interest, in addition to payment in full of their allowed claim, or (2) by amending section 502(b)(2) to provide that unmatured interest is disallowed "except in the case of a solvent debtor." It did neither.

Thus, the repeal of section 1124(3) does not support the Indenture Trustees' argument that an unimpaired creditor must receive post-petition interest at its full contract rate.

c. Solvent Debtor Exception Cases

The Indenture Trustees argue that, because there is no express answer in the Bankruptcy Code or Legislative History, the answer lies in the solvent debtor exception articulated by the courts. While that concept arose under the Bankruptcy Act, they contend that it survives under the Bankruptcy Code because it has not been repudiated by any of the provisions of the Code. E.g., Cohen v. de la Cruz, 523 U.S. 213, 221, 118 S.Ct. 1212, 140 L.Ed.2d 341 (1998) (interpreting dischargeability provisions consistently with practice under the Bankruptcy Act because the Court "will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure"). The Indenture Trustees assert that the solvent debtor exception (as articulated by courts under the Act and the Code) mandates that, because the Debtors are solvent, all of the Noteholders' contract rights must be preserved, including the right to be paid post-petition interest at their contract rate.[26]

The Debtors contend that none of the Supreme Court cases cited by the Indenture Trustees support their contention, because they were all cases dealing with the entitlement of secured creditors to post-petition interest.[27] The Debtors further argue that the Bankruptcy Code expressly incorporated the rulings of those cases in sections 506(b) and 1129(b)(2)(A). They contend that cases granting secured creditors post-petition interest cannot be extended to unsecured creditors in the face of specific provisions of the Code, such as sections 502(b) and 506(b). Law v. Siegel, 571 U.S. 415, 421, 134 S.Ct. 1188, 188 L.Ed.2d 146 (2014) (holding that "equitable powers [that] remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code").

The Court agrees with the Debtors that cases cited by the Indenture Trustees which mandate the payment of interest to secured creditors at their contract rate when a debtor is solvent[28] are not applicable to the instant case which concerns

26. E.g., City of New York v. Saper, 336 U.S. 328, 330 n.7, 69 S.Ct. 554, 93 L.Ed. 710 (1949); Vanston Bondholders Protective Comm. v. Green, 329 U.S. 156, 67 S.Ct. 237, 91 L.Ed. 162 (1946); Consolidated Rock Prods. Co. v. Du Bois, 312 U.S. 510, 61 S.Ct. 675, 85 L.Ed. 982 (1941); Am. Iron & Steel Mfg. Co. v. Seaboard Air Line Ry., 233 U.S. 261, 264, 34 S.Ct. 502, 58 L.Ed. 949 (1914); In re Ultra Petroleum, 943 F.3d at 765; Gen. Elec. Capital Corp. v. Future Media Prods., Inc., 547 F.3d 956, 961 (9th Cir. 2008); In re Gencarelli, 501 F.3d 1, 7 (1st Cir. 2007); In re Dow Corning Corp., 456 F.3d 668, 679-80 (6th Cir. 2006); In re Terry Ltd. P'ship, 27 F.3d 241, 243 (7th Cir. 1994); In re Laymon, 958 F.2d 72, 75 (5th Cir. 1992).

27. Vanston Bondholders, 329 U.S. 156, 67 S.Ct. 237; Consolidated Rock, 312 U.S. 510, 61 S.Ct. 675, 85 L.Ed. 982; Am. Iron, 233 U.S. 261, 34 S.Ct. 502.

28. Vanston Bondholders, 329 U.S. 156, 67 S.Ct. 237; Consolidated Rock, 312 U.S. 510, 61 S.Ct. 675; Am. Iron, 233 U.S. 261, 34 S.Ct. 502; GECC, 547 F.3d at 961; Gencarelli, 501 F.3d at 5, 8; Terry Ltd., 27 F.3d at 242-43; Laymon, 958 F.2d at 75; Ruskin v. Griffiths, 269 F.2d 827, 830-832 (2d Cir. 1959).

unsecured creditors' rights. Timbers of Inwood, 484 U.S. at 379, 108 S.Ct. 626 (holding that the right to post-petition interest provided under section 506(b) is not applicable to undersecured creditors but that, instead, section 726(a)(5) provides the rule for treatment of unsecured creditors in the rare solvent debtor case).

The other Supreme Court case cited by the Indenture Trustees is Saper, which is also not supportive of their argument. City of New York v. Saper, 336 U.S. 328, 331, 69 S.Ct. 554, 93 L.Ed. 710 (1949) (holding that interest on tax claims, like other unsecured claims, stopped accruing on the bankruptcy filing date). The Court in Saper relied on English law from which the Bankruptcy Act was derived and did note, albeit in dicta, that English law had an exception to that rule, in the event that a debtor was solvent. Id. at 330 n.7, 69 S.Ct. 554 (1949). The Supreme Court made no comment, however, on what post-petition interest was required by that exception.

Although the Indenture Trustees cite Circuit Court cases which hold that unsecured creditors in solvent chapter 11 debtor cases are also entitled to post-petition interest at their contract rate, a closer reading of those cases show that many of them (1) relied on Supreme Court and other authority mandating such treatment for secured creditors, without explaining why it applies to unsecured creditors,[29] (2) relied on the fair and equitable test embodied in section 1129(b) which on its face is not applicable to unimpaired creditors,[30] and/or (3) expressly acknowledged that any right of an unsecured creditor to interest is subject to section 502(b).[31]

In a recent case, the Bankruptcy Court on remand in Ultra Petroleum also concluded that the passage of the Bankruptcy Code did not abolish the solvent debtor exception. 624 B.R. at 196-200. The Ultra Petroleum Court determined that under that exception, unimpaired creditors in a solvent chapter 11 debtor case were entitled to post-petition interest at the default rates provided in their contracts because they were entitled to have their equitable rights fully enforced under section 1124(1). Id. at 203-04.

[12] The Ultra Petroleum Court's analysis is not persuasive. A bankruptcy court cannot use equitable principles to modify express language of the Code. United States v. Noland, 517 U.S. 535, 538, 116 S.Ct. 1524, 134 L.Ed.2d 748

29. Dow Corning, 456 F.3d at 679 (relying on In re Chicago, Milwaukee, St. Paul & Pac. R.R. Co., 791 F.2d 524, 528 (7th Cir. 1986), Ruskin, 269 F.2d at 831, and Debentureholders Protective Comm. of Cont'l Inv. Corp. v. Cont'l Inv. Corp., 679 F.2d 264, 269 (1st Cir. 1982)); Chicago, 791 F.2d at 528 (simply stating the solvent debtor exception applied to unsecured creditors without citation to any caselaw in support, while also acknowledging that "[t]he fact that a proceeding is equitable does not give the judge a free-floating discretion to redistribute rights in accordance with his personal views of justice and fairness, however enlightened those views may be."); Debentureholders, 679 F.2d at 269 (relying on Vanston, 329 U.S. 156, 67 S.Ct. 237 and Ruskin, 269 F.2d 827).

30. Dow Corning, 456 F.3d at 678-80 (ruling was premised on section 1129(b), because the court was considering the rights of impaired creditors, not unimpaired creditors, in a solvent chapter 11 debtor case). Further, Dow Corning is contrary to the many cases that conclude that impaired creditors are only entitled to post-petition interest at the federal judgment rate under sections 1129(a)(7) and 726(a)(5). E.g., Cardelucci, 285 F.3d at 1234; PG&E, 610 B.R. at 315; Washington Mutual, 461 B.R. at 242.

31. In Gencarelli, the First Circuit held that the contractual claims of unsecured creditors should be enforced in solvent chapter 11 debtor cases "unless one of the section 502 exceptions applies" and remanded the case to determine if any provision of that section did apply. 501 F.3d at 5, 8.

(1996). Section 502(b)(2) expressly disallows claims of unsecured creditors for unmatured interest. When a debtor is solvent, the Bankruptcy Code does not waive the application of section 502(b)(2). The Third Circuit has held that section 1124(1) does not mandate that unimpaired creditors receive all of their contract rights where those rights are expressly disallowed by section 502(b) of the Code. PPI, 324 F.3d at 202-03.[32] Therefore, under Third Circuit precedent, this Court cannot agree with the Bankruptcy Court in Ultra Petroleum that being unimpaired mandates that the Noteholders receive their contract rate of interest in contravention of section 502(b)(2).

The Indenture Trustees also rely on the Bankruptcy Court's decision in Energy Future. In re Energy Future Holdings Corp., 540 B.R. 109 (Bankr. D. Del. 2015). In that case the Bankruptcy Court was considering an objection to the unsecured PIK noteholders' claims to post-petition interest and concluded that any claim for post-petition interest must be disallowed as a result of section 502(b). Id. at 111. The Court, however, then elaborated on what the debtors' plan would have to provide in order for those creditors to be unimpaired. It concluded that the "plan in this case need not provide for the payment in cash on the effective date of post-petition interest at the contract rate in order for the PIK Noteholders to be unimpaired." Id. (citing PPI, 324 F.3d at 205). Nonetheless, the Court concluded that under the equitable concepts embodied in the fair and equitable test under section 1129(b), "the Court has the discretion to exercise its equitable power to require, among other things, the payment of post-petition interest, which may be at the contract rate or such other rate as the Court deems appropriate." Id. at 124.

The Court finds the test articulated by the Bankruptcy Court in Energy Future, however, to be problematic. First, the Court relied on the fair and equitable test of section 1129(b), which by its express terms does not apply to unimpaired creditors.[33] Further, it provides no guidance to debtors or creditors as to precisely how unimpaired creditors must be treated and thus will result in endless litigation. Finally, leaving the determination of what interest, if any, an unimpaired creditor is entitled to receive in a solvent chapter 11 debtor case completely within the discretion of the bankruptcy court also runs counter to recent Supreme Court jurisprudence (and Congressional amendments) that have sought to curb the bankruptcy court's exercise of equitable discretion.[34]

32. Significantly, in PPI, the Third Circuit held that a landlord's claim was capped by section 502(b)(6) even though that conclusion meant that the debtor's equity would be getting a distribution (i.e., it was a solvent chapter 11 debtor case). 324 F.3d at 200-04.

33. 11 U.S.C. § 1129(b) (mandating that the court "shall confirm the plan ... if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.") (emphasis added). See also PPI, 324 F.3d at 205 n.14.

34. E.g., Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 206, 108 S.Ct. 963, 99 L.Ed.2d 169 (1988) (rejecting equitable arguments that absolute priority rule did not apply to the case at bar, the Court concluded that "whatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code."); In re Frederickson, 545 F.3d 652, 658 (8th Cir. 2008) ("In enacting BAPCPA, Congress reduced the amount of discretion that bankruptcy courts previously had over the calculation of an above-median debtor's income and expenses .... to eliminate what it perceived as widespread abuse of the system. ...").

d. Proper Treatment of Unimpaired Creditors in Solvent Chapter 11 Debtor Cases

The Court is not persuaded that the Bankruptcy Code incorporated the solvent debtor exception to the extent suggested by the Bankruptcy Courts in Ultra Petroleum (to mandate the reinstatement of all contract rights to interest notwithstanding their disallowance by section 502(b)) and in Energy Future (to permit the exercise of broad equitable discretion by the bankruptcy court to determine what interest, if any, unimpaired creditors are entitled to receive). Rather, after consideration of the cases cited by the parties, the express language of the Bankruptcy Code, and its Legislative History, the Court is convinced that the solvent debtor exception survived passage of the Bankruptcy Code only to a limited extent. The Bankruptcy Code expressly codified the solvent debtor exception in section 506(b) as to oversecured creditors and in section 1129(a)(7) and 726(a)(5) as to unsecured creditors. While the latter sections currently only apply to impaired creditors, when the Bankruptcy Code was originally enacted they applied to all unsecured creditors, impaired and unimpaired.[35] As the Court concluded above, when the 1984 amendment made section 1129(a)(7) applicable to impaired creditors only, Congress was motivated by the desire to require voting only by impaired creditors, rather than by a desire to assure that unimpaired creditors get their contract rate of interest.[36]

Significantly, neither the Bankruptcy Code nor the Legislative History expressly state that unimpaired creditors are entitled to their contract rate of interest or even to more than impaired creditors in the case of a solvent debtor. Instead the Legislative History provides strong evidence Congress intended that unimpaired creditors in a solvent chapter 11 debtor case should receive post-petition interest only in accordance with sections 1129(a)(7) and 726(a)(5).[37] That is what the Debtors contend the Noteholders are entitled to receive in this case.

The Indenture Trustees complain, however, that the Debtors treated the Noteholders not as impaired, but as unimpaired, thereby depriving them of the right to vote. The Court finds that the result would have been no different. If the Noteholders had been treated as impaired and if they had voted against the Plan, they would have received the same treatment: payment in full in cash of their allowed claim plus post-petition interest in accordance with sections 1129(a)(7) and 726(a)(5).[38]

It is important to emphasize that the Court's ruling in this case is limited to the issue of what post-petition interest unimpaired creditors must receive in the rare case when a chapter 11 debtor proves to be solvent and their claims are being paid in full in cash on the effective date of the plan. Concluding that sections 1129(a)(7) and 726(a)(5) apply to both impaired and unimpaired unsecured creditors where the debtor is solvent does not offend the basic policy of the Bankruptcy Code to assure that creditors of the same priority generally receive like treatment. While section 726(a)(5) is made applicable in chapter 11 cases only to impaired creditors, when a

35. An Act to Establish a uniform Law on the Subject of Bankruptcies, Pub. L. No. 95-598, § 1129(a)(7), 92 Stat. 2549 (1978).

36. See discussion in Part C.2.b, supra.

37. Id.

38. Of course, even unimpaired creditors have the right to object to confirmation of the plan. It appears that the Indenture Trustees agreed that, rather than object to confirmation of the Debtors' Plan in this case, their objection to treatment of the Noteholders' claims would be decided in this adversary (or the claims resolution process). (D.I. 5261 at ¶¶ 26 & 27.)

debtor is solvent, impaired creditors essentially are unimpaired, in the sense that they are entitled to payment in full of their allowed claims and postpetition interest, albeit at the federal judgment rate, before any distribution can be made to equity. 11 U.S.C. §§ 726(a)(5) & 1129(a)(7). The Legislative History to section 1124(3)'s repeal suggests that Congress believed that there is no legitimate reason when a debtor is solvent to distinguish between impaired and unimpaired unsecured creditors who are receiving payment of their claims in cash in full. Consequently, the Court concludes that both should receive the same treatment: payment of their allowed claim plus post-petition interest at the federal judgment rate in accordance with section 726(a)(5).

Such a rule promotes several important policies of the Bankruptcy Code. First, as noted, it is consistent with the underlying principle of the Bankruptcy Code that creditors with the same priority (such as unsecured creditors) should be similarly treated. Providing that all general unsecured creditors are entitled to the same post-petition interest in a solvent chapter 11 debtor case prevents a debtor from paying preferred creditors more than others simply by classifying them as unimpaired.

Second, it is an easy and predictable rule to apply (as opposed to determining interest based on each creditor's contract rights or relying on discretion exercised by the court on a case by case basis). This promotes predictability and the efficient administration of the bankruptcy estate.[39]

The Court in PG&E reached a similar conclusion. 610 B.R. at 315. That Court addressed the arguments of numerous unimpaired creditors that they were entitled to post-petition interest at various rates, determined by contracts between the debtors and the respective claimants, different state's judgment rates, or some other rate. Id. at 310. It rejected those arguments noting that

> Cardelucci, in answering the narrow question [of what the proper rate of post-petition interest is in a solvent chapter 11 debtor case], drew no distinction as to whether the rule it announced was confined only to impaired claims. The clear and unequivocal analysis based on section 726(a)(5) is obvious: it applies to all unsecured and undersecured claims in a surplus estate.

Id. at 315.

Consequently, the Court concludes that the Indenture Trustees have not stated a plausible claim that the Debtors must pay post-petition interest on the Notes at the rates specified in the Indentures rather than at the federal judgment rate. As a result, the Court will grant the Debtors' Motion to Dismiss Count 2 of the Complaint.[40]

IV. CONCLUSION

For the reasons set forth above, the Court will grant the Debtors' Motion to Dismiss Count 1 as to the 2022/2024 Senior Notes, but deny it as to the 2026/2028 Senior Notes, and grant the Debtors' Motion to Dismiss Count 2.

39. While the Indenture Trustees assert that the calculation of their contract interest claim is a relatively simple math exercise, in large cases with multiple unimpaired creditors that would not be true. E.g., PG&E, 610 B.R. at 310.

40. As a result of this conclusion, to the extent that the Court determines that the redemption premium is the economic equivalent of interest, that claim too would be limited by the application of the federal judgment rate.

Bankruptcy Roundtable
Indiana Continuing Legal Education Forum
August 19 and 20, 2022

Kayla Britton & Victoria Blackwell
Faegre Drinker Biddle & Reath LLP
Indianapolis, Indiana
kayla.britton@faegredrinker.com

Merchant Cash Advance Agreements - True Sale or Secured Loan?

I. Introduction

In recent years, merchant cash advances ("MCAs") have become an increasingly popular funding source for small businesses who need quick access to resources or who may be otherwise unable to get financing through traditional bank loans because of their financial situation, credit score, or the size of the loan.[1] Although MCA lenders in 2014 only provided an estimated $8 billion to businesses, the total estimated funds grew to $19 billion in 2019.[2] However, as traditional banks become more conservative in their lending practices, many small businesses may be forced to turn to MCA lenders for funding in the future.

MCAs are essentially the "pay day" loans of the business world because they allow businesses to get an upfront payment to help provide immediate working capital in exchange for "selling" the MCA lender a percentage of the business's current and future receivables.[3] While these MCA agreements often state that the transaction is not a loan, they often include language

[1] Ben Luthi, *Is a Merchant Cash Advance Right for Your Small Business?*, US NEWS (Jan. 28, 2022, 8:44 AM), https://money.usnews.com/loans/small-business-loans/articles/is-a-merchant-cash-advance-right-for-your-small-business.
[2] Gretchen Morgenson, *FTC official: Legal 'loan sharks' may be exploiting coronavirus to squeeze small businesses*, NBC NEWS (June 29, 2020, 8:57 PM), https://www.nbcnews.com/business/economy/ftc-official-legal-loan-sharks-may-be-exploiting-coronavirus-squeeze-n1173346.
[3] Julia Rittenberg & Rob Watts, *Is A Merchant Cash Advance Right For Your Business?*, FORBES ADVISOR (Apr. 4, 2022, 2:24 PM), https://www.forbes.com/advisor/business/merchant-cash-advance/.

that is more typically seen in loan agreements and in practice, appear to operate more like loans. The MCA lender is repaid by either having the debtor remit a percentage of its daily sales to the MCA lender, or the debtor allows the MCA lender to make a fixed withdrawal on a daily or weekly basis from the business's bank account.[4] Additionally, MCA lenders apply a fee called a factor rate. These high factor rates are often much higher than the interest rate that would be applied to a traditional bank loan and lead to these already struggling businesses having to pay back much more money than they originally borrowed, further deteriorating their financial position.[5]

Since MCAs have elements of both loans and sales, the courts have grappled with the issue of whether these transactions should be properly characterized as true sales or loans. This characterization is especially important if the borrower ends up in bankruptcy or in litigation with their MCA financer.[6] If the bankruptcy court finds that the transaction was a true sale, then the business's purchased receivables would not be property of the bankruptcy estate.[7] The automatic stay also would not be apply, and the MCA company could continue to collect on the assigned receivables post-petition.[8] However, if the bankruptcy court finds that the transaction was a secured loan, the receivables would be cash collateral of the MCA company, and the automatic stay would apply.[9] Outside of bankruptcy, the transaction will be subject to the applicable state's usury laws if a court determines the transaction is a loan.[10] However, if the court finds that it was a sale, then the usury defense will be unavailable to the borrower.

---

[4] Luthi, *supra* note 1.
[5] Rittenberg & Watts, *supra* note 3.
[6] Kara J. Bruce, *The Murky Process of Characterizing Merchant Cash Advance Agreements*, 42 No. 4 BANKRUPTCY LAW LETTER NL 1 (2022).
[7] *Receivables Transactions Revisited: Recent Decisions Split on Sale vs. Loan Characterization*, CROWELL & MORING LLP (Feb. 7, 2022), https://www.crowell.com/NewsEvents/AlertsNewsletters/all/Receivables-Transactions-Revisited-Recent-Decisions-Split-on-Sale-vs-Loan-Characterization.
[8] *Id*.
[9] *Id*.
[10] *Id*.

II. How Do Courts Determine Whether an MCA Agreement is a Loan or True Sale?

Courts look at a variety of factors to determine whether to characterize an MCA agreement as a loan or true sale. However, despite courts using the same set of factors or a combination of similar factors, courts across the country are still reaching differing conclusions on how to characterize these transactions. "[W]hile the path courts take through this recharacterization analysis is unpredictable, the goal is generally clear: to assess which party—buyer or seller—holds the risks, benefits, obligations, and other attributes we typically associate with ownership."[11]

A. "Totality-of-the-Circumstances" Approach

Some courts use a "totality-of-the-circumstances" approach, which looks at eight different factors.[12] These factors include: (1) the agreement's language and the parties' conduct; (2) whether there is "recourse to the seller"'; (3) whether a seller retains the "servicing and commingling of proceeds"; (4) whether the purchaser failed to investigate the debtor business's credit; (5) whether a seller has a "right to excess collections"; (6) whether the purchaser has a right to change the pricing terms; (7) whether the seller retains the right to unilaterally change the terms for a transferred asset; and (8) whether a seller retains the right to repurchase a transferred asset."[13] While a court may use these factors to guide their analysis, "it is the rare case in which each of the factors points in the same direction" due to the MCA lenders' "bifurcat[ing] the traditional indicia of ownership, transferring some of the benefits and burdens, and retaining others."[14]

In *Matter of Cornerstone Tower Services, Inc.*,[15] the court applied the totality of the circumstances test and noted, "No single factor is conclusive to the analysis and all the attributes

[11] Bruce, *supra* note 6.
[12] *Id*.
[13] *Matter of* Cornerstone Tower Services, Inc., 2018 WL 6199131, at *5 (Bankr. D. Neb. 2018).
[14] Bruce, *supra* note 6.
[15] 2018 WL 6199131 (Bankr. D. Neb. 2018).

of the transaction must be examined, but the allocation of risk is primary to the determination."[16] In applying the factors, the court determined: (1) the parties' agreement clearly stated that the transaction was sale[17]; (2) "[u]nder the terms of the parties' agreement, LG … [did] not have a right of recourse"[18]; (3) "Cornerstone was obligated under the agreement to collect and deposit the receivables and permit LG to make daily withdrawals of the contract percentage"[19]; (4) there was no evidence to determine whether or not LG ever investigated Cornerstone's debts[20]; (5) LG was only permitted to withdraw a specific percentage from Cornerstone's account, subject to a monthly cap, and Cornerstone retained control of the balance[21]; (6) LG was not given unilateral power to change pricing[22]; (7) Cornerstone assigned their right to unliterally change the terms of the transferred assets because Cornerstone agreed to "irrevocably appoint LG as its agent and attorney-in-fact with full authority to, among other things, collect the amounts due under the agreement from customers or account debtors"[23]; and (8) the contract did not provide Cornerstone the right to repurchase its accounts.[24] Based upon the court's analysis of the factors, the court found that there had been a true sale.[25]

Similarly, the court in *In re R&J Pizza Corporation*[26] determined that the MCA transaction in question was a sale. R&J Pizza and Merchant Cash & Capital, LLC, a MCA provider ("MCC") entered into an agreement where R&J Pizza sold, "and MCC purchased, an undivided 16% interest

---

[16] *Id*. at *6.
[17] *Id*.
[18] *Id*. at *8 ("Nothing in the agreement can be construed to be an obligation to repurchase accounts, a guarantee of the collectibility [sic] of individual accounts, a reserve to be released only when receivables are paid, or any other sort of recourse."); The court noted that the second factor was the most complicated for the court to determine, but ultimately the court found that the agreement did not provide recourse to LG.
[19] *Id*. at *6.
[20] *Id*.
[21] *Id*.
[22] *Id*.
[23] *Id*.
[24] *Id*.
[25] *Id*. at *8.
[26] 2014 WL 12973408 (Bankr. E.D. N.Y. 2014).

in future credit card, debit card, bank card and/or other charge card (collectively, 'Credit Card') receivables (the 'Accounts') due to the Debtor in the total amount of $129,000.00."[27] At the same time, the parties also entered into an agreement with Newtek Merchant Solutions ("Newtek"), a credit card processing company, "which authorized Newtek to direct cash attributable to the purchased accounts directly to MCC."[28] One year after the original agreement, the parties entered into a modification agreement in which MCC agreed to buy and R&J Pizza agreed to sell 13% more of R&J Pizza's receivables "until the aggregate total of the purchase price … [was] paid in full,"[29] but MCC did not have the right to charge interest regardless of the length of time it took for R&J Pizza to repay the debt in full.[30] Subsequent to the date R&J Pizza filed their petition for relief under Chapter 11, R&J Pizza stopped using Newtek as their processor and retained a new processor without informing MCC, both of which were violations of their agreement with MCC; and R&J Pizza did not inform the new processor to forward to MCC their portion of the purchased accounts.[31] As such, MCC argued that the unpaid portion of the purchased accounts was the property of MCC, rather than the property of the bankruptcy estate.[32] While the court did not address all eight factors, the court examined five of the factors and determined: (1) the language of the contract clearly provided that the transaction was a sale[33]; (2) the agreement provided MCC with no recourse against R&J Pizza for non-collection[34]; (3) R&J Pizza was not provided with the right to repurchase its accounts[35]; (4) R&J Pizza did not retain any right to commingle other credit card receivables with those purchased by MCC nor could R&J Pizza collect proceeds of the

---

[27] *Id.* at *1.
[28] *Id.*
[29] *Id.* at *2.
[30] *Receivables Transactions Revisited: Recent Decisions Split on Sale vs. Loan Characterization, supra* note 7.
[31] *In re R&J Pizza Corp*., at *2.
[32] *Id*.
[33] *Id*. at *3-4.
[34] *Id*. at *4.
[35] *Id*.

accounts MCC purchased, rather R&J Pizza was expressly required to only use a processor approved by MCC[36]; and (5) MCC was given no rights to alter the pricing terms.[37] Ultimately, the court determined that the transaction was a true sale.[38] As such, R&J Pizza retained no rights to the purchased receivables so the accounts were not part of the bankruptcy estate.[39]

The court in *In re Shoot the Moon, LLC*[40] cited the eight factor test, noting that a main consideration which connects all of the factors is the allocation of risk between the parties; however, the opinion only discussed three of the findings in detail, all of which supported the court's conclusion that the transaction was a loan.[41] The court explained, "A sale typically occurs when the risk of loss from the purchased assets passes to the buyer – a gamble usually reflected in the purchase price"; however, with "a disguised loan, the parties may employ various methods to allocate risk – the putative seller typically remains exposed to the underlying receivables and may grant the putative buyer recourse to sources of recovery beyond the receivables."[42] Further, the court noted that it would "look to the overall transactional substance rather than attempt to formulate a material discrepancy between New York and Montana law on the matter."[43] In applying the factors, the court determined: (1) the securities interests were much broader than those typically associated with a sale, but "akin to those associated with a loan"[44]; (2) the contract provided CapCall with significant recourse rights and an "overbroad collateral package"[45]; and (3)

---

[36] *Id*. at *5.
[37] *Id*. at *5-6.
[38] *Id*. at *6.
[39] *Id*.
[40] 635 B.R. 797 (Bankr. D. Mont. 2021).
[41] *Id*. at 813.
[42] *Id*. at 814.
[43] *Id*.
[44] *Id*.
[45] *Id*. at 816; *See id.* at 817 (The terms of the contract "[a]s a whole, … provide CapCall with at least conditional recourse and expanded legal rights against the Shoot the Moon entities and the personal guarantors." Additionally, the terms of the contract "allocate[s] great risk to the Shoot the Moon counterparty while protecting CapCall with much more than just the receivables. CapCall's panoply of rights, remedies, and potential control is highly unusual

"the parties' course of performance … reflects a debtor-creditor relationship."[46] Ultimately, the court concluded that "that the parties' actions show that they intended to transact via loans" because the "evidence reveal[ed] a course of dealing deeply inconsistent with true sales of receivables."[47] The opinion acknowledged that there was language in the agreement which stated that the transaction was not a loan; however, the court noted that "this *ipse dixit* is hardly convincing; '[s]imply calling transactions "sales" does not make them so' because '[l]abels cannot change the true nature of the underlying transactions.'"[48]

B. New York Three-Factor Approach

Under the current New York approach, courts characterize MCA transactions as either a loan or true sale by examining three-factors: (1) whether the agreement has a reconciliation provision; (2) "whether the agreement has an indefinite term"; and (3) whether a buyer has any recourse against the seller if the seller declares bankruptcy.[49] Although many MCA agreements are governed by New York law, courts across the country using the three-factor test still reach differing conclusions on whether an MCA transaction should be characterized as a loan or true sale.

In *Womack v. Capital Stack, LLC,* the court noted that "[a]n MCA transaction is not a loan where the agreement provided that the buyer purchased a fixed amount of the seller's future sales proceeds which were deliverable to the buyer from a percentage of the seller's daily sales

---

in the context of an asset sale. Such an overall arrangement is consistent with a debtor-creditor relationship, not a seller-buyer relationship.")

[46] *Id*. at 817.

[47] *Id*. at 819.

[48] *Id*. (quoting Fireman's Fund Ins. v. Grover (*In re* Woodson Co.), 813 F.2d 266, 272 (9th Cir. 1987)).

[49] *In re* GMI Group, Inc., 606 B.R. 467, 484-85 (Bankr. N.D. Ga. 2019); *see also* Womack v. Capital Stack, LLC, 2019 WL 4142740, at *5 (S.D.N.Y. 2019) ("New York State Courts encourage courts to consider three factors to determine if an agreement is a loan or a merchant agreement: (1) whether there is a reconciliation provision; (2) whether the agreement has an indefinite term; and (3) whether the plaintiff has any recourse should the merchant declare bankruptcy.")

proceeds."[50] Further, "MCA transactions cannot be considered loans where the MCA funders' purchase price was placed at hazard and they had no absolute right of repayment if the businesses failed."[51] After applying the three-factor test, the court determined that the transaction was a sale because the agreement: (1) had a reconciliation provision; (2) provided the MCA lender with a fixed percentage of the business's receivables until the purchased amount was fully repaid regardless of how long repayment would take; and (3) expressly stated that the MCA lender had no recourse against the seller if the seller declared bankruptcy, thus the MCA lender bore the risk of loss since the seller did not have an unconditional repayment requirement.[52]

The court in *In re GMI Group* applied the same three-factor test but found that the MCA agreement was a loan under New York law because while the factors were present, "…those factors—though helpful in the analysis—are not determinative."[53] Instead, a court "must examine the actual substance rather than the form of the Agreement to determine its true nature."[54] Furthermore, "[t]he ultimate touchstone of whether a transaction constitutes a loan is if it provides for guaranteed repayment." The court ultimately determined that the transaction in question was a loan.[55] While the agreement stated that the buyer would have no recourse against the seller if they filed for bankruptcy, the seller was required to have double the daily repayment amount in their account at all times.[56] If the seller failed to maintain the required threshold, the seller would be in breach of the agreement, and the debt would be accelerated.[57] The court noted that by requiring the seller to always have double the daily repayment amount in their account, the seller "was sure

[50] 2019 WL 4142740, at *5 (S.D.N.Y. 2019).
[51] *Id*.
[52] *Id*. at *5-6.
[53] *In re* GMI Group, Inc., 606 B.R. 467, 485 (Bankr. N.D. Ga. 2019).
[54] *Id.*
[55] *Id.* at 486.
[56] *Id.*
[57] *Id.*

to default from the outset"; therefore, the buyer bore "no actual or appreciable risk that it … [would] not receive repayment in full."[58]

III. Other Issues to Consider

A. New York is the Primary Choice of Law for MCA agreements

Most MCA agreements are governed by New York law, and New York law "is predisposed against finding usury, particularly in commercial contracts."[59] As such, New York has a "growing body" of case law characterizing MCA agreements true sales.[60] This expanding body of case law was noted by the court in *Womack*, which supported its decision that the MCA agreement in question was a sale by including a string cite to twenty-eight recent New York state and federal court decisions applying New York law and determining "that similar MCA transactions were not loans subject to New York's usury laws" because the transactions were sales.[61] In addition to applying the three-factor test, the *Womack* court also noted that under current New York law, an MCA agreement is a sale, not a loan where the MCA lender "1) purchases a fixed amount of the seller's future sales proceeds; 2) the proceeds are deliverable from a percentage of the seller's daily sales proceeds; and, 3) the agreement provides no liability if the seller ceases operations in the ordinary course of business."[62]

Additionally, under New York law, a borrower / seller can be required to sign an affidavit that serves as a confession of judgment. Although confession of judgment provisions are not

[58] *Id.* at 487 (The court noted that "[u]pon default, the Daily Amount will equal 100 percent of all of the Debtor's Future Receipts and the full, uncollected Purchased Amount will be immediately due and payable in full." Additionally, there were protection in the MCA agreement which were "designed to protect Defendant's interests in collecting the full Purchased Amount, such as the UCC-1 financing statement and related security interest, the Confessed Judgment, and the Guaranty, will be triggered." Furthermore, "if default by the Debtor is a certainty or near certainty, the provisions professing contingent repayment and protections for the Debtor if it files for bankruptcy or ceases/slows operations have no practical effect.")
[59] Bruce, *supra* note 6.
[60] *Id*. (citing Womack v. Capital Stack, LLC, 2019 WL 4142740 (S.D.N.Y. 2019)).
[61] Womack v. Capital Stack, LLC, 2019 WL 4142740, at * 7 (S.D.N.Y. 2019); *see* Bruce, *supra* note 6.
[62] Womack v. Capital Stack, LLC, 2019 WL 4142740, at * 7 (S.D.N.Y. 2019).

allowed in consumer credit transactions and are barred entirely in some jurisdictions,[63] any judgments entered pursuant to a confession of judgment may be enforceable in jurisdictions which bar them if New York law governs the contract.[64]

B. Additional Issues Which Lean Towards Characterizing MCAs As Loans

Additional issues that courts should consider when determining whether to characterize an MCA agreement as a loan or a sale include: (1) whether the reconciliation provisions provide the buyer with too much discretion to adjust payment requirements[65]; (2) whether the buyer's repayment is tied to all of the seller's receivables rather than an identified set of receivables[66]; (3) whether the agreement provides for remedies which are more similar to those seen in loans, rather than sales[67]; and (4) whether the substance of the agreement is more similar to a loan despite the agreement's language stating that the transaction is a sale, specifically whether the buyer or seller has the benefits of ownership.[68]

i. Reconciliation Provisions Negating Buyer's Risk

Typically, MCA agreements have a reconciliation provision which provides how, and which parties can adjust the seller's daily payment requirements.[69] These reconciliation provisions

[63] Bruce, *supra* note 6; *See* IND. CODE § 34–54–4–1(3) (West 2022) (making it a Class B Misdemeanor to attempt "to recover upon or enforce within Indiana a judgment obtained in any other jurisdiction based upon a cognovit note").
[64] *See* EBF Partners, LLC v. Novabella, Inc., 96 N.E.3d 87, 88-89 (Ind. Ct. App. 2018) ("Although cognovit notes are prohibited in Indiana, the Full Faith and Credit Clause of our Federal Constitution requires reversal of the trial court's judgment" which dismissed EBF's petition to domesticate a New York court's judgment that had been "entered pursuant to a confession of judgment in a cognovit note, against Novabella Inc." Since New York court's judgment "appears on its face to be rendered by a court of competent jurisdiction and Novabella did not challenge the jurisdiction of the New York court to enter the judgment, the trial court was required to afford full faith and credit to the New York judgment."); *see id.* at 92 (quoting Cox v. First Nat. Bank of Woodlawn, 426 N.E.2d 426, 430 (Ind. Ct. App. 1981) ("However, 'in spite of Indiana's aversion to cognovit provisions, a valid foreign judgment based on a cognovit note will be given full faith and credit in Indiana.'")); *but see* IND. CODE § 34–54–3–4 (West 2022) (providing that certain foreign judgments are unenforceable in Indiana, including judgments rendered by a court in another state which are based upon a contract containing a prohibited provision under Indiana law).
[65] Bruce, *supra* note 6.
[66] *Id.*
[67] *Id.*
[68] *Id.*
[69] *Id.*

determine the MCA lender's overall risk in the transaction.[70] In *LG Funding, LLC v. United Senior Properties of Olathe, LLC*, the court affirmed a denial of summary judgment on the grounds that there were "triable issues of fact" as to whether the agreement was a criminally usurious loan because the agreement provided that the MCA lender could just adjust payment amounts "at its *sole discretion* and as it deems appropriate" so the lender did "did not assume the risk that [the seller] … would have less-than-expected or no revenues."[71]

ii. Loan-Like Repayment Structure

When evaluating an MCA agreement, the courts should note whether the repayment structure of MCA agreement is more similar to that of a loan or a sale, and how this impacts the risk borne by each party.[72] Specifically, courts should consider how the repayment structure of many MCA agreements is more similar to that of a secured loan because it "places the risk of loss as to any individual account on the seller."[73] In contrast, "[w]hen a buyer buys an identifiable pool of specific receivables, as in a traditional factoring arrangement, the buyer typically bears the loss when any one of those accounts is not repaid."[74]

iii. Overly-Broad Remedies

Another consideration which leans towards characterizing an MCA transaction as a loan are the loan-like remedies given to the lenders in many MCA agreements.[75] "[M]any MCA agreements are supported by broad collateral packages extending far beyond the receivables

---

[70] McNider Marine, LLC v. Yellowstone Capital, LLC, 2019 WL 6257463, *4 (N.Y. Sup 2019), *appeal dismissed*, 199 A.D.3d 1301, 154 N.Y.S.3d 508 (4th Dep't 2021); *see* Bruce, *supra* note 6.
[71] LG Funding, LLC v. United Senior Properties of Olathe, LLC, 181 A.D.3d 664, 666, 122 N.Y.S.3d 309, 312-313 (2d Dep't 2020); *see* Bruce, *supra* note 6.
[72] Bruce, *supra* note 6.
[73] *Id*. (citing John F. Hilson & Stephen L. Sepinuck, *A "Sale" of Future Receivables: Disguising A Secured Loan as a Purchase of Hope*, 9 TRANSACTIONAL LAW. 14, 15-16 (2019)).
[74] *Id*.
[75] *Id*.

subject to the transaction."[76] Additionally, the acceleration provisions in most MCA agreements, which give the MCA lender the right to accelerate the repayment upon certain conditions occurring, are more similar to those seen in secured loans.[77]

iv. Ownership Benefits

Finally, courts should consider the actual substance of the MCA agreement rather than merely accepting the language stating that the transaction is a sale.[78] The court in *In re Shoot the Moon, LLC* acknowledged that there was language in the agreement which stated that the transaction was not a loan; however, the court noted that "this *ipse dixit* is hardly convincing; '[s]imply calling transactions "sales" does not make them so' because '[l]abels cannot change the true nature of the underlying transactions.'"[79] Specifically, courts should examine who enjoys the benefits and burdens of ownership.[80] With an MCA agreement, the lender is only purchasing a percentage of the receivables, but control and ownership of the balance remains with the debtor.[81] As such, while the debtor business cannot do something to the purchased account which would violate the terms of the MCA agreement, they can do anything which would not constitute a breach.[82] Additionally, "the merchant also [must] continue[] to service the underlying accounts, … a burden … typically associate[d] with ownership."[83]

IV. Conclusion and Implications

As it becomes more difficult for small businesses to receive funding from traditional

[76] *Id*. (citing *In re* Shoot The Moon, LLC, 635 B.R. 797, 814-15 (Bankr. D. Mont. 2021)).
[77] *Id*. (citing Anderson v. Koch, 2019 WL 1233700, at *4 (Minn. Ct. App. 2019)).
[78] *Id*.
[79] *In re* Shoot The Moon, LLC, 635 B.R. 797, 819 (Bankr. D. Mont. 2021) (quoting Fireman's Fund Ins. v. Grover (*In re* Woodson Co.), 813 F.2d 266, 272 (9th Cir. 1987)).
[80] Bruce, *supra* note 6.
[81] *Id*.
[82] *Id*.
[83] *Id*.

sources, funding through MCA lenders will continue to grow and as a result, more courts will be asked to determine whether these MCA transactions should be properly characterized as loans or true sales. Since MCA agreements have aspects of both loans and sales, a court needs to look beyond the language calling the transaction a sale and instead look at the actual substance of the agreement, including the loan-like remedies and repayment structure which greatly minimize the MCA lender's risk of not being repaid. All of these considerations point towards MCA agreements being characterized as loans rather than sales.

V. Discussion Points/Questions

A. While the majority of New York courts have determined that MCA agreements are true sales and not loans, what considerations should other jurisdictions applying New York law consider as part of their analysis?

B. Should the Federal Trade Commission and Congress create additional regulations applicable to these transactions?

C. If the MCA agreement is accompanied by a confession of judgment, could the entire agreement be unenforceable in Indiana because it is a cognovit note (as long as there was no judgment from a foreign court related to the cognovit note)?

Is An Arbitration Clause Enforced
If It's Part of an Executory Contract That's Rejected?
(*In re Highland Capital Management*, LP)

Robyn L. Moberly, Judge
United States Bankruptcy Court
For the Southern District of Indiana
Pat Marshall, Law Clerk

I. Background

Contracts and agreements typically contain provisions where the parties agree to submit their disputes arising from the contract to arbitration. While judicial reluctance in the past resulted in these arbitration clauses seldom being enforced in bankruptcy, the recent trend has been in favor of enforcement of such clauses. This article explores how the decision in *Highland Capital Management, LP* differs from that trend.

A. The Federal Arbitration Act

The Federal Arbitration Act ("FAA") (9 U.S.C. §1 *et seq.*) was enacted in 1925 in response to widespread judicial hostility to arbitration agreements. *AT & T Mobility LLC v. Concepcion*, 563 U.S. 333, 339, 131 S.Ct. 1740, 1744, 179 L.Ed.2d 742 (2011). Section 2 of the FAA provides:

> A written provision in …a contract…to settle by arbitration a controversy thereafter arising out of such contract…shall be valid, irrevocable and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

Section 4 of the FAA provides in part that

> A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any

> United States district court which, save for such agreement, would have jurisdiction under title 28…for an order directing that such arbitration proceed in the manner provided for in such agreement.

The FAA reflects a liberal federal policy favoring arbitration and recognizes that arbitration is matter of contract to which the parties to the contract agreed. *Id.* The FAA requires arbitration agreements to be placed on equal footing with other contracts and rigorously enforces them according to their terms. *Id.* The trend had developed to not only favor enforcement of arbitration clauses but to also increasingly limit a court's discretion to refuse to enforce arbitration clauses. *In re Weinstock*, No. 96-3114DWS, Adv. No. 99-0056, 1999 WL 342764 at *5 (Bankr. E. D. Penn. May 25, 1999). The mandate to enforce an arbitration clause applies equally to claims based on statutory rights (such as claims under the bankruptcy code). *Shearson/Am Exp., Inc. v. McMahon*, 482 U.S. 220, 226, 107 S.Ct. 2332, 2337, 96 L.Ed.2d 185 (1987). This FAA mandate can be overridden only if (1) the statutory text or the legislative history of the statute shows a contrary congressional command or (2) if there is an inherent conflict between arbitration and the statute's underlying purposes. *Id.*

B. The FAA and the Bankruptcy Code

The Supreme Court has rejected every such effort to "conjure conflicts" between the FAA and other federal statutes and has steadfastly enforced arbitration agreements. *Epic Sys. Corp. v Lewis*, 138 S.Ct. 1612, 1627, 200 L.Ed.2d 889 (2018). (noting that it found no congressional intent to displace the FAA in the Sherman and Clayton Acts, the Discrimination in Employment Act, the Credit

Repair Organizations Act, the Securities Act of 1933, the Securities Exchange Act of 1934, and the Racketeer Influenced and Corrupt Organizations Act.) To date, the Supreme Court has not been asked to consider the enforcement of arbitration agreements in bankruptcy. The appellate courts that have considered arbitration agreements in bankruptcy have not found any indication in either the text or the legislative history that suggests Congress intended for the Bankruptcy Code to override the FAA. *Roth v. Butler University, et al.*, *(In re Roth)* 594 B.R. 672, 676 (Bankr. S. D. Ind. 2018). Thus, the question of whether an arbitration clause is enforceable in a bankruptcy context involves the second *McMahon* prong of whether arbitration would present an inherent conflict with the Bankruptcy Code's underlying purposes. If it does, the Bankruptcy Court has discretion (although is not required) to deny enforcement.

The majority of courts that have exercised discretion and *denied* enforcement of an arbitration clause in a bankruptcy case have done so where a "core" claim is involved, and arbitration would conflict with the purposes of the Bankruptcy Code. For example, bankruptcy courts have exercised discretion and have denied enforcement of arbitration agreements with respect to student loan dischargeability See, *Roth*, 594 B.R. at 677 (arbitration would impede a debtor's "fresh start" and would interfere with a bankruptcy court's essential function of determining the dischargeability of debts) and *In re Golden*, 587 B.R. 414 (Bankr. E.D.N.Y. 2018)(same); violations of the discharge injunction, See, *In re Anderson*, 884 F.3d 382 (2nd Cir. 2018) (arbitration would impede the debtor's fresh start and a bankruptcy court's inherent power to enforce its own orders), *Matter of Henry*, 944 F.3d 587 (5th Cir. 2019)(arbitration would interfere with a bankruptcy goal of centralized resolutions of bankruptcy issues and a bankruptcy court's "undisputed power" to enforce its own orders); and *In re National Gypsum Co.*, 118 F.3d 1056 (5th Cir. 1997)(reiterating that bankruptcy courts have discretion to deny enforcement of arbitration clauses in core cases when the only rights at issue were created by the Bankruptcy Code rather than inherited from a debtor's pre-petition property); and avoidance and recovery of fraudulent transfers under §544(b) See, *In re Gandy,* 299 F.3d 489 (5th Cir. 2002)(avoidance claim represented "very nearly the entirety" of the bankruptcy estate and arbitration would interfere with the "expeditious and equitable distribution" of estate assets). However, arbitration of even a "core" claim is appropriate if it would not conflict with the purposes of the bankruptcy code. See, *In re Williams*, 564 B.R. 770 (Bankr. S.D. Fla. 2017)(student loan dischargeability claim ordered to arbitration where debtor had received a chapter 7 discharge and arbitration would not interfere with distribution of the estate or an ongoing reorganization); *In re Banks*, 549 B.R. 257 (Bankr. D. Or. 2016 (motion to compel arbitration of violation of the stay granted where chapter 13 plan had been confirmed, property of the estate had revested in the debtor, and recovery on the claim would not augment the confirmed plan); *In re Statewide Realty Co.,* 159 B.R. 719 (Bankr. D.N.J. 1993)(arbitration ordered to determine §365(g) rejection damages where such a determination required only application of contract law). [1]

II. The FAA and Executory Contracts

A. Rejection of an Executory Contract

Rejection of an executory contract is not a revocation, repudiation, or cancellation of the contract; rather it constitutes a breach as of the petition date for which the counterparty to the contract may seek damages under §365(g)(1) and §502(g)(1). *In re Highland Capital Management, L.P.,* Case No. 19-34054-sgj11, Adv. No. 21-03003-sgl, 2021 WL 5769320 at *7 (Bankr. N. D. Tex. December 3, 2021); *In re Fleming Companies, Inc.*, 325 B.R. 687, 693 (Bankr. D. Del. 2005). Notably, courts have held that an arbitration clause is not invalidated by rejection and, as such, a party can still be compelled to arbitrate issues related to the pre-petition acts covered by the agreement:

> The argument that a party's unilateral termination of a contract voids the arbitration clause fails for obvious reasons To allow a party to avoid arbitration by simply terminating the contract would render arbitration clauses illusory and meaningless…A party not wishing to arbitrate its alleged breach could simply terminate the contract and avoid any obligation to arbitrate.
>
> [A similar rationale] applies when a debtor rejects a contract. A rejection in bankruptcy does not alter the substantive rights of the parties that formed

[1] The majority of courts have concluded that a bankruptcy court does not have discretion to refuse to compel arbitration of a non-core matter. See*, MBNA AM. Bank NA v. Hill*, 436 F.3d 104, 108 (2nd Cir. 2006); *Hays & Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc*., 885 F.2d 1149, 1156 (3rd Cir. 1989); *Gandy,* 299 F.3d at 495. However, some courts have disregarded the "core/ non-core" distinction and focused on whether the proceeding derives exclusively from the provisions of the Bankruptcy Code and, if so, whether arbitration would conflict with the purposes of the Code. See, *In re Brown*, 354 B.R. 591, 597 (D.R. I. 2006)(affirming denial of motion to compel arbitration of claim to rescind pre petition mortgage under the TILA, holding that the outcome would clearly affect the debtor's chapter 13 plan and the distribution creditors would receive.)

> pre-petition…While a debtor may reject a contract in its "entirety", it may not invalidate freely negotiated methods of dispute resolution [such as arbitration provisions] as they apply to pre-petition acts.

Southeastern Pa. Transp. Auth. v. AWS Remediation, Inc., No. Civ. A. 03-695, 2003 WL 21994811 at *3 (E.D. Pa. August 18, 2003). See also, *Fleming,* 325 B.R. at 693, *In re Monge Oil Corp.*, 83 B.R. 305, 308 (Bankr. E. D. Penn. 1988)("Rejection does not make the contract null and void ab initio; …[t]hus, it may not follow from §365(g)(1) that a rejection of a contract voids a compulsory arbitration clause"); *Societe Nationale Algerienne Pour La Recherche v. Distrigas Corp.,* 80 B.R. 606, 609 (D. Mass. 1987) (arbitration provision remained operative despite debtor's rejection of the underlying contract in bankruptcy); *In re IndyMac Bancorp, Inc.*, Adv. No. 2:09-ap-0 1698-BB, 2012 WL 1037481 at *30 (Bankr. C. D. Cal. March 29, 2012) ("Beyond creating a breach and yielding a claim against the estate, rejection does not substantively affect the contract – it is not terminated, vaporized, or otherwise cancelled").

B. Determination of Rejection Damages Claim

Litigation involving rejection of executory contracts that contain arbitration clauses typically dealt with whether determination of the rejection damages claim against the estate was arbitrable. Once the contract is rejected, the counterparty is left with an unsecured damages claim pursuant to §365(g)(1) and §502(g)(1). Can the counterparty compel arbitration of this rejection damages claim? The allowance of such a claim is a "core" proceeding under 28 U.S.C. §157 (b)(2)(B). Allowing an arbitrator to determine a claim against the estate would take away a primary function of the bankruptcy court and thus would conflict with the purposes of the Code under the *McMahon* test. However, courts have compelled arbitration where determination of the claim required only application of contract or non-bankruptcy law. See, *In re Statewide Realty*, 159 B.R. 719, 724 (parties had been in arbitration pre-petition, bankruptcy court had already determined that rejection was a proper exercise of the debtor's business judgment and assessment of allowable damages merely required the application of contract law); *In re Weinstock*, 1999 WL 342764 at *8 (court granted motion to stay pending arbitration in chapter 7 case where partnership agreement had been rejected, adopting *Statewide Realty's* reasoning). Courts are more apt to deny enforcement of arbitration agreements where there are several rejection claims or the rejection claim is one of the most substantial of the estate which would have considerable impact on the chapter 11 debtor's reorganization. *In re Mirant*, 316 B.R. 234, 244 (Bankr. N. D. Tex. 2004) ("To cede the court's authority to an arbitrator to quantify one of the most substantial claims in this case would frustrate this court's reordering of the debtor-creditor relationship and would hinder its control of the reorganization process").

III. The *Highland Capital* Case

Highland Capital did not involve determination of a rejection damages claim. Rather, the reorganized chapter 11 debtor in *Highland Capital* [2] sued for breach of contract and turnover of tens of millions of dollars owed under certain promissory notes. The defendants were obligors on the notes and were closely related to the

[2] *In re Highland Capital Management, L.P.*, Case No. 19-34054-sgj11, Adv. No. 21-03003-sgl, 2021 WL 5769320 at *7 (Bankr. N. D. Tex. December 3, 2021).

debtor's former president. The defendants alleged that the debtor orally agreed that the underlying notes would be forgiven as compensation to the debtor's former president. Upon this revelation, the reorganized debtor amended its complaint and sued the former president, his sister and the limited partner who allegedly entered into the oral agreement on the pre-petition debtor's behalf (the "Added Defendants") for breach of fiduciary duties.

The debtor's confirmed plan provided for the rejection of the pre-petition debtor's limited partnership agreement which contained a mandatory arbitration clause. The parties agreed that the arbitration clause applied only to the fiduciary duty counts brought against the Added Defendants. The Added Defendants moved to compel arbitration of those counts. The reorganized debtor did not dispute that the fiduciary duty counts involved non-core matters but argued that it was no longer bound by the limited partnership agreement and that the Added Defendants could not compel arbitration of those counts since specific performance was no longer a viable remedy.

Rejection deprives a counterparty of a specific performance remedy that it may have otherwise have under applicable non-bankruptcy law for breach of the contract or lease. *IndyMac Bancorp* at *31 quoting 3 Collier on Bankruptcy ¶365.10[1] (16th ed. rev. 2011). Applying this rule, *Highland Capital* held that an arbitration clause itself is severable and a separate executory contract, capable of rejection in bankruptcy. Since a counterparty would not have the remedy of specific performance against a trustee, the reorganized debtor in *Highland Capital* could not be forced to specifically perform under the arbitration clause – i.e., submit to arbitration. The court noted that "…although arbitration survives the contract as a matter of contract law, executory obligations may be avoided by the trustee" and "if specific performance is not available against a trustee, it follows that an arbitration agreement is like any other executory contract which the trustee may reject". *Highland Capital*, 2021 WL 5769320 at *7. The *Highland* court deferred to the "compelling reasoning" of the district court opinion of *Janvey v.Alguire*, Case No. 3:09-CV-0724-N (Order of July 20, 2014). In that case, the district court referred to *Prima Paint Corp. v. Flood & Concklin Mfg.*,388 U.S. 395, 404 , 87 S.Ct. 1801, 18 L.Ed.2d 1270 (1967) which declared that "it is now firmly established…that an arbitration clause is considered a separable contract between the parties which survives as an obligation of the promisor even if the underlying contract is voidable". See also, *Buckeye Check Cashing Inc. v. Cardegna*, 546 U.S. 440, 445, 126 S.Ct. 1204 (2006) ("as a matter of substantive federal arbitration law, an arbitration provision is severable from the remainder of the contract"). Using this "separable" concept, the *Janvey* court concluded that "arbitration agreements must be analyzed as separate executory contracts, based on the nature of the agreement as well as arbitration caselaw regarding severability" and that an arbitration agreement is a "classic executory contract, since neither side has substantially performed the arbitration agreement at the time enforcement is sought" (quoting Jay Lawrence Westbrook, *The Coming Encounter: International Arbitration and Bankruptcy*, 67 Minn. L. Rev. 595, 623 & n.26). The *Janvey* court concluded that the appropriate remedy could *not* be for the court to require specific performance of the arbitration clause – i.e., to compel arbitration – of the trustee.

It is this rationale in *Janvey* upon which the court in *Highland Capital* relied when it held that "the Arbitration Clause should likewise be considered a separate executory agreement that was rejected. Accordingly, Highland cannot be forced to specifically perform under the Arbitration Clause or the [limited partnership agreement] by mandatorily participating in arbitration of [the fiduciary duty counts]." [3]

Given its finding that the arbitration clause itself had been rejected, the *Highland* court did not engage in an extensive *McMahon* analysis. On one hand, a traditional *McMahon* analysis would have favored arbitration. The *Highland* court acknowledged that the fiduciary duty counts were non-core but did not expound on why – or if—arbitration of them would conflict with the purposes of the bankruptcy code. The opinion mentioned that the defendant noteholders owed "tens of millions" under the notes, but the Added Defendants were not noteholders. The basis of the claims against them were breach of certain fiduciary duties owed to the pre-petition debtor and the opinion is silent as to whether recovery against them would significantly augment the estate. Furthermore, the chapter 11 plan had been

---

[3] The *Highland* court in the alternative held that, even if the arbitration clause should be enforced, the Added Defendants waived their right to compel enforcement of it by waiting seven months after the litigation against them began to raise the arbitration issue. Furthermore, the arbitration clause in the limited partnership agreement allowed only very narrow discovery and the Added Defendants had propounded discovery that significantly exceeded the scope allowed and later negotiated stipulations with Highland regarding Highland's response to the extended discovery which the court approved. *Highland*, at *8. For more discussion of waiver, see Section III B, *infra*, referring to the *Morgan v. Sundance* case.

confirmed and presumably property of the estate had revested in the reorganized debtor. See, §1141(b).

On the other hand, since only the fiduciary counts against the Added Defendants (and not the counts against the noteholders) fell within the coverage of the arbitration clause, ordering arbitration of just those counts of the amended complaint would have run afoul of the bankruptcy code's purpose of avoiding piecemeal litigation and centralizing all disputes in one forum. The *Highland* court did note that "[t]he court…also finds as a matter of law that requiring arbitration in this case would impose undue and unwarranted burdens and expenses on the parties to the detriment of Highland's creditors." *Highland* at *7. This suggests that arbitration would have frustrated the bankruptcy code's function to determine and oversee the amount of distribution to creditors. Regardless, *Highland Capital* is noteworthy in that it views the arbitration clause as a separate executory contract and does not engage in the traditional *McMahon* analysis or acknowledge the FAA's strong mandate in favor of arbitration.

A. Lingering issues

Perhaps *Highland Capital* raises more questions than it answers. Should an arbitration clause be considered a severable contract or an executory provision in an integrated contract? Is a severable arbitration clause deemed rejected when the underlying contract is rejected, or does a debtor have to take additional affirmative steps to specifically reject it? Under what circumstances would a debtor reject the underlying contract but want to enforce the arbitration clause? [4] Is an arbitration clause truly "executory"? [5] If rejection merely constitutes a breach, why does rejection of even an arbitration clause render it unenforceable? If arbitration clauses can be rejected merely by rejecting the underlying contract, doesn't that go against the strong support for arbitration under the FAA? Congress knew how to provide in §365 that rejection under that section takes precedence over the FAA, but it did not do so. Should a debtor who agreed pre-petition to arbitrate contractual disputes be able to escape that obligation by merely unilaterally rejecting the contract in bankruptcy and doesn't that unilateral rejection render the arbitration clause illusory and meaningless? The Supreme Court at some point will surely consider the enforcement of arbitration clauses where the underlying contract has been rejected in bankruptcy and hopefully its analysis will provide clarity to these issues.

[4] In *Fleming*, the chapter 11 debtor pre-petition sold a grocery store and the buyer executed several documents, including a facility standby agreement ("FSA") and promissory notes, in favor of the debtor. After its chapter 11 case was filed, the debtor rejected the FSA and sought to sell substantially all of its assets, including the notes. A dispute as to the assumption and assignment of the notes arose post-sale when the buyer of the grocery store filed a complaint in the bankruptcy court alleging that the notes were unenforceable as a result of fraud. The FSA contained an arbitration clause and the debtor sought to compel arbitration of the claims brought by the buyers. The court determined that the FSA and the promissory notes were "integrated" sufficiently for the arbitration clause to apply to disputes about the notes and notes that rejection of the FSA did not invalidate the arbitration clause. The court granted the debtor's motion to compel arbitration. *Fleming*, 325 B.R. at 691-694.

[5] An arbitration clause in an otherwise non executory contract does not make that contract executory. See, *Hays & Co. v Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 885 F.2d 1149, 1150 (3rd Cir. 1989) (noting bankruptcy court's ruling that arbitration clause alone did not render customer agreement executory); *In re Gencor Indus. Inc.*, 298 B.R. 902, 907-913 (Bankr. M.D.Fla. 2003) (settlement agreement that contained mandatory arbitration clause was not an executory contract).

B. Recent Developments –

A Continued Retreat from Federal Courts' Enforcement of the FAA?

Meanwhile, the Supreme Court has addressed the application of the FAA in other contexts. The Supreme Court had held previously that a federal court needed an independent jurisdictional basis to compel arbitration under Section 4 of the FAA as that section alone did not create subject-matter jurisdiction. *Vaden v. Discover Bank*, 556 U.S. 49, 129 S.Ct. 1262, 173 L.Ed. 2d 206 (2009). The Court reasoned that specific language in Section 4 ("save for such agreement, would have jurisdiction under title 28") instructed a federal court to "look through" the petition to compel arbitration to the underlying substantive dispute and the court could rule on the petition only if the underlying dispute fell within its jurisdiction.

Sections 9 and 10 of the FAA allow a party to petition a federal court to confirm or vacate arbitral awards. Those sections do not contain any of the "save for" language contained in Section 4 upon which *Valen* relied. Thus, *Vaden*'s "look through" approach did not apply to Sections 9 and 10 and a federal court need look only to the application to either confirm or vacate the award and not the underlying substantive dispute between the parties to determine whether it has jurisdiction to decide the application. *Badgerow v. Walters*, 142 S.Ct. 1310, 212 L.Ed.2d 355 (2022). The application to confirm or vacate itself must reflect federal jurisdiction for the district court to decide it without looking at the underlying dispute.

Badgerow was unique in that the underlying dispute involved unlawful termination of employment claims under both state and federal law. When the matter was arbitrated in favor of the employer, the employee sued in state court to vacate the arbitral award. The employer, in turn, removed the state court action to federal court and filed an application with the district court to confirm the award. It was in this context that the Supreme Court determined that it need look only to the application to confirm the award to determine whether the district court had jurisdiction to decide it. There was no diversity of parties and the application itself involved no federal issue, even though the underlying dispute did. It is interesting to note that, had the employer petitioned to compel arbitration under Section 4 of the FAA (in the event the employee sued in state court and did not proceed to arbitration first) a federal district court presumably would have had jurisdiction to hear the petition to compel. But when it comes to either confirming or vacating arbitral awards, the Supreme Court seems content to allow state courts to determine those issues -- even if the underlying dispute involves federal law – unless the application to vacate or confirm itself presents federal issues.

A defendant in a lawsuit may file an application to stay litigation under Section 3 of the FAA when the plaintiff who has agreed to arbitrate files a lawsuit instead. The defendant, however, risks waiving its right to arbitration if it proceeds with litigation and waits too long to apply for the stay. The Eighth Circuit, along with eight other circuits, held that the test to determine whether such waiver occurred required a showing that the defendant's conduct has prejudiced the other side, a rule that it said was derived from the FAA's policy favoring arbitration since “prejudice” may not be so easily shown. That rule was challenged in *Morgan v Sundance, Inc. ,* 142 S.Ct. 1708 (2022).

In *Morgan*, the plaintiff asserted that her employer did not pay overtime to employees who worked more than 40 hours a week, in violation of the Fair Labor Standards Act. The plaintiff had agreed to arbitrate when she was hired but she filed a lawsuit instead. The employer/ defendant moved to dismiss the lawsuit as duplicative of another action brought by other employees of the same company, but that motion was denied. The defendant then answered the plaintiff's complaint and asserted 14 affirmative defenses, none of which mentioned the plaintiff's agreement to submit to arbitration. The defendant even participated in mediation and when that was not successful, it moved to stay the litigation under Section 3 and compel arbitration under Section 4 of the FAA. By that point, the case was eight months down the line.

The plaintiff argued that it had been prejudiced by the defendant's eight-month delay and that the defendant had waived its right to arbitrate. The district court agreed. The 8th Circuit Court of Appeals reversed and found no prejudice in that formal discovery had not yet begun and that the parties had not yet contested any matters going to the merits. However, the dissent pointed out that a showing of prejudice was not required to prove waiver outside the arbitration context.

The Supreme Court reversed the Eight Circuit and determined that “the FAA's policy favoring arbitration does not authorize federal courts to invent special, arbitration “preferring procedural rules.” *Id.* at 1713. It noted that the FAA's policy was to make arbitration agreements as enforceable as other contracts, but not more so and that a court cannot devise "novel rules" to favor arbitration over litigation. *Id*.

Both *Badgerow* and *Morgan* were penned by Justice Kagan. *Morgan* was a unanimous decision and Justice Breyer was the lone dissent in *Badgerow*. Both cases signal a retreat from the FAA's strong policy of favoring arbitration. Whether the Supreme Court continues that retreat in the bankruptcy context remains to be seen.

Sigmund J. Beck Advanced Bankruptcy Roundtable
West Baden Springs Resort
West Baden Springs, Indiana
August 19-20, 2022

Stay Away, You're Not Invited:
Does a Creditors Committee Have Standing to Intervene in an Adversary Proceeding?

Edward M. ("Ted") King
Frost Brown Todd LLC
Louisville, Kentucky

Materials –

A. *Dillworth v. Diaz et al.* (In re Bal Harbour Quarzo, LLC), 638 B.R. 660 (Bankr. S.D.Fl. 2022).

B. *Term Loan Holder Comm. v. Ozer Grp., L.L.C. et al.* (In re Caldor Corp.), 303 F.3d 161 (2d Cir. 2002).

Right to Be Heard Generally. Does a creditors committee have the right to intervene and be heard in an adversary proceeding? This is an open issue in the Seventh Circuit and subject to a circuit split between (a) the First, Second and Third Circuits that hold in the affirmative and (b) the Fifth Circuit, which holds in the negative. In *Dilworth v. Diaz,* Judge Scott Grossman of the United States Bankruptcy Court for the Southern District of Florida recently sided with the Fifth Circuit's minority view, holding that, as a matter of right, a committee did not have standing to intervene in an adversary proceeding.

The first question is whether, under Fed. R. Civ. P. 24(a)(1), a party "is given an unconditional right to intervene by a federal statute." In a chapter 11 case, a committee or other party in interest usually begins its argument for intervention as a matter of right citing section 1109(b) of the Bankruptcy Code, which provides that "[a] party in interest, including the debtor, the trustee, a creditors' committee, an equity security holders' committee, a creditor, an equity security holder, or any indenture trustee, may raise and may appear and be heard on any issue in a case under this chapter." The question then comes down to whether an adversary proceeding is a "case" under chapter 11.

If a court finds that the Bankruptcy Code does not provide intervention as a right to satisfy Fed. R. Civ. P. 24(a)(1), a party seeking to intervene may argue for intervention under Fed. R. Civ. P. 24(a)(2), which affords a party the right to intervene who:

> (2) claims an interest relating to the property or transaction that is the subject of the action, and is so situated that disposing of the action may as a practical matter impair or impede the movant's ability to protect its interest, unless existing parties adequately represent that interest.

There is a four-part test for intervention as a right under Fed. R. Civ. P. 24(a)(1): "the application for intervention must be timely; (2) the applicant must have a sufficient interest in the litigation; (3) the interest must be affected or impaired, as a practical matter, by the disposition of the action; and, (4) the interest must not be adequately represented by a party already in the litigation. *In re All Matters Related to N. Am. Refractories Co.*, 634 B.R. 713, 716 (Bankr. W.D. Pa. 2021).

Finally, a party can argue for "permissive intervention" under Fed. R. Civ. P. 24(b)(1)(B), which provides that "on timely motion a court may permit anyone to intervene who has a claim or defense that shares with the main action a common question of law or fact. It is well-recognized that such permissive intervention is discretionary with the Court." *Id.*[1]

[1] Fed. R. Civ. P. 2018 also provides for permissive intervention, but only under "a case under the Code." *In re Roman Cath. Church of Archdiocese of Santa Fe*, 2021 WL 4943473, at *5 (Bankr. D.N.M. Oct. 22, 2021). A bankruptcy court, therefore, which rules that "a case under this chapter" under Fed. R. Civ. P. 1109 does not include an adversary proceeding would also presumably find that a "case under the Code" under Fed. R. Civ. P. 2018 does not an include an adversary proceeding, and thus would not reach a Fed. R. Civ. P. 2018 analysis.

Dillworth Facts. The facts of *Dillworth* are common and straightforward. A chapter 11 debtor, in a case with a committee, confirmed a chapter 11 plan that transferred all causes of action to a liquidating trustee, but preserved the existence of the committee to represent the interests of the unsecured creditors during the pendency of the liquidating trust.

The liquidating trustee filed an action against several foreign defendants for breach of fiduciary duty, avoidance of fraudulent transfers, and a number of other claims. Two of the three defendants lived in Columbia and the liquidating trustee did not serve them with the complaint for about two years after the adversary was filed. Shortly after the defendants answered, the committee moved to intervene in the adversary proceeding.

The liquidating trustee and the committee were prepared to tender a stipulation under which the trustee had the right to proceed with the adversary proceeding as plaintiff but subject to the committee's consultation rights and right to attend depositions and hearings. The defendants opposed intervention, as did one creditor who was concerned about the administrative expenses of the committee's counsel.

Circuit Split; Majority View. The majority view, taken by the First, Second, Third, Fourth and Tenth Circuits is that the phrase "any issue in a case" "plainly grants a right to raise, appear and be heard on *any issue* regardless whether it arises in a contested matter or an adversary proceeding." *Term Loan Holder Comm. v. Ozer Group, L.L.C. et al.* (In re Caldor Corp.), 303 F.3d 161, 165 (2d Cir. 2002). In *Caldor,* the Second Circuit purported to undertake a "plain language" analysis to conclude that a case includes an adversary proceeding. It found that a case is an "umbrella litigation often covering numerous actions that are related only by the debtor's status as a litigant." *Caldor,* 161 F.R. at 168 (internal quotation marks and citations omitted).

Minority View. In *Dillworth*, however, Judge Grossman disagreed with the majority view, and adopted the Fifth Circuit's position in *Fuel Oil Supply and Terminaling v. Gulf Oil Corp.*, 762 F.2d 1283 (5th Cir. 1985). In *Fuel Oil*, the Fifth Circuit observed that while the majority view has some facial appeal, Rule 24 "has been narrowly construed" and noted that "courts have been hesitant to find unconditional statutory rights of intervention." *Fuel Oil*, 762 F.2d at 1286. The Fifth Circuit noted the distinctions drawn under title 28 between cases and adversary proceedings and quoted the advisory committee note to Bankruptcy Rule 7024, which provides that "intervention in a case and intervention in an adversary proceeding must be brought separately." The Fifth Circuit held that "[b]ecause of the limited scope of Rule 24(a)(1) and the distinctions Congress has drawn between bankruptcy 'cases' and 'proceedings'… Congress did not grant an absolute statutory right to intervene in bankruptcy adversary proceedings through § 1109(b)." *Id.* at 1287.

Putting a finer point on the Fifth Circuit's statutory analysis, Judge Grossman noted that plain text of the Bankruptcy Code actually supports the minority view. He pointed to section 307 of the Bankruptcy Code, which allows the United States Trustee to "appear and be heard on any issue in any case ***or proceeding*** under this title" which "clearly shows that Congress knows how to distinguish between a case and a proceeding." *Dillworth,* 638 B.R. at 666. If Congress wanted to give a committee the right to appear and be heard in an adversary proceeding, it knew how to do so as it did for the U.S. Trustee under section 307. But in section 1109, "the right to raise and appear and be heard on any issue" is "limited only to a chapter 11 case, and does not include related adversary proceedings." *Id.*

No Intervention of Right Relating to Property or Transaction. In addition to being able to intervene as a matter of right pursuant to a federal statute, a party in interest may intervene in an adversary proceeding if it satisfies the requirements of Fed. R. Civ. P. 24(a)(2). Judge Grossman held that the committee failed to establish a right to intervene based on Rule 24(a)(2). He found that the committee did not have a legally cognizable interest in the claims raised in the action. He noted that all right, title and interest in avoidance actions vested in the liquidating trustee. He also observed that while the committee represented the interests of unsecured creditors who were the beneficiaries of the avoidance action recoveries, only the liquidating trustee had the right to bring the avoidance action. *Id.* at 667. Further, Judge Grossman noted that the committee did not satisfy additional requirements imposed by the Tenth Circuit including (a) timeliness (the committee waited two years to move to intervene), (b) prejudice to the parties (the plaintiff and defendants had already agreed to a scheduling order), and (c) prejudice to the would-be intervenor (the liquidating trustee already represented the interests of the unsecured creditors, so the committee faced no prejudice by not be allowed to intervene). *Id.* at 668-69.

No Permissive Intervention Under Fed. R. Civ. P. 24(b)(2)

Finally, Judge Grossman ruled that he would not grant the committee permissive intervention under Rule 24(b)(2), because "the committee – which was created by the plan and liquidating trust agreement – has no claim or defense in its own right that it shares with the adversary proceeding as a common question of law or fact." *Id*. at 669.

Discussion Questions:

1. Do you favor the majority view from *Caldor* or the minority view adopted by Judge Grossman in *Dillworth?*

2. Are there policy justifications for limiting the intervention rights to contested matters? It would be easy to imagine a contested matter where a committee's involvement would also be wholly duplicative and administratively costly while its interests were adequately

represented by the liquidating trustee. Or, to imagine a different adversary proceeding where a committee would have clearly added value and so been granted permissive intervention because its interests were not protected by the liquidating trustee. So, from a policy standpoint, should a committee have to justify (or not have to justify) its involvement the same either way?

3. In a case where a chapter 11 plan is confirmed, what might be a strategy for a committee wanting to be heard in a post-confirmation adversary proceeding?

0000000.0001543 4866-9036-8804v2

AAR Rules). So, for example, assuming that "[t]he long-standing and universal practice within the rail industry is to return empty cars to their owner without attempting to impose any freight charge" (which is the SLC's main extrinsic evidence contention), that does not mean that AAR Car Service Rule 2 itself prohibits the imposition of tariffs or other charges. For example, such tariffs or other charges for the transportation of empty cars may be invalid or unreasonable by reason of rate setting statutes such as 49 U.S.C. §§ 10701, 10702 and 10704. Possibly, as the SLC also suggested in the Opposition and at oral argument, a tariff or other charge cannot be imposed for the movement of empty cars unless the owner has "request[ed]" return of the empty cars under 49 U.S.C. §§ 11101(a) and (b).[9] Or, maybe there is some other reason for the alleged industry course of dealing (like an informal "protocol"). The Court simply does not know. But, just because "a long-standing and universal practice within the rail industry" not to charge for the movement of empty cars exists, that does not mean AAR Car Service Rule 2 is ambiguous.

Accordingly, as a matter of Colorado contract law, the Court rejects the SLC's invitation for the Court to determine that AAR Car Service Rule 2 is ambiguous.

VII. Conclusion.

In an effort to narrow the issues for trial, the Trustee has requested partial summary judgment on a very narrow question: Does AAR Car Service Rule 2 preclude the Trustee from imposing a tariff or charge for the return of empty SLC-owned freight cars? The Trustee has met his summary judgment burden. For the reasons set forth above, the Court concurs with the Trustee that AAR Car Service Rule 2 does not preclude the Trustee from imposing a tariff or charge for the return of empty SLC-owned freight cars. Thus, the Court grants the Summary Judgment Motion and enters partial summary judgment on that discrete issue regarding AAR Car Service Rule 2.

IN RE: DEFOOR CENTRE, LLC, Debtor.

Case No. 8:20-bk-04273-MGW

United States Bankruptcy Court,
M.D. Florida,
Tampa Division.

Signed December 07, 2021

Background: Chapter 11 debtor sought post-confirmation Rule 2004 discovery from creditor. Creditor objected.

Holdings: The Bankruptcy Court, Michael G. Williamson, J., held that:

(1) Bankruptcy Court had jurisdiction to rule on request for post-confirmation Rule 2004 discovery, and

(2) debtor was not entitled to post-confirmation Rule 2004 discovery to investigate potential claims that debtor already identified in its schedules and articulated facts giving rise to.

Request for Rule 2004 discovery denied.

9. 49 U.S.C. §§ 11101 states: "(a) A rail carrier providing transportation or service subject to the jurisdiction of the Board . . . shall provide the transportation or service on reasonable request . . . . (b) A rail carrier shall also provide to any person, on request, the carrier's rates and other service terms." In one of its many alternative arguments, the SLC suggests that the Trustee cannot impose the Tariff because it is not really a "tariff" at all and since charges can only be assessed "on request." Opp'n at 10-11.

1. Bankruptcy ⚷3047(1), 3570

When considering whether to allow postconfirmation Rule 2004 discovery, bankruptcy courts should take into consideration their limited "related to" postconfirmation jurisdiction; if matter being investigated under Rule 2004 is one that lies outside bankruptcy court's jurisdiction, then no cause exists for Rule 2004 discovery. 28 U.S.C.A. §§ 157, 1334; Fed. R. Bankr. P. 2004.

2. Bankruptcy ⚷3040.1

Rule 2004 examination is meant to provide debtor with the preliminary information needed to file a complaint. Fed. R. Bankr. P. 2004.

3. Bankruptcy ⚷3570

Bankruptcy courts have jurisdiction over Rule 2004 motions post-confirmation because Rule 2004 discovery "arises in" case under title 11. 28 U.S.C.A. §§ 157, 1334; Fed. R. Bankr. P. 2004.

4. Bankruptcy ⚷3570

"Arising-in" jurisdiction, unlike "related-to" jurisdiction, is not restricted post-confirmation. 28 U.S.C.A. §§ 157, 1334.

5. Bankruptcy ⚷3047(1), 3570

Mere fact that post-confirmation Rule 2004 discovery may reveal claims that lie outside bankruptcy court's jurisdiction does not, by itself, preclude Rule 2004 discovery. 28 U.S.C.A. §§ 157, 1334; Fed. R. Bankr. P. 2004.

6. Bankruptcy ⚷3047(1)

Post-confirmation Rule 2004 discovery should not be permitted when it is being used to gain advantage in private litigation. Fed. R. Bankr. P. 2004.

7. Bankruptcy ⚷3570

Bankruptcy Court had jurisdiction to rule on Chapter 11 debtor's request for post-confirmation Rule 2004 discovery from creditor; plan specifically referenced the potential causes of action against creditor. 28 U.S.C.A. §§ 157, 1334; Fed. R. Bankr. P. 2004.

8. Bankruptcy ⚷3040.1

For bankruptcy court to grant Rule 2004 discovery, it must make finding of "good cause." Fed. R. Bankr. P. 2004.

9. Bankruptcy ⚷3041

As party seeking discovery under Rule 2004, debtor bears burden of proving that "good cause" exists for discovery it seeks. Fed. R. Bankr. P. 2004.

10. Bankruptcy ⚷3041

Debtor can prove "good cause" for Rule 2004 discovery by showing that either discovery is needed to establish claim or that denial of discovery would cause undue hardship or injustice. Fed. R. Bankr. P. 2004.

11. Bankruptcy ⚷3047(1)

Chapter 11 debtor was not entitled to post-confirmation Rule 2004 discovery from creditor to investigate potential claims, which debtor had already identified in its schedules and articulated the facts giving rise to those potential claims in its case management summary, and debtor had included the potential causes of action in its plan; debtor had the preliminary information needed to file an adversary complaint against creditor and therefore Rule 2004 discovery appeared to be an attempt by debtor to gain a strategic advantage in private litigation, and because debtor would have ample opportunity to conduct discovery once it filed an adversary complaint, it would not suffer a hardship or be prejudiced by denial of Rule 2004 discovery. Fed. R. Bankr. P. 2004.

12. Bankruptcy ⚷3040.1

Under "pending proceeding" rule, once adversary proceeding or contested matter is commenced, discovery should be pursued under the Federal Rules of Civil Procedure, as incorporated in Bankruptcy Rules, and not Rule 2004. Fed. R. Civ. P. 1 et seq.; Fed. R. Bankr. P. 2004.

Mark F. Robens, Esq., Stichter, Riedel, Blain & Postler, P.A., Tampa, Counsel for Newtek Business Lending, LLC.

David S. Jennis, Esq., Mary A. Joyner, Esq., Brandon, Counsel for Debtor.

MEMORANDUM OPINION ON POST-CONFIRMATION RULE 2004 DISCOVERY

Michael G. Williamson, United States Bankruptcy Judge

After confirming its chapter 11 plan, the Debtor sought Rule 2004 discovery from Newtek Business Lending. The Debtor wanted to use the Rule 2004 discovery to investigate potential causes of action against Newtek that would fund a distribution to the Debtor's equity holders. The potential causes of action were listed in the Debtor's schedules; described in some detail in the Debtor's case management summary; and provided for in the Debtor's confirmed plan. Newtek objected to the Rule 2004 discovery because, in its view, the causes of action the Debtor sought to investigate were outside this Court's limited post-confirmation "related-to" jurisdiction.

[1] When considering whether to allow post-confirmation Rule 2004 discovery, bankruptcy courts should take into consideration their limited "related-to" post-confirmation jurisdiction: if the matter being investigated under Rule 2004 is one that lies outside the bankruptcy court's jurisdiction, then no cause exists for the Rule 2004 discovery. But here, the Court cannot tell whether the Debtor's potential causes of action lie outside this Court's jurisdiction because those causes of action haven't been filed yet.

[2] Even so, the Court will deny the Debtor's request for Rule 2004 discovery. A Rule 2004 examination is meant to provide the Debtor with the preliminary information needed to file a complaint. Here, the Debtor already has that information. To allow the Debtor to use Rule 2004 when it already has the preliminary information needed to file its potential causes of action would give the Debtor an undue strategic advantage in what amounts to private litigation.

I. Background.[1]

The Debtor used to own an event center in Atlanta, Georgia, known as the Defoor Center.[2] Prepetition, the Debtor contracted to sell the Defoor Center to GB Square, LLC.[3] According to the Debtor, Newtek Business Lending, an approved SBA lender, agreed to fund the purchase.[4]

As the Debtor tells the story, Newtek agreed to close the loan by April 15, 2020. Then, as the Debtor and GB Square

1. The background for this Memorandum Opinion largely comes from the Debtor's motion to compel Rule 2004 discovery (Doc. No. 120), case management summary (Doc. No. 8), and Subchapter V plan (Doc. No. 54), as well as argument by Debtor's counsel at the August 17, 2021 hearing on the Debtor's motion to compel Rule 2004 discovery. The Court assumes Newtek disputes the Debtor's allegations of wrongdoing. In setting forth the background of this dispute, the Court is not making any findings regarding Newtek's alleged wrongdoing.

2. Doc. No. 8, ¶¶ 2 & 7.

3. *Id.* at ¶ 10.

4. *Id.* at ¶ 12.

neared the closing date, Newtek asked to extend the closing to May 7, 2020.[5] But, on May 6, 2020, Newtek's president apparently advised the Debtor and GB Square that, even though the loan had been fully approved by Newtek and the SBA, Newtek was pausing all lending until further notice.[6]

In the meantime, the Debtor's mortgage lender had sued to foreclose its mortgage on the Defoor Center.[7] The Debtor had managed to (literally and figuratively) buy more time from its lender so that it could close the sale with GB Square.[8] But the lender ultimately gave the Debtor a drop-dead date of May 21, 2020—just two weeks after Newtek advised GB Square it was pausing all lending until further notice.[9] With no funding from Newtek in place to close the sale, the Debtor filed for chapter 11 bankruptcy.[10]

The same day it filed this case, the Debtor filed a motion seeking approval of the sale of the Defoor Center to GB Square.[11] In its sale motion, the Debtor indicated that GB Square had been in constant contact with Newtek and that Newtek had assured GB Square that financing for the sale would be forthcoming.[12] Although the Court approved the sale motion, Newtek did not provide the funding. Instead, to close the sale, GB Square had to obtain alternate financing,[13] which was more expensive than GB Square anticipated.

Both the Debtor and GB Square believe they have causes of action against Newtek based on Newtek's alleged failure to fund the loan. GB Square assigned whatever causes of action it may have against Newtek, if any, to the Debtor. Under the Debtor's Subchapter V plan, the proceeds from any litigation against Newtek would be used to fund the distribution to Class 4 equity claims.[14] The Debtor's plan specifically provided that the Court retained jurisdiction over any potential claims against Newtek.[15]

After the Debtor confirmed its plan, it served a Rule 2004 subpoena on Newtek.[16] Rule 2004, of course, permits a debtor-in-possession to examine non-debtors regarding (among other things) the debtor's property, financial condition, and matters affecting the administration of the debtor's estate. The Rule 2004 subpoena demanded that Newtek produce fourteen categories of documents, including all communications with the Debtor, GB Square, and the SBA; all documents relating to any transactions with GB Square; all wire transfers, canceled checks, or other documents relating to any loans to GB Square; all internal documents on how Newtek advises customers about Paycheck

5. *Id.* at ¶¶ 13 & 14.

6. *Id.* at ¶¶ 15 – 17.

7. *Id.* at ¶ 23.

8. *Id.* at ¶¶ 23 & 24.

9. *Id.* ¶¶ 16, 23 & 24.

10. *Id.* at ¶ 24.

11. Doc. No. 3.

12. *Id.* at ¶ 3.

13. Doc. No. 40-1.

14. Doc. No. 54, Art. 6. Other creditors were to be paid from the proceeds from the sale of the Defoor Center. *Id.*

15. Doc. No. 54, § 13.2.3. The plan reserves jurisdiction to determine all "Causes of Action." *Id.* "Causes of Action" is expressly defined to include any claims against Newtek. *Id.* at § 1.2.15 ("The Causes of Action include but are not limited to those against Newtek Business Lending and/or the U.S. Small Business Administration.").

16. Doc. No. 119.

Protection Program (PPP) loans; and all internal documents on how Newtek processes, approves, and funds PPP loans.[17]

When Newtek failed to produce documents responsive to the subpoena, the Debtor moved to compel production.[18] Newtek has objected. Newtek primarily argues that this Court's "related-to" jurisdiction is limited post-confirmation to matters having a "close nexus" to—i.e., matters relating to the interpretation, consummation, execution, or administration of—the Debtor's Subchapter V plan or this bankruptcy case.[19] Because, in Newtek's view, the Debtor has failed to demonstrate how the claims it seeks to investigate have a close nexus to the Debtor's plan or this bankruptcy case, Newtek says the Court should not compel Rule 2004 discovery.[20]

II. Conclusions of Law.

More than thirty years ago, in *In re Cinderella Clothing Industries, Inc.*, the court considered its authority to order a Rule 2004 examination post-confirmation.[21] There, a group of creditors compromised their administrative claims so the debtor could confirm a plan.[22] The plan provided for the sale of the debtor's assets to an entity called Since 1914, Inc., which was wholly owned by Jolene, Inc.[23] After confirmation, the creditors discovered that Jolene, Inc. allegedly transferred its interest in Since 1914, Inc. to a group of individuals headed by the debtor's president.[24] Because the creditors would not have compromised their administrative claims (or voted for confirmation) had they known the debtor's assets were being sold to a group headed by the debtor's president, they sought to examine various individuals under Rule 2004 in an effort to have the case dismissed or converted (or to have the plan modified).[25]

In deciding whether it had the power to order the Rule 2004 examinations, the court explained that the decision to allow a Rule 2004 examination after confirmation must be considered in the context of a bankruptcy court's limited post-confirmation jurisdiction.[26] Thus, while the broad language of Rule 2004 plainly permits use of Rule 2004 post-confirmation, the court reasoned that a Rule 2004 examination "must be limited to issues which the court, at that time, still has the power to entertain."[27]

Those issues, in the court's view, were "restricted to the administration of the case post-confirmation."[28] The critical issue, then, was whether the proposed Rule 2004 examinations would produce "any information germane to the administration of the case," such as a motion to dismiss or

17. *Id.*

18. Doc. No. 120.

19. Doc. No. 131, ¶ 8 (citing *Jeffrey L. Miller Invs., Inc. v. Premier Realty Advisors, LLC (In re Jeffrey L. Miller Invs., Inc.),* 624 B.R. 913 (Bankr. M.D. Fla. 2021)).

20. *Id.* at ¶¶ 8 – 13.

21. 93 B.R. 373, 376 – 78 (Bankr. E.D. Pa. 1988) ("The first issue concerns the power of a bankruptcy court to order Rule 2004 examinations of the debtor's principals and non-debtor parties post-confirmation.")

22. *Id.* at 374 – 75.

23. *Id.* at 374 – 75.

24. *Id.*

25. *Id.* at 378.

26. *Id.* at 377.

27. *Id.*

28. *Id.*

convert the case, a motion to modify the plan, or a motion seeking to revoke the confirmation order.[29] The court concluded that, by and large, they would not.

While the facts the creditors sought to discover—i.e., that the debtor failed to adequately disclose the nature of the asset purchase agreement before confirmation—could have been grounds for revoking the confirmation order, the creditors missed the 180-deadline for seeking revocation.[30] What's more, the creditors could not use the Rule 2004 discovery to seek modification of the plan because they lacked standing to do so.[31]

The creditors did, however, have the right to compel compliance with the plan (or have the case dismissed or converted) based on Since 1914, Inc.'s failure to make payments under the asset purchase agreement and, in turn, the debtor's failure to make its plan payments.[32] But the Rule 2004 examinations did not seek discovery regarding whether payments had been made under the asset purchase agreement or the plan.[33] In fact, the debtor conceded the payments had not been made. So the court declined to permit the Rule 2004 examinations as proposed, though it did allow the creditors to conduct limited Rule 2004 examinations regarding enforcement of the asset purchase agreement and the debtor's ability to comply with the confirmed plan.[34]

More recently, the court in *Millennium Lab Holdings II, LLC* took a different approach to post-confirmation Rule 2004 discovery.[35] In that case, the debtor's confirmed plan established two trusts: a "Corporate Trust" and a "Lender Trust."[36] The "Corporate Trust" held the debtor's retained causes of action, while the "Lender Trust" held causes of action contributed by certain lenders.[37] The trustee of the two trusts was responsible for investigating potential claims against third parties relating to the debtor's financial collapse.[38] As part of his investigation, the trustee sought to examine the third parties under Rule 2004.[39] The third parties objected to the Rule 2004 discovery, arguing the court lacked subject-matter jurisdiction to order Rule 2004 examinations.[40]

The court overruled the third parties' subject-matter jurisdiction objection. Although the court acknowledged that its post-confirmation "related-to" jurisdiction was limited to matters having a close nexus to the debtor's plan or bankruptcy case,[41] the court explained that Rule 2004 examinations fall within the court's "arising in title 11" jurisdiction, which is not limited post-confirmation.[42] That should have ended the court's inquiry.

The creditors, however, argued that the court should look through the Rule 2004 motion to the causes of action the trustee may bring based on the information learned during the Rule 2004 examina-

29. *Id.* at 377 – 78.

30. *Id.* at 375, 378.

31. *Id.* at 378.

32. *Id.* at 379.

33. *Id.*

34. *Id.*

35. 562 B.R. 614 (Bankr. D. Del. 2016).

36. *Id.* at 619.

37. *Id.*

38. *Id.*

39. *Id.* at 619 – 620.

40. *Id.* at 620.

41. *Id.* at 621 – 22.

42. *Id.* at 622 – 23.

tions.[43] According to the creditors, the causes of action the trustee hoped to discover lacked the requisite "close nexus" for "related to" jurisdiction. Therefore, the creditors argued, the court lacked subject-matter jurisdiction to order Rule 2004 discovery.

The court rejected that approach because there was no way to determine which causes of action the trustee may discover:

> [T]he Objectors argue that the Court, in conducting its post-confirmation jurisdictional analysis, should not look at the Rule 2004 Motion itself, but rather should look through the Motion to the underlying causes of actions that the Trustee may bring based on information gathered from his investigations. The Objectors contend that because the causes of action that will follow an investigation are non-core and do not have the requisite "close nexus" to the bankruptcy proceeding, the Court does not have jurisdiction to adjudicate this Rule 2004 Motion. *Such a contention endows the Court with prophetic powers it does not, and cannot, have. As numerous courts have recognized when presented with a Rule 2004 motion, "there is no way to determine where the investigations will lead, what claims may be revealed, and what issues are core and non-core."*[44]

Having concluded it had jurisdiction to order Rule 2004 discovery, the court went on to consider whether the trustee established "good cause" for the requested Rule 2004 examinations.

As for the Rule 2004 examinations on the Corporate Trust's behalf, the trustee argued the facts as he knew them created a strong suspicion of wrongdoing but that the documents and information he had access to were not enough to determine the scope of the trustee's viable claims, which would benefit all claimants in Class 2 of the debtor's confirmed plan.[45] The court concluded that was sufficient to establish cause for a Rule 2004 examination on the Corporate Trust's behalf.[46]

The Rule 2004 examinations on the Lender Trust's behalf, though, were a different story. Although that trust was established under the plan, it consisted of claims belonging to certain lenders—not the debtor. And only those lenders—not all Class 2 claimants—would benefit from any recovery. So the court viewed the Rule 2004 examination on the Lender Trust's behalf as an impermissible attempt to gain a strategic advantage in what amounted to private litigation:

> In this case, the Trustee is entitled to Rule 2004 examinations on behalf of the Corporate Trust, as such an examination is a "legitimate post-confirmation inquiry" to ascertain potential causes of action, which success would benefit the Debtors' creditor body. Any request for information regarding potential causes of action belonging to the Lenders' Trust, however, is denied, as Rule 2004 was not intended to provide private litigants [i.e. the Consenting Lenders] with "a strategic advantage in fishing for potential private litigation." The fact that the Lender Trust was created by the Plan does not infuse the Lender Trust with bankruptcy tools that would not otherwise be available to third party creditors pursuing claims against non-

43. *Id.* at 623.

44. *Id.* (emphasis added) (citations omitted).

45. *Id.* at 627 – 28.

46. *Id.*

debtor entities.[47]

At first glance, the approaches taken by the *Cinderella Clothing* and *Millennium Lab Holdings* courts appear at odds. In fact, the *Millennium Lab Holdings* court noted that it disagreed with the *Cinderella Clothing* court with respect to part of its analysis.[48] But this Court believes that *Cinderella Clothing* and *Millennium Lab Holdings* can be read together and that three principles can be gleaned from doing so.

[3–6] First, bankruptcy courts have jurisdiction over Rule 2004 motions post-confirmation because Rule 2004 discovery "arises in" a case under title 11. And "arising-in" jurisdiction—unlike "related-to" jurisdiction—is not restricted post-confirmation. Second, when considering whether "good cause" exists for post-confirmation Rule 2004 discovery, bankruptcy courts should take into consideration their limited "related-to" post-confirmation jurisdiction: if the matter that is being investigated under Rule 2004 is one that lies outside the bankruptcy court's jurisdiction, then no cause exists for the Rule 2004 discovery; but the mere fact that Rule 2004 discovery *may* reveal claims that lie outside the court's jurisdiction does not, by itself, preclude Rule 2004 discovery. Third, Rule 2004 discovery should not be permitted when it is being used to gain an advantage in private litigation.

[7] How do those principles apply here? For starters, this Court has jurisdiction to order Rule 2004 discovery post-confirmation. In considering whether to do so, the Court is not convinced, at this point, that the claims the Debtor seeks to investigate lie, as Newtek argues, outside this Court's limited post-confirmation related-to jurisdiction.

To be sure, the Court is sympathetic to Newtek's argument. After all, eight months ago, in *In re Jeffrey L. Miller Investments, Inc.*, this Court dismissed an adversary proceeding for lack of subject-matter jurisdiction on facts similar to those here.[49]

In *Jeffrey L. Miller Investments*, the debtor sued Premier Realty Advisors (and its principals) for allegedly fraudulently inducing the debtor to enter into a real estate sales contract. The debtor filed its adversary complaint two months after confirming its chapter 11 plan. By the time the debtor had filed its complaint, its plan had been fully consummated: the debtor's real property (its primary asset) had been sold at an auction; all the debtor's allowed claims had been paid in full from the sales proceeds; and the surplus sales proceeds had been distributed to the Debtor's principal.[50]

In ruling on a motion to dismiss, this Court noted that its post-confirmation "related-to" jurisdiction was limited to matters having a close nexus to the chapter 11 plan or the bankruptcy case—i.e., matters affecting the interpretation, consummation, execution, or administration of the confirmed plan.[51] Because the debtor's plan had already been fully consummated, and any recovery was only for the benefit of the debtor's principal, this Court concluded there was no close nexus to the chapter 11

47. *Id.* at 629.

48. *Id.* at 624.

49. *Jeffrey L. Miller Invs., Inc. v. Premier Realty Advisors, LLC (In re Jeffrey L. Miller Invs., Inc.),* 624 B.R. 913, 916 – 917 (Bankr. M.D. Fla. 2021).

50. *Id.* Indeed, all that had happened *before* the debtor in that case had confirmed its plan.

51. *Id.*

plan or the bankruptcy case; therefore, the Court concluded it lacked subject-matter jurisdiction over the debtor's claims.[52]

Here, like in *Jeffrey L. Miller Investments*, the Debtor's primary asset was real property;[53] the property was sold before confirmation;[54] the sales proceeds were sufficient to pay allowed claims (other than claims of equity holders);[55] the plan was substantially consummated before the Debtor began pursuing its post-confirmation claims;[56] and the main (if not sole) beneficiaries of the post-confirmation claims were equity holders.[57] But there are two key differences between this case and *Jeffrey L. Miller Investments*.

First, unlike in *Jeffrey L. Miller Investments*, the plan in this case specifically referenced the potential causes of action against Newtek.[58] At least one court has suggested that the requisite "close nexus" may exist if the plan specifically enumerated a cause of action over which the bankruptcy court had jurisdiction.[59] Second, and more important, the procedural posture in *Jeffrey L. Miller Investments* was different: there, unlike here, the debtor had alleged its post-confirmation claims in a complaint, which allowed the Court to determine whether there was a close nexus to the debtor's plan or bankruptcy case.

Like the *Millennium Lab Holdings* court, this Court is not endowed with prophetic powers that allow it to pre-judge subject-matter jurisdiction over yet-to-be-filed causes of action. At this stage, the Court cannot definitively say that the causes of action the Debtor is pursuing lie outside this Court's subject-matter jurisdiction. So lack of subject-matter jurisdiction is not grounds for denying Rule 2004 discovery. Even so, the Court will deny Rule 2004 discovery for another reason.

[8–10] For the Court to grant Rule 2004 discovery, it must make a finding of "good cause."[60] As the party seeking discovery under Rule 2004, the Debtor bears the burden of proving that "good cause" exists for the discovery it seeks.[61] The Debtor can prove good cause by showing that either the Rule 2004 discovery is needed to establish a claim or that denial of the Rule 2004 discovery would cause undue hardship or injustice.[62] The Debtor has failed to make that showing here.

52. *Id.* at 920.

53. Doc. No. 1.

54. Doc. No. 1; Doc. No. 43.

55. Doc. No. 73, ¶ 10.

56. Doc. No. 103.

57. Doc. No. 54, Art. 6.

58. Doc. No. 54, § 1.2.15.

59. *BWI Liquidating Corp. v. City of Rialto (In re BWI Liquidating Corp.)*, 437 B.R. 160, 165 (Bankr. D. Del. 2010) ("A 'close nexus' may be found where the plan specifically enumerates the cause of action.").

60. *In re Gaime*, 2018 WL 7199806, at *2 (Bankr. M.D. Fla. Dec. 18, 2018) ("In granting a request for Rule 2004 examination, the court must make a finding of 'good cause.' ").

61. *Id.*; *see also In re Wilcher*, 56 B.R. 428, 434 (Bankr. N.D. Ill. 1985) ("Although a Rule 2004 examination may be ordered *ex parte*, once a motion to quash a subpoena is made, the examiner bears the burden of proving that good cause exists for taking the requested discovery."); *In re Serignese*, 2019 WL 2366424, at *2 (Bankr. S.D.N.Y. June 3, 2019) ("The Movants bear the burden of showing good cause for the [Rule 2004] examination they are seeking.").

62. *In re Gaime*, 2018 WL 7199806, at *2 ("This burden can be satisfied by demonstrating either that the Rule 2004 discovery is needed to establish a claim, or that the denial of the discovery would cause undue hardship or injustice.").

[11] For starters, the Debtor is not a newcomer to the scene.[63] Rather, the Debtor was one party to the transaction that gives rise to the alleged claims against Newtek.[64] The Debtor was able to identify the potential cause of action against Newtek on its schedules;[65] it articulated the facts giving rise to its potential claims (whether direct or by way of assignment) in its Case Management Summary;[66] and it included the potential causes of action in its plan.[67]

Given that, it is apparent the Debtor has the preliminary information needed to bring whatever claims it may have against Newtek. That preliminary information is all Rule 2004 is intended to provide:

> Rule 2004 examinations are meant to obtain preliminary information. Parties then use that information to file adversary proceedings and get more details in the discovery process.[68]

Because the Debtor will have ample opportunity to conduct discovery once it files an adversary complaint, it will not suffer a hardship or be prejudiced by the denial of Rule 2004 discovery.

[12] To the contrary, allowing the Debtor to conduct Rule 2004 discovery would give the Debtor an unfair strategic advantage. Unlike Rule 26 of the Federal Rules of Civil Procedure, which generally prohibits "fishing expeditions,"[69] Rule 2004 "is often described as being in the nature of a fishing expedition."[70] Had the Debtor already filed its alleged claims against Newtek, the "pending proceeding" rule would bar the Debtor from circumventing the Federal Rules' prohibition on "fishing expeditions."[71]

63. *In Good Hope Refineries, Inc.*, 9 B.R. 421, 422 (Bankr. D. Mass. 1981) (explaining that an examination under then Bankruptcy Rule 205(a), a precursor to Rule 2004, was "intended to give the Trustee, a newcomer into the Debtor's affairs, all available information as to the Debtor's commercial existence"); *Schlossberg v. Madeoy (In re Madeoy)*, 2015 WL 4879960, at *7 (Bankr. D. Md. July 30, 2015) (explaining that as a newcomer to the debtor's transactions, "the investigative tools provided to the Trustee [under Rule 2004] are crucial to enable him, as for all trustees, to obtain an understanding of the assets and transactions of the estate and to determine whether factual support exists to bring claims").

64. Doc. No. 8, ¶¶ 10 – 23. The Debtor also took assignment of whatever potential claims may belong to GB Square, the other party to the transaction.

65. Doc. No. 1, Schedule A/B.

66. Doc. No. 8, ¶¶ 10 – 23.

67. Doc. No. 54, § 1.2.15.

68. *In re Scherer*, 2019 WL 10733909, at *1 (Bankr. M.D. Fla. Feb. 7, 2019).

69. *In re The Charles F. Hamblen Post 37 Am. Legion Dep't of Fla., Inc.*, 2019 WL 10733641, at *2 (Bankr. M.D. Fla. June 26, 2019) ("Although the scope of discovery is broad, 'the discovery rules do not permit the [parties] to go on a fishing expedition.' "); *Sec. Inv. Protection Corp. v. Bernard L. Madoff Inv. Secs. LLC*, 496 B.R. 713, 724 (Bankr. S.D.N.Y. 2013) (explaining that "many courts have 'routinely decline[d] to authorize fishing expeditions' ").

70. *In re Vox II, LLC*, 2008 WL 596697, at *2 (Bankr. D. Md. Mar. 4, 2008) ("Discovery under Rule 2004 is far broader than discovery under the Federal Rules of Civil Procedure and is often described as being in the nature of a fishing expedition.").

71. *In re Gaime*, 2018 WL 7199806, at *3 (Bankr. M.D. Fla. Dec. 18, 2018). "Under this [pending proceeding] rule, 'once an adversary proceeding or contested matter is commenced, discovery should be pursued under the Federal Rules of Civil Procedure and not Rule 2004.' " *Id.* (quoting *In re Glitnir banki hf.*, 2011 WL 3652764, at *4 (Bankr. S.D.N.Y. Aug. 19, 2011)).

Although the Debtor has not yet filed an adversary proceeding, it has the preliminary information to do so. The Debtor should not be allowed to delay the filing of an adversary proceeding so that it can avoid the "pending proceeding" rule and gain a tactical advantage by "going fishing" under Rule 2004, thereby discovering information it could not in the adversary proceeding.

This is particularly true here because the Debtor's claims are tantamount to private litigation: the Debtor is pursuing a claim it took assignment of from a non-debtor (along with whatever direct claims it may have) against a stranger to the bankruptcy proceeding for the benefit of equity. Indeed, the Rule 2004 discovery here is very much like the Rule 2004 discovery that the *Millennium Lab Holdings* court prohibited.

Recall, in *Millennium Lab Holdings*, the trustee under the debtor's confirmed plan sought to investigate claims held by the Lender Trust (which held claims belonging to some of the debtor's lenders). Even though the Lender Trust was created by the plan, the *Millennium Lab Holdings* court concluded that the discovery sought did not fall within Rule 2004 because "Rule 2004 was not intended to provide private litigants [i.e. the Consenting Lenders] with 'a strategic advantage in fishing for potential private litigation.' "[72]

III. Conclusion

More than thirty years ago, in discussing the scope of Bankruptcy Rule 205, which is the precursor to Rule 2004, the bankruptcy court in *In re Good Hope Refineries, Inc.* explained that discovery under Rule 205 (now Rule 2004) was not intended to provide a party a strategic advantage in private litigation:

> Rule 205 is intended to provide the Trustee, generally new to the case, with a very broad discovery device to aid in an efficient and expeditious ingathering of all of the pertinent facts necessary in the effective administration of the estates.
>
> *It is not intended to give the rehabilitated debtor post confirmation a strategic advantage in fishing for potential private litigation.* Our basic concept of fair play expressed in the constitutional legalese of equal protection and due process should require all litigants to use the same discovery and procedural rules when not directly engaged in those activities that call for the bankruptcy umbrella, namely, that collection of activities characterized as the administration of the estate.[73]

Because the Rule 2004 discovery here appears to be an attempt by the Debtor to gain a strategic advantage in private litigation, as opposed to an attempt to discover the preliminary information needed to file an adversary complaint against Newtek, the Court will enter a separate order denying the Debtor's request for Rule 2004 discovery.

ORDERED.

WEST KEY NUMBER SYSTEM

72. 562 B.R. 614, 629 (Bankr. D. Del. 2016).

73. *In Good Hope Refineries, Inc.*, 9 B.R. 421, 423 (Bankr. D. Mass. 1981) (emphasis added).

§ 30.30. Because of this, we see no relevant distinction between this case and *Smith–Hunter;* due to the City's abandonment of the criminal action, it has been constructively dismissed. Accordingly, we hold that Pelcher has satisfied the favorable termination element of a claim for malicious prosecution.

CONCLUSION

The judgment of the district court is hereby AFFIRMED with respect to plaintiffs Rogers and Emigh. We REVERSE the grant of summary judgment with respect to plaintiff Pelcher and REMAND to the district court for proceedings not inconsistent with this opinion.

In re The CALDOR CORPORATION, Caldor, Inc.—CT, Caldor, Inc.—N.Y., Debtors.

Term Loan Holder Committee, Appellant,

v.

Ozer Group, L.L.C., Gordon Brothers Retail Partners, L.L.C., Wind–Down Oversight Committee, Caldor, Inc.—N.Y., The Caldor Corporation, Caldor, Inc.—CT & SBCG Co., LLC, Appellees.

Docket No. 00–5044.

United States Court of Appeals, Second Circuit.

Argued: Jan. 23, 2001.

Decided: Sept. 9, 2002.

Term loan holder committee brought motion to intervene in adversary proceeding brought by joint liquidators against Chapter 11 debtors. The bankruptcy court, James L. Garrity, Jr., denied the motion. The United States District Court for the Southern District of New York, Robert W. Sweet, J., affirmed. Committee appealed. The Court of Appeals, F.I. Parker, Circuit Judge, held that committee had unconditional statutory right as party in interest to intervene.

Reversed and remanded.

1. Bankruptcy 🔑3782

In an appeal from a district court's affirmation of a bankruptcy court ruling, the review of the bankruptcy court's decision by the Court of Appeals is independent and plenary, and the Court of Appeals reviews the bankruptcy court's interpretation of the bankruptcy statute de novo.

2. Bankruptcy 🔑3024

Creditors' committees under Chapter 11 have an implied qualified right to initiate adversary proceedings where the trustee or debtor in possession unjustifiably fails to bring suit. Bankr.Code, 11 U.S.C.A. §§ 1103(c)(5), 1109(b).

3. Bankruptcy 🔑2160

Term loan holder committee had unconditional statutory right as party in interest to intervene in adversary proceeding that occurred in connection with Chapter 11 case. Bankr.Code, 11 U.S.C.A. § 1109(b); 28 U.S.C.A. § 2075; Fed.Rules Civ.Proc.Rule 24(a)(1), 28 U.S.C.A.

4. Bankruptcy 🔑2021.1

The task of resolving a dispute over the meaning of a provision of the Bank-

quently, plaintiffs have no forum to obtain a formal dismissal of the underlying criminal action even though such a dismissal is preordained.

ruptcy Code begins where all such inquires must begin, with the language of the statute itself; as long as the statutory scheme is coherent and consistent, there generally is no need for a court to inquire beyond the plain language of the statute.

5. Statutes ⟹190

The first step in interpreting a statute is to determine whether the language at issue has a plain and unambiguous meaning with regard to the particular dispute in the case; thus, a court begins by inquiring whether the plain language of the statute, when given its ordinary, common meaning, is ambiguous.

6. Bankruptcy ⟹2201

The "case" triggered by a bankruptcy petition is an umbrella litigation often covering numerous actions that are related only by the debtor's status as a litigant.

See publication Words and Phrases for other judicial constructions and definitions.

7. Bankruptcy ⟹2156

A bankruptcy "proceeding" is a particular dispute or matter arising within a pending case, as opposed to the case as a whole.

See publication Words and Phrases for other judicial constructions and definitions.

8. Bankruptcy ⟹2151

An "issue" is a point in dispute between two or more parties.

See publication Words and Phrases for other judicial constructions and definitions.

9. Bankruptcy ⟹2205

The phrase "any issue in a case," in the right to be heard provision under Chapter 11, grants a right to raise, appear, and be heard on any issue regardless of whether it arises in a contested matter or an adversary proceeding. Bankr.Code, 11 U.S.C.A. § 1109(b).

See publication Words and Phrases for other judicial constructions and definitions.

Martin J. Bienenstock (Michele J. Meises, Weil, Gotshal & Manges LLP, New York, NY), for Appellant.

Stephen J. Shimshak (Allan J. Arffa, Curtis J. Weidler, Paul, Weiss, Rifkind, Wharton & Garrison, New York, NY), for Appellee.

Before: WALKER, Chief Judge, F.I. PARKER and KATZMANN Circuit Judges.

F.I. PARKER, Circuit Judge.

Term Loan Holder Committee ("TLHC") moved to intervene pursuant to 11 U.S.C. § 1109 and Federal Rule of Civil Procedure 24 in an adversary proceeding initiated by The Ozer Group, LLC, Gordon Brothers Retail Partners, LLC, and SBCG Co., LLC (collectively, the "Joint Liquidators") against debtors, The Caldor Corporation, Caldor, Inc.—CT, Caldor, Inc.—N.Y., *et al.* (collectively, "Caldor"). The United States Bankruptcy Court for the Southern District of New York (James L. Garrity, Jr., *Bankr.Judge*) denied TLHC's motion by order dated September 30, 1999, and the United States District Court for the Southern District of New York (Robert W. Sweet, *Judge*), affirmed the denial by order dated May 8, 2000.

On this appeal, TLHC contends that in reaching their decisions, the bankruptcy and district courts erroneously interpreted § 1109(b) of the Bankruptcy Code, which states that a party in interest "may raise and may appear and be heard on any issue in a case under this chapter." 11 U.S.C. § 1109(b). TLHC argues that this provision creates an unconditional statutory right for parties in interest to intervene in adversary proceedings that occur in connection with a Chapter 11 bankruptcy case. Because we find that the plain text of the statute indicates Congress intended to grant such a right, we reverse the lower courts' decisions and remand this case for further proceedings consistent with this opinion.

I. BACKGROUND

Caldor constituted one of the largest discount retailers in the Northeast–Mid–Atlantic Corridor, operating 145 stores in ten East Coast states. On September 18, 1995, Caldor filed for protection under Chapter 11 of the Bankruptcy Code. Pursuant to §§ 1107 and 1108 of the Bankruptcy Code, Caldor remained in possession and control of its businesses as a debtor in possession.

TLHC represents the holders of a term loan under a credit agreement dated October 21, 1993 ("Term Loan Holders") and the holders of a real estate loan under a credit agreement dated August 8, 1995 ("Real Estate Loan Holders"). At the time of Caldor's bankruptcy petition, the term loan, worth approximately $215 million, secured by a first lien against Caldor's inventory and proceeds, and the real estate loan, worth $37.1 million, was secured by real estate owned by Caldor. As part of Caldor's post-petition financing plan, the Term Loan Holders were granted a second lien against most of Caldor's real estate interests, and the Real Estate Loan Holders were granted a third lien against such interests. The Term Loan Holders and Real Estate Loan Holders both looked toward the proceeds from the sale of Caldor's inventory and leases to satisfy their secured claims.

After unsuccessfully attempting to reorganize, Caldor decided in early 1999 to wind down its operations and liquidate its assets. By a January 22, 1999 order, the bankruptcy court approved Caldor's wind-down decision.

Pursuant to a settlement agreement among the Term Loan Holders, the Real Estate Loan Holders, and Caldor, approved by the bankruptcy court on February 8, 1999, the Term Loan Holders and the Real Estate Loan Holders were paid certain proceeds of their collateral and were granted, and still hold, allowed administrative claims aggregating $20 million.

As part of its wind-down, Caldor decided to sell substantially all of its inventory in the remaining stores (the "Merchandise"). Caldor solicited bids for the right to purchase the inventory and chose to sell its Merchandise to the Joint Liquidators, who had formed a joint venture. The Joint Liquidators and Caldor negotiated a Purchase and License Agreement (the "Purchase Agreement"), executed on or about February 1, 1999. By application dated February 2, 1999, (the "Application"), Caldor sought an order from the bankruptcy court approving the Purchase Agreement. TLHC filed a limited objection to the break-up fee requested in the Application and participated at the hearing to approve the Application on February 11, 1999. After the hearing and competitive bidding in open court, the bankruptcy court approved an amended version of the Purchase Agreement by an order dated February 11, 1999 (the "Approval Order").

Pursuant to the Purchase Agreement and the Approval Order, the Joint Liquidators transferred over $223 million to Caldor and conducted going-out-of-business sales at Caldor's stores, selling all of Caldor's remaining inventory to the public. The going-out-of-business sales commenced on February 12, 1999 and were completed in mid-March.

Thereafter, Caldor allegedly refused to honor certain purchase price adjustment provisions of the Purchase Agreement. Based on this refusal, the Joint Liquidators initiated this Adversary Proceeding against Caldor on July 19, 1999, alleging breach of contract and related claims, and seeking over $26 million in damages. Caldor answered the Joint Liquidators' complaint by stating various affirmative defenses and counterclaims for, among other things, reformation of the contract based on mutual mistake and fraud in the inducement.

On August 19, 1999, TLHC moved to intervene in the Adversary Proceeding under 11 U.S.C. § 1109(b) and Federal Rule of Civil Procedure ("FRCP") 24.[1] TLHC sought intervention as a matter of right under FRCP 24(a), arguing that § 1109(b) conferred on it a right to appear and be heard. TLHC asserted furthermore that its constituents' administrative claim for $20 million constituted the largest single administrative claim in Caldor's Chapter 11 case, and since Caldor's estates were administratively insolvent, the outcome of the Joint Liquidators' Adversary Proceeding seeking $26 million from Caldor would "necessarily impact upon the amount of property of the estates available for the benefit of creditors." TLHC Mot. to Intervene, Aug. 19, 1999 ¶¶ 14–15. In light of its pecuniary interest in the outcome of the Adversary Proceeding, TLHC argued that it was the "true party in interest in Caldor's [C]hapter 11 case." *Id.* ¶ 15. TLHC also sought permissive intervention under FRCP 24(b).

The Joint Liquidators opposed TLHC's motion, denying there were any grounds for TLHC to intervene as of right or permissively. In particular the Joint Liquidators argued that § 1109(b) provided a party in interest with a right to be heard in a case only and that it stated nothing about intervention in an adversary proceeding.

Caldor, for its part, urged the bankruptcy court to grant TLHC's motion, acknowledging that it had "solicited and encouraged the active participation of [TLHC] in this adversary proceeding." Caldor Corp. Resp. to TLHC Mot. to Intervene, Sept. 21, 1999, ¶ 7.

On September 30, 1999, the bankruptcy court denied TLHC's motion and read its opinion into the record. Noting that the Joint Liquidators did not dispute that TLHC was a party in interest under § 1109(b), the bankruptcy court acknowledged the split in authority over whether § 1109(b) applies to a Chapter 11 case only or to adversary proceedings commenced in such a case as well. The bankruptcy court cited *Official Unsecured Creditors' Com-*

1. Pursuant to Federal Rule of Bankruptcy Procedure ("FRBP") 7001, intervention in adversary proceedings is governed by FRBP 7024, which adopts FRCP 24. FRCP 24 provides in relevant part:

> (a) Intervention of Right. Upon timely application anyone shall be permitted to intervene in an action: (1) when a statute of the United States confers an unconditional right to intervene; or (2) when the applicant claims an interest relating to the property or transaction which is the subject of the action and the applicant is so situated that the disposition of the action may as a practical matter impair or impede the applicant's ability to protect that interest, unless the applicant's interest is adequately represented by existing parties.
>
> (b) Permissive Intervention. Upon timely application anyone may be permitted to intervene in an action: (1) when a statute of the United States confers a conditional right to intervene; or (2) when an applicant's claim or defense and the main action have a question of law or fact in common.... In exercising its discretion the court shall consider whether the intervention will unduly delay or prejudice the adjudication of the rights of the original parties.

Fed.R.Civ.P. 24.

mittee v. Michaels (In re Marin Motor Oil, Inc.), 689 F.2d 445 (3d Cir.1982) *cert. denied,* 459 U.S. 1206, 103 S.Ct. 1196, 75 L.Ed.2d 440 (1983) and *Sarah R. Neuman Foundation, Inc. v. Garrity (In re Neuman),* 124 B.R. 155 (S.D.N.Y.1991) for the proposition that § 1109(b) grants a right to intervene in adversary proceedings, and *Fuel Oil Supply and Terminaling v. Gulf Oil Corp.,* 762 F.2d 1283 (5th Cir.1985) and *995 Fifth Avenue Associates, L.P. v. New York State Department of Taxation and Finance (In re 995 Fifth Avenue Associates, L.P.),* 157 B.R. 942 (S.D.N.Y.1993) for the opposing view that § 1109(b) is applicable only to the Chapter 11 case. The bankruptcy court concluded that the latter cases "state the better view" and held that § 1109(b) therefore provided no basis for TLHC to intervene under FRCP 24(a)(1).

With regard to FRCP 24(a)(2), the bankruptcy court reasoned that Caldor, as a debtor-in-possession, was a fiduciary of its creditors and that in liquidating its assets, Caldor was obligated to act in the best interests of its creditors. The court found that TLHC failed to allege or adduce any evidence that Caldor would not adequately represent TLHC's interests in the Adversary Proceeding and rejected TLHC's bid to intervene under FRCP 24(a)(2). The bankruptcy court also denied TLHC permission to intervene under FRCP 24(b), concluding that TLHC's interest in maximizing its recovery in Caldor's administratively insolvent case was not a claim or defense within the meaning of FRCP 24(b)(2).

TLHC appealed, and the district court affirmed the bankruptcy court's decision in *Term Loan Holder Comm. v. Ozer Group, LLC (In re Caldor, Inc.—N.Y.),* No. 95 B 44080(JLG), 2000 WL 546465 (S.D.N.Y. May 3, 2000). The district court reviewed the cases identified by the bankruptcy court on the application of § 1109(b) to adversary proceedings and agreed with the bankruptcy court that "*Fuel Oil* and *995 Fifth Avenue* provide[d] slightly more persuasive reasoning" than *Marin* and *Neuman. Id.* at *4. The district court explained:

> As those decisions point out, "legislative and judicial signposts demonstrate that 'Congress did not create an absolute statutory right to intervene in bankruptcy adversary proceedings through § 1109(b)' but instead 'intended courts to apply Rule 24(a)(2) . . . to applications to intervene in bankruptcy proceedings under § 1109(b).' "

Id. (quoting *995 Fifth Avenue,* 157 B.R. at 948 (quoting *Fuel Oil,* 762 F.2d at 1287)).

In further support of its decision not to follow *Marin,* the district court pointed out that *Marin* 's reasoning followed the then-current version of *Collier on Bankruptcy. Id.* The court observed that since *Marin* was decided, the treatise had changed its position several times through its various revisions, from favoring a view that § 1109(b) covered adversary proceedings to opposing such an view and then back again to favoring it. "Collier's flip-flop over the past twenty years undermines its authoritativeness, though it is also an indication of the closeness of the question." *Id.*

The district court also noted that in light of *Fuel Oil* and other opinions critical of *Marin,* the Third Circuit itself had subsequently questioned "whether or not [*Marin*] is the better view." *Id.* (quoting *Phar–Mor, Inc. v. Coopers & Lybrand,* 22 F.3d 1228, 1233 (3d Cir.1994)). The court stated that in *Phar–Mor,* the Third Circuit suggested it might have rejected *Marin* 's position were it not for the circuit's internal operating procedures requiring the court to sit *en banc* to depart from a prior panel's decision. *Id.*

Finally, the district court explained that *Marin*'s holding was founded in part on the *Marin* Court's conclusion that " 'Congress intended a creditors' committee to have more extensive rights in a reorganization than in a liquidation.' " *Id.* at *5 (quoting *Marin,* 689 F.2d at 450, 455–56). In the present Chapter 11 case, the district court reasoned, Caldor has abandoned its reorganization efforts and moved into liquidation. *Id.* "All other considerations aside, the fact that Caldor is in liquidation tips the balance against a statutory right to intervene." *Id.*

After concluding that § 1109(b) provided TLHC no avenue to intervene under FRCP 24(a)(1), the district court also affirmed the bankruptcy court's decision not to grant TLHC leave to intervene under FRCP 24(a)(2) or (b). *Id.* at *5–*6

TLHC now appeals from the district court's holding solely on the issue of whether § 1109(b) confers on a party in interest an unconditional right to intervene in an adversary proceeding within the meaning of FRCP 24(a)(1). This Court has jurisdiction pursuant to 28 U.S.C. § 158(d).

II. DISCUSSION

[1] In this appeal from a district court's affirmation of a bankruptcy court ruling, our review of the bankruptcy court's decision is "independent and plenary," *Bell v. Bell (In re Bell),* 225 F.3d 203, 209 (2d Cir.2000), and we review the bankruptcy court's interpretation of the bankruptcy statute *de novo, Capital Communications Fed. Credit Union v. Boodrow (In re Boodrow),* 126 F.3d 43, 47 (2d Cir.1997).

A. *Prior case law*

[2, 3] Whether § 1109(b) confers on parties in interest an unconditional right to intervene in adversary proceedings is a question of first impression in this Circuit.[2] To date, the Third and Fifth Circuits are the only Courts of Appeals to have ruled on the issue.

In *Official Unsecured Creditors' Committee v. Michaels (In re Marin Motor Oil, Inc.),* 689 F.2d 445 (3d Cir.1982), the Third Circuit answered the instant question in the affirmative. Looking first to the text of § 1109(b), the *Marin* Court found that the "language of the statute would seem clearly to favor the position espoused by the [Creditors'] Committee" that the provision accorded it an absolute right to intervene in an adversary proceeding instituted in connection with the Chapter 11 case. *Id.* at 449.

The *Marin* Court buttressed its interpretation of the statutory language with a detailed account of the statutory and legislative history of § 1109(b), showing that § 1109(b) was derived from § 206 of Chapter X of the predecessor bankruptcy law. *Id.* at 451. The Court explained that former § 206 had granted creditors "the right to be heard on all matters arising in a proceeding under this chapter" and had been construed by courts and commentators to provide an absolute right to appear and be heard in adversary proceedings. *Id.* at 451–52 (internal quotation marks omitted). Finally, the *Marin* Court reviewed the existing bankruptcy court case law on § 1109(b) and determined that it generally supported the view that § 1109(b) "should be given as broad and absolute a reading as [§] 206 had received." *Id.* at 453.

2. In *Unsecured Creditors Comm. v. Noyes (In re STN Enters.),* 779 F.2d 901, 904 (2d Cir. 1985), we held that 11 U.S.C. §§ 1103(c)(5) and 1109(b) implied a qualified right for creditors' committees to initiate adversary proceedings where the trustee or debtor in possession unjustifiably failed to bring suit.

In *Fuel Oil Supply & Terminaling v. Gulf Oil Corp.,* 762 F.2d 1283 (5th Cir. 1985), the Fifth Circuit rejected *Marin* and held that § 1109(b) was not addressed to adversary proceedings. The *Fuel Oil* Court explained:

> At first blush, prior bankruptcy practice and the legislative history of § 1109(b) appear to support the view of the Third Circuit that § 1109(b) requires a bankruptcy court automatically to allow a party in interest to intervene in adversary proceedings.... Furthermore, as the *Marin* court pointed out, the Bankruptcy Code makes no distinction between "case" and "adversary proceeding" for intervention purposes. Based on the Bankruptcy Code alone, therefore, the argument that § 1109(b) creates an absolute right to intervene in adversary proceedings appears strong.

Id. at 1285–86.

The Fifth Circuit concluded, however, that the *Marin* Court's reasoning based on the text of the statute, legislative history, and prior bankruptcy practice "loses much of its force ... when § 1109(b) is juxtaposed with the procedural rules governing intervention." *Id.* at 1286. The *Fuel Oil* Court observed that courts are hesitant to find unconditional statutory rights of intervention and tend to construe FRCP 24(a)(1) narrowly. In light of the fact that "[t]he statutes that do confer an absolute right to intervene generally confer that right upon the United States or a federal regulatory commission," the Court found that "[§] 1109(b) is not the type of statute generally considered to provide an absolute right to intervene." *Id.*

The *Fuel Oil* Court further noted that Congress had drawn "distinctions between bankruptcy 'cases' and the proceedings related to them" in several provisions in Title 28 of the United States Code and in the bankruptcy rules. *Id.* In particular, the Court pointed out that the advisory committee note to FRBP 7024 provided that "[i]ntervention in a case and intervention in an adversary proceeding must be sought separately." Fed. R. Bankr.P. 7024 advisory comm. note. According to the Court, this note "makes no sense if intervention in the 'case' provided entrance to the adversary proceeding as well." *Id.*

Finally, the *Fuel Oil* Court reasoned on policy grounds that Congress must have intended courts to apply FRCP 24(a)(2) rather than FRCP 24(a)(1) to applications to intervene in adversary proceeding. *Id.* at 1287. By applying FRCP 24(a)(2), "the bankruptcy court is permitted to control the proceeding by restricting intervention to those persons whose interests in the outcome of the proceeding are not already adequately represented by existing parties." *Id.*

Although no other circuit courts have directly addressed this issue, the First, Fourth, and Tenth Circuits have indicated in dicta that they favor the Fifth Circuit's view. *See Richman v. First Woman's Bank (In re Richman),* 104 F.3d 654, 658 (4th Cir.1997) (adopting *Fuel Oil*'s policy arguments concerning intervention in the context of a Chapter 7 proceeding); *Vermejo Park Corp. v. Kaiser Coal Corp. (In re Kaiser Steel Corp.),* 998 F.2d 783, 790 (10th Cir.1993); *Kowal v. Malkemus (In re Thompson),* 965 F.2d 1136, 1142 n. 8 (1st Cir.1992) (citing *Fuel Oil* for the proposition that § 1109(b) does not afford a right to intervene under FRCP 24(a)(1)).

B. *Analysis*

[4, 5] The task of resolving a dispute over the meaning of a provision of the Bankruptcy Code "begins where all such inquires must begin: with the language of the statute itself." *United States v. Ron Pair Enters.,* 489 U.S. 235, 241, 109 S.Ct. 1026, 103 L.Ed.2d 290 (1989). "[A]s long as the statutory scheme is coherent and consistent, there generally is no need for a court to inquire beyond the plain language of the statute." *Id.* at 240–41, 109 S.Ct. 1026. "Our first step in interpreting a statute is to determine whether the language at issue has a plain and unambiguous meaning with regard to the particular dispute in the case." *Robinson v. Shell Oil Co.,* 519 U.S. 337, 340, 117 S.Ct. 843, 136 L.Ed.2d 808 (1997). We thus begin by inquiring whether the plain language of the statute, when given "its ordinary, common meaning," *Tyler v. Douglas,* 280 F.3d 116, 122 (2d Cir.2001), is ambiguous.

1.

The text of § 1109(b) states in relevant part that "[a] party in interest ... may raise and may appear and be heard on any issue in a case under this chapter." 11 U.S.C. § 1109(b). The crucial issue before us is whether we should read the term "case" in § 1109(b) to exclude adversary proceedings. *In re Marin,* 689 F.2d at 450. We therefore first consider the meanings of "case," "proceeding," and "issue."

"Case," as used in the Bankruptcy Code, refers to litigation "commenced by the filing with the bankruptcy court of a petition" under the appropriate chapter of Title 11. *See* 11 U.S.C. §§ 301, 302, 303(b), 304(a). The bankruptcy "case" remains open until "an estate is fully administered and the court has discharged the trustee." 11 U.S.C. § 350. As one court has explained, "[t]he 'case' is the basis for taking control of all pertinent interests in property, dealing with that property, determining entitlements to distributions, [establishing] the procedures for administering the mechanism, and discharging the debtor." *Menk v. LaPaglia (In re Menk),* 241 B.R. 896, 908 (B.A.P. 9th Cir.1999).

[6] While "case" is a term of art in the bankruptcy context, it is a term that is well-understood. Indeed, the Joint Liquidators have pointed to no authority that disagrees with the commonplace notion that the "case" triggered by a bankruptcy petition is an "umbrella litigation often covering numerous actions that are related only by the debtor's status as a litigant." *Sonnax Indus. v. Tri Component Prods. Corp. (In re Sonnax Indus.),* 907 F.2d 1280, 1283 (2d Cir.1990); *see, e.g., Bank United v. Manley,* 273 B.R. 229, 235 (N.D.Ala.2001) ("A title 11 case is the umbrella under which all of the proceedings that follow the filing of a bankruptcy petition take place." (internal quotation marks and citation omitted)); 7 *Collier on Bankruptcy* ¶ 1109.04[1][a][i] (15th ed. rev.2001) ("A bankruptcy case is ... in colloquial terms, 'the whole ball of wax.' ").

[7] The term "proceeding," too, has a generally accepted meaning in the bankruptcy context. *Black's* indicates that a bankruptcy proceeding is a "particular dispute or matter arising within a pending case—as opposed to the case as a whole." *Black's Law Dictionary* 1221 (7th ed.1999). This definition is in accord with one of the primary understandings of the term "proceeding" outside of bankruptcy as simply "[a]n act or step that is part of a larger action." *Id.; see, e.g., In re G.T.L. Corp.,* 211 B.R. 241, 244–45 (Bankr.N.D.Ohio 1997) ("A proceeding can be thought of as a step within the bankruptcy case. [The term] encompasses all disputes that rise to the level of a litigated or contested matter." (citation omitted)).[3]

3. The advisory committee note to former bankruptcy rule 101 summarized what continues to be the ordinary understanding of the terms "case" and "proceeding" in bankruptcy. The note stated:

[8] Finally, an "issue" is a "point in dispute between two or more parties." *Black's Law Dictionary* 835 (7th ed.1999).

[9] With this understanding of the relevant terms in mind, we turn to the text of § 1109(b). It is important to recognize, as the Third Circuit did, that the "exact language" of § 1109(b) "grants a right to appear and be heard not in 'a case' but '*on any issue in a case.*'" *Marin*, 689 F.2d at 451 (emphasis added). The "issues" referred to in § 1109(b) occur in proceedings, which themselves occur in and constitute part of the "case." While the bankruptcy rules "distinguish ... between different types of litigated matters [that arise during the pendency of a bankruptcy case] and divide them into contested matters and adversary proceedings," 10 *Collier on Bankruptcy* at 7000–1 (15th ed. rev.2001), the plain text of § 1109(b) does not distinguish between *issues* that occur in these different types of proceedings within a Chapter 11 case.[4] We hold, therefore, that the phrase "any issue in a case" plainly grants a right to raise, appear and be heard on *any issue* regardless whether it arises in a contested matter or an adversary proceeding. Other courts that have similarly focused on the text of § 1109(b) have reached the same conclusion. *See, e.g., Neuman*, 124 B.R. at 159–60; *Hadar Leasing Int'l Co. v. D.H. Overmyer Telecasting Co. (In re*

> A proceeding initiated by a petition for an adjudication under the Bankruptcy Act is designated a "bankruptcy case" for the purpose of these rules. The term embraces all controversies determinable by the court of bankruptcy and all the matters of administration arising during the pendency of the case.... The word "proceeding" as used in these rules generally refers to a litigated matter arising within a case during the course of administration of an estate. The term "case" therefore refers to the overall spectrum of legal action taken under one of the debtor relief chapters. It is the widest term functionally. The term "proceeding," by contrast, refers to any particular action raised or commended within the case, including motions and adversary proceedings, whether such actions raise disputed or consensual matters.

2 *Collier on Bankruptcy* ¶ 301.03 (15th ed. rev.2001) (quoting former bankruptcy rule 101 advisory comm. note).

4. With regard to the difference between adversary proceedings and contested matters, *Collier's* explains:

> To determine those matters which are required to be brought as adversary proceedings, reference must be made in the first instance to [FRBP] 7001, which contains a categorization of the types of proceedings governed by Part VII [of the FRBP]. An adversary proceeding is further distinguished through the use of formal pleadings-a complaint to institute such a proceeding and an answer to respond to the allegations of the complaint. On the other hand, a contested matter is raised by motion pursuant to Rule 9014.

10 *Collier on Bankruptcy* at 7000–1 (15th ed. rev.2001).

"Most litigated matters in a bankruptcy case are adversary proceedings," *Marin*, 689 F.2d at 450, which have been described as "full blown federal lawsuits within the larger bankruptcy case," *Section 1120(1) Comm. of Unsecured Creditors v. Interfirst Bank Dallas, N.A., (In re Wood & Locker, Inc.)*, 868 F.2d 139, 142 (5th Cir.1989); *see also Murphy v. Mich. Guar. Agency (In re Murphy)*, 271 F.3d 629, 632 (5th Cir.2001) (adversary proceedings are proceedings "commenced in the bankruptcy court that are adversar[ial] in nature in which one party seeks affirmative relief from another before a bankruptcy court sitting as a trial court over the matters in litigation before it." (citation omitted)). Thus, "based on the premise that to the extent possible practice before the bankruptcy courts and the district court should be the same," the bankruptcy rules governing adversary proceedings "either incorporate or are adaptations of most of the Federal Rules of Civil Procedure." Fed. R. Bankr.P. 7001–1983 advisory comm. note; *see also In re Pub. Serv. Co. of N.H.*, 898 F.2d 1, 2 (1st Cir.1990) (Breyer, J.) (noting the bankruptcy rules "draw strong analogies between an 'adversary proceeding' in bankruptcy and an ordinary 'case' in a district court.").

D.H. Overmyer Telecasting Co.), 53 B.R. 963, 975 (N.D.Ohio 1984) ("The language of § 1109(b) clearly provides an equity security holder with the right to be heard in an adversary proceeding[ ]. Any other construction given to the statute would be contrary to the accepted principles of statutory interpretation." (internal citation omitted)).

2.

Despite this straightforward reading of § 1109(b), the Joint Liquidators contend that the statutory language is ambiguous and that we " 'must look to the statute as a whole and construct an interpretation that comports with its primary purpose and does not lead to anomalous or unreasonable results.' " Appellees' Br. at 14 (quoting *Conn. v. United States Dep't of the Interior,* 228 F.3d 82, 89 (2d Cir.2000)). We reject the Joint Liquidators' effort to construct a narrow interpretation of § 1109(b) based on various materials extrinsic to the text for the following reasons.

a.

The Joint Liquidators argue first that the mere fact that various courts have reached divergent results on the question of § 1109(b)'s applicability to adversary proceedings indicates that the text of the provision must be ambiguous. This argument is unpersuasive because the courts that adopted a narrow view of § 1109(b) based their decisions on grounds other than the text of § 1109(b), relying, for example, on the bankruptcy rules, advisory committee notes, legislative history, or policy concerns. *See, e.g., Fuel Oil,* 762 F.2d at 1286–87; *995 Fifth Ave.,* 157 B.R. at 948–51; *Sarah R. Neuman Found., Inc. v. Garrity (In re Neuman)*, 103 B.R. 491, 495 (Bankr.S.D.N.Y.1989) ("This court views the issue as one which implicates broad issues of bankruptcy policy") *rev'd* 124 B.R. 155 (S.D.N.Y.1991); *Rollert Co. v. Charter Crude Oil Co. (In re Charter Co.),* 50 B.R. 57, 61 (Bankr.W.D.Tex.1985) ("*Marin* can be distinguished by a subsequent change in the Rules of Bankruptcy Procedure."); *First Wis. Nat'l Bank v. Terex Corp. (In re Terex Corp.),* 53 B.R. 616, 623 (Bankr.N.D.Ohio 1985) (*Marin* "misreads the legislative history to section 1109, and considers the issue from too narrow a perspective"). As noted above, even the *Fuel Oil* Court conceded that "[b]ased on the Bankruptcy Code alone . . . , the argument that § 1109(b) creates an absolute right to intervene in adversary proceedings appears strong." 762 F.2d at 1286. The fact that a number of courts have elevated other sources above the text does not prove that the text is ambiguous.

b.

The Joint Liquidators further contend that failing to construct an interpretation of "case" in § 1109(b) that excludes adversary proceedings would render § 1109(b) inconsistent with the bankruptcy rules and advisory committee notes. There appear to us to be at least two problems with this line of argument. First, as a general matter, forsaking the plain meaning of a provision of the Bankruptcy Code solely because that meaning conflicts with a bankruptcy rule would run afoul of 28 U.S.C. § 2075. Second, we disagree, in any event, that the bankruptcy rules or the advisory committee notes require the interpretation of "case" advocated by the Joint Liquidators.

The Rules Enabling Act ("REA") provides in relevant part that "[t]he Supreme Court shall have the power to prescribe by general rules, the forms of process, writs, pleadings, and motions, and the practice and procedure in cases under title 11. *Such rules shall not abridge, enlarge, or* *modify any substantive right.*" 28 U.S.C. § 2075 (emphasis added).[5]

The Joint Liquidators argue that courts interpreting § 1109(b) narrowly have simply used the rules as evidence of Congress's intent. Concerning the *Fuel Oil* Court's reliance on the rules, we are urged to follow *995 Fifth Ave.*, which concluded, "[f]ar from using [FRBP] 7024 to modify or enlarge a substantive right, the Fifth Circuit merely looked to 7024 to help it ascertain Congress's intent regarding the scope of § 1109(b)." 157 B.R. at 948.[6] "Because [§] 1109(b) does not grant parties in interest the absolute right to intervene in adversary proceedings" the Joint Liquidators assert, "the District Court's decision did not violate 28 U.S.C. § 2075." Appellees' Br. at 29. In other words, according to the Joint Liquidators, only if we assume from the outset that the term "case" includes adversary proceedings would we be in danger of using the rules to modify a substantive right. If we refrain from adopting a view of the scope of § 1109(b) before turning to the rules, this reasoning goes, then we are merely using the rules to assist our understanding of Congressional intent as to the breadth of the intervention right conferred in the Code.

Fortunately, we need not puzzle long over this chicken and the egg dilemma. The REA admonishes us that the Code rather than the rules provides the controlling indication of Congress's intent with regard to substantive rights.[7] In light of the REA's placement of the rules in a subsidiary position to the Code, we believe that the proper interpretive approach is to give the language of § 1109(b) its most natural reading in the context of the Code first. Just as under the REA we must not read the rules to abridge rights granted in the Code, we believe that we must also refuse to use the rules to create ambiguity in an otherwise clear Code provision.

Although we conclude that we need not resort to the rules and advisory committee notes to discern Congress's intent in § 1109(b), we add that we find no tension between our reading of § 1109(b) and the rules and notes relied on by the Joint Liquidators.

Two bankruptcy rules deal with intervention, FRBP 7024 and 2018. FRBP 7024 governs intervention in an adversary proceeding and directs simply that "Rule 24 F.R. Civ. P. applies in adversary proceedings." Fed. R. Bankr.P. 7024. The Joint Liquidators assert that a broad interpretation of § 1109(b) would render FRBP 7024 a "nullity." They suggest that reading § 1109(b) to confer an unconditional right to intervene within the meaning of FRCP 24(a)(1) would make FRCP 24(a)(2) and (b)(1) & (2) superfluous in adversary

5. As an aside, we note that the Joint Liquidators' assertion that Congress intended categorically to distinguish cases from proceedings would appear to lead to the conclusion that the Supreme Court has no power under § 2075 to prescribe rules for adversary proceedings since that section refers only to practice and procedure "in cases." Obviously, however, the Joint Liquidators do not argue for this peculiar result.

6. *But see Official Comm. of Unsecured Creditors of Allegheny Int'l, Inc. v. Mellon Bank, N.A. (In re Allegheny Int'l, Inc.),* 107 B.R. 518, 524–25 (W.D.Pa.1989) (reversing, pursuant in part to § 2075, a bankruptcy court's holding that bankruptcy rules 2018 and 7024 overruled *Marin* 's interpretation of § 1109(b)).

7. Furthermore, the advisory committee note to FRBP 1001 states that "procedural rules promulgated pursuant to 28 U.S.C. § 2075 [must] be consistent with the bankruptcy statute.... Thus, ... any procedural matters contained in title 11 or 28 U.S.C. with respect to cases filed under 11 U.S.C. would control." Fed. R. Bankr.P. 1001 advisory comm. note (1983).

proceedings. This argument is flawed for the simple reason that § 1109(b), by its express terms, pertains only to parties in interest; other entities seeking intervention in an adversary proceeding may well find it necessary to enter those proceedings by way of FRCP 24(a)(2), (b)(1), or (b)(2). *See* Fed.R.Civ.P. 24(a)(2), (b)(1), (b)(2).

FRBP 2018 governs permissive intervention in a case.[8] The Joint Liquidators appear to concede that FRBP 2018 is not inconsistent with a broad interpretation of § 1109(b) because FRBP 2018 applies to entities that are not parties in interest and not entitled to intervene as of right under § 1109(b). Appellees' Br. at 20; *cf. In re Addison Cmty. Hosp. Auth.*, 175 B.R. 646, 650 (Bankr.E.D.Mich.1994) ("Rule 2018(a) provides for intervention by entities not otherwise having a right to participate in the bankruptcy case under § 1109 or other provisions. Consequently, an entity given the right to be heard under § 1109 need not seek leave under Rule 2018(a) to intervene in a case." (citation omitted)).

Although apparently conceding the consistency of FRBP 2018, itself, with our interpretation of § 1109(b), the Joint Liquidators do contend that the advisory committee notes to both FRBP 7024 and 2018 indicate that Congress intended the term "case" in § 1109(b) to exclude "adversary proceedings." The advisory committee note to FRBP 7024 states:

> A person may seek to intervene in the case under the Code or in an adversary proceeding relating to the case under the Code. Intervention in a case under the Code is governed by Rule 2018 and intervention in an adversary proceeding is governed by this rule. Intervention in a case and intervention in an adversary proceeding must be sought separately.

Fed. R. Bankr.P. 7024 advisory comm. note.

The advisory committee note to FRBP 2018 states in relevant part:

> This rule ... implements §§ 1109 and 1164 of the Code. Pursuant to § 1109 of the Code, parties in interest have a right to be heard.... This rule does not apply in adversary proceedings. For intervention in adversary proceedings, see Rule 7024.... Subdivision (a) [of this rule] ... permits intervention of an entity ... not otherwise entitled to do so under the Code or this rule. Such a party seeking to intervene must show cause therefor.

Fed. R. Bankr.P.2018 advisory comm. (1983).[9]

8. FRBP 2018 states in relevant part:

> (a) Permissive Intervention.
> In a case under the Code, after hearing on such notice as the court directs and for cause shown, the court may permit any interested entity to intervene generally or with respect to any specified matter.

Fed. R. Bankr.P.2018. Other sections of the rule provide for intervention by a state attorney general, the Secretary of the Treasury in a Chapter 9 case, and labor unions. *Id.*

9. While the advisory committee note to FRBP 2018 states that it "implements" § 1109, it is clear that § 1109(b) provides for intervention as of right by a party in interest while FRBP 2018 provides for permissive intervention by an entity not otherwise entitled to do so under the Code (*e.g.*, an entity other than a party in interest under § 1109(b)). As one court has observed, "Rule 2018(a) appears to apply to parties *not* governed by § 1109(b). Therefore, the language in the Advisory Committee note stating that Rule 2018 implements § 1109 is at best ambiguous, and does not seem sufficient basis for determining that § 1109 is exclusively limited to proceedings for which Rule 2018 is applicable." *In re Allegheny*, 107 B.R. at 524; *see also S. Blvd., Inc. v. Martin Paint Stores (In re Martin Paint Stores)*, 207 B.R. 57, 62 (S.D.N.Y.1997) ("Permissive intervention [in a case under FRBP 2018] provides the Bankruptcy Courts with a mechanism to allow entities that do not technically qualify as 'parties in interest' to participate in proceedings....").

Although the bankruptcy rules and the advisory committee notes envision separate formalities for intervening in cases and adversary proceedings, they do not necessitate that the term "case" in § 1109(b) be construed to exclude adversary proceedings.[10] In *Marin,* the Third Circuit confronted a comparable argument that adversary proceedings could not fall within the scope of the term "case" on the ground that a case is commenced by the filing of a petition and an adversary proceeding commenced separately by the filing of a complaint. The *Marin* Court concluded this distinction proved little: "an adversary proceeding is commenced in a different manner from the case with which it is connected; no one has ever questioned this." 689 F.2d at 450. Likewise, although the manner for obtaining leave to intervene in an adversary proceeding differs under the rules from the manner for obtaining leave to intervene in the case, this difference is irrelevant to the question of whether an entity possesses a right to intervene. Here, as everyone agrees, § 1109(b) grants parties in interest the right to raise and appear and be heard on any issue in a Chapter 11 case; nothing in FRBP 2018 and 7024 is inconsistent with the conclusion that issues raised in an adversary proceeding are issues in the Chapter 11 case within the plain meaning of § 1109(b).

c.

The Joint Liquidators argue that "the statutory scheme" supports the inference that Congress regarded cases and adversary proceedings as distinct concepts for intervention purposes. Appellees' Br. at 22–23. They point to 11 U.S.C. § 307 and to several provisions in Title II of the Bankruptcy Reform Act of 1978, Pub.L. No. 95–598, 92 Stat. 2549 (1978) (the "1978 Reform Act" or "Act").

With regard to § 307, the Bankruptcy Code provides that the United States Trustee "may raise and may appear and be heard on any issue in any case or proceeding under [Title 11]." 11 U.S.C. § 307. The Joint Liquidators argue that had Congress intended the phrase "issue in a case" in § 1109(b) to embrace adversary proceedings, it would not have been necessary for Congress to have included the phrase "or proceeding" in § 307. We note, however, that § 307 was added to the Code in 1986, subsequent to the conflicting decisions in *Marin* and *Fuel Oil* on the meaning of § 1109(b). *See* Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Pub.L. No. 99–554, § 205, 100 Stat. 3098 (1986). Rather than conclude Congress intended to grant the United States Trustee intervention rights significantly greater than those granted parties in interest by virtually identical statutory language, we find it more likely that Congress simply added the word "proceeding" to § 307 to alleviate doubts that the intervention rights extend to all proceedings in a case.

The remaining provisions identified by the Joint Liquidators as evidencing a statutory scheme in which "case" excludes adversary proceedings appear in the 1978 Reform Act's amendments to Title 28 of the United States Code. As the Joint Liq-

10. *Cf. Kowal v. Malkemus (In re Thompson),* 965 F.2d 1136, 1141 n. 7 (1st Cir.1992) ("An entity asserting a protectable interest in an adversary proceeding, yet not a 'party in interest' to the larger bankruptcy case, must first seek intervention in the bankruptcy case under Bankruptcy Rule 2018. Whereas Bankruptcy Rule 7024 governs intervention in an adversary proceeding within the bankruptcy case. [sic] Thus, intervention must be separately permitted in the bankruptcy case and in an adversary proceeding within the bankruptcy case.")

uidators and several courts have pointed out, the distinctions drawn by Congress between cases and proceedings under Title 28 "include separate provisions dealing with jurisdiction, 28 U.S.C. § 1471(a) and (b); abstention, 28 U.S.C. § 1471(d) and 11 U.S.C. § 305; venue, 28 U.S.C. § 1472 and § 1473; and jury trials, 28 U.S.C. § 1480(a)." *Fuel Oil,* 762 F.2d at 1286; *see also 995 Fifth Ave.,* 157 B.R. at 949 (relying on the distinctions in Title 28 as a basis for reading § 1109(b) narrowly); *Megan–Racine Assocs. v. Niagara Mohawk Power Corp. (In re Megan–Racine Assocs.),* 176 B.R. 687, 692 (Bankr.N.D.N.Y. 1994) (same); *Kenan v. FDIC (In re George Rodman, Inc.),* 33 B.R. 348, 349 (Bankr.W.D.Okla.1983) (same). We disagree that these distinctions occur within the "statutory scheme" relevant to discerning Congress's intent in § 1109(b).

With the 1978 Reform Act, Congress conducted a massive overhaul of both the bankruptcy law and the judicial system within which it was administered. *N. Pipeline Constr. Co. v. Marathon Pipe Line Co.,* 458 U.S. 50, 52–53, 102 S.Ct. 2858, 73 L.Ed.2d 598 (1982). Title I of the 1978 Reform Act enacted Title 11 of the United States Code, creating the new substantive law of bankruptcy, while Title II of the Act consisted of amendments to Title 28 of the United States Code, creating a new bankruptcy court system. 1 *Collier on Bankruptcy* ¶ 1.01[3] (15th ed. rev.2001). The Joint Liquidators focus on distinctions that appeared in Title II, in which Congress established courts possessing jurisdiction to render final decisions in all proceedings that would affect the outcome of a bankruptcy case, including proceedings "related to" the case but based on state law.

Under the law prior to the 1978 Reform Act, district courts had jurisdiction over bankruptcy cases and typically referred bankruptcy matters to "referees." *Marathon,* 458 U.S. at 53, 102 S.Ct. 2858. "Under this system, bankruptcy referees played a dual role: deciding disputes and administering bankruptcies." *Phar–Mor, Inc.,* 22 F.3d at 1234. The referees had limited jurisdiction to decide issues that were tangentially related to the bankruptcy case. *Marathon,* 458 U.S. at 53, 102 S.Ct. 2858. One of the primary goals of the 1978 Reform Act, therefore, was "to ensure adjudication of all claims in a single forum and to avoid the delay and expense of jurisdictional disputes." *Id.* at 87, n. 40, 102 S.Ct. 2858. To achieve this, Congress created a system of bankruptcy courts having jurisdiction over "all cases under title 11" as well as "all civil proceedings arising under title 11 or arising in or related to cases under title 11." *See* 1978 Reform Act, Title II, Sec. 241(a) (28 U.S.C. § 1471(a)-(c)), *reprinted in Collier on Bankruptcy* App. at Pt. 4–169 (15th ed. rev.2001).[11] The House Report called the expanded jurisdiction of these courts "a significant change from current law" and stated that the bankruptcy courts would have the "broadest grant of jurisdiction to dispose of proceedings that arise in bankruptcy cases or under the bankruptcy code." H.R.Rep. No. 95–595, 445 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6400. Concerning the term "proceeding" in these provisions, the House Report explained:

> The bill uses the term 'proceeding' instead of the current 'matters and proceedings' found in the Bankruptcy Act

11. The Supreme Court subsequently found key elements of the new bankruptcy court system unconstitutional. *Marathon,* 458 U.S. 50, 76, 83, 86, 102 S.Ct. 2858, 73 L.Ed.2d 598 (1982). To solve these constitutional problems, Congress made further modifications to the system with the Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub.L. No. 98–353, 98 Stat. 333.

> and Rules. The change is intended to conform the terminology of [T]itle 28, under which anything that occurs within a case is a proceeding. Thus, proceeding here is used in its broadest sense, and would encompass what are now called contested matters, adversary proceedings, and plenary actions under the current bankruptcy law. It also includes any disputes related to administrative matters in a bankruptcy case.

Id. at 445, *reprinted in* 1978 U.S.C.C.A.N. 5963, 6400–01. The House Report further stated that the provisions granting jurisdiction over proceedings " 'arising under title 11,' 'arising under a case under title 11,' and 'related to a case under title 11,' " were intended to "leave no doubt as to the scope of the bankruptcy court's jurisdiction over disputes." *Id.* at 445–46, *reprinted in* 1978 U.S.C.C.A.N. 5963, 6401.

As the 95th Congress collected different types of proceedings—including those based on state law—into the fold of the bankruptcy court system, it was indeed aware of the distinction between cases and proceedings for purposes of jurisdiction, venue, and abstention. These distinctions, however, do not demonstrate that Congress, in the different context of deciding parties' rights within the substantive bankruptcy law, intended the term "case" to exclude adversary proceedings.

d.

Finally, the Joint Liquidators argue that refusing to recognize an unconditional right under § 1109(b) for parties in interest to intervene in adversary proceedings would have "the salutary effect of granting bankruptcy judges a reasonable, objective basis for balancing the interests of litigants in adversary proceedings with those of would-be intervenors." Appellees' Br. at 4.

Certainly, reasonable arguments can be made on both sides of the policy questions connected with an unconditional right to intervene. The *Fuel Oil* Court was concerned that such a right would open the door to "perhaps hundreds" of creditors becoming automatic parties to an adversary proceedings. 762 F.2d at 1287. One bankruptcy court similarly feared extensive intervention "could produce complete chaos in the administration of the estate." *Neuman,* 103 B.R. at 499. Another court expected that "[a]llowing every creditor and other party in interest under § 1109(b) to intervene ... would impede the court's ability to understand or to manage the proceeding effectively." *995 Fifth Ave.,* 157 B.R. at 951.

The *Marin* Court, on the other hand, considered such policy concerns "unrealistic." 689 F.2d at 453.

> Appellants claim that the confusion, disorder, and expense that supposedly would be entailed by allowing each creditor or stockholder to intervene in adversary proceedings are such that it is "clearly unthinkable" that Congress could have intended to allow such a result. But the unqualified right of creditors and stockholders to intervene appears to have been the rule under [the prior bankruptcy law] for approximately 40 years, and the legislative history of section 1109(b) shows no dissatisfaction with it.

Id.

After living with the *Marin* decision for over a decade, the Third Circuit continued to find that policy concerns favored an unconditional right to intervene.

> Section 1109(b) is an important monitoring tool at the disposal of the creditors' committee. Intervention under that section appears to be appropriate to the extent it will: (1) minimize the need for extensive judicial oversight, (2) speed

> the debtor's successful reorganization, and (3) allow the creditors' committee to exert enough leverage on the debtor-in-possession so that the debtor-in-possession does not use its extensive flexibility and discretion in a Chapter 11 reorganization to compromise the creditors' interests. In short, interests of efficiency and fair play underlie § 1109(b), and the driving force behind the *Marin* decision was the belief that allowing intervention into adversary proceedings would best serve those interests.

Phar–Mor, Inc., 22 F.3d at 1240.

We need not choose among the competing policy rationales for and against an unconditional right to intervene, because we "do not sit to assess the relative merits of different approaches to various bankruptcy problems." *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.,* 530 U.S. 1, 13, 120 S.Ct. 1942, 147 L.Ed.2d 1 (2000). "It suffices that the natural reading of the text produces the result we announce," *id.,* and "[u]nless it leads to absurd or futile results, we must enforce what Congress has commanded whether or not we agree with its policy choices," *Bell v. Bell (In re Bell),* 225 F.3d 203, 219 (2d Cir.2000) (internal quotation marks and citation omitted).

* * * * * *

The Joint Liquidators' argument that TLHC lacks standing to intervene, raised for the first time on appeal, is without merit.

III. CONCLUSION

For the foregoing reasons, we reverse the district court's order of May 8, 2000 and the bankruptcy court's order of September 30, 1999 and hold that TLHC possesses an unconditional right to intervene under 11 U.S.C. § 1109(b) and Fed. R. Civ. P. 24(a)(1).

Raymond FREIER, Individually, as Administrator of the Estate of Rose Freier, deceased, and as surviving spouse of Rose Freier, Arthur L. Phillips, Administrator of the Estate of Leo Phillips, deceased, and Dorothy Phillips, as the surviving Spouse of Leo Phillips, Tab Fuqua, Charlotte Mucha, individually, as Executrix of the Estate of Alfred G. Mucha, deceased, and as surviving spouse of Alfred Mucha, John Farino, Administrator of the Estates of Mary Jane Farino and Robert Farino, deceased, Grace Astor, individually, and as surviving spouse of Evo T. Astor, Harry Basinski, Sr., Ellen Basinski, his spouse, Kathy Kaminski, Administratrix of the Estate of Joseph Inzinna, deceased, Mary Ylmar, Marie Manolis, Executrix of the Estate of Louis Manolis, deceased, and individually as the surviving spouse of Louis Manolis, legal representative of the Estate of Leo Ott, deceased, and Administratrix of Mary M. Sturm, deceased, William Neilsen, Betty Barabasz, Executrix of the Estate of George Pagels, deceased, Gloria Pagels, Individually as the surviving spouse of George Pagels, Joseph Grandillo, executor of the Estate of Stephen Grandillo, deceased, Shirley Kuczka, Executrix of the Estate of Henry Kuczka, deceased, and individually as the surviving spouse of Henry

NONCONSENSUAL THIRD-PARTY RELEASES—WILL NIRVANA LAST?

BY: MICHAEL W. HILE
JACOBSON HILE KIGHT LLC
The Elliott House
208 East 9th Street
Indianapolis, IN 46202
mhile@jhklegal.com

Seminar Materials for
The Sigmund J. Beck Advanced Bankruptcy Roundtable 2022
August 19-20, 2022
West Baden Springs Hotel/ French Lick Resort Casino
West Baden Springs, Indiana 47432

Are nonconsensual third-party releases of nonderivative claims still viable? Yes, no, and maybe? In the Seventh Circuit, the answer is a resounding yes, even though the leading case is closer to a case about an "exculpatory provision" than a true nonconsensual third-party release of nonderivative claims.[1] *See Airadigm Communs., Inc. v. FCC (In re Airadigm Communs., Inc.)*, 519 F.3d 640, 657 (7th Cir. 2008) ("First the limitation itself is narrow: It applies only to claims 'arising out of or in connection with' the reorganization itself and does not include 'willful misconduct.'"). In any case, the Seventh Circuit Court of Appeals has found that nonconsensual third-party releases are permitted pursuant to 11 U.S.C. §§ 105 and 1123 (b)(6) and the bankruptcy court's residual authority "if the release is 'appropriate' and not inconsistent with any other provision of the bankruptcy code." *Id.*

In the Seventh Circuit, whether a release is appropriate is a fact intensive analysis depending on the type of reorganization*.* *Id.* The release must be necessary to the reorganization and appropriately tailored to be authorized by the bankruptcy court's residual authority. *Id.* Considerations in *Airadigm* included: how broad the release was (it did not include blanket immunity and did not include willful misconduct); whether it granted immunity to matters beyond the jurisdiction of the Bankruptcy Code or unrelated to the reorganization itself; whether the release was subject to other provisions of the plan; and whether the bankruptcy court made specific findings that the consideration for the release was necessary and essential to the plan. *Id.*

Because the appropriateness analysis of a third-party release includes consideration of the connection between the bankruptcy court's subject matter jurisdiction and the scope of the release, the Seventh Circuit's more limited "related to" jurisdiction jurisprudence may limit the

[1] The focus of this discussion is nonconsensual third-party releases and does not focus on what is or is not consent.

scope of the claims that may be released. *See In re FedPak Systems, Inc.*, 80 F.3d 207, 213-14 (7th Cir. 1996) (a dispute is related to bankruptcy when resolution affects the amount of property for distribution to creditors or the allocation of property among creditors); *but see Bush v. United States,* 939 F. 3d 839, 846 (7th Cir. 2019) (the Seventh Circuit clarified "related to" jurisprudence stressing that precedent is not overruled or modified but the test is applied *ex ante* at the commencement of a dispute and "is satisfied when the resolution has potential effect on other creditors.").

In any case, barring Supreme Court rulings or legislation to the contrary, we live and practice bankruptcy law in the debtor paradise of the Seventh Circuit and third-party releases are on the table in plan discussions/negotiations. The same cannot be said for other Circuits and their practitioners as outlined by Judge McMahon of the United States District for the Southern District of New York in her lengthy opinion vacating the confirmation order in the *Purdue Pharma* chapter 11 cases because the "Bankruptcy Code does not authorize such non-consensual non-debtor releases: not in its express text (which is conceded); not in its silence (which is disputed); and not in any section or sections of the Bankruptcy Code that, read singly or together, purport to confer generalized or 'residual' powers on a court sitting in bankruptcy." *In re Purdue Pharma, L.P.*, 635 B.R. 26, 37-38 (S.D.N.Y. 2021). Judge McMahon qualified her findings regarding nonconsensual non-debtor releases noting that they were made with respect to direct/particularized claims by third parties against non-debtors as set forth in the relevant releases of the *Purdue Pharma* plan. She found that third parties could (just making sure, could or could not?) be compelled to release non-debtors from derivative claims -- "claims that would render the Sacklers liable because of Purdue's actions (which conduct may or may not have been committed because of the Sacklers)." *Id*. at 90. The *Purdue Pharma* opinion contains an exhaustive review of case law respecting statutory authority for nonconsensual third-party releases from the various circuits. Judge McMahon's characterizations of the law in the various circuits is discussed below.

Judge McMahon concluded that the Fifth, Ninth, and Tenth Circuits "reject entirely the notion that a court can authorize non-debtor releases outside of the asbestos context." *Id.* at 104.

The Third Circuit Court of Appeal has "concluded that the bankruptcy court had constitutional authority to extinguish certain third-party claims by confirming a chapter 11 plan," but "has not identified any section of the Bankruptcy Code that authorizes such non-debtor releases." *Id.*

The First, Eighth, and D.C. Circuits have not weighed in on the question of statutory authority for non-debtor releases even though some of their decisions have permitted third party releases to stand because of equitable mootness determinations and/or without statutory citation for support. *Id.* at 105.

Finally, "[t]he Fourth and Eleventh Circuits have concluded that Section 105(a), without more, authorizes such releases." *Id.* She distinguished this law from that of the Second Circuit (which controls her actions), which she found clearly holds that "[s]ection 105(a), standing alone, does not confer such authority on the bankruptcy court outside the asbestos context." *Id*. at 104.

Judge McMahon further found that "the Sixth and Seventh Circuits, both of which have concluded that Sections 105(a) and 1123(b)(6) of the Bankruptcy Code, read together, codify something that they call a bankruptcy court's 'residual authority,' and hold that bankruptcy court can impose non-consensual releases of third-party claims against non-debtors in connection with a chapter 11 plan pursuant to that 'residual authority." *Id.*

Finally, although most practitioners would advise that the Second Circuit has authorized nonconsensual third-party releases, Judge McMahon concluded that is not the case. "The only fair characterization of the law on the subject of statutory authority to release and enjoin the prosecution of third-party claims against non-debtors in a bankruptcy case is: unsettled, except in asbestos cases, where statutory authority is clear. Because the [Second Circuit] Court of Appeals has decided every other case on non-statutory ground, its only clear statement is that Section 105(a), standing alone, does not confer such authority on the bankruptcy court outside the asbestos context." *Id*.

In *Purdue Pharma*, Judge McMahon concluded that the Bankruptcy Court lacked constitutional authority under *Stern* to enter a final order granting the release rejecting the bankruptcy court's finding that it could issue a final order granting a release in the contest of confirming a plan which is the most core of bankruptcy proceedings. Confirming a plan, a core matter, is not the same as "finally dispos[ing] of claims that were non-consensually extinguished pursuant to that plan over which. . . [the Bankruptcy Judge recognized] he has only 'related to' jurisdiction over the third-party claims against the non-debtor Sacklers." *Id* at 80. The Court found that a third-party release and injunction enforcing it finally determines a claim and is equivalent to a judgment dismissing the claim and, thereby refuting the debtors' and others' argument that *Stern* only limits "adjudication" of claims – not their termination without adjudication. *Id*. at 81.[2] She found that this likely was a distinction without a difference as she

---

[2] *But see In re Millennium Lab Holdings II, LLC*, 945 F. 3d 126 (3rd Cir. 2019), *cert. den. sub nom*. *Loan Trust v. Millennium Lab Holdings*, 2020 U.S. LEXIS 2850 (U.S., May 26, 2020) where the Third Circuit held that "the Bankruptcy Court's conclusion that the release provisions were integral to the restructuring was well-reasoned and well-supported by the record. Consequently, the bankruptcy court was constitutionally authorized to confirm the plan in which those provision appeared." *Id.* at 140. In other words, *Stern* did not preclude the bankruptcy court's issuance of a final confirmation order for a plan containing nonconsensual third-party

was required to review the confirmation order under a *de novo* review of law and fact, regardless of whether she is making proposed findings of fact or entering a final order. *Id*. at 82.

On substance, Judge McMahon concluded that applicable Supreme Court authority requires specific statutory authorization for bankruptcy court action. *Id*. at 94. She further found that the bankruptcy court's equitable powers could only be exercised in the context of furthering a specific Bankruptcy Code section as the Code is a comprehensive law and cannot be supplemented without ignoring its comprehensiveness. *Id*. She further concluded that Supreme Court precedent rejected "rare variances" from the specific commands of the Bankruptcy Code, *id*., and that the "Second Circuit signaled that a Bankruptcy Code [sic] [Court] could not order the non-consensual release of third-party claims against non-debtors unless some provision of the Bankruptcy Code aside from Section 105(a) authorized it to do so." *Id*. at 115. Accordingly, she concluded that Sections 105, 1123(a)(5) and (a)(6), and 1129(a)(1) of the Bankruptcy Code do not authorize a nonconsensual, third-party release. *Id*. at 109. She further found that absence of a

releases. The court, however, did not "broadly sanction[] the permissibility of nonconsensual third-party releases in bankruptcy reorganization plans." *Id*. at 139. It dismissed the appeal on equitable mootness grounds. *Id*. at 144. The District Court for the Eastern District of Virginia also considered the (the Stern effect?) *Stern* effect on confirmation of a plan with third-party releases in *Patterson v. Mahwah Bergen Retail Grp., Inc.*, 636 B.R. 641 (E.D Va., June 28, 2021). The district court held that *Stern* limited the bankruptcy court's ability to issue a final order on the releases and the released parties had no ascertainable connection to the debtor's bankruptcy case. The court left open the potential for third-party releases but voided the consensual third-party releases in the plan and remanded the matter to a different bankruptcy judge to proceed to confirmation without the releases and a modified exculpation provision because it found that the opt-out third-party release had not been properly supported by analysis and findings pursuant to Fourth Circuit precedent. Significantly, the Court concluded that consent for the consensual releases could not be inferred from the parties' inaction in failing to affirmatively opt-out of the third-party releases. This case is evidence of the district court's disenchantment with bankruptcy court practice respecting third-party releases but does not otherwise alter the Fourth Circuit's favorable jurisprudence on this issue. Because this case is technically a "consensual" release it is outside the scope of this presentation.

prohibition to such relief in the Bankruptcy code did not make for support of such relief in a comprehensive statutory scheme. Id. at 110. Finally, she also reasoned that Congress's adoption of Sections 524(g) and (h) of the Bankruptcy Code approving third-party releases and injunctions solely in asbestos cases is evidence of its intention not to authorize such releases in other cases. As a result, she vacated the confirmation order and certain adjunct orders.

The debtors appealed her decision to the Second Circuit Court of Appeals, and arguments were held at the end of April. Based upon mediation between the debtors, the Sacklers, and the various state objectors, a settlement was reached and approved by the Bankruptcy Court that is conditioned on the Second Circuit overturning the District Court opinion and reinstating the bankruptcy court's confirmation order. *See* Motion of Debtors Pursuant to 11 U.S.C. § 105(a) and 363(b) for Entry of an Order Authorizing and Approving Settlement Term Sheet (the "Settlement Motion"). See also Order Granting the Settlement Motion, dated March 10, 2022 (the "Settlement Order"). Copies of both the Settlement Motion and Settlement Order are annexed hereto. As part of the settlement, the states agreed not to file briefs with the Second Circuit or participate in the appeal. The settlement resulted in an additional $1.2-1.6 billion to the approximately $4.4 billion fund to pay claims and included certain other concessions from the Sacklers (*mea culpas* of sorts). In exchange, the Sacklers retain their third-party releases. The Settlement is subject to the confirmation order being reinstated on appeal to the Second Circuit and becoming a final order not subject to further appeals. Apparently, pressure by the victims convinced the state Attorneys General not to make perfect the enemy of the good and to reach a settlement to permit the funds to be disbursed as promptly as possible. The opinion of the Second Circuit has not yet been issued, but the parties are anticipating an expedited decision. There remain other objecting creditors whose objections have not yet been settled and may require consideration depending on the Second Circuit decision. The Settlement Motion references provisions that are applicable respecting a grant of *certiorari* for instance.

In addition to potential Supreme Court guidance on grant of *certiorari* that could shatter our Seventh Circuit third-party release nirvana, Democratic members of Congress have introduced legislation intended to curb nonconsensual third-party releases. Senate Bill, S. 2497 was introduced by Senators Warren, Durbin, and Blumenthal on July 28, 2021. It is cited as the "Nondebtor Release Prohibition Act of 2021." The Senate Bill, which has been referred to the Committee on the Judiciary and pends there, proposes the addition of section 113 to the Bankruptcy Code that would prevent the bankruptcy court from approving any provision of a plan or otherwise for discharge, release, termination, or modification of the liability of a non-debtor party on a claim or cause of action of an entity other than the debtor or the estate. It also prohibits injunctions in support thereof. Subsection b of the proposed section 113 provides that nothing in the limitations of subsection (a) affects any power the bankruptcy court may have to authorize six delineated actions. Among them is approving plans with consensual releases but with restrictions on how that consent may be obtained (for instance, in writing and not by plan voting or induced by more favorable plan treatment). Finally, the proposed statute permits injunctions of actions against non-debtors (or their property) but only for a period of 90 days. A copy of the Senate Bill is attached.

Conclusion: Further guidance from the Supreme Court or Congress or both is needed to clarify the viability of nonconsensual third-party releases in bankruptcy plans. Until then, we can blissfully live in our Seventh Circuit third-party release nirvana While some ambiguity as to the viability of a nonconsensual third-party release may focus the parties and bring them to terms (even after an appeal as in *Purdue Pharma*), the expense of pursuing such relief as evidence by the *Purdue Pharma* seems wasteful (note even the $6 billion settlement remains subject to Second Circuit and Supreme Court actions so it is not yet a fait accompli and will consume more time and resources). Legislative actions do not seem likely in light of the many other items on Congress's table and midterm elections amidst political divide.

User Name: Michael Hile

Date and Time: Wednesday, August 3, 2022 12:27:00 PM EDT

Job Number: 176598096

Document (1)

1. *In re Purdue Pharma, L.P., 635 B.R. 26*

   Client/Matter: -None-

   Search Terms: Purdue Pharma

   Search Type: Natural Language

   Narrowed by:

Content Type	**Narrowed by**
Cases	Court: Federal > 2nd Circuit

Caution
As of: August 3, 2022 4:27 PM Z

In re Purdue Pharma, L.P.

United States District Court for the Southern District of New York

December 16, 2021, Decided; December 16, 2021, Filed

21 cv 7532 (CM) [Master Case; rel: 21 cv 7585 (CM); 21 cv 7961 (CM); 21 cv 7962 (CM); 21 cv 7966 (CM); 21 cv 7969 (CM); 21 cv 8034 (CM); 21 cv 8042 (CM); 21 cv 8049 (CM); 21 cv 8055 (CM); 21 cv 8139 (CM); 21 cv 8258 (CM); 21 cv 8271 (CM); 21 cv 8548 (CM); 21 cv 8557 (CM); 21 cv 8566 (CM)

Reporter

635 B.R. 26 *; 2021 U.S. Dist. LEXIS 242236 **; 2021 WL 5979108

In re: ***PURDUE PHARMA***, L.P.; This Filing Relates to ALL MATTERS

Prior History: *In re **Purdue Pharma** L.P., 633 B.R. 53, 2021 Bankr. LEXIS 2555, 2021 WL 4240974 (Bankr. S.D.N.Y., Sept. 17, 2021)*

Core Terms

bankruptcy court, non-debtor, settlement, releases, Shareholder, Drain, third-party, opioid, injunction, Confirmation, parties, cases, claimants, mediation, approve, enjoin, third party, entities, distributions, provisions, authorize, statutory authority, pain, reorganization plan, lawsuits, non-consensual, trusts, addiction, asbestos, billion

Case Summary

Overview

HOLDINGS: [1]-In an appeal from an order confirming the Plan of Reorganization proposed by the debtors, the bankruptcy court had related to subject matter jurisdiction to approve the release of direct, non- derivative third-party claims against the non-debtors because the third-party claims might have had a conceivable impact on the res of the debtors' estate; [2]- The Bankruptcy Code did not authorize a bankruptcy court to order the nonconsensual release of third-party claims against non-debtors in connection with the confirmation of a chapter 11 bankruptcy plan; [3]-The bankruptcy court did not fail to provide equal treatment between the Canadian appellants and their domestic unsecured creditor counterparts because the Canadian Appellants belonged to a different class than their counterparts for perfectly legitimate reasons.

Outcome

Confirmation order and related advance order vacated.

LexisNexis® Headnotes

Evidence > Judicial Notice > Adjudicative Facts > Judicial Records

Evidence > Judicial Notice > Adjudicative Facts > Public Records

HN1[] **Adjudicative Facts, Judicial Records**

A court may take judicial notice, whether requested or not. Judicial notice may be taken at any stage of the proceeding. Judicial notice may encompass the status of other lawsuits in other courts and the substance of papers filed in those actions. Courts may take judicial notice of relevant matters of public record.

Bankruptcy Law > Procedural Matters > Jurisdiction > Noncore Proceedings

HN2[] **Jurisdiction, Noncore Proceedings**

Under the law of the Second Circuit, the Bankruptcy Court has broad related to jurisdiction over any civil proceedings that might have any conceivable effect on the estate.

Bankruptcy Law > ... > Bankruptcy > Case Administration > Bankruptcy Court Powers

Bankruptcy Law > ... > Plans > Plan

Contents > Discretionary Provisions

HN3[ ] **Case Administration, Bankruptcy Court Powers**

The Bankruptcy Code does not authorize a bankruptcy court to order the nonconsensual release of third-party claims against non-debtors in connection with the confirmation of a chapter 11 bankruptcy plan. 11 U.S.C.S. §§ 105(a) and 1123(a)(5) & (b)(6), whether read individually or together, do not provide a bankruptcy court with such authority; and there is no such thing as equitable authority or residual authority in a bankruptcy court untethered to some specific, substantive grant of authority in the Bankruptcy Code.

Bankruptcy Law > Claims > Types of Claims > Claim Classification

HN4[ ] **Types of Claims, Claim Classification**

The Bankruptcy Code does not require that all creditor classes be treated the same — only that there be a reasonable basis for any differentiation between classes.

Bankruptcy Law > ... > Judicial Review > Standards of Review > Clear Error Review

Bankruptcy Law > ... > Judicial Review > Standards of Review > De Novo Standard of Review

HN5[ ] **Standards of Review, Clear Error Review**

The bankruptcy court has jurisdiction to hear bankruptcy appeals pursuant to 28 U.S.C.S. § 158(a). Generally in bankruptcy appeals, the district court reviews the bankruptcy court's factual findings for clear error and its conclusions of law de novo. Conclusions of law reviewed de novo include rulings as to the bankruptcy court's jurisdiction and interpretations of the Constitution. As to findings of fact, the clear error standard is a deferential one. A finding of fact is clearly erroneous only if the district court is left with the definite and firm conviction that a mistake has been committed.

Bankruptcy Law > ... > Judicial Review > Standards of Review > De Novo Standard of Review

HN6[ ] **Standards of Review, De Novo Standard of Review**

The standard of review of findings of fact is far less deferential if a bankruptcy court is presented with something it cannot adjudicate to final judgment as a constitutional matter unless the parties consent. In such a circumstance, a bankruptcy judge has authority only to hear the proceeding and submit proposed findings of fact and conclusions of law to the district court for de novo review and entry of judgment. In that case, the findings of fact are reviewed de novo as well. If a bankruptcy court issues a final order in the mistaken belief that it has constitutional authority to do so, the district court can treat a bankruptcy court's order as a report and recommendation, but it must review the proceeding de novo and enter final judgment.

Bankruptcy Law > Procedural Matters > Jurisdiction > Core Proceedings

Bankruptcy Law > Procedural Matters > Jurisdiction > Noncore Proceedings

Bankruptcy Law > Procedural Matters > Jurisdiction > Federal District Courts

HN7[ ] **Jurisdiction, Core Proceedings**

In 28 U.S.C.S. § 157(a), Congress divided bankruptcy proceedings into three types: (1) those that arise under title 11; (2) those that arise in a title 11 case; (3) and those that are related to a title 11 case. Cases that arise under or arise in a title 11 matter are known as core bankruptcy proceedings, while related to proceedings are non-core. 28 U.S.C.S. § 157(b)(1)-(2)(C). Every proceeding pending before a bankruptcy court is either core or non-core. The core vs. non-core distinction is critical when assessing a bankruptcy court's constitutional authority to enter a final judgment disposing of that proceeding. In particular, a bankruptcy court lacks the constitutional authority to enter a final judgment in a proceeding over which it has only related to subject matter jurisdiction unless all parties consent.

Governments > Courts > Common Law

HN8[ ] **Courts, Common Law**

The U.S. Supreme Court has ruled that Congress could not withdraw from judicial cognizance any matter which, from its nature, is the subject of a suit at common law, or in equity, or in admiralty.

Bankruptcy Law > ... > Bankruptcy > Case Administration > Bankruptcy Court Powers

Governments > Courts > Authority to Adjudicate

HN9[ ] Case Administration, Bankruptcy Court Powers

Bankruptcy courts have the power to enter a final judgment only in proceedings that stem from the bankruptcy itself or would necessarily be resolved in the claims allowance process.

Bankruptcy Law > ... > Bankruptcy > Case Administration > Bankruptcy Court Powers

Bankruptcy Law > ... > Plans > Plan Contents > Discretionary Provisions

HN10[ ] Case Administration, Bankruptcy Court Powers

In assessing a court's jurisdiction to enjoin a third party dispute under a plan, the question is not whether the court has jurisdiction over the settlement that incorporates the third party release, but whether it has jurisdiction over the attempts to enjoin the creditors' unasserted claims against the third party. That proposition applies with equal force to a bankruptcy court's authority.

Bankruptcy Law > Procedural Matters > Jurisdiction > Noncore Proceedings

HN11[ ] Jurisdiction, Noncore Proceedings

A bankruptcy court's order extinguishing a non-core claim and enjoining its prosecution without an adjudication on the merits finally determines that claim. It is equivalent to entering a judgment dismissing the claim. It bars the claim under principles of former adjudication. Therefore, Congress may not allow a bankruptcy court to enter such an order absent the parties' consent.

Bankruptcy Law > Procedural Matters

Constitutional Law > ... > Fundamental Rights > Procedural Due Process > Scope of Protection

HN12[ ] Bankruptcy Law, Procedural Matters

A nonconsensual third-party release is essentially a final judgment against the claimant, in favor of the non- debtor, entered without any hearing on the merits. A third-party release has the effect of a judgment — a judgment against the claimant and in favor of the non- debtor, accomplished without due process.

Bankruptcy Law > Procedural Matters

Civil Procedure > Judgments > Preclusion of Judgments > Res Judicata

HN13[ ] Bankruptcy Law, Procedural Matters

The U.S. Supreme Court has twice held that non-consensual third-party releases confirmed by final order are entitled to res judicata claim preclusion barring any subsequent action bringing a released claim.

Bankruptcy Law > Procedural Matters > Jurisdiction > Federal District Courts

Civil Procedure > ... > In Rem & Personal Jurisdiction > In Rem Actions > True In Rem Actions

Bankruptcy Law > Procedural Matters > Jurisdiction > Noncore Proceedings

HN14[ ] Jurisdiction, Federal District Courts

A bankruptcy court is a creature of statute. Its subject matter jurisdiction is in rem and is limited to the res of the estate. Its jurisdiction is limited to civil proceedings arising under title 11, or arising in or related to cases under title 11. 28 U.S.C.S. § 1334(b). A proceeding arises under title 11 if the claims invoke substantive rights created by that title. A proceeding arises in a title 11 case if for example Parties, by their conduct, submit themselves to the bankruptcy court's jurisdiction by litigating proofs of claim without contesting personal jurisdiction. And a proceeding is related to a title 11 proceeding if its outcome might have any conceivable effect on the bankrupt estate.

Bankruptcy Law > Procedural Matters > Jurisdiction > Noncore Proceedings

HN15[] Jurisdiction, Noncore Proceedings

The release of most third-party claims against a non-debtor touches the outer limit of the Bankruptcy Court's jurisdiction. But the Second Circuit defines that limit quite broadly. The standard is not that an action's outcome will certainly have, or even that it is likely to have, an effect on the res of the estate, as is the case in some other Circuits. It is, rather, whether it might have any conceivable impact on the estate.

Bankruptcy Law > Procedural Matters > Jurisdiction

Civil Procedure > ... > In Rem & Personal Jurisdiction > In Rem Actions > True In Rem Actions

HN16[] Procedural Matters, Jurisdiction

Decades ago, the Second Circuit concluded that the outer limit of a bankruptcy court's in rem jurisdiction was defined by whether the outcome of a proceeding asserting a particular claim might have any conceivable effect on the res of the estate.

Bankruptcy Law > Procedural Matters > Jurisdiction > Noncore Proceedings

HN17[] Jurisdiction, Noncore Proceedings

The United States Supreme Court has decreed that related to jurisdiction was a grant of some breadth and that jurisdiction of bankruptcy courts may extend broadly in reorganization under Chapter 11.

Bankruptcy Law > Procedural Matters > Jurisdiction > Noncore Proceedings

HN18[] Jurisdiction, Noncore Proceedings

In the Second Circuit, it is well settled that the only question a court need ask is whether the action's outcome might have any conceivable effect on the bankrupt estate. If the answer to that question is yes, then related to jurisdiction exists-no matter how implausible it is that the action's outcome actually will have an effect on the estate.

Bankruptcy Law > Procedural Matters > Jurisdiction > Noncore Proceedings

HN19[] Jurisdiction, Noncore Proceedings

The existence of strong interconnections between the third-party action and the bankruptcy has been cited frequently by courts in concluding that the third-party litigation is related to the bankruptcy proceeding.

Bankruptcy Law > ... > Discharge & Dischargeability > Effect of Discharge > Effect on Third Parties

HN20[] Effect of Discharge, Effect on Third Parties

One and only one section of the Bankruptcy Code expressly authorizes a bankruptcy court to enjoin third party claims against non-debtors without the consent of those third parties. That section is 11 U.S.C.S. § 524(g), which was passed by Congress in 1994. It provides for such an injunction solely and exclusively in cases involving injuries arising from the manufacture and sale of asbestos. And it sets out a host of conditions that must be satisfied before any such injunction can be entered.

Bankruptcy Law > ... > Discharge & Dischargeability > Effect of Discharge > Effect on Third Parties

HN21[] Effect of Discharge, Effect on Third Parties

11 U.S.C.S. § 524(g) injunctions barring third party claims against non-debtors cannot be entered in favor of just any non-debtor. They are limited to enjoin actions against a specific set of non-debtors: those who have a particular relationship to the debtor, including owners, managers, officers, directors, employees, insurers, and financiers. 11 U.S.C.S. § 524(g)(4)(A). The language of

the statute plainly indicates that Congress believed that *§ 524(g)* created an exception to what would otherwise be the applicable rule of law.

Bankruptcy Law > ... > Discharge & Dischargeability > Effect of Discharge > Effect on Third Parties

HN22[] Effect of Discharge, Effect on Third Parties

That *11 U.S.C.S. § 524(g)* applies only to asbestos cases is clear. The statute explicitly states than the trust that is to assume the liabilities of a debtor be set up in connection with actions seeking recovery for damages allegedly caused by the presence of, or exposure to, asbestos or asbestos-containing products. *11 U.S.C.S. § 524(g)(2)(B)(i)(I)*.

Bankruptcy Law > ... > Bankruptcy > Case Administration > Bankruptcy Court Powers

Civil Procedure > Preliminary Considerations > Equity > Relief

HN23[] Case Administration, Bankruptcy Court Powers

The traditional equitable power of a bankruptcy court can only be exercised within the confines of the Bankruptcy Code.

Bankruptcy Law > ... > Bankruptcy > Case Administration > Bankruptcy Court Powers

Governments > Courts > Authority to Adjudicate

HN24[] Case Administration, Bankruptcy Court Powers

A bankruptcy court lacks the power to award relief that varies or exceeds the protections contained in the Bankruptcy Code-not even in rare cases, and not even when those orders would help facilitate a particular reorganization.

Bankruptcy Law > Exemptions > Bankruptcy Code Exemptions

Bankruptcy Law > ... > Bankruptcy > Case Administration > Bankruptcy Court Powers

HN25[] Exemptions, Bankruptcy Code Exemptions

A bankruptcy court may not exercise its authority to carry out the provisions of the Bankruptcy Code by taking an action inconsistent with its other provisions. There is no authority for bankruptcy courts to deny an exemption on a ground not specified in the Code, because the Bankruptcy Code was intended to be a comprehensive statement of the rights and procedures applicable in bankruptcy. The Code explicitly exempts certain debtor assets from the bankruptcy estate and provides a finite number of exceptions and limitations to those asset exemptions. *11 U.S.C.S. § 522*. To the U.S. Supreme Court, comprehensive means precisely that: The Code's meticulous-not to say mind-numbingly detailed-enumeration of exemptions and exceptions to those exemptions confirms that courts are not authorized to create additional exceptions.

Bankruptcy Law > ... > Plan Confirmation > Prerequisites > Administrative & Gap Claims

Bankruptcy Law > ... > Plan Confirmation > Prerequisites > Impaired Class Consent

Bankruptcy Law > ... > Reorganizations > Plans > Impairment of Claims

Bankruptcy Law > ... > Plans > Plan Confirmation > Consensual Confirmations

HN26[] Prerequisites, Administrative & Gap Claims

In chapter 11 bankruptcies, a plan that does not follow normal priority rules cannot be confirmed over the objection of an impaired class of creditors. *11 U.S.C.S. § 1129(b)*.

Bankruptcy Law > ... > Discharge & Dischargeability > Effect of Discharge > Effect on

Third Parties

HN27[] **Effect of Discharge, Effect on Third Parties**

The U.S. Court of Appeals for the Second Circuit has concluded that a bankruptcy court only has jurisdiction to enjoin third-party non-debtor claims that directly affect the res of the bankruptcy estate, and claims asserted against non-debtors that sought to recover directly from the debtor's insurer for the insurer's own independent wrongdoing did not have such impact.

Bankruptcy Law > Procedural Matters > Jurisdiction

Governments > Courts > Authority to Adjudicate

HN28[] **Procedural Matters, Jurisdiction**

Subject matter jurisdiction cannot be conferred by consent of the parties. Where a court lacks subject matter jurisdiction over a dispute, the parties cannot create it by agreement even in a plan of reorganization.

Bankruptcy Law > ... > Bankruptcy > Case Administration > Bankruptcy Court Powers

HN29[] **Case Administration, Bankruptcy Court Powers**

The equitable power conferred on the bankruptcy court by *11 U.S.C.S. § 105(a)* is the power to exercise equity in carrying out the provisions of the Bankruptcy Code, rather than to further the purposes of the Bankruptcy Code generally, or otherwise to do the right thing. This language suggests that an exercise of *§ 105* power be tied to another Bankruptcy Code section and not merely to a general bankruptcy concept or objective.

Bankruptcy Law > ... > Bankruptcy > Case Administration > Bankruptcy Court Powers

HN30[] **Case Administration, Bankruptcy Court Powers**

11 U.S.C.S. § 105(a) authorizes the bankruptcy court to issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of the Bankruptcy Code; but *§ 105(a)* does not allow the bankruptcy court to create substantive rights that are otherwise unavailable under applicable law. Any power that a judge enjoys under *§ 105* must derive ultimately from some other provision of the Bankruptcy Code.

Bankruptcy Law > ... > Bankruptcy > Case Administration > Bankruptcy Court Powers

Bankruptcy Law > ... > Automatic Stay > Violations of Stay > Contempt Actions

Bankruptcy Law > ... > Discharge & Dischargeability > Effect of Discharge > Protection of Debtors

Bankruptcy Law > ... > Reorganizations > Plans > Plan Contents

HN31[] **Case Administration, Bankruptcy Court Powers**

11 U.S.C.S. § 1123(b)(6) provides that a plan may include any other appropriate provision not inconsistent with the applicable provisions of this title. *11 U.S.C.S. § 1123(b)(6)*. In form, *§ 1123(b)(6)* is substantively analogous to *11 U.S.C.S. § 105(a)*'s authorization of any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. *11 U.S.C.S. § 105(a)*.

Bankruptcy Law > Discharge & Dischargeability > Exceptions to Discharge > Government Penalties & Taxes

HN32[] **Exceptions to Discharge, Government Penalties & Taxes**

A debtor's discharge cannot relieve him of any debt to the extent such debt is for a fine, penalty, or forfeiture payable to and for the benefit of a governmental unit, and is not compensation for actual pecuniary loss, other than a tax penalty *11 U.S.C.S. § 523(a)(7)*.

Bankruptcy Law > ... > Plans > Plan Contents > Discretionary Provisions

Bankruptcy Law > ... > Plans > Plan Contents > Mandatory Provisions

HN33[] Plan Contents, Discretionary Provisions

Section 1123(a)(5) of the Bankruptcy Code provides that a plan of reorganization must provide adequate means for its implementation. *11 U.S.C.S. § 1123(a)(5)*. That section contains a laundry list of things that a plan can include in order to make sure that resources are available to implement the plan - any of which can be ordered by a bankruptcy court. Injunctions against the prosecution of third-party claims against non-debtors, and the release of such claims, are nowhere to be found on that list. Every single example listed in *§ 1123(a)(5)(A) through (J)* authorizes the court to do something with the debtor's assets (retaining estate property; transfer of property; sale of property; satisfaction or modification of a lien; cancellation or modification of an indenture or similar instrument; curing or waiving defaults; extension of maturity dates; issuing securities; even amending the debtor's charter). Since the bankruptcy court has in rem jurisdiction over the res of the debtor's estate, none of that should be surprising.

Bankruptcy Law > ... > Bankruptcy > Reorganizations > Plans

HN34[] Reorganizations, Plans

None of the types of relief listed in *11 U.S.C.S. § 1123(a)(5)* involves disposing of property belonging to someone other than the debtor or a creditor of the debtor. That is because it is the debtor's resources-not the resources of some third party-that are supposed to be used to implement a plan that will adjust the debtor's relations with its creditors.

Bankruptcy Law > ... > Bankruptcy > Case Administration > Bankruptcy Court Powers

Bankruptcy Law > ... > Plan Confirmation > Prerequisites > Plan Compliance With Code

Bankruptcy Law > ... > Discharge & Dischargeability > Effect of Discharge > Protection of Debtors

HN35[] Case Administration, Bankruptcy Court Powers

11 U.S.C.S. § 1129 is entitled Confirmation of plan, and *§ 1129(a)(1)* provides that a bankruptcy court shall confirm a plan only if the plan complies with the applicable provisions of this title. *11 U.S.C.S. § 1129*. *Section 1129(a)* confers no substantive right that could be used to undergird an *11 U.S.C.S. § 105(a)* injunction. One highly general provision simply does not confer substantive authority that is required to invoke another highly general provision.

Bankruptcy Law > Procedural Matters

HN36[] Bankruptcy Law, Procedural Matters

The Bankruptcy Code provides a comprehensive federal system to govern the orderly conduct of debtors' affairs and creditors' rights. "Comprehensive" means complete, including all elements.

Governments > Legislation > Interpretation

HN37[] Legislation, Interpretation

It is a commonplace of statutory construction that the specific governs the general.

Bankruptcy Law > ... > Bankruptcy > Case Administration > Bankruptcy Court Powers

Civil Procedure > ... > In Rem & Personal Jurisdiction > In Rem Actions > True In Rem Actions

HN38[] Case Administration, Bankruptcy Court Powers

The special remedial scheme contemplated by the Bankruptcy Code addresses the rights of persons who have claims against a debtor in bankruptcy-not claims against other non-debtors. The Code lays out a claims allowance process so that creditors can file their claims against someone who has invoked the protection of the Bankruptcy Code; it provides a mechanism for those parties to litigate those claims against the debtor and to determine their value. In order to take advantage of this special remedial scheme, debtors have to declare bankruptcy, disclose their assets, and apply them-all of them, with de minimis exceptions-to the resolution of the claims of their creditors. Non-debtors have no such obligations, and so do not have any rights at all under the special remedial scheme that is bankruptcy -

certainly not the right to have claims that are being asserted against them outside the bankruptcy process released. The special remedial scheme due process exception relating to in rem bankruptcy proceedings simply does not give a bankruptcy court subject matter jurisdiction to release in personam third-party claims against a non-debtor.

Bankruptcy Law > ... > Bankruptcy > Case Administration > Bankruptcy Court Powers

Governments > Courts > Authority to Adjudicate

HN39[] Case Administration, Bankruptcy Court Powers

Just as, a court's ability to provide finality to a third-party is defined by its jurisdiction, not its good intentions, so too its power to grant relief to a non-debtor from non-derivative third party claims can only be exercised within the confines of the Bankruptcy Code.

Bankruptcy Law > Claims > Types of Claims > Claim Classification

HN40[] Types of Claims, Claim Classification

The Bankruptcy Code does not require that all creditor classes be treated equally, only that there be a reasonable basis for any differentiation.

Bankruptcy Law > Claims > Types of Claims > Claim Classification

HN41[] Types of Claims, Claim Classification

A chapter 11 plan may separately classify similar claims so long as the classification scheme has a reasonable basis for doing so.

Bankruptcy Law > Claims > Types of Claims > Claim Classification

Bankruptcy Law > ... > Plan Confirmation > Prerequisites > Impaired Class Consent

Bankruptcy Law > ... > Reorganizations > Plans > Plan Acceptance

Bankruptcy Law > ... > Plans > Plan Confirmation > Consensual Confirmations

HN42[] Types of Claims, Claim Classification

Under the Bankruptcy Code, only creditors of a dissenting class can object to the confirmation of a plan on the grounds that the plan discriminates against its creditor class. Pursuant to section 1129(b)(1) of the Bankruptcy Code, a plan shall be confirmed if the plan does not discriminate unfairly with respect to each class of claims or interests that is impaired under, and has not accepted, the plan. 11 U.S.C.S. § 1129(b)(1).

Counsel: [1]** For The State of Washington, Appellant (7:21-cv-07532-CM): Matthew J. Gold, Robert Michael Tuchman, LEAD ATTORNEYS, Kleinberg, Kaplan, Wolff & Cohen, P.C., New York, NY.

For ***Purdue Pharma*** L.P., Appellee (7:21-cv-07532-CM): Benjamin S. Kaminetzky, Eli James Vonnegut, Marshall Scott Huebner, Timothy E. Graulich, LEAD ATTORNEYS, Davis Polk & Wardwell LLP (NYC), New York, NY; Christopher Scott Robertson, LEAD ATTORNEY, Davis Polk & Wardwell LLP, New York, NY.

For The Official Committee of Unsecured Creditors of ***Purdue Pharma*** L.P., et al., Interested Party (7:21-cv-07532-CM): Erik Preis, LEAD ATTORNEY, Akin Gump Strauss Hauer & Feld LLP, New York, NY; Mitchell Patrick Hurley, LEAD ATTORNEY, Akin Gump Strauss Hauer & Feld LLP (NYC), New York, NY.

For Ad Hoc Committee of Governmental and Other Contingent Litigation Claimants, Interested Party (7:21-cv-07532-CM): Kenneth H. Eckstein, LEAD ATTORNEY, David Ellis Blabey, Jr., Kramer Levin Naftalis & Frankel, LLP, New York, NY; Rachael Lynn Ringer, Kramer Levin Naftalis & Frankel, New York, NY.

For Ad Hoc Group of Individual Victims of ***Purdue Pharma***, L.P., Intervenor (7:21-cv-07532-CM): J. Christopher Shore, White & Case LLP (NY), New York, NY.

For **[**2]** The District of Columbia, Appellant (7:21-cv-07585-CM): Matthew J. Gold, Robert Michael Tuchman, LEAD ATTORNEYS, Kleinberg, Kaplan, Wolff & Cohen, P.C., New York, NY.

For ***Purdue Pharma*** L.P., Appellee (7:21-cv-07585-

CM): Benjamin S. Kaminetzky, Eli James Vonnegut, Marshall Scott Huebner, Timothy E. Graulich, LEAD ATTORNEYS, Davis Polk & Wardwell LLP (NYC), New York, NY; Christopher Scott Robertson, LEAD ATTORNEY, Davis Polk & Wardwell LLP, New York, NY.

For Multi-State Governmental Entities Group, Appellee (7:21-cv-07585-CM): James Paul Wehner, Jr., Todd Evan Phillips, Caplin & Drysdale, Chartered, Washington, DC.

For Raymond Sackler Family, Appellee (7:21-cv-07585-CM): Gerard Henry Uzzi, LEAD ATTORNEY, Milbank, Tweed, Hadley & McCloy LLP (NYC), New York, NY; Gregory P. Joseph, LEAD ATTORNEY, Mara Ann Leventhal, Joseph Hage Aaronson LLC, New York, NY; Alexander Lees, Milbank LLP, New York, NY.

For Mortimer-side Initial Covered Sackler Persons, Appellee (7:21-cv-07585-CM): Maura Kathleen Monaghan, LEAD ATTORNEY, Jasmine Ball, Debevoise & Plimpton, LLP (NYC), New York, NY.

For The Official Committee of Unsecured Creditors of ***Purdue Pharma*** L.P., et al., Interested Party (7:21-cv-07585-CM): **[**3]** Erik Preis, LEAD ATTORNEY, Akin Gump Strauss Hauer & Feld LLP, New York, NY; Mitchell Patrick Hurley, LEAD ATTORNEY, Akin Gump Strauss Hauer & Feld LLP (NYC), New York, NY.

For Ad Hoc Committee of Governmental and Other Contingent Litigation Claimants, Interested Party (7:21-cv-07585-CM): Kenneth H. Eckstein, LEAD ATTORNEY, David Ellis Blabey, Jr., Kramer Levin Naftalis & Frankel, LLP, New York, NY; Rachael Lynn Ringer, Kramer Levin Naftalis & Frankel, New York, NY.

For Ad Hoc Group of Individual Victims of ***Purdue Pharma***, L.P., Intervenor (7:21-cv-07585-CM): Alice Tsier, J. Christopher Shore, White & Case LLP (NY), New York, NY; Michele Meises, White & Case LLP, New York, NY.

For The City of Grande Prairie, as Representative Plaintiff for a Class Consisting of All Canadian Municipalities, the Cities of Brantford, Grand Prairie, Lethbridge, and Wetaskiwin., Appellant (7:21-cv-07961-CM): Allen J. Underwood, II, Becker Meisel, LLC, Livingston, NJ.

For ***Purdue Pharma*** L.P., Appellee (7:21-cv-07961-CM): Benjamin S. Kaminetzky, Eli James Vonnegut, Marshall Scott Huebner, Timothy E. Graulich, LEAD ATTORNEYS, Davis Polk & Wardwell LLP (NYC), New York, NY; Christopher Scott Robertson, LEAD ATTORNEY, **[**4]** Davis Polk & Wardwell LLP, New York, NY.

For Multi-State Governmental Entities Group, Appellee (7:21-cv-07961-CM): James Paul Wehner, Jr., Todd Evan Phillips, Caplin & Drysdale, Chartered, Washington, DC.

For The Official Committee of Unsecured Creditors of ***Purdue Pharma*** L.P., et al., Interested Party (7:21-cv-07961-CM): Erik Preis, LEAD ATTORNEY, Akin Gump Strauss Hauer & Feld LLP, New York, NY; Mitchell Patrick Hurley, LEAD ATTORNEY, Akin Gump Strauss Hauer & Feld LLP (NYC), New York, NY.

For Ad Hoc Committee of Governmental and Other Contingent Litigation Claimants, Interested Party (7:21-cv-07961-CM): Kenneth H. Eckstein, LEAD ATTORNEY, David Ellis Blabey, Jr., Kramer Levin Naftalis & Frankel, LLP, New York, NY; Rachael Lynn Ringer, Kramer Levin Naftalis & Frankel, New York, NY.

For Ad Hoc Group of Individual Victims of ***Purdue Pharma***, L.P., Intervenor (7:21-cv-07961-CM): J. Christopher Shore, White & Case LLP (NY), New York, NY.

For The Peter Ballantyne Cree Nation on behalf of All Canadian First Nations and Metis People, the Peter Ballantyne Cree Nation on behalf itself, and the Lac La Ronge Indian Band., Appellant (7:21-cv-07962-CM): Allen J. Underwood, II, LEAD ATTORNEY, Becker Meisel, **[**5]** LLC, Livingston, NJ.

For ***Purdue Pharma*** L.P., Appellee (7:21-cv-07962-CM): Benjamin S. Kaminetzky, Eli James Vonnegut, Marshall Scott Huebner, Timothy E. Graulich, LEAD ATTORNEYS, Davis Polk & Wardwell LLP (NYC), New York, NY; Christopher Scott Robertson, LEAD ATTORNEY, Davis Polk & Wardwell LLP, New York, NY.

For Multi-State Governmental Entities Group, Appellee (7:21-cv-07962-CM): James Paul Wehner, Jr., Todd Evan Phillips, Caplin & Drysdale, Chartered, Washington, DC.

For The Official Committee of Unsecured Creditors of ***Purdue Pharma*** L.P., et al., Interested Party (7:21-cv-07962-CM): Erik Preis, LEAD ATTORNEY, Akin Gump Strauss Hauer & Feld LLP, New York, NY; Mitchell Patrick Hurley, LEAD ATTORNEY, Akin Gump Strauss Hauer & Feld LLP (NYC), New York, NY.

For Ad Hoc Committee of Governmental and Other Contingent Litigation Claimants, Interested Party (7:21-cv-07962-CM): Kenneth H. Eckstein, LEAD ATTORNEY, David Ellis Blabey, Jr., Kramer Levin

Naftalis & Frankel, LLP, New York, NY; Rachael Lynn Ringer, Kramer Levin Naftalis & Frankel, New York, NY.

For Ad Hoc Group of Individual Victims of ***Purdue Pharma***, L.P., Intervenor (7:21-cv-07962-CM): J. Christopher Shore, White & Case LLP (NY), New **[**6]** York, NY.

For U.S. Trustee William K. Harrington, the United States Trustee for Region 2, Appellant (7:21-cv-07969-CM): Andrew D. Velez-Rivera, LEAD ATTORNEY, Ust, New York, NY; Beth Ann Levene, LEAD ATTORNEY, Ust, Washington, DC; Paul Kenan Schwartzberg, LEAD ATTORNEY, Office of The United States Trustee(NYC), New York, NY.

For ***Purdue Pharma*** L.P., Appellee (7:21-cv-07969-CM): Benjamin S. Kaminetzky, Eli James Vonnegut, Marshall Scott Huebner, Timothy E. Graulich, LEAD ATTORNEYS, Davis Polk & Wardwell LLP (NYC), New York, NY; Christopher Scott Robertson, LEAD ATTORNEY, Davis Polk & Wardwell LLP, New York, NY.

For Raymond Sackler Family/Side B of the Sackler Family, Appellee (7:21-cv-07969-CM): Alexander Lees, LEAD ATTORNEY, Milbank LLP, New York, NY; Gerard Henry Uzzi, LEAD ATTORNEY, Milbank, Tweed, Hadley & McCloy LLP (NYC), New York, NY; Gregory P. Joseph, Mara Ann Leventhal, LEAD ATTORNEYS, Joseph Hage Aaronson LLC, New York, NY.

For Mortimer Sackler Family/Side A of the Sackler Family, Appellee (7:21-cv-07969-CM): Jasmine Ball, Maura Kathleen Monaghan, LEAD ATTORNEYS, Debevoise & Plimpton, LLP (NYC), New York, NY; Jeffrey J. Rosen, LEAD ATTORNEY, Debevoise & Plimpton LLP, New York, **[**7]** NY.

For Multi-State Governmental Entities Group, Appellee (7:21-cv-07969-CM): James Paul Wehner, Jr., Todd Evan Phillips, Caplin & Drysdale, Chartered, Washington, DC.

For Raymond Sackler Family, Appellee (7:21-cv-07969-CM): Gregory P. Joseph, LEAD ATTORNEY, Mara Ann Leventhal, Joseph Hage Aaronson LLC, New York, NY; Alexander Lees, Milbank LLP, New York, NY.

For Mortimer-side Initial Covered Sackler Persons, Appellee (7:21-cv-07969-CM): Maura Kathleen Monaghan, LEAD ATTORNEY, Jasmine Ball, Debevoise & Plimpton, LLP (NYC), New York, NY.

For The Official Committee of Unsecured Creditors of ***Purdue Pharma*** L.P., et al., Interested Party (7:21-cv-07969-CM): Erik Preis, LEAD ATTORNEY, Akin Gump Strauss Hauer & Feld LLP, New York, NY; Mitchell Patrick Hurley, LEAD ATTORNEY, Akin Gump Strauss Hauer & Feld LLP (NYC), New York, NY.

For Ad Hoc Committee of Governmental and Other Contingent Litigation Claimants, Interested Party (7:21-cv-07969-CM): Kenneth H. Eckstein, LEAD ATTORNEY, David Ellis Blabey, Jr., Kramer Levin Naftalis & Frankel, LLP, New York, NY; Rachael Lynn Ringer, Kramer Levin Naftalis & Frankel, New York, NY.

For Ad Hoc Group of Individual Victims of ***Purdue Pharma***, L.P., Intervenor **[**8]** (7:21-cv-07969-CM): Alice Tsier, J. Christopher Shore, White & Case LLP (NY), New York, NY; Michele Meises, White & Case LLP, New York, NY.

State of Maryland, Appellant (7:21-cv-08034-CM), Pro se.

For ***Purdue Pharma*** L.P., Appellee (7:21-cv-08034-CM): Benjamin S. Kaminetzky, Kathryn S. Benedict, Marshall Scott Huebner, Timothy E. Graulich, LEAD ATTORNEYS, Davis Polk & Wardwell LLP (NYC), New York, NY; Christopher Scott Robertson, LEAD ATTORNEY, Davis Polk & Wardwell LLP, New York, NY.

For Raymond Sackler Family, Appellee (7:21-cv-08034-CM): Alexander Lees, LEAD ATTORNEY, Milbank LLP, New York, NY; Gerard Henry Uzzi, LEAD ATTORNEY, Milbank, Tweed, Hadley & McCloy LLP (NYC), New York, NY; Gregory P. Joseph, Mara Ann Leventhal, LEAD ATTORNEYS, Joseph Hage Aaronson LLC, New York, NY.

For Mortimer Sackler Family, Appellee (7:21-cv-08034-CM): Jasmine Ball, Maura Kathleen Monaghan, LEAD ATTORNEYS, Debevoise & Plimpton, LLP (NYC), New York, NY; Jeffrey J. Rosen, LEAD ATTORNEY, Debevoise & Plimpton LLP, New York, NY.

For Multi-State Governmental Entities Group, Appellee (7:21-cv-08034-CM): James Paul Wehner, Jr., Todd Evan Phillips, Caplin & Drysdale, Chartered, Washington, DC.

For The Official Committee **[**9]** of Unsecured Creditors of ***Purdue Pharma*** L.P., et al., Interested Party (7:21-cv-08034-CM): Erik Preis, LEAD ATTORNEY, Akin Gump Strauss Hauer & Feld LLP, New York, NY; Mitchell Patrick Hurley, LEAD ATTORNEY, Akin Gump Strauss Hauer & Feld LLP (NYC), New York, NY.

For Ad Hoc Committee of Governmental and Other Contingent Litigation Claimants, Interested Party (7:21-

cv-08034-CM): Kenneth H. Eckstein, LEAD ATTORNEY, David Ellis Blabey, Jr., Kramer Levin Naftalis & Frankel, LLP, New York, NY; Rachael Lynn Ringer, Kramer Levin Naftalis & Frankel, New York, NY.

For Ad Hoc Group of Individual Victims of ***Purdue Pharma***, L.P., Intervenor (7:21-cv-08034-CM): J. Christopher Shore, White & Case LLP (NY), New York, NY.

For State of Connecticut, William Tong, Attorney General, Appellants (7:21-cv-08042-CM): Irve Jay Goldman, LEAD ATTORNEY, Pullman & Comley, LLC (Bridgeport), Bridgeport, CT.

For ***Purdue Pharma*** L.P., Appellee (7:21-cv-08042-CM): Benjamin S. Kaminetzky, Eli James Vonnegut, Marshall Scott Huebner, Timothy E. Graulich, LEAD ATTORNEYS, Davis Polk & Wardwell LLP (NYC), New York, NY; Christopher Scott Robertson, LEAD ATTORNEY, Davis Polk & Wardwell LLP, New York, NY.

For Raymond Sackler Family/Side **[**10]** B of the Sackler Family, Appellee (7:21-cv-08042-CM): Alexander Lees, LEAD ATTORNEY, Milbank LLP, New York, NY; Gerard Henry Uzzi, LEAD ATTORNEY, Milbank, Tweed, Hadley & McCloy LLP (NYC), New York, NY.

For Mortimer Sackler Family/Side A of the Sackler Family, Appellee (7:21-cv-08042-CM): Jasmine Ball, Maura Kathleen Monaghan, LEAD ATTORNEYS, Debevoise & Plimpton, LLP (NYC), New York, NY; Jeffrey J. Rosen, LEAD ATTORNEY, Debevoise & Plimpton LLP, New York, NY.

For Multi-State Governmental Entities Group, Appellee (7:21-cv-08042-CM): James Paul Wehner, Jr., Todd Evan Phillips, Caplin & Drysdale, Chartered, Washington, DC.

For The Official Committee of Unsecured Creditors of ***Purdue Pharma*** L.P., et al., Interested Party (7:21-cv-08042-CM): Erik Preis, LEAD ATTORNEY, Akin Gump Strauss Hauer & Feld LLP, New York, NY; Mitchell Patrick Hurley, LEAD ATTORNEY, Akin Gump Strauss Hauer & Feld LLP (NYC), New York, NY.

For Ad Hoc Committee of Governmental and Other Contingent Litigation Claimants, Interested Party (7:21-cv-08042-CM): Kenneth H. Eckstein, LEAD ATTORNEY, David Ellis Blabey, Jr., Kramer Levin Naftalis & Frankel, LLP, New York, NY; Rachael Lynn Ringer, Kramer Levin Naftalis & Frankel, **[**11]** New York, NY.

For Ad Hoc Group of Individual Victims of ***Purdue Pharma***, L.P., Intervenor (7:21-cv-08042-CM): J. Christopher Shore, White & Case LLP (NY), New York, NY.

Ronald Bass, Appellant (7:21-cv-08049-CM), Pro se, N. Plainfield, NJ.

For ***Purdue Pharma*** L.P., Appellee (7:21-cv-08049-CM): Benjamin S. Kaminetzky, Eli James Vonnegut, Marshall Scott Huebner, Timothy E. Graulich, LEAD ATTORNEYS, Davis Polk & Wardwell LLP (NYC), New York, NY; Christopher Scott Robertson, LEAD ATTORNEY, Davis Polk & Wardwell LLP, New York, NY.

For Multi-State Governmental Entities Group, Appellee (7:21-cv-08049-CM): James Paul Wehner, Jr., Todd Evan Phillips, Caplin & Drysdale, Chartered, Washington, DC.

For The Official Committee of Unsecured Creditors of ***Purdue Pharma*** L.P., et al., Interested Party (7:21-cv-08049-CM): Erik Preis, LEAD ATTORNEY, Akin Gump Strauss Hauer & Feld LLP, New York, NY; Mitchell Patrick Hurley, LEAD ATTORNEY, Akin Gump Strauss Hauer & Feld LLP (NYC), New York, NY.

For Ad Hoc Committee of Governmental and Other Contingent Litigation Claimants, Interested Party (7:21-cv-08049-CM): Kenneth H. Eckstein, LEAD ATTORNEY, David Ellis Blabey, Jr., Kramer Levin Naftalis & Frankel, LLP, New York, **[**12]** NY; Rachael Lynn Ringer, Kramer Levin Naftalis & Frankel, New York, NY.

For Ad Hoc Group of Individual Victims of ***Purdue Pharma***, L.P., Intervenor (7:21-cv-08049-CM): J. Christopher Shore, White & Case LLP (NY), New York, NY.

For State of California, Appellant (7:21-cv-08055-CM): Bernard Ardavan Eskandari, LEAD ATTORNEY, California Department of Justice, Civil Division, St. Deputy Atty. General, Los Angeles, CA; Nicklas Arnold Akers, California Attorney General's Office, San Francisco, CA.

For People of The State of California, by and through Attorney General Rob Bonta, Appellant (7:21-cv-08055-CM): Bernard Ardavan Eskandari, LEAD ATTORNEY, California Department of Justice, Civil Division, St. Deputy Atty. General, Los Angeles, CA; Nicklas Arnold Akers, California Attorney General's Office, San Francisco, CA; Appellee, ***Purdue Pharma*** L.P., LEAD ATTORNEY; Benjamin S. Kaminetzky, Eli James Vonnegut, Marshall Scott Huebner, Timothy E. Graulich, LEAD ATTORNEYS, Davis Polk & Wardwell LLP (NYC), New York, NY; Christopher Scott Robertson, LEAD ATTORNEY, Davis Polk & Wardwell LLP, New York, NY; Appellee, Multi-State Governmental Entities Group; James Paul Wehner, Jr., Todd Evan Phillips, Caplin **[**13]** & Drysdale, Chartered, Washington, DC.

For The Official Committee of Unsecured Creditors of ***Purdue Pharma*** L.P., et al., Interested Party (7:21-cv-08055-CM): Erik Preis, LEAD ATTORNEY, Akin Gump Strauss Hauer & Feld LLP, New York, NY; Mitchell Patrick Hurley, LEAD ATTORNEY, Akin Gump Strauss Hauer & Feld LLP (NYC), New York, NY.

For Ad Hoc Committee of Governmental and Other Contingent Litigation Claimants, Interested Party (7:21-cv-08055-CM): Kenneth H. Eckstein, LEAD ATTORNEY, David Ellis Blabey, Jr., Kramer Levin Naftalis & Frankel, LLP, New York, NY; Rachael Lynn Ringer, Kramer Levin Naftalis & Frankel, New York, NY.

For Ad Hoc Group of Individual Victims of ***Purdue Pharma***, L.P., Intervenor (7:21-cv-08055-CM): J. Christopher Shore, White & Case LLP (NY), New York, NY.

For The State of Delaware, by and through Attorney General Jennings, Appellant (7:21-cv-08139-CM): Jillian Amy Lazar, LEAD ATTORNEY, Delaware Department of Justice, Willmington, DE.

For ***Purdue Pharma*** L.P., Appellee (7:21-cv-08139-CM): Benjamin S. Kaminetzky, Eli James Vonnegut, Marshall Scott Huebner, Timothy E. Graulich, LEAD ATTORNEYS, Davis Polk & Wardwell LLP (NYC), New York, NY; Christopher Scott Robertson, LEAD ATTORNEY, **[**14]** Davis Polk & Wardwell LLP, New York, NY.

For Raymond Sackler Family/Side B of the Sackler Family, Appellee (7:21-cv-08139-CM): Alexander Lees, LEAD ATTORNEY, Milbank LLP, New York, NY; Gerard Henry Uzzi, LEAD ATTORNEY, Milbank, Tweed, Hadley & McCloy LLP (NYC), New York, NY.

For Mortimer Sackler Family/Side A of the Sackler Family, Appellee (7:21-cv-08139-CM): Jasmine Ball, Maura Kathleen Monaghan, LEAD ATTORNEYS, Debevoise & Plimpton, LLP (NYC), New York, NY; Jeffrey J. Rosen, LEAD ATTORNEY, Debevoise & Plimpton LLP, New York, NY.

For Multi-State Governmental Entities Group, Appellee (7:21-cv-08139-CM): James Paul Wehner, Jr., Todd Evan Phillips, Caplin & Drysdale, Chartered, Washington, DC.

For Ad Hoc Committee of Governmental and Other Contingent Litigation Claimants, Interested Party (7:21-cv-08139-CM): Kenneth H. Eckstein, LEAD ATTORNEY, David Ellis Blabey, Jr., Kramer Levin Naftalis & Frankel, LLP, New York, NY; Rachael Lynn Ringer, Kramer Levin Naftalis & Frankel, New York, NY.

For State of Oregon, Appellant (7:21-cv-08271-CM): Matthew J. Gold, LEAD ATTORNEY, Kleinberg, Kaplan, Wolff & Cohen, P.C., New York, NY.

For ***Purdue Pharma*** L.P., Appellee (7:21-cv-08271-CM): Benjamin S. Kaminetzky, **[**15]** Eli James Vonnegut, Marshall Scott Huebner, Timothy E. Graulich, LEAD ATTORNEYS, Davis Polk & Wardwell LLP (NYC), New York, NY; Christopher Scott Robertson, LEAD ATTORNEY, Davis Polk & Wardwell LLP, New York, NY.

For The Official Committee of Unsecured Creditors of ***Purdue Pharma*** L.P., et al., Appellee (7:21-cv-08271-CM): Erik Preis, LEAD ATTORNEY, Akin Gump Strauss Hauer & Feld LLP, New York, NY; Mitchell Patrick Hurley, LEAD ATTORNEY, Akin Gump Strauss Hauer & Feld LLP (NYC), New York, NY.

For Multi-State Governmental Entities Group, Appellee (7:21-cv-08271-CM): James Paul Wehner, Jr., Todd Evan Phillips, Caplin & Drysdale, Chartered, Washington, DC.

For Raymond Sackler Family, Appellee (7:21-cv-08271-CM): Gerard Henry Uzzi, LEAD ATTORNEY, Milbank, Tweed, Hadley & McCloy LLP (NYC), New York, NY; Gregory P. Joseph, LEAD ATTORNEY, Mara Ann Leventhal, Joseph Hage Aaronson LLC, New York, NY; Alexander Lees, Milbank LLP, New York, NY.

For Mortimer-side Initial Covered Sackler Persons, Appellee (7:21-cv-08271-CM): Maura Kathleen Monaghan, LEAD ATTORNEY, Jasmine Ball, Debevoise & Plimpton, LLP (NYC), New York, NY.

For Ad Hoc Group of Individual Victims of ***Purdue Pharma***, L.P., Intervenor (7:21-cv-08271-CM): **[**16]** Alice Tsier, J. Christopher Shore, White & Case LLP (NY), New York, NY; Michele Meises, White & Case LLP, New York, NY.

For U.S. Trustee William K. Harrington, the United States Trustee for Region 2, Appellant (7:21-cv-07966-CM): Andrew D. Velez-Rivera, LEAD ATTORNEY, Ust, New York, NY; Beth Ann Levene, LEAD ATTORNEY, Ust, Washington, DC; Paul Kenan Schwartzberg, LEAD ATTORNEY, Office of The United States Trustee(NYC), New York, NY; Sumi Kay Sakata, Ust, Executive Office for U.S. Trustees, Washington D.C., DC.

For ***Purdue Pharma*** L.P., Appellee (7:21-cv-07966-CM): Benjamin S. Kaminetzky, Eli James Vonnegut, Marshall Scott Huebner, Timothy E. Graulich, LEAD ATTORNEYS, Davis Polk & Wardwell LLP (NYC), New York, NY; Christopher Scott Robertson, LEAD ATTORNEY, Davis Polk & Wardwell LLP, New York, NY.

For Ad Hoc Group of Individual Victims of ***Purdue Pharma***, L.P., Appellee (7:21-cv-07966-CM): Alice Tsier, J. Christopher Shore, White & Case LLP (NY), New York, NY; Michele Meises, White & Case LLP, New York, NY.

For Multi-State Governmental Entities Group, Appellee (7:21-cv-07966-CM): James Paul Wehner, Jr., Todd Evan Phillips, Caplin & Drysdale, Chartered, Washington, DC.

For Raymond Sackler Family, **[**17]** Appellee (7:21-cv-07966-CM): Gerard Henry Uzzi, LEAD ATTORNEY, Alexander Lees, Milbank LLP, New York, NY; Gregory P. Joseph, LEAD ATTORNEY, Mara Ann Leventhal, Joseph Hage Aaronson LLC, New York, NY.

For Mortimer-side Initial Covered Sackler Persons, Appellee (7:21-cv-07966-CM): Maura Kathleen Monaghan, LEAD ATTORNEY, Jasmine Ball, Debevoise & Plimpton, LLP (NYC), New York, NY.

For The Official Committee of Unsecured Creditors of ***Purdue Pharma*** L.P., et al., Interested Party (7:21-cv-07966-CM): Erik Preis, LEAD ATTORNEY, Akin Gump Strauss Hauer & Feld LLP, New York, NY; Mitchell Patrick Hurley, LEAD ATTORNEY, Akin Gump Strauss Hauer & Feld LLP (NYC), New York, NY; Z.W. Julius Chen, LEAD ATTORNEY, Akin Gump Strauss Hauer & Feld LLP, Washington DC, DC.

For Ad Hoc Committee of Governmental and Other Contingent Litigation Claimants, Interested Party (7:21-cv-07966-CM): Kenneth H. Eckstein, LEAD ATTORNEY, Jonathan Mark Wagner, Kramer Levin Naftalis & Frankel, LLP, New York, NY; Daniel Isaac Wolf, Gilbert LLP, District of Columbia, Washington, DC; David Ellis Blabey, Jr., Kramer, Levin, Naftalis & Frankel, LLP, New York, NY; Rachael Lynn Ringer, Kramer Levin Naftalis & Frankel, New York, NY. **[**18]**

For United States of America, Amicus (7:21-cv-07966-CM): Danielle Judith Levine, U.S. Attorney Office SDNY, New York, NY.

State of Rhode Island, Appellant (7:21-cv-08258-CM), Pro se.

Peter F. Neronha, Attorney General, Appellant (7:21-cv-08258-CM), Pro se.

For ***Purdue Pharma*** L.P., Appellee (7:21-cv-08258-CM): Benjamin S. Kaminetzky, Eli James Vonnegut, Marshall Scott Huebner, Timothy E. Graulich, LEAD ATTORNEYS, Davis Polk & Wardwell LLP (NYC), New York, NY; Christopher Scott Robertson, LEAD ATTORNEY, Davis Polk & Wardwell LLP, New York, NY.

For The Official Committee of Unsecured Creditors of ***Purdue Pharma*** L.P., et al., Appellee (7:21-cv-08258-CM): Erik Preis, LEAD ATTORNEY, Akin Gump Strauss Hauer & Feld LLP, New York, NY; Mitchell Patrick Hurley, LEAD ATTORNEY, Akin Gump Strauss Hauer & Feld LLP (NYC), New York, NY.

For Multi-State Governmental Entities Group, Appellee (7:21-cv-08258-CM): James Paul Wehner, Jr., Todd Evan Phillips, Caplin & Drysdale, Chartered, Washington, DC.

For Ad Hoc Group of Individual Victims of ***Purdue Pharma***, L.P., Appellee (7:21-cv-08258-CM): Alice Tsier, J. Christopher Shore, White & Case LLP (NY), New York, NY; Michele Meises, White & Case LLP, New York, NY.

For **[**19]** Mortimer-side Initial Covered Sackler Persons, Appellee (7:21-cv-08258-CM): Maura Kathleen Monaghan, LEAD ATTORNEY, Jasmine Ball, Debevoise & Plimpton, LLP (NYC), New York, NY.

For Ad Hoc Committee of Governmental and Other Contingent Litigation Claimants, Interested Party (7:21-cv-08258-CM): Kenneth H. Eckstein, LEAD ATTORNEY, David Ellis Blabey, Jr., Kramer Levin Naftalis & Frankel, LLP, New York, NY; Daniel Isaac Wolf, Gilbert LLP, District of Columbia, Washington, Washington, DC; Rachael Lynn Ringer, Kramer Levin Naftalis & Frankel, New York, NY; Amicus, United States of America; Danielle Judith Levine, U.S. Attorney Office SDNY, New York, NY.

For State of Vermont, Appellant (7:21-cv-08548-CM): Jill Abrams, LEAD ATTORNEY, Office of the Attorney General, Attorney Generals Office, Montpelier, VT.

For ***Purdue Pharma*** L.P., Appellee (7:21-cv-08548-CM): Benjamin S. Kaminetzky, Eli James Vonnegut, Marshall Scott Huebner, Timothy E. Graulich, LEAD ATTORNEYS, Davis Polk & Wardwell LLP (NYC), New York, NY; Christopher Scott Robertson, LEAD ATTORNEY, Davis Polk & Wardwell LLP, New York, NY.

For Mortimer-side Initial Covered Sackler Persons, Appellee (7:21-cv-08548-CM): Maura Kathleen Monaghan, **[**20]** LEAD ATTORNEY, Jasmine Ball, Debevoise & Plimpton, LLP (NYC), New York, NY; Amicus, United States of America; Danielle Judith Levine, U.S. Attorney Office SDNY, New York, NY.

Maria Ecke, Appellant (7:21-cv-08566-CM), Pro se, West Simsbury, CT.

Andrew Ecke, Appellant (7:21-cv-08566-CM), Pro se, West Simsbury, CT.

Richard Ecke, Appellant (7:21-cv-08566-CM), Pro se, West Simsbury, CT.

For ***Purdue Pharma*** L.P., Appellee (7:21-cv-08566-CM): Benjamin S. Kaminetzky, Eli James Vonnegut, Marshall Scott Huebner, Timothy E. Graulich, LEAD ATTORNEYS, Davis Polk & Wardwell LLP (NYC), New York, NY; Christopher Scott Robertson, LEAD ATTORNEY, Davis Polk & Wardwell LLP, New York, NY.

For United States of America, Amicus (7:21-cv-08566-CM): Danielle Judith Levine, U.S. Attorney Office SDNY, New York, NY.

Ellen Isaacs, on Behalf of Patrick Ryan Wroblewski, Appellant, Pro se.

For ***Purdue Pharma*** L.P., Appellee (7:21-cv-08557-CM): Benjamin S. Kaminetzky, Eli James Vonnegut, Marshall Scott Huebner, Timothy E. Graulich, LEAD ATTORNEYS, Davis Polk & Wardwell LLP (NYC), New York, NY; Christopher Scott Robertson, LEAD ATTORNEY, Davis Polk & Wardwell LLP, New York, NY.

For Mortimer-side Initial Covered Sackler Persons, **[**21]** Appellee (7:21-cv-08557-CM): Maura Kathleen Monaghan, LEAD ATTORNEY, Jasmine Ball, Debevoise & Plimpton, LLP (NYC), New York, NY.

For United States of America, Amicus (7:21-cv-08557-CM): Danielle Judith Levine, U.S. Attorney Office SDNY, New York, NY.

Judges: Colleen McMahon, UNITED STATES DISTRICT JUDGE.

Opinion by: Colleen McMahon

Opinion

[*34] DECISION AND ORDER ON APPEAL

McMahon, J.:

This is an appeal from an order of the United States Bankruptcy Court for the Southern District of New York ("Bankruptcy Court") (Drain, B.J.), announced from the bench on September 1, 2021, and filed on September 17, 2021, confirming the Plan of Reorganization proposed by Debtors ***Purdue Pharma*** L.P. ("***Purdue*** ***Pharma***") and certain associated companies[1] (the "Confirmation Order"). Appeal is also taken from two merged and related orders of the Bankruptcy Court: the June 3, 2021, order approving ***Purdue***'s disclosure statement and solicitation materials (the "Disclosure Order") and the September 15, 2021, order authorizing the implementation of certain preliminary aspects of the Plan (the "Advance Order").

Purdue's bankruptcy was occasioned by a health crisis that was, in significant part, of its own making: an explosion of opioid addiction in the **[**22]** United States over the past two decades, which can be traced largely to the over-prescription of highly addictive medications, including, specifically and principally, ***Purdue***'s proprietary, OxyContin.

Despite a 2007 Plea Agreement with the United States — in which ***Purdue*** admitted that it had falsely marketed OxyContin as non-addictive and had submitted false claims to the federal government for reimbursement of medically unnecessary opioid prescriptions ("2007 Plea Agreement") — ***Purdue***'s profits after 2007 were driven almost exclusively by its aggressive marketing of OxyContin. (*See* JX-2094.0047-88; JX-2481). But by 2019, ***Purdue*** was facing thousands of lawsuits brought by persons who had become addicted to OxyContin and by the estates of addicts who had overdosed — either on OxyContin itself or on the street drugs (heroin, fentanyl) for which ***Purdue***'s product served as a feeder. It also faced new federal, state and local Medicare reimbursement claims and a number of new false marketing claims brought under various state consumer

[1] ***Purdue Pharma*** Inc. ("PPI"), ***Purdue*** Transdermal Technologies L.P., ***Purdue Pharma*** Manufacturing L.P., ***Purdue*** Pharmaceuticals L.P., Imbrium Therapeutics L.P., Adlon Therapeutics L.P., Greenfield BioVentures L.P., Seven Seas Hill Corp., Ophir Green Corp., ***Purdue Pharma*** of Puerto Rico, Avrio Health L.P., ***Purdue*** Pharmaceutical Products L.P., ***Purdue*** Neuroscience Company, Nayatt Cove Lifescience Inc., Button Land L.P., Rhodes Associates L.P., Paul Land Inc., Quidnick Land L.P., Rhodes Pharmaceuticals L.P., Rhodes Technologies, UDF LP, SVC ***Pharma*** LP, and

SVC ***Pharma*** Inc. (together, the "Debtors" or "***Purdue***").

protection **[*35]** laws. Finally, in November 2020, ***Purdue*** pled guilty to a criminal Information filed by the Department of Justice ("DOJ") in the United States District **[**23]** Court for the District of New Jersey; in its plea agreement, the company (though not the people through whom the company acted) admitted to substantial deliberate wrongful conduct ("2020 Plea Agreement"). *See USA v. **Purdue Pharma** L.P.*, No. 2:20-cr-01028.

Engulfed in a veritable tsunami of litigation, ***Purdue*** filed for chapter 11 bankruptcy in September 2019. The intent was for a "*Manville*-style" bankruptcy that would resolve both existing and future claims against the company arising from the prescription of OxyContin. The automatic stay brought a stop to civil litigation against ***Purdue***; and a court-ordered stay halted litigation against certain non-debtors affiliated with the company — principally members of the Sackler family (the "Sacklers" or "Sackler family"),[2] which had long owned the privately-held company — to buy time to craft a resolution. For two years, committees of various classes of creditors — individuals, state and local governments, indigenous North American tribes, even representatives of unborn children who were destined to suffer from opioid addiction — negotiated with ***Purdue*** and the Sacklers under the watchful eye of the experienced Bankruptcy Judge, with the assistance **[**24]** of two of this country's finest and most experienced mediators (Layn Phillips and Kenneth Feinberg), as well as a second Bankruptcy Judge (The Hon. Shelley Chapman).

Eventually, the parties crafted a plan of reorganization for ***Purdue*** that would, if implemented, afford billions of dollars for the resolution of both private and public claims, while funding opioid relief and education programs that could provide tremendous benefit to the consuming public at large (the "Plan").[3] That Plan was approved by supermajority of the votes cast by the members of each class of creditors.[4] It was confirmed by Judge Drain, who had invested so much of himself in the effort to find a workable solution to a seemingly intractable problem.

But not everyone voted yes. Eight states and the District of Columbia ("D.C."), as well as certain Canadian municipalities and Canadian indigenous tribes, the City of Seattle (alone among all voting municipalities in the United States), as well as some 2,683 individual personal injury claimants, voted against the adoption of the Plan. The same states, municipalities and tribes, together with three of those individual claimants (representing themselves), filed formal objections **[**25]** to the Plan and have appealed from its confirmation.[5] The United States Trustee (the "U.S. Trustee") in Bankruptcy[6] and the U.S. **[*36]** Attorney's Office for this District on behalf of the United States of America join in their objections.

All Appellants assign the same reason for their opposition: the Plan provides broad releases, not just of derivative, but of particularized or direct claims — including claims predicated on fraud, misrepresentation, and willful misconduct under various state consumer protection statutes — to the members of the Sackler family (none of whom is a debtor in the bankruptcy case) and to their affiliates and related entities. As the opioid crisis continued and worsened in the wake of ***Purdue***'s 2007 Plea Agreement, the Sacklers — or at least those members of the family who were actively involved in the day to day management of ***Purdue***[7] —

[2] The Sacklers or Sackler family in this opinion means the Mortimer D. Sackler Family (also known as "Side A" of the Sackler family) and the Raymond R. Sackler Family (also known as "Side B" of the Sackler family).

[3] The Plan refers to confirmed chapter 11 bankruptcy plan of reorganization at Bankruptcy Docket Number 3726. (*See* Dkt. No. 91-3, at App.1070-1227).

[4] It is true that many members of some creditor classes did not cast a vote, but the law provides that a plan must be approved, not by a supermajority of all eligible voters, but by a supermajority of all actual voters. *11 U.S.C. § 1126*. That being so, there is no merit to Appellants' argument that the court should not deem the Plan approved by a supermajority of the affected creditor classes.

[5] While the City of Seattle objected to the Plan before the Bankruptcy Court, it did not appeal.

[6] The U.S. Trustee "is a DOJ official appointed by the Attorney General to supervise the administration of bankruptcy cases" and has standing under *11 U.S.C. § 307* to appear in bankruptcy cases and "comment on proposed disclosure statements and chapter 11 plans." (Dkt. No. 91, at 8 (citing *28 U.S.C. §§ 581-589* and *28 U.S.C. § 586(a)(3)(B)*).

[7] Ilene Sackler Lefcourt, Kathe Sackler, Mortimer D.A. Sackler, Theresa Sackler, Richard Sackler, Jonathan Sackler, and David Sackler were at some or all relevant times directors of ***Purdue*** and its related enterprises. Mortimer D. Sackler and Raymond Sackler had management roles at the company as co-chief executive officers; Richard Sackler also served as president; and Mortimer D.A. Sackler, Ilene Sackler Lefcourt,

were well aware that they were exposed to personal liability over OxyContin. Concerned about how their personal financial situation might be affected, the family began what one member described as an "aggressive[]" program of withdrawing money from ***Purdue*** almost as soon as the ink was dry on the 2007 papers. The Sacklers upstreaming **[**26]** some $10.4 billion out of the company between 2008 and 2017, which, according to their own expert, substantially reduced ***Purdue***'s "solvency cushion." Over half of that money was either invested in offshore companies owned by the Sacklers or deposited into spendthrift trusts that could not be reached in bankruptcy and off-shore entities located in places like the Bailiwick of Jersey.

When the family fortune was secure, the Sackler family members withdrew from ***Purdue***'s Board and management. Bankruptcy discussions commenced the following year. As part of those pre-filing discussions, the Sacklers offered to contribute toward a settlement, but if — and only if — every member of the family could "achieve global peace" from all civil (not criminal) litigation, including litigation by ***Purdue*** to claw back the money that had been taken out of the corporation. The Plan confirmed by the Bankruptcy Court extinguishes all civil claims against the Sacklers that relate in any way to the operations of ***Purdue*** — including claims on which certain members of the Sackler family could be held personally liable to entities other than ***Purdue*** (principally the various states). These claims could not be released **[**27]** if the Sacklers were themselves debtors in bankruptcy.

Appellants attack the legality of the Plan's non-consensual release of third-party claims against non-debtors on a number of grounds. They argue that the release (referred to in this opinion as the "Section 10.7 Shareholder Release") is both constitutionally defective and not statutorily authorized; that the Bankruptcy Court lacks constitutional authority and subject matter jurisdiction to approve the release or to carry out certain "gatekeeping" aspects of the Plan that relate to it; and that granting a release to the non-debtor Sacklers is unwarranted as a matter of fact and would constitute an abuse of the bankruptcy process.

[*37] Debtors and those who voted in favor of the Plan — buttressed by Judge Drain's comprehensive Confirmation Order — argue that the Bankruptcy Court had undoubted jurisdiction to impose these broad third-party releases; insist that they are a necessary feature of the Plan; point out the tremendous public benefit that will be realized by implementing the Plan's many forward-looking provisions; and urge that the alternative — ***Purdue***'s liquidation — will inevitably yield far less benefit to all creditors and victims, **[**28]** in light of the cost and extraordinary hurdles that would have to be surmounted in order to claw back the billions of dollars that the Sacklers have taken out of ***Purdue***.

Two of the questions raised by appellants are easily answered. The Bankruptcy Court had undoubted subject matter jurisdiction to enter the challenged releases. And while it may have lacked constitutional authority to give them final approval under the rule of *Stern v. Marshall, 564 U.S. 462, 131 S. Ct. 2594, 180 L. Ed. 2d 475 (2011)*, that matters little in the great scheme of things; it changes the level of deference this court should give to Judge Drain's findings of fact, but those findings are essentially unchallenged.

The great unsettled question in this case is whether the Bankruptcy Court — or any court — is statutorily authorized to grant such releases. This issue has split the federal Circuits for decades. While the Circuits that say no are united in their reasoning, the Circuits that say yes offer various justifications for their conclusions. And — crucially for this case — although the Second Circuit identified the question as open back in 2005, it has not yet had occasion to analyze the issue. Its only guidance to the lower courts, uttered in that 2005 opinion, is this: because **[**29]** statutory authority is questionable and such releases can be abused, they should be granted sparingly and only in "unique" cases.

This will no longer do. Either statutory authority exists or it does not. There is no principled basis for acting on questionable authority in "rare" or "unique" cases, especially as the United States Supreme Court has recently held that there is no "rare case" rule in bankruptcy that allows a court to trump the Bankruptcy Code. *See* *Czyzewski v. Jevic Holding Corp., 137 S. Ct. 973, 986, 197 L. Ed. 2d 398 (2017)*.

Moreover, the lower courts desperately need a clear answer. As one of my colleagues on the Bankruptcy Court recently noted, plans releasing non-debtors from third party claims are no rarity: "Unfortunately, in actual practice the parties . . . often seek to impose involuntary releases based solely on the contention that anybody who makes a contribution to the case has earned a third-party release. *Almost every proposed Chapter 11*

---

and Kathe Sackler held officer roles as vice presidents. Mariana Sackler worked at ***Purdue*** in research and development.

Plan that I receive includes proposed releases." In re Aegean Marine Petroleum Network Inc., 599 B.R. 717, 726 (S.D.N.Y. 2019) (Wiles, B.J.) (emphasis added). When every case is unique, none is unique. Given the frequency with which this issue arises, the time has come for a comprehensive analysis of whether authority for such releases can be found in the Bankruptcy Code — that **[**30]** "comprehensive scheme" devised by Congress for resolving debtor-creditor relations. *See* RadLAX Gateway Hotel, LLC v. Amalgamated Bank, 566 U.S. 639, 645, 132 S. Ct. 2065, 182 L. Ed. 2d 967 (2012).

Aided by superb briefing and argument on both sides of the question, and by extended ruminations on the subject by several esteemed bankruptcy judges of our own District — Judge Drain not the least — this Court concludes that the Bankruptcy Code does not authorize such non-consensual non-debtor releases: not in its express **[*38]** text (which is conceded); not in its silence (which is disputed); and not in any section or sections of the Bankruptcy Code that, read singly or together, purport to confer generalized or "residual" powers on a court sitting in bankruptcy. For that reason, the Confirmation Order (and the Advance Order that flows from it) must be vacated.

Because I conclude that the Bankruptcy Court lacked statutory authority to impose the Section 10.7 Shareholder Release, I need not and do not reach the constitutional questions that have been raised by the parties. Nor do I need to decide whether this is a case in which such releases should be imposed if my statutory analysis is incorrect. Those issues may need to be addressed some day, but they do not need to be addressed in order to dispose **[**31]** of this appeal.

This opinion will not be the last word on the subject, nor should it be. This issue has hovered over bankruptcy law for thirty-five years — ever since Congress added §§ 524(g) and (h) to the Bankruptcy Code. It must be put to rest sometime; at least in this Circuit, it should be put to rest now.

PARTIES [8]

The Appellants in this case are the U.S. Trustee William K. Harrington; the States of California, Connecticut, Delaware, Maryland, Oregon, Rhode Island, Vermont, Washington, and D.C. (together, the "State Appellants"); the City of Grande Prairie as Representative for a Class Consisting of All Canadian Municipalities, the Cities of Brantford, Grand Prairie, Lethbridge, and Wetaskiwin; the Peter Ballantyne Cree Nation on behalf of All Canadian First Nations and Metis People; the Peter Ballantyne Cree Nation on behalf itself, and the Lac La Ronge Indian Band (together, the "Canadian Appellants"); and *pro se* Appellants Ronald Bass, Marie Ecke, Andrew Ecke, Richard Ecke, and Ellen Isaacs on Behalf of Patrick Ryan Wroblewski (together, the "Pro Se Appellants").

The Appellees are the ***Purdue*** Debtors, as well as the Official Committee of Unsecured Creditors of ***Purdue Pharma*** L.P., et al. (the **[**32]** "UCC"),[9] the Ad Hoc Committee of Governmental and Other Contingent Litigation Claimants ("AHC"),[10] the Ad Hoc Group of Individual Victims of ***Purdue Pharma***, L.P. ("PI Ad Hoc Group"), the Multi-State Governmental Entities Group ("MSGE"), the Mortimer-side Initial Covered Sackler Persons ("Side A"), and the Raymond Sackler Family ("Side B").

The Ad Hoc Committee of NAS Children ("NAS Children") appears as *amicus curiae* and has filed an *amicus* brief. (Dkt. No. 158). The U.S. Attorney's Office for this District also appears on behalf of the United States of America as *amicus curiae* and has filed a statement of interest in this case. (Dkt. No. 94).

BACKGROUND

The following facts are derived from the appellate record as designated by the parties to this appeal, unless indicated otherwise. (*See* Dkt. Nos. 78-1, 105, 255). The **[*39]** Court judicially notices certain public court records and other matters that are subject to judicial notice. *See* Fed. R. Evid. 201 (b)-(d).[11]

---

[8] In this decision, docket numbers abbreviated "Dkt. No." refer to the consolidated docketed appeals at 7:21-cv-7532; docket numbers abbreviated "Bankr. Dkt. No." refer to the underlying bankruptcy docket at 19-23649.

[9] The UCC is also referred to in court filings and the appellate record as the "Creditors' Committee." The Court uses the terminology "UCC" consistent with the language provided in the glossary at Docket Number 115-1.

[10] The AHC is also referred to in court filings and the appellate record as the "Ad Hoc Committee." The Court uses the terminology "AHC" consistent with the language provided in the glossary at Docket Number 115-1.

[11] ***HN1***[] *See Garber v. Legg Mason Inc., 347 F. App'x 665,*

I. ***Purdue Pharma***, L.P.

Purdue — originally known as "***Purdue*** Frederick Company" — was founded by John ***Purdue*** Gray and George Frederick Bingham in 1892. The company was sold to brothers Arthur, Mortimer and Raymond Sackler in 1952. (*See* JX-2148; JX-1985, at 33:12-13). **[**33]**

Purdue Pharma, the Debtors' main operating entity, is a Delaware limited partnership headquartered in Stamford, Connecticut. (Dkt. No. 91-4, at App.1244). ***Purdue*** Phanna's general partner is ***Purdue Pharma*** Inc. ("PPI"), a New York corporation, also headquartered in Stamford, Connecticut. (*Id.*, JX-1221). The board of directors of PPI manages ***Purdue Pharma*** (the "Board"). (Dkt. No. 91-4, at App.1250). ***Purdue*** ***Pharma*** has 22 wholly owned subsidiaries in the United States and the British Virgin Islands. (.*Id* at App.1244).

Purdue Pharma is wholly owned by Pharmaceutical Research Associates, L.P. ("PRA"), a Delaware limited partnership that is not a debtor in this case. (.*Id* at App.1252). PRA is 99.5% owned, in equal parts, by non-debtors Beacon Company ("Beacon"), a Delaware general partnership, and Rosebay Medical Company L.P. ("Rosebay"), a Delaware limited partnership, which are in turn owned by certain trusts established for the benefit of the Sackler Families. (*Id.*. Beacon is the partnership of Side A of the Sackler family; Rosebay is the partnership of Side B of the Sackler family. (*See* JX-1987, at 42:10-23; JX-3298 at 160:8-10).[12]

---

669 (2d Cir. 2009) ("' [a] court may take judicial notice, whether requested or not.') (quoting Fed. R. Evid. 201(c)); Hotel Emps. & Rest. Emps. Union, Local 100 of New York, N.Y. & Vicinity, AFL-CIO v. City of NY Dep't of Parks & Recreation, 311 F.3d 534, 540 n.1 (2d Cir. 2002) ("Judicial notice may be taken at any stage of the proceeding.') (quoting Fed. R. Evid. 201(d)); Schenk v. Citibank/Citigroup/Citicorp, No. 10-CV-5056 (SAS), 2010 U.S. Dist. LEXIS 130305, 2010 WL 5094360, at *2 (S.D.N.Y. Dec. 9, 2010) (citing Anderson v. Rochester-Genesee Reg'l Transp. Auth., 337 F.3d 201, 205 n.4 (2d Cir. 2003)) ("Judicial notice may encompass the status of other lawsuits in other courts and the substance of papers filed in those actions"); Giraldo v. Kessler, 694 F.3d 161, 163 (2d Cir. 2012) (courts may "take judicial notice of relevant matters of public record.").

[12] In this opinion, unless otherwise specified, where reference is made to the "Sackler entities" this means Rosebay and Beacon, as well as other Sackler family affiliated trusts and entities relevant to this appeal, including those in Exhibit X to the Settlement Agreement, incorporated into the Plan. (*See* Dkt. No. 91-3, at App. 1112, App.1041-1069).

Purdue Pharma operates ***Purdue***'s branded prescription pharmaceutical **[**34]** business, which includes both opioid and non-opioid products. (Dkt. No. 91-4, at App.1244). OxyContin is one of ***Purdue Pharma***'s three principal branded opioid medications. (*Id.*. The other two are Hysingla and Butrans. (*Id.*. ***Purdue*** generated approximately $34 billion in revenue total between 19962019, most of which came from OxyContin sales (*See e.g.*, JX-2481); prior to bankruptcy, OxyContin accounted for some 91% of ***Purdue***'s U.S. revenue. (*See* JX-1984, at 40:24-41:5; JX-3275, at 338:6-9; JX-0999).

Purdue Pharma manufactures OxyContin for itself and, in limited quantities, for certain foreign independent associated companies ("IAC"), which are ultimately owned by the Sackler family. (Dkt. No. 91-4, at App.1245). ***Purdue Pharma*** receives royalties from IACs' sales for OxyContin **[*40]** abroad. (*Id.*. The IACs are not debtors in this case.

Until early 2019, members of the Sackler family served as directors of ***Purdue***; the last Sackler's resignation from the Board became effective in the beginning of that year, although many family members stepped down during 2018.

II. The Sackler Family

Since ***Purdue*** was sold to brothers Arthur, Mortimer and Raymond Sackler in 1952 (*see* JX-1985, at 33:12-13),[13] the company **[**35]** has been closely held and closely run by members of the Sackler family, many of whom took on an active role in the company comparable to that of senior management prior to 2018. *See* *In re **Purdue Pharma** L.P., No. 19-23649, 633 B.R. 53, 2021 Bankr. LEXIS 2555, 2021 WL 4240974, at *33 (Bankr. S.D.N.Y. Sept. 17, 2021)*. In large part due to the success of their pharmaceutical business, the Sackler family have long been ranked on Forbes' list of America's Richest Families, becoming one of the top twenty wealthiest families in America in 2015, with a reported net worth of $14 billion dollars. (*See* JX-1985, at 40:24-42:10).

Mortimer Sackler's side of the family is known as "Side A," and Raymond Sackler's side is known as "Side B."

[13] The Arthur Sackler family sold its interest in ***Purdue*** to the other two branches of the family prior to the invention of OxyContin and has no involvement in the company or in this bankruptcy.

(Dkt. No. 91-4, at App.1250). From approximately 1993 until 2018, there were always at least six or seven members of the Sackler family on the Board; independent directors never equaled or outnumbered the number of Sackler family directors on the Board. (*See* Confr. Hr'g Tr., Aug. 19, 2021, at 159:17-25, 22:5-9; Dkt. No. 91-4, at App.1345).

In addition to ***Purdue***, certain members of the Sackler family served as directors of an entity called "MNP," later "MNC" ("MNP/MNC"), which operated as an advisory board for IACs worldwide, including for "specific pharmaceutical manufacturer IACs" and "corporations **[**36]** throughout the world that [the Sackler] family owns and that are in the . . . pharmaceutical business." (*See* Confr. Hr'g Tr., Aug. 18, 2021, at 31:8-18; Confr. Hr'g Tr., Aug. 19, 2021, at 24:12-23). MNP/MNC's recommendations were typically followed by the IACs. (Confr. Hr'g Tr., Aug. 19, 2021, at 23:9-17).

A. Side A

Mortimer D. Sackler, who died in 2010, served as the co-chief executive officer of ***Purdue*** with his brother Raymond until the end of his life. (JX-3275.0168-69; Dkt. No. 91-5, at App.2089).

Three of his seven children — Ilene Sackler Lefcourt, Kathe Sackler, and Mortimer David Alfons Sackler ("Mortimer D.A. Sackler") — sat on the Board of ***Purdue*** for nearly 30 years, until 2018. (Confr. Hr'g Tr., Aug. 19, 2021, at 19:13-20, 158:6-15; JX-3298.0037; Dkt. No. 91-5, at App.2089). They also served as officers of ***Purdue***, with Mortimer D.A. and Ilene holding the title of vice president and Kathe the title of senior vice president. (Confr. Hr'g Tr., Aug. 19, 2021, at 19:21-25, 22:18-23:4, 158:16-21; JX-3298.0075; JX3275.0169).

Mortimer Sackler's wife Theresa Sackler also served on the Board of ***Purdue*** from 1993 until 2018, explaining that her "husband asked me to join . . . it was a family **[**37]** company and he felt that family members should be on the board." (JX-3275.0034, 36; Dkt. No. 91-4, at App.1345).

All four — Ilene, Kathe, Theresa, and Mortimer D.A. Sackler — served as directors on the board of MNP/MNC for many years. (Confr. Hr'g Tr., Aug. 19, **[*41]** 2021, at 19:21-25, 22:18-23:4, 161:2-11; JX-3298.0080; JX-3275.0059).

B. Side B

Raymond Sackler, who died in 2017, served as co-chief executive officer of ***Purdue*** with his brother Mortimer D. Sackler. (*See* JX-3275.0168-69).

Raymond Sackler's wife and two sons served as Board members of ***Purdue***. (*See* Dkt. No. 91-4, at App.1345). His sons, Jonathan and Richard Sackler, served from 1990 until 2018, and his wife Beverly Sackler from approximately 1993 until 2017. (*See id.*; Confr. Hr'g Tr., Aug. 18, 2021, at 30:6-8).

In addition to his role as director, Richard Sackler also served as president of ***Purdue*** from 2000-2003, co- chair of the Board from 2003-2007, and chair of the Board from approximately 2008 until 2010 or 2011. (Confr. Hr'g Tr., Aug. 18, 2021, at 30:6-22, 44:20-21). He served as a director of MNP/MNC until 2018 and has served as director of at least one IAC. (.*Id* at 31:23-32:19).

Richard Sackler's son David Sacker also served **[**38]** on the Board from 2012 until 2018 and as a director of MNP/MNC. (Confr. Hr'g Tr., Aug. 17, 2021, at 43:12-14, 44:6-13).

Finally, Mariana Sackler, Richard Sackler's daughter, held several roles within the "family business" (JX-1991, at 58:19-25), including working as a consultant in the "research and development department" of ***Purdue*** on OxyContin projects and a "PR" role at Mundipharma Italy, an IAC, advancing "information around topics about pain in Italy" and "marketing and selling OxyContin" there. (.*Id* at 30:4-18; 32:12-33:3; 58:19- 64:25). Marianna has never been an officer or director of ***Purdue***.

III. OxyContin

OxyContin is a synthetic opioid analgesic — a powerful narcotic substance designed to relieve pain. (*See* JX-2181; JX-2195.0048; JX-2195.0059). Opioid analgesics have been available for several decades to treat moderate to severe pain. (JX-2181; Dkt. No. 91-4, at App.1259). But until the early 1980's they were limited to immediate-release dosage forms. (JX-2181; *see* JX-2199). Immediate-release pain killers are less than ideal because they control pain for only 4-6 hours at a time; by contrast, a controlled-release pain killer can provide relief from serious pain for up to 12 **[**39]** hours at a time. (*See* Dkt. No. 91-4, at App.1259; JX-2181; JX- 2199; JX-2185-0010).

In the early 1980's, ***Purdue*** developed its first controlled-release morphine drug which it marketed as "MS Contin" (also called "MSContin" and "MS-Contin"). (JX-2181; *see* JX-2199; JX-2180-0030, 0084). MS Contin solved many of the difficulties associated with immediate-release opioids, and it was marketed, largely without abuse, throughout the 1980's and 1990's. (JX-2180-0015, 0078; Dkt. No. 91-4, at App.1262). However, morphine's stigma as an addictive narcotic caused patients and physicians alike to avoid it. (*See* JX-2180-0030).

So ***Purdue*** concentrated on the research, development, and testing of a non-morphine drug: its controlled-release semisynthetic opioid analgesic named "OxyContin." (*See* JX-2181; JX-2199; Dkt. No. 91-4, at App.1261-62). In December 1995, the Food and Drug Administration ("FDA") approved OxyContin for use. (*Id.*. OxyContin's formulations were labeled as "extended release" or "time release" doses because the active ingredients continuously enter into a patient's system over time; a single dose could provide relief from serious pain for up to 12 hours. (*See* JX-2181). **[*42]** A 2000 *Time* Magazine **[**40]** article explains that OxyContin was quickly "hailed as a miracle" after its introduction in 1995, because "it eases chronic pain because its dissolvable coating allows a measured does of the opiate oxycodone to be released into the bloodstream." (JX-2147).

For years, ***Purdue*** contended that OxyContin, due to its "time release" formulation, posed virtually no threat of either abuse or addiction — as opposed to other pain relief drugs, such as Percocet or Vicodin, which are not controlled-release painkillers. *See the* ***Purdue*** *Frederick Company, Inc.*, No. 1:07-cr-00029, Dkt. No. 5-1, at ¶¶20-27 ("Agreed Statement"); (Dkt. No. 9-14, at App.1268-1269). ***Purdue*** delivered that message to prescribing physicians and patients alike.

But time-release OxyContin proved to have an efficacy and safety profile similar to that of immediate-release opioid pain relievers. (*See* JX-2195.0027, 48-49, 59). Indeed, in 2001, the FDA required that ***Purdue*** remove from its drug label the claim that OxyContin had a very low risk of iatrogenic addiction; ***Purdue*** was ordered to add instead the highest level of safety warning that the FDA can place on an approved drug product. (*See* JX-2181; JX-2199; JX-2220).

IV. *Purdue*'s [**41] Deceptive Marketing of OxyContin

To promote its new product OxyContin, ***Purdue*** launched an aggressive marketing campaign. (*See* JX- 2153). That campaign was multi-fold, aiming in part to combat concerns about the abuse potential of opioids and to encourage doctors to prescribe OxyContin for more and different types of pain. (*See* Dkt. No. 91-4, at App.1268-1269; Agreed Statement, at ¶20; JX- 2181.0002).

Before OxyContin, opioid pain relievers were usually prescribed for cancer patients and patients with chronic diseases whose pain was "undertreated." (*See* JX-2181.0002). But ***Purdue*** pushed OxyContin as a treatment for many types of pain patients, including those with "noncancer pain" and other "nonmalignant" pain. (*Id.; see id.* at 0023, 0044). ***Purdue*** repeatedly published advertisements claiming, for example, that OxyContin can be an effective "first-line therapy for the treatment of arthritis" and safely used for "osteoarthritis pain" (JX-2218) and in many cases "mak[ing] unsubstantiated efficacy claims promoting the use of OxyContin for pain relief," "promoting OxyContin for a much broader range of patients with pain than are appropriate for the drug," "overstaffing] the safety profile of **[**42]** OxyContin," and repeatedly omitting OxyContin's "abuse liability" (JX-2221) — all of which was contemporaneously documented in FDA warning letters to the company throughout the early 2000's. (*See, e.g.*, JX-2218; JX-2221).

By its marketing campaign, ***Purdue*** sought to eliminate concerns regarding "OxyContin's addictive potential." (*See* Agreed Statement, at ¶¶19-20; Dkt. No. 91-4, at App.1268-1269). To do this, ***Purdue*** needed to encourage doctors and patients to overcome their reservations about the use of opioids. For this purpose, ***Purdue*** created a website called *"In The Face of Pain,"* which promoted OxyContin pain treatment and urged patients to "overcome" their "concerns about addiction." *See* Petition, *State of Kansas, ex rel. Derek Schmidt, Attorney General v.* ***Purdue Pharma*** *L.P., et al.*, Case No. 2019-cv-000369, at ¶89 (Shawnee Cnty. Dist. Ct. May 16, 2019). Testimonials on the website were allegedly presented as personal stories of OxyContin patients who had overcome life-long struggles with debilitating pain, although they were allegedly written **[*43]** by ***Purdue*** consultants who were paid to promote the drug. *Id.*

Purdue also allegedly distributed pamphlets to doctors. *Id.* at ¶33. In one such **[**43]** pamphlet, *Providing Relief Preventing Abuse: A Reference Guide To Controlled Substance Prescribing Practices*, ***Purdue*** wrote that addiction "is not caused by drugs." *Id.* In another, the "Resource Guide for People with Pain," ***Purdue*** explained, "Many people living with pain and even some healthcare providers believe that opioid medications are addictive. The truth is that when properly prescribed by a healthcare professional and taken as directed, these medications give relief — not a 'high.'" *Id.* at ¶35.

Purdue's marketing campaign proved successful. OxyContin was widely prescribed; bonuses to ***Purdue*** sales representatives for the sale of OxyContin increased from $1 million in 1996 to $40 million by 2001; and by 2001, annual sales of OxyContin reached $1 billion. (JX-2181.0007; JX-2151). By 2001, OxyContin was "the most prescribed brand-name narcotic medication" in the U.S. (JX-2181.0002, 0007).

V. The Opioid Crisis

But OxyContin's popularity as a pain reliever coincided with the scourge of widespread abuse of the drug around the country. (*See, e.g.*, JX-2147; JX-2148; JX- 2149; JX-2180-0078; JX-2181). Many individuals who had been prescribed OxyContin by their doctors for legitimate pain conditions **[**44]** became addicted to the drug. (*See* JX-2181). And hundreds of thousands of seasoned addicts and novice drug abusers, including teenagers, quickly discovered that crushing an OxyContin tablet and then snorting or injecting it resulted in a quick "morphine-like high." (*See* JX-2148; JX-2149; JX-2183; JX-2195.0059).

By the early 2000's, rates of opioid addiction in connection with OxyContin use were skyrocketing throughout the country. (*See* JX-2147; JX-2148; JX-2149). In the early years, "remote, rural areas" were particularly hard hit, due in part to the fact that these areas are

> home to large populations of disabled and chronically ill people who are in need of pain relief; they're marked by high unemployment and a lack of economic opportunity; they're remote, far from the network of Interstates and metropolises through which heroin and cocaine travel; and they're areas where prescription drugs have been abused—though in much smaller numbers—in the past.

*Foister v. **Purdue Pharma**, L.P., 295 F. Supp. 2d 693, 696 (E.D. Ky. 2003)* (quotation and internal citation omitted).

However, the crisis was not limited to one type of community or part of the country. (*See* JX-2147). Pill mills opened in urban areas, as unscrupulous physicians began writing prescriptions for OxyContin **[**45]** to stooge purchasers (often drug addicts themselves), who were recruited to obtain and fill prescriptions, turning over the pills to drug dealers, who resold them on the street, making astronomical profits. (*See* JX-2175; JX-2176). This Court presided over the criminal trial of a doctor who ran such a pill mill in Hamilton Heights on the Upper West Side of Manhattan, through which he garnered millions of dollars in ill-gotten gains at the expense of desperate people who were addicted to OxyContin. *See United States v. Mirilashvili*, No. 14-cr-0810 (CM), Dkt. No. 1 (S.D.N.Y. Dec. 9, 2014).

Prosecutions like the one of Dr. Mirilashvili, coupled with enhanced regulatory oversight over both prescribers of opioids and pharmacies that had filled suspiciously high numbers of prescriptions, reduced the number of illicit prescriptions of OxyContin. **[*44]** But drying up the source. did not end the problem of addiction. Individuals who had been feeding an OxyContin habit turned to alternative sources to get their fix — including street drugs like heroin and its even stronger and more lethal cousin, fentanyl, which is fast acting and 100 times more potent than morphine. (*See* JX-2195.0050-52). The recent **[**46]** increase in overdose deaths in this country is driven in significant part by the increasingly widespread use of fentanyl. (*See* Dkt. No. 91-4, at App.1271).

In 2017, the U.S. Department of Health and Human Services ("DHHS") declared the opioid epidemic to be a national public health emergency.[14] According to the Centers for Disease Control and Prevention, from 1999 to 2019, nearly 247,000 people died in the United States from overdoses involving prescription opioids.[15] DHHS estimates the "economic burden" of prescription opioid misuse in the United States is between $53-72 billion a year, including medical costs, lost work productivity,

---

[14] *HHS Acting Secretary Declares Public Health Emergency to Address National Opioid Crisis*, DHHS (Oct. 26, 2017), https://www.hhs.gov/about/news/2017/10/26/hhs-acting-secretary-declares-public-health-emergency-address-national-opioid-crisis.html.

[15] *Drug Overdose: Overview*, Centers for Disease Control and Prevention (Mar. 17, 2021), https://www.cdc.gov/drugoverdose/deaths/prescription/overview.html.

addiction treatment, and criminal justice costs.[16]

Today, it is estimated that between 21-29% of patients who are prescribed opioids for chronic pain misuse them.[17] Between 8-12% of people who are using an opioid for chronic pain develop an opioid use disorder. *Id.* An estimated 4-6% of those who misuse prescription opioids transition to using heroin. *Id.* About 80% of people who use heroin first misused prescription opioids. *Id.* OxyContin, it **[**47]** seems, is the ultimate "gateway" drug.

VI. Pre-Bankruptcy Litigation Involving ***Purdue*** and Members of the Sackler Family

With the swelling opioid crisis, ***Purdue*** began to face inquiries about and investigations into OxyContin.

In 2000, the U.S. Attorney of Maine alerted the company to widespread abuse of the drug in rural Maine. (*See* JX-2151; JX-2180-0078; JX-2181). In 2001, the Attorney General of Virginia Mark Earley requested a meeting with company officials regarding widespread abuse of the drug in Virginia. (*See* JX-2151). By 2002, the then-***Purdue*** spokesman Tim Bannon confirmed that there were federal investigations into ***Purdue***'s marketing of OxyContin. (*Id.*.

Two decades of litigation, both civil and criminal, ensued.

A. The First Round of Lawsuit: 2001-2007

By 2001, plaintiffs across the country had begun to file individual and class actions against ***Purdue*** in state and federal courts, including in the U.S. District Court for the Southern District of New York and in the Supreme Court of the State of New York. (*See e.g.*, JX-2181; Dkt. No. 91-5, at App.2037-2038).[18] Members of the Sackler **[*45]** family were not named as defendants in these lawsuits. (*See* Dkt. No. 91-5, at App.2040). **[**48]**

Plaintiffs in early cases plead a variety of theories of liability pursuant to which ***Purdue*** could be held liable as a result of its development, testing, manufacturing, distributing and marketing of OxyContin, including: negligence, strict product liability, failure to warn, breach of express and/or implied warranty, violation of state consumer protection statutes, conspiracy, fraud, and unjust enrichment. *See e.g.,* *Wethington v. **Purdue Pharma** LP, 218 F.R.D. 577, 581 n. 1 (S.D. Ohio 2003)*.

Many of the early cases filed were class actions that sought certification of classes of people who had been prescribed OxyContin and suffered harm as a result. *See e.g., Hurtado v. **Purdue Pharma** Co., 6 Misc. 3d 1015[A], 800 N.Y.S.2d 347, 2005 NY Slip Op 50045[U], 2005 WL 192351, at *9-14 [Sup. Ct. Richmond Cnty. 2005]* (discussing cases). But given the stringent requirements for class certification, class certification motions in these cases were often denied. For example, in *Foister v. **Purdue Pharma** **[**49]** L.P.*, plaintiffs in the Eastern District of Kentucky sought unsuccessfully to certify class of "all persons who have been harmed due to the addictive nature of OxyContin." *No. Civ.A. 01-268—DCR, 2002 U.S. Dist. LEXIS 8192, 2002 WL 1008608, at *1 (E.D. Ky. Feb. 26, 2002)*; *see also* *Gevedon v. **Purdue Pharma**, 212 F.R.D. 333, 336 (E.D. Ky. Oct. 17, 2002)* (denying class certification); *Campbell v. **Purdue Pharma**, L.P., No. 1:02 CV 00163 TCM, 2004 U.S. Dist. LEXIS 31173, 2004 WL 5840206, at *1 (ED Mo. June 25, 2004)* (denying class certification). Class certification was generally deemed

[16] DHHS, "Addressing Prescription Drug Abuse in the United States," *available at* https://www.cdc.gov/drugoverdose/pdf/hhs_prescriptiondrug_abuse_report_09.2013.pdf.

[17] *Opioid Overdose Crisis*, National Institute on Drug Abuse (Mar. 11, 2021), https://www.drugabuse.gov/drug-topics/opioids/opioid-overdose-crisis.

[18] *See Hurtado, et al. v. The **Purdue Pharma** Co.*, No. 12648/03 (Richmond Cnty., filed 2003); *Sara v. The **Purdue Pharma** Co.*, No. 13699/03 (Richmond Cnty., filed 2003); *Serafin v. **Purdue Pharma**, L.P.*, No. 103031/04 (New York Cnty., filed 2004); *Washington v. **Purdue Pharma** L.P.*, No. 107841/04 (New York Cnty., filed 2004); *Machey v. The **Purdue Pharma** Co.*, No. 1:04-cv-02098 (S.D.N.Y., filed 2004); *Pratt v. The **Purdue Pharma** Co.*, No. 1:04-cv-02100 (S.D.N.Y., filed 2004); *Wilson v. The **Purdue Pharma** Co.*, No. 1:04-cv-02103 (S.D.N.Y., filed 2004); *Ruth v. The **Purdue Pharma** Co.*, No. 1:04-cv-02101 (S.D.N.Y., filed 2004); *Terry v. The **Purdue Pharma** Co.*, No. 1:04-cv-02102 (S.D.N.Y., filed 2004); *Foister v. **Purdue Pharma** L.P.*, No. 6:01-cv- 00268 (E.D. Ky., removed 2001); *Gevedon v. **Purdue Pharma***, No. 7:02-cv-00008 (E.D. Ky., removed 2002); *Campbell v. **Purdue Pharma**, L.P.*, No. 1:02-cv-00163 TCM (ED Mo. removed 2002); *Howland et al. v. **Purdue Pharma**, L.P. et al.*, No. CV01 07 1651 (Butler Cnty. Ohio, filed 2001); *see also* *In re OxyContin Products Liability Litigation, 268 F.Supp.2d 1380, 1380 (J.P.M.L 2003)* (stating 20 actions then pending in five federal districts in South Carolina, Mississippi, Alabama, and Louisiana).

inappropriate because courts concluded that individual questions predominated ("addiction to the drug is an individualized question of fact"), thus precluding a finding of commonality. *See* *Howland et al. v. **Purdue** **Pharma**, L.P. et al., 104 Ohio St. 3d 584, 2004- Ohio 6552, 821 N.E.2d 141, 146-147 (Oh. Sup. Ct. Dec. 15, 2004)*. When such motions were granted, the decisions were often reversed. *See id.*

Absent class certification, the sheer number of individual cases that were filed meant that cases had to be sent to judicial coordinating panels. In New York, for example, five state cases were transferred to the New York Litigation Coordinating Panel in 2005 — after which 1,117 additional lawsuits were filed and coordinated. *See Hurtado, 6 Misc. 3d 1015[A], 800 N.Y.S.2d 347, 2005 WL 192351, at *15*; *Matter of OxyContin, 15 Misc.3d 388, 390, 833 N.Y.S.2d 357 (Sup. Ct. Richmond Cnty. 2007)*. Within these coordinated cases, after much discovery, settlements were pursued. *See e.g., Matter of OxyContin II, 23 Misc.3d 974, 975, 881 N.Y.S.2d 812 (Sup. Ct. Richmond Cnty. 2009)* (discussing efforts in 2006-2007 to reach a "universal settlement" of the thousands of New York cases).

Discovery in these lawsuits proved useful to state and federal regulatory agencies **[*46]** that were also investigating ***Purdue***'s **[**50]** role in the opioid crisis. Attorney Jayne Conroy, who testified at the Confirmation Hearing on behalf of the AHC, explained that the discovery taken by her firm in hundreds of New York cases against ***Purdue*** was later subpoenaed by the Justice Department as part of the federal government's 2006-2007 investigation into ***Purdue***. (Dkt. No. 91-5, at App.2038-2039).

B. The 2007 Settlement and 2007 Plea Agreement

1. ***Purdue***'s 2007 Settlements with 26 States and the District of Columbia

In 2007, twenty-six states[19] and D.C. settled investigations into ***Purdue***'s promotional and marketing practices regarding OxyContin for $19.5 million ("2007

[19] Settling states were Arizona, Arkansas, California, Connecticut, Idaho, Illinois, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Montana, Nebraska, Nevada, New Mexico, North Carolina, Ohio, Oregon, Pennsylvania, South Carolina, Tennessee, Texas, Vermont, Virginia, Washington, and Wisconsin. This includes all State Appellants except Delaware and Rhode Island.

Settlement").[20] (Dkt. No. 914, at App.1269-70; *see* JX-2152). As part of the 2007 Settlement, ***Purdue*** entered into a consent judgment with each government party. (Dkt. No. 91-4, at App.1270); *see, e.g.*, Consent Judgement, *Washington v.* ***Purdue Pharma*** *L.P.*, Cause No. 07-2-00917-2 (Sup. Ct. Wash. Thurston Cnty. May 9, 2007), at Section I(M), ¶25 ("Consent Judgment").

Pursuant to the Consent Judgment, ***Purdue*** agreed to "establish, implement and follow an OxyContin abuse and diversion detection" ("ADD") program which "consist[ed] of internal procedures designed to identify **[**51]** potential abuse or diversion of OxyContin" for a minimum of ten years. (*See* Dkt. No. 91-4, at App.1270; Consent Judgment, ¶¶13-14). ***Purdue*** also agreed to submit "annual compliance certifications to a multistate group of attorneys general for three years." (Dkt. No. 91-4, at App.1270).

In exchange for ***Purdue***'s payment and compliance, the settling States agreed to:

> release[] and forever discharge[], to the fullest extent permitted by law, ***Purdue*** *and its past and present officers, directors, shareholders*, employees, co-promoters, affiliates, parents, subsidiaries, predecessors, assigns, and successors (collectively, the "Releasees"), of and from any and all civil causes of action, claims, damages, costs, attorney's fees, or penalties that the Attorney General could have asserted against the Releasees under the State Consumer Protection Law by reason· of any conduct that has occurred at any time up to and including the Effective Date of this Judgment relating to or based upon the Subject Matter of this Judgment ("Released Claims").

(Consent Judgement, Section VI) (emphasis added). According to Judge Drain, these 2007 releases covered about seventy-seven members of the Sackler family. *In re* ***Purdue Pharma*** *L.P., 2021 Bankr. LEXIS 2555, 2021 WL 4240974, at *31*. The **[**52]** release covered only claims that could have been asserted by the Attorneys General of the settling states; among the claims that were not released were: (1) private rights of action by

[20] ***Purdue*** is defined in the Consent Judgment as ***Purdue Pharma***, PPI, The ***Purdue*** Frederick Company, and all of their United States affiliates, subsidiaries, predecessors, successors, parents and assigns, who manufacture, sell, distribute and/or promote OxyContin.

consumers, (2) claims relating to best price, average wholesale price or wholesale acquisition cost reporting practices or Medicaid fraud or abuse; (3) claims asserting antitrust, environmental or tax liability; **[*47]**
(4) claims for property damage; (5) claims to enforce the terms and conditions of the judgment; and (6) any state or federal criminal liability that any person or entity, including Releasees, has or may have to the settling state.

Some of the states did not participate in this 2007 Settlement. Several had already entered into individual settlements with ***Purdue***, while others entered into separate settlements subsequently. (*See* Dkt. No. 91-4, at App.1270). For example, in 2002, Florida settled an investigation into ***Purdue*** for $500,000 (*id.*); in 2004, West Virginia settled an action against ***Purdue*** for $10 million (*id.*); in 2006, Mississippi settled its investigation into ***Purdue*** for $250,000 (*id.*). In 2015, New York signed an assurance of discontinuance of its investigation in exchange for ***Purdue***'s **[**53]** payment of a $75,000 penalty and certain promises, including ongoing implementation of the ADD program in New York and submission to annual reviews and monitoring by the Attorney General. *Id.*; *In the Matter of **Purdue Pharma** L.P.*, Attorney General of the State of New York Assurance No. 15-151, at ¶¶8, 28, 38, 40, 49 (Aug. 19, 2015). In 2016, Kentucky settled an action against ***Purdue*** for $24 million. (Dkt. No. 91-4, at App.1270). And in March 2019, ***Purdue*** agreed to pay the State of Oklahoma $270 million to settle that state's opioid claims. (*Id.* at App.1278); *see* Consent Judgment, *Oklahoma v. **Purdue Pharma** et al.*, No. CJ-2017-816, § 4.1 (Dist. Ct. Cleveland Cnty. Mar. 26, 2019).

The releases in these separate cases generally extinguished the claims of the respective state against ***Purdue*** for opioid-related misconduct. For example, the West Virginia settlement released "any and all claims and demands" of the Attorney General of West Virginia (on behalf of the state and state agencies) against ***Purdue*** and its affiliates, shareholders, officers, directors, and others[21] that were "sustained or incurred as a result of the manufacture, marketing and sale of OxyContin" in West Virginia. (*See* JX-2225). **[**54]** Similarly, the Oklahoma settlement released "any and all claims of any nature" of the Attorney General (the state and its subdivisions) against ***Purdue***, its officers, directors, shareholders, direct and indirect owners, beneficiaries of the owners, and enumerated others, arising out of the conduct alleged in the complaint, including conduct related to the marketing and sale of opioids in Oklahoma. *See* Consent Judgment, *Oklahoma v. **Purdue Pharma** et al.*, No. CJ-2017-816, §§ 1.1, 5.1, 5.2 (Dist. Ct. Cleveland Cnty. Mar. 26, 2019).

2. ***Purdue*** Frederick Company, Inc.'s 2007 Plea Agreement and Related Civil Settlements

Also in 2007, ***Purdue*** Frederick Company[22] pled guilty to one felony count of misbranding OxyContin, with the intent to defraud or mislead, in violation of 21 U.S.C. §§ 331(a), 333(a)(2). **[*48]** (Dkt. No. 91-4, at App.1268-69; *see* JX-2153-JX-2168); *see* JX-1899. ***Purdue*** Frederick's President and CEO Michael Friedman, its Executive Vice President and Chief Legal Officer Howard R. Udell, and its Chief Scientific Officer Paul D. Goldenheim, in their capacity as corporate officers, each pled guilty to a misdemeanor charge of misbranding. (Dkt. No. 91-4, at App.1268 **[*49]**); *see The **Purdue** Frederick Company, Inc.*, No. 1:07-cr-00029, **[**55]** at Dkt. Nos. 7-9.

As part of the Agreed Statement of Facts, the ***Purdue*** Frederick Company admitted that:

> [b]eginning on or about December 12, 1995, and continuing until on or about June 30, 2001, certain ***PURDUE*** supervisors and employees, with the intent to defraud or mislead, marketed and promoted OxyContin as less addictive, less subject to abuse and diversion, and less likely to cause tolerance and withdrawal than other pain medications . . .

(Agreed Statement, at ¶20; *see* Dkt. No. 91-4, at App.1268-1269).

As part of the 2007 Plea Agreement, ***Purdue*** Frederick agreed to pay over $600 million dollars in fines and various other payments.[23] (Dkt. No. 91-4, at App.1269;

[21] "all . . . present, former, or future masters, insurers, principals, agents, assigns, officers, directors, shareholders, owners, employees, attorneys, representatives. subsidiaries, divisions, affiliates, associated companies, holding companies, partnerships, and joint ventures . . . " (JX-2225).

[22] ***Purdue*** Frederick Company is an affiliate of ***Purdue*** that manufactures and distributes OxyContin. (Dkt. No. 91-4, at App.1268).

[23] The fine and payments include: approximately $276.1 million forfeited to the United States; approximately $160 million paid to federal and state government agencies to resolve liability for false claims made to Medicaid and other government

JX-1899, at § 3). This included $160 million to the United States and the states to settle various civil claims that had been asserted by governments — over $100 million to the United States and over $59 million to "Each state that elects to participate in this settlement . .
." (JX-1899, at § 3(b)). In the federal government's settlement agreement, the United States and its various departments agreed to release "***Purdue*** *and its current and former directors, officers, employees, affiliates, owners*, predecessors, successors and **[**56]** assigns from any civil or administrative monetary claim the United States has or may have" under federal statutes creating causes of action for civil damages or penalties, as well as from administrative actions under various federal departments and programs. (*See id.* at Dkt. No. 5-4, at § IIII). The participating states' settlement agreement and release were limited to Medicaid fraud claims:

> release and forever discharge [the] Company *and its current and former directors, officers, employees, affiliates, owners*, predecessors, successors and assigns from any civil or administrative monetary claim that the State has or may have for any claim submitted or caused to be submitted to the State Medicaid Program for the Covered Conduct . . .

See The ***Purdue*** *Frederick Company, Inc., et al.*, No. 1:07-cr-00029, Dkt. No. 5-14, at §III(2)) (emphasis added).

All states except Kentucky opted into the federal settlement. *See id.* at Dkt. No. 141, at 5.

An additional $130 million was set aside to settle private civil liability claims related to OxyContin. (*Id.* at § 3(d)). Ms. Conroy of the AHC testified in the Confirmation Hearing that her approximately 5,000 clients received a total of $75 million out of **[**57]** this settlement fund. (Dkt. No. 91-5, at App.2039).

As part of the resolution of the criminal case, ***Purdue*** agreed to a five-year corporate integrity program with the DHHS, pursuant to which DHHS was to monitor ***Purdue***'s compliance with federal healthcare law. This monitoring period expired on July 30, 2012. (Dkt. No. 91-4, at App.1269); *see The* ***Purdue*** *Frederick Company, Inc.*, No. 1:07-cr-00029, at Dkt. No. 5-5. In 2013, ***Purdue*** completed the corporate integrity program with no significant adverse findings. (Dkt. No. 91-4, at App.1269).

The Honorable James P. Jones approved the 2007 Plea Agreement in July of that year. *See The* ***Purdue*** *Frederick Company, Inc.*, No. 1:07-cr-00029, at Dkt. No. 77.

C. The Second Round of Lawsuits: 2014-2019

The 2007 Settlement and Plea Agreement were intended to resolve for all time issues relating to ***Purdue***'s misrepresentations about OxyContin. (Dkt. No. 91-5, at App.2039). The corporate integrity agreement with DHHS meant ongoing monitoring (*see The* ***Purdue*** *Frederick Company, Inc.*, No. 1:07-cr- 00029, at Dkt. No. 5-5), and the ADD program agreed to with the 26 states and D.C. was meant to create internal procedures that would identify and interrupt abuse or diversion **[**58]** related to OxyContin. (Consent Judgment, ¶14). ***Purdue***, for its part, insisted in its Informational Brief before the Bankruptcy Court that it "accepted responsibility for the misconduct in 2007 and has since then strived never to repeat it." (Dkt. No. 91-4, at App.1268).

However, if ***Purdue***'s admissions in its 2020 Plea Agreement are believed, this purported acceptance of responsibility was a charade, and the oversight mechanisms built into the settlements were a conspicuous failure. Judge Drain found that the Sacklers had an "evident desire to continue to drive profits from the products' sale," *In re* ***Purdue Pharma*** *L.P., 2021 Bankr. LEXIS 2555, 2021 WL 4240974, at *33*, and as they did so, the opioid crisis not only continued, it worsened. (*See* Dkt. No. 91-5, at App.2039-2040; JX-2185). As Mortimer D.A. Sackler testified in the Confirmation Hearing, "overdose deaths .
. . continued to rise . . . The overdose deaths kept going up and up." (Confr. Hr'g Tr. Aug. 19, 2021, at 52:7-12).

Starting in about 2014, new lawsuits began to be filed against ***Purdue*** concerning its promotion and marketing of OxyContin. (*See e.g.*, JX-2411). But this time, members of the Sackler family were named as defendants. (*See, e.g.*, Confr. Hr'g Tr. Aug. 16, 2021, at 69: 4-15).

healthcare programs; approximately $130 million set aside to resolve private civil claims; approximately $5.3 million paid to the Virginia Attorney General's Medicaid Fraud Control Unit; approximately $20 million paid to fund the Virginia Prescription Monitoring Program; approximately $3 million to Federal and State Medicaid programs for improperly calculated Medicaid rebates; approximately $5 million in monitoring costs; and a $500,000 maximum statutory fine.

1. The Federal **[**59]** Multi-District Litigation in the Northern District of Ohio

At the end of 2017, sixty-four federal cases that had been brought in nine districts across the country by various government entities (state, cities, and counties) against ***Purdue*** and other defendants — including pharmacies (like Rite Aid), pharmaceutical companies (like Johnson & Johnson), and pharmaceutical distributors (like McKesson Corporation) - were sent to coordinated multi-district litigation in the Northern District of Ohio ("Opioid MDL"). *See IN RE: National Prescription Opiate Litigation*, MDL-2804, Dkt. No. 1, at Schedule A. The cases in the Opioid MDL asserted a variety of claims against ***Purdue*** and others for their role in the opioid crisis, under theories of liability including: (1) public nuisance, (2) false representations,
(3) unjust enrichment, (4) common law *parens patriae*, (5) negligence, (6) gross negligence, and (7) consumer protection act claims. (Dkt. No. 91-4, at App.1276); *see e.g.*, Complaint, *County of San Joaquin, et al. v. **Purdue Pharma** L.P., et al.*, No. 2:17-cv-01485, Dkt. No. 1, Ex. 1 (E.D. Ca. May 24, 2017); Complaint, *Everett v. **Purdue Pharma** LP et al.*, No. 2:17-00209, Dkt. No. 1-1 (W.D. Wa. **[**60]** Jan. 18, 2017).

The Opioid MDL was assigned to The Honorable Dan A. Polster. At the time of **[*50]** ***Purdue***'s filing for bankruptcy, approximately 2,200 actions against ***Purdue*** related to the opioid crisis were pending before Judge Polster. (*See* Dkt. No. 91-4, at App.1273).

Judge Polster put the cases before him on a settlement track and litigation track and assigned a Special Master to assist in their management. (*See* MDL Dkt. No. 2676, at 3). Given "the immense scope of the opioid crisis" Judge Polster was "very active from the outset of [the] MDL in encouraging all sides to consider settlement." (MDL Dkt. No. 2676, at 11).

Within the litigation track, Judge Polster designated attorneys to coordinate discovery in related state and federal cases (MDL Dkt. No. 616) and issued a case management order meant to "facilitate, to the maximum extent possible, coordination with parallel state court cases." (MDL Dkt. No. 876, at ¶I(b)). Judge Polster ordered the establishment of a joint database of all prescription opiate cases filed in state and federal courts, so that information and documents could be tracked and discovery cross-noticed. (*Id.* at ¶¶III-V).

Over 450 depositions were taken under the Opioid **[**61]** MDL umbrella, and over 160 million pages of documents were produced. (MDL Dkt. No. 2676, at 5; *see* Dkt. No. 91-4, at App.1276).

The extensive discovery in the Opioid MDL, and the discovery coordination it facilitated, revealed for the first time the involvement of certain members of the Sackler family in acts that ***Purdue*** had agreed not to commit as part of the 2007 Plea Agreement. Schedule A to the 2020 Plea Agreement — to which facts the corporation has stipulated, so they are deemed proved[24] - chronicles ***Purdue***'s extensive violation of the 2007 Plea Agreement, which began almost from the time the ink was dry on the papers. (*See* JX-2094.0006, 0015-18). Unable to deny what was apparent from the Opioid MDL discovery, the corporation admitted that ***Purdue*** had engaged in aggressive efforts to boost opioid sales, including: offering payments to induce health care providers to write more prescriptions of ***Purdue*** opioid products, offering "prescription savings cards" for health care providers to give patients to encourage them to fill prescriptions for opioids, and failing to maintain effective controls against diversion, which included failing to inform the United States Drug Enforcement Administration **[**62]** that health care providers flagged for abuse filled over 1.4 million OxyContin prescriptions. (*Id.*).

Evidence produced in discovery also "subjected the Sacklers to increasing scrutiny and pointed towards culpability of certain members of the family . . ." (Dkt. No. 91-5, at App.2040). This evidence demonstrated that members of the Sackler family were heavily involved in decisions on how to market and sell opioids (*see* JX-2944-45, JX-2952, JX-3013-14, JX-1652).
Certain Sacklers, notably Richard, Mortimer D.A., and Theresa, aggressively set and pushed sales targets for OxyContin that were higher than those recommended by ***Purdue*** executives (*see* Confr. Hr'g Tr., Aug. 18, 2021, at 84:2-6; Dkt. No. 91-4, at App.1350-51); accompanied sales representatives on "ride along" visits to health care providers to promote "the sale of ***Purdue***'s opioids" (Confr. Hr'g Tr., Aug. 18, 2021, at 70:2-7); approved countless settlements related to ***Purdue***'s culpable conduct (*id.* at 126:2-18); and oversaw sales and marketing budgets and corresponding upward trends in OxyContin prescribing. (Confr. Hr'g Tr., Aug. 19, 2021, at 106:15-109:6).

As discovery turned up evidence of the involvement of members of the Sackler **[**63]** **[*51]** family in ***Purdue***'s misconduct, those family members were

---

[24] The Sacklers do not concede the truth of ***Purdue***'s

admissions.

added as defendants in a number of cases pending against ***Purdue***. For example, attorney Jayne Conroy testified that, as a result of information disclosed during the Opioid MDL discovery, she added the Sacklers as defendants in the lawsuits her firm was pursuing against ***Purdue*** in New York State Supreme Court. (Confr. Hr'g Tr. Aug. 16, 2021, at 70:16-25; *see also* Dkt. No. 91-5, at App.2040). Peter Weinberger, another attorney with AHC, similarly acknowledged to the Bankruptcy Court that, "State complaints naming Sackler family members relied on MDL documents extensively." (Bankr. Dkt. No. 3449, at ¶¶ 36-37, 40).

2. State Multi-District Litigations

In addition to the Opioid MDL, over 390 parallel actions against ***Purdue*** proliferated in state courts, as well as in local courts in D.C., Puerto Rico, and Guam. (Dkt. No. 91-4, at App.1273). The causes of actions asserted in these various litigations included: (1) violations of state false claims acts; (2) violations of state consumer protection laws; (3) public nuisance; (4) fraud; (5) negligence; (6) unjust enrichment; (7) civil conspiracy; (8) violations of state controlled-substances **[**64]** acts; (9) fraudulent transfer; (10) strict products liability; and (11) wrongful death and loss of consortium. (*Id.*, at App.1276).

In some states, these lawsuits were consolidated in coordinated state proceedings. (*Id.* at App.1273-1274; *see e.g.*, Dkt. No. 91-5, at App.2039-2040). Such coordination occurred in Connecticut, Illinois, New York, Pennsylvania, Texas, and South Carolina. (Dkt. No. 91-4, at App.1273). In New York, cases brought by 58 counties and two dozen cities against ***Purdue*** were transferred to and coordinated in Suffolk County. (Dkt. No. 91-5, at App.2040).

While members of the Sackler family were not originally named as defendants in these state court coordinated actions, once their role in the marketing of OxyContin post-2007 was revealed in the Opioid MDL discovery, complaints in many state litigations were amended to name members of the Sackler family as defendants. (*See, e.g.*, Dkt. No. 91-5, at App.2040; *see* Bankr. Dkt. No. 3449, at ¶¶ 36-37, 40). Specifically, Richard Sackler, Jonathan Sackler, Mortimer D.A. Sackler, Kathy Sackler, Ilene Sackler Lefcourt, Beverly Sackler, Theresa Sackler, Mariana Sackler, and David Sackler were named as defendants in various lawsuits. **[**65]** (*See e.g.*, Dkt. No. 91-7, at App.2402-2597). In at least three of these cases, state courts denied the Sackler defendants' motions to dismiss the claims against them. (*See* Dkt. No. 94, at 5; Dkt. No. 91-5, At App.2041); *see e.g.*, Order, *In re Opioid Litigation*, No. 400000/2017, Dkt. No. 1191 (Sup. Ct. Suffolk Cnty. June 21, 2019).

Thus, when ***Purdue*** filed for bankruptcy in September 2019, ". . . the threat of liability for at least some members of the [Sackler] family was real and [] without the protections of bankruptcy, individual family members were at risk of substantial judgments against them." (*See* Dkt. No. 91-5, at App.2040). As explained by the UCC in the Confirmation Hearing, it was estimated that ". . . litigating against the Sacklers could eventually lead to a judgment or multiple judgments greater than $4.275 billion." (Bankr. Dkt. No. 3460, at 33; *see also* Bankr. Dkt. No. 3449, at ¶ 10).

3. The Renewed Lawsuits Against ***Purdue*** and Members of the Sackler Family by the Individual States

But private litigation was far from the only game in town. By the middle of 2019, forty-nine states' Attorneys General had filed new or amended lawsuits against ***Purdue***, all of which named specific **[**66]** members of the Sackler family and/or Sackler-related entities. (*See* App.1274); *see e.g.*, **[*52]** Amended Complaint, *New York v.* ***Purdue Pharma*** *L.P., et al.*, No. 400016/2018 (Sup. Ct. Suffolk Cnty. Mar. 28, 2019). For example, in March 2019, the New York Attorney General amended its earlier complaint against ***Purdue*** to add claims against the same eight members of the Sackler family and various Sackler entities.[25] *Id.* at ¶¶814-900. The newly-asserted claims included claims for public nuisance, fraud, gross negligence, willful misconduct, unjust enrichment, fraudulent conveyances, violations of state finance laws and social services laws, and "repeated and persistent" fraud and illegality in violation of *Executive Law § 63(12)*. *Id.* Against the "Sackler entities," the complaint asserted claims for unjust enrichment and fraudulent conveyance. *Id.*

The Attorneys General of all but one of the State Appellants — California, Connecticut, Delaware, Maryland, Oregon, Rhode Island, Vermont, and D.C. - filed or amended complaints that include a range of charges against both ***Purdue*** and members of the Sackler family. (*See, e.g.*, Dkt. No. 103-7, at A-1553; Dkt. No. 95-1, at A0008; Dkt. No. 91-7, at App.2598; Dkt. No. 91-8, at App.2661; **[**67]** Dkt. No. 91-9, at App.3153; Dkt. No. 121-2, at MDA-008; JX-1647; JX-

[25] The entities were described as those "known and unknown entities" that the Sacklers allegedly "used as vehicles to transfer funds from ***Purdue*** directly or indirectly to themselves,"

including Rosebay and Beacon. *Id.* at ¶¶49-54.

0946). The State of Washington did not assert claims against members of the Sackler family specifically but asserted claims against "Does 1 through 99" and "Doe Corporations 1 through 99" who — although not yet named — allegedly acted with ***Purdue*** "in committing all acts" in their complaint. (*See* Dkt No. 103-3, at App-630; JX-0944). This left open the possibility of naming members of the Sackler family and Sackler family entities.

The State Appellants' asserted claims included:

- fraudulent transfer (*see e.g.*, Dkt. No. 91-7, at App. 2649; Dkt. No. 91-9, at App.3194);
- fraud and fraudulent misrepresentation (*see e.g.*, Dkt. No. 91-9, at App.3184);
- unjust enrichment (*see e.g.*, Dkt. No. 91-9, at App.3192; Dkt. No. 103-7, at A-1752; JX-1647.0199);
- negligence (*see e.g.*, Dkt. No. 91-8, at App.2766; Dkt. No. 91-9, at App.3187; JX-0944.0123);
- public nuisance (*see e.g.*, Dkt. No. 91-8, at App.2768-69; Dkt. No. 91-9, at App.3175; Dkt. No. 103-7, at A-1749; Dkt. No. 95-1, at A0068; JX-1647.0197; JX-0944.0120); and
- violation of state consumer protection statutes by deceptive and unfair acts and practices. (*see e.g.*, Dkt. No. 91-7, **[**68]** at App.2642-2648; Dkt. No. 91-8, at App.2764; Dkt. No. 103-7, at A-1746-47; Dkt. No. 95-1, at A0066-67; Dkt. No. 121-2, at MDA-110; JX-1647.0194; JX-0944.0118).

For example, California asserted two claims for violations of its *False Advertising Law (Cal. Bus. & Prof. Code § 17500 et seq.)*, and *Unfair Competition Law (Cal. Bus. & Prof. Code § 17200 et seq.)*, as well as a public nuisance claim (*Cal. Civ. Code §3494 et seq.*), against ***Purdue*** and nine individual members of the Sackler family, including Mariana Sackler.[26] (Dkt. No. 95-1, **[*53]** at A0066-68; JX-0947). California sought, *inter alia*, the assessment of civil penalties against each defendant and an order directing ***Purdue*** and the Sacklers to abate the public nuisance.

Connecticut — the state where ***Purdue***'s headquarters are located — asserted four claims for violations of its *Unfair Trade Practices Act (Conn. Gen. Stat. §42-110a et seq.)* and one claim for fraudulent transfer against ***Purdue*** and eight individual members of the Sackler family. (Dkt. No. 91-7, at App.2642-49; JX-0840). Connecticut sought, *inter alia*, civil penalties, restitution, and disgorgement from all defendants, including the Sacklers.

Delaware — where ***Purdue Pharma***'s limited partnership **[**69]** was formed — asserted three claims for violations of *Delaware's Consumer Fraud Act (6 Del. C. §2511 et seq.*) as well as claims for negligence and public nuisance against seven individual members of the Sackler family.[27] (Dkt. No. 91-8, at App.2764-2768; JX-0945; JX-1646). Delaware sought, *inter alia*, civil penalties and abatement.

Maryland asserted a claim for violation of the state's consumer protection laws (*Md. Code Ann., Com. Law §§13-301 et seq.*) against the same seven individual members of the Sackler family. (*See* Dkt. No. 121-2, at MDA-008). Maryland, like the other opposing states, sought civil penalties against the Sackler defendants, among other relief.

Oregon asserted three claims against ***Purdue*** and eight individual members of the Sackler family — the first seeking a declaratory judgment that ***Purdue*** and related entities are the alter egos of the Sacklers and that the state may pierce the corporate veil; the other two asserting claims for fraudulent conveyance. (*See* JX-1647). Oregon sought, *inter alia*, a judgment restraining the Sackler defendants from disposing of property and ordering a return of the conveyed funds.

---

[26] A California court recently issued a "tentative decision" rejecting the public nuisance theory of liability against Johnson & Johnson and other pharmaceutical companies, including Teva, Allergan, Endo and Janssen. *See* Tentative Decision, *California v. **Purdue Pharma**, L.P., et al.*, No. 30-2014-00725287-CU-BT-CXC, Dkt. No. 7939 (Cal. Sup. Ct. Nov. 1, 2021). The same theory of liability was thrown out by the Oklahoma Supreme Court in a case against Johnson & Johnson. *See State ex rel. Hunter v. Johnson & Johnson, 499 P.3d 719-, 2021 OK 54, 2021 WL 5191372 (Okla. Sup. Ct. Nov. 9, 2021)*. However, also last month, an Ohio jury found

three major pharmacy chains liable for damages on the theory that their filling of pill mill prescriptions for opioids created a public nuisance. *See Ohio jury holds CVS, Walgreens and Walmart liable for opioid crisis*, NPR (Nov. 23, 2021), *available at* https://www.npr.org/2021/11/23/1058539458/a-jury-in-ohio-says-americas-big-pharmacy-chains-are-liable-for-the-opioid-epide.

[27] Beverly Sackler was not sued in Delaware or Maryland. Mariana Sackler was only sued in California.

Rhode Island asserted six claims against ***Purdue*** and the eight individual members of the Sackler family for public nuisance, fraud and fraudulent misrepresentation, **[**70]** fraudulent and voidable transfers, violations of Rhode Island's State False Claims Act (R.I. Gen. Laws §9-1.1-1 et seq.), negligence, and unjust enrichment. (Dkt. No. 91-9, at App.3175-94; JX-1648; JX-2214). Rhode Island sought, *inter alia*, civil penalties, treble damages, disgorgement, and restitution.

Vermont asserted four claims against the eight individual members of the Sackler family: two violations of the Vermont Consumer Protection Act (9 V.S.A. §2451 et seq.), unjust enrichment, and public nuisance. (Dkt. No. 103-7, at A-1746-52; JX-1649). Vermont also sought civil penalties, among other relief.

Washington State brought an action against ***Purdue***, "Does 1 through 99," and "Doe Corporations 1 through 99" for violating the Washington's Consumer Protection Act (Wash. Rev. Code §19.86), for causing a public nuisance, and for breaching **[*54]** Washington's common law of negligence. (JX-0944). The Complaint sought abatement, restitution, and statutory penalties, among other relief.

D.C. brought two claims against ***Purdue*** and Richard Sackler for violations of its consumer protection statutes (D.C. Code §28-3904(f)). (*See* JX-0946). D.C. sought, like the others and among other relief, statutory civil penalties against each defendant.

Each State Appellant filed its claims before ***Purdue*** filed for bankruptcy in September 2019. **[**71]** None of the cases had been litigated to judgment.[28] (*See* Dkt. 91-4, at App.1278). These cases were not subject to the automatic stay that stopped private litigation in its tracks once ***Purdue*** filed, (11 USCA § 362(b)), but the Bankruptcy Court preliminarily enjoined all litigation against ***Purdue*** and the Sacklers; that order was affirmed by this court, Dunaway v. ***Purdue*** Pharm. L.P. (In re ***Purdue*** Pharm. L.P.), 619 B.R. 38 (S.D.N.Y. 2020). As a result, no activity has taken place in any of these lawsuits since shortly after ***Purdue***'s filing.

4. Lawsuits in Canada

In Canada, a number of class actions were filed against certain of the Debtors with allegations similar to those made in the U.S. (*See* Dkt. No. 91-4, at App.1273, 1477; *see e.g.*, Dkt No. 98-1, at 13-102, 113-202). Prior to ***Purdue***'s Chapter 11 filing, the lead plaintiffs in ten of the Canadian class actions settled their claims for $20 million, and ***Purdue Pharma*** (Canada) ("***Purdue*** Canada")[29] placed that amount in trust pending approval of the settlement by the Ontario Superior Court of Justice, the Superior Court of Quebec, the Supreme Court of Nova Scotia and the Saskatchewan Court of Queen's Bench (the "Canadian Settlement"). (Dkt. No. 91-4, at App.1477-1478). The Canadian Settlement, once approved and after funds are disbursed, **[**72]** "completely and unconditionally released, forever discharged, and acquitted [the Debtors] from any and all Settled Patient Claims against the Debtors and from any other Proof of Claim or portion thereof in respect of any Settled Patient Claim filed against any Debtor." (*Id.*). Under the Canadian Settlement, no member of the Canadian classes party to that settlement can recover from any source other than the Canadian Settlement trust, and every class member in a settling class bears the burden of proving in the U.S. bankruptcy that its claim was not released and discharged by the Canadian Settlement. (*Id.*).

However, the Canadian Settlement did not cover the claims of the Canadian Appellants, which are Canadian municipalities and indigenous tribes. The Canadian Appellants' lawsuits concerned sales and distribution of OxyContin in Canada, affecting Canadian communities, by ***Purdue*** Canada, which the Canadian Appellants assert was controlled by Sackler family members. (Dkt. 98, at 5; Bank. Dkt. No. 3421, at 89-92). The Canadian Appellants' lawsuits against ***Purdue*** Canada assert, *inter alia*, claims for conspiracy, public nuisance, negligence, fraud, and unjust enrichment. (Dkt No. 98-1, at 18-19). **[**73]** The Canadian Appellants also stated at oral argument that that they "were barred by **[*55]** the imposition of the stay and the stay-related orders" - the preliminary injunction described above - "from actually naming [certain] Competition Act claim[s] against the Sacklers and the [Shareholder Released Parties]," which they would assert if given the

[28] Prior to bankruptcy, the lawsuit brought by North Dakota was litigated to judgment, and that judgment was in favor of ***Purdue***.

(*See* Dkt. No. 91-4, at App.1278).

[29] ***Purdue*** Canada is an IAC. It is not a Debtor in this case. ***Purdue*** Canada as defined in the Shareholder Settlement Agreement, means Bard Pharmaceuticals Inc., Elvium Life Sciences GP Inc., Elvium Life Sciences Limited Partnership, Elvium ULC, ***Purdue*** Frederick Inc. (Canada), ***Purdue Pharma*** (Canada), ***Purdue Pharma*** Inc. (Canada), and ***Purdue Pharma*** ULC. (JX-1625.0027).

opportunity. (Oral Arg. Tr., Nov. 30, 2021, at 80:11-16).

The Canadian Appellants do not include the Canadian federal government or any Canadian province — all of whom seem to be content with the fact that the Plan excludes claims against ***Purdue*** Canada. (*See* Plan, at 10). Indeed, the ten Canadian provinces for their part seem to believe their claims are excluded and have decided to pursue their claims in Canada instead. For example, in press on the topic, Reidar Mogerman, counsel for the British Columbia government, explained that the provinces gave up their claims (worth US$67.4 billion) before the Bankruptcy Court in the U.S. to protect lawsuits they filed against ***Purdue***'s Canadian entities.[30] "We didn't want to get swallowed in competition with the U.S. claims and lose our Canadian claims," he explained to the press. *Id.* To date, in Canada, the **[**74]** various Canadian provinces have asked the Ontario Superior Court of Justice to continue to pursue their separate class actions against ***Purdue*** Canada. *Id.*

VII. Members of The Sackler Family Insulate Themselves Against Creditors

As Judge Drain found, the evidence indicates members of the Sackler family distributed significant sums of ***Purdue*** money to themselves in the years 2008-2016, during which time those Sackler family members were closely involved in the operations of ***Purdue*** and aware of the opioid crisis and the litigation risk. *See* *In re **Purdue Pharma** L.P., 2021 Bankr. LEXIS 2555, 2021 WL 4240974, at *32*. As detailed below, this "aggressive[]" (to use Richard Sackler's word, *see* JX- 1703) pattern of distribution of earnings to shareholders represented a sharp departure from prior practice in two ways.

First, during the period 1996-2007, ***Purdue*** up-streamed on average 9% of its revenue per year to the Sacklers; but during the period 2008-2016, ***Purdue*** up-streamed on average 53%, and as much as 70%, of its revenue to the Sacklers. (*See* JX-2481).

Second, during the earlier period (1996-2007), the Sacklers kept less than 10% of the money that was distributed by ***Purdue*** for themselves, while **[**75]** using over 90% of those distributions to pay taxes on ***Purdue***'s earnings; but during the years between 2008-2016, the Sacklers retained, in one form or another, 56% of those distributed earnings, while using just 44% to pay taxes. (Bankr. Dkt. 3410-2).

The 2008-2016 distributions to shareholders also contrasted with the practices of ***Purdue***'s peer pharmaceutical companies. (*See* JX 1703).

According to the Sacklers' own expert, this pattern of upstreaming corporate earnings substantially depleted ***Purdue***'s treasury during that eight-year period. (JX-0431, p. 77, Fig. 10).

*A. The Sacklers Cause the Transfer of Billions of Dollars from **Purdue** to Themselves*

In March 2007, Richard, Jonathan, Kathe, and Mortimer Sackler exchanged emails noting that the "future course [for the business] is uncertain" (JX-2976) and identified the "emergence of numerous new lawsuits" as a "risk[] . . . we're not **[*56]** really braced for." (JX-2957). Just a few months later, in May, shortly after the 2007 guilty plea and settlement, David Sackler emailed Jonathan Sackler, Richard Sackler, and their financial advisor, expressing concern about the family's personal liability for the opioid crisis: "what do you think is going **[**76]** on in all of these courtrooms right now? We're rich? For how long? Until suits get through to the family?" (JX- 2237; *see also* JX-2096, at ¶ 161). In his deposition, David Sackler agreed that his May 17, 2007, email reflects "concern[] that the family would be sued in connection with ***Purdue***'s sale of OxyContin." (JX-1989, at 183:14-184:20, 187:18-188:20). Less than a week after David Sackler sent his email, Richard and Jonathan Sackler met with a bankruptcy attorney, though ***Purdue*** was not in debt and not at risk of bankruptcy. (*See* JX-2985; JX-2986).

Thereafter, on July 26, 2007, a family financial advisor sent a confidential memorandum to Jonathan Sackler, in which he advised that ***Purdue*** faced "[u]ncapped liabilities" that posed "a huge valuation question" for ***Purdue*** at that very moment — the moment when the Plea and settlements were ostensibly ending any illegal behavior and putting further corporate liability — and potential shareholder liability — in the rear view mirror. (JX-1660, at 2-3). He added, "I presume the family has taken most of the appropriate defensive measures." (*Id.* at 3; *see also* JX-2241). One such measure, proposed in a separate memorandum, was "to distribute more **[**77]** free cash flow so [the owners] can purchase diversifying assets." (JX-2254; *see also* JX-

[30] *Provinces plan legal push against **Purdue Pharma** in wake of U.S. opioid deal*, The Globe and Mail (Sept. 3, 2021), https://www.theglobeandmail.com/canada/article-provinces-plan-legal-push-against-***purdue-pharma***-in-wake-of-us-opioid.

2096, at ¶ 162).

By January 2008, the anxiety over impending lawsuits was apparent; Richard Sackler emailed Mortimer Sackler that, "I've been told by Silbert that I will be [sued] and probably soon." (JX-3001). Mortimer Sackler lamented in a later email in February 2008 that he wished to get out of the pharmaceutical business altogether "given the horrible risks, outlooks, difficulties, etc." (Bankr. Dkt. No. 2161, at Ex. 67). In this vein, in April 18, 2008, Richard Sackler warned in a memo that the business posed a "dangerous concentration of risk" and proposed that the family either sell the company or "distribute more free cash flow" to themselves. (JX- 2214, ¶ 86; JX-3004; JX-3104). The family chose the latter course.

Beginning in 2008, ***Purdue*** began to make significant cash distributions to and for the benefit of the Sacklers. (JX-1988, at 226:13-19 (deposition of Richard Sackler); Confr. Hr'g Tr., Aug. 19, 2021, at 149:6-14 (testimony of Mortimer D.A. Sackler); Confr. Hr'g Tr., Aug. 18, 2021, at 65:8-17 (testimony of Richard Sackler); *see also* Dkt. No. 91-4, at App.1544). As noted above, about **[**78]** 44% of the money distributed went to pay taxes; a small fraction was invested in the IACs, which were owned by the Sacklers; and the rest went to Rosebay and Beacon, the Side A and B Sackler family trusts. (*See* JX-1987, at 156:8-158:4; Confr. Hr'g Tr., Aug. 19, 2021, at 27:7-28:1-12).

In the years leading up to the 2007 Plea Agreement and Settlement, the Sackler family had been content to leave most of ***Purdue***'s earnings in the company, except insofar as was necessary to pay taxes. In response to a question from this Court, Debtors acknowledged that, between January 1, 1995 and December 31, 2007, distributions to the Sacklers totaled
$1.322 billion, of which $1.192 billion (or 90.2%) was used to pay taxes. (Dkt. No. 177; *see* JX-3050.0042; JX-2481; Bankr. Dkt. 3410-2). In the twelve years prior to 2008, the Sacklers took personal distributions from ***Purdue*** that averaged 9% of ***Purdue***'s revenue. (*See* JX-2481).

[*57] After 2007, ***Purdue*** went from distributing less than 15% of its revenue to distributing as much as 70% of revenue.[31] (*Id.*). It also jumped from distributing approximately 38% of its free cash flow in 2006 to distributing 167.4% of free cash flow in 2007 and continued to distribute free **[**79]** cash flow in the 90% range for the next decade. (*Id.*). These distributions totaled approximately $10.4 Billion. (*See* Dkt. No. 91-4, at App.1544; Bankr. Dkt. No. 3410-1, at ¶ 12; Confr. Hr'g Tr., Aug. 18, 2021, at 65:8-17 (testimony of Richard Sackler); Confr. Hr'g Tr., Aug. 19, 2021, at 27:7-28:1-12, 149:6-14 (testimony of Mortimer D.A. Sackler)).

Approximately $4.6 billion of that amount was used to pay pass through taxes (*see* Bankr. Dkt. 3410-2), which attests to the tremendous profitability of ***Purdue***'s OxyContin business during that same eleven-year period. In fact, the vast majority of ***Purdue***'s earnings between 2008-2017 came from OxyContin sales. (*See* JX-1984, at 40:24-41:5; JX-3275, at 338:6-9; JX-0999).

According to the Sacklers' own expert, the change in distribution pattern drained ***Purdue***'s total assets by 75% and ***Purdue***'s "solvency cushion" by 82% between 2008 and 2016. (JX-0431, p 77, Fig. 10). Richard Sackler later acknowledged in an email in 2014 that, "in the years when the business was producing massive amounts of cash, the shareholders departed from the practice of our industry peers and took the money out of the business." (JX 1703). In at least one email in 2014, **[**80]** Jonathan Sackler referred to this distributing of cash flow from OxyContin as a "milking" program. (JX-2974).

The obvious implication of this evidence was recognized by Judge Drain in his bankruptcy decision, discussed *infra* in Background Section XII. *See* *In re **Purdue Pharma** L.P., 2021 Bankr. LEXIS 2555, 2021 WL 4240974, at *27, 31, 32-33*. In particular, Judge Drain noted, "I do have an extensive report and trial declarations as to the nature of the assertedly over $11 billion of avoidable transfers, when they occurred, what they comprised, and who they were made to," *2021 Bankr. LEXIS 2555, [WL] at 31*; and found, "The record suggest[s] that at least some of the Sacklers were very aware of the risk of opioid-related litigation claims against ***Purdue*** and sought to shield themselves from the economic effect of such claims by causing ***Purdue*** to make billions of dollars of transfers to them and to shield their own assets, as well, from collection." *2021 Bankr. LEXIS 2555, [WL] at 32*. While he made no finding that these distributions qualified as fraudulent

31 The absolute amount of these distributions dwarfed distributions for the 1995-2007 period because concerns about the validity of ***Purdue***'s OxyContin patent capped its earnings until 2008, when it was definitively held that the patent was valid. (*See* Dkt. No. 241, at 6). After that, ***Purdue***'s earnings soared — as did both the amount owed in taxes and the amount that ended up in the Sackler family trusts.

conveyances, or that they could be recouped by ***Purdue***, Judge Drain also acknowledged that the estate had potential claims of "over $11 billon of assertedly avoidable transfers." *2021 Bankr. LEXIS 2555, [WL] at 27*.

As Judge Drain also acknowledged, the distribution of ***Purdue*** money to the Sackler **[**81]** family occurred during a time when members of the Sackler family, including those named in many pending cases, were closely involved in the operations of ***Purdue*** and well aware of the opioid crisis and the litigation risk. He said, "The testimony that I heard from the Sacklers tended to show, that as a closely held company ***Purdue*** was run differently than a public company and that its Board and shareholders took a major role in corporate decision-making, including ***Purdue***'s practices regarding its opioid products that was more **[*58]** akin to the role of senior management." *2021 Bankr. LEXIS 2555, [WL] at 33*. As Richard Sackler acknowledged in the Confirmation Hearing, he oversaw as director "many settlements," stating, "I was director, and I cannot count up all the settlements that the company entered into while I was a director. But there were many settlements, both private and public." (Confr. Hr'g Tr., Aug. 18, 2021, at 126:2-18). For example, as part of the Board, he approved the settlement of $24 million to the State of Kentucky to resolve unlawful and unfair deceptive trade practice allegations against ***Purdue*** in 2015. (*Id.* at 124:16-125:1).

The Sacklers vehemently deny any suggestion that any of these transfers **[**82]** would qualify as fraudulent conveyances. (*See* JX-2096, at ¶G). However, in Addendum A to the 2020 "Settlement Agreement" with the DOJ, the Government asserted its confidence that it could prove that: "From approximately 2008 to 2018, at the Named Sacklers' request, billions of dollars were transferred out of ***Purdue*** as cash distributions of profits and transfers of assets into Sackler family holding companies and trusts. Certain of these distributions and transfers were made with the intent to hinder future creditors and/or were otherwise voidable as fraudulent transfers." (*Id.* at Addendum A, ¶6; *see also id.* at ¶¶158-159)

The fact of these extensive transfers of money out of ***Purdue*** and into the family coffers is not contested. For example, during the Confirmation Hearing, when Richard Sackler was asked if it were "true that during that time period generally [2008-2018] . . . the ***Purdue*** Board of Directors transferred out billions of dollars to Sackler family trusts or holding companies," he answered, "Yes . . . yes, that we did." (Confr. Hr'g Tr., Aug. 18, 2021, at 65:8-17). Only whether those transfers (or any of them) would qualify as fraudulent conveyances is in dispute. But while **[**83]** that presents an important and interesting question, I agree with Judge Drain that it was not one he needed to resolve in order to rule on the confirmability of the Plan. But at some point — certainly by 2018 — ***Purdue*** itself was in a precarious financial position in face of the lawsuits. At the time of the bankruptcy filing, ***Purdue*** represented that, while it had "no funded debt and no material past due trade obligations" — or even any "judgment creditors" — "the onslaught of lawsuits has proved unmanageable" and "will result only in the financial and operational destruction of the Debtors and the immense value they could otherwise provide . . . " (Dkt. No. 91-4, at App.1237).

B. A Pre-Petition Settlement Framework Is Proposed That Would Release the Sackler Family From Liability.

In the months before ***Purdue*** filed for bankruptcy, ***Purdue***, the Sackler family (now no longer represented on ***Purdue***'s Board) and Sackler entities were engaged in discussions about a potential framework for settlement of all claims against ***Purdue*** and the Sacklers with "the various parties in the MDL litigation" and certain "subgroups" of creditors and potential creditors. (*See* Confr. Hr'g Tr., Aug. 12, 2021, at **[**84]** 152:23-153:22). John Dubel testified in the Confirmation Hearing[32] that the pre-petition settlement framework discussions involved the concept of third-party releases *and* the concept of using the bankruptcy **[*59]** process to release all claims against the Sacklers in exchange for their contribution of funding to the settlement. (*Id.* at 154:1-5). Mr. Dubel explained:

> [I]t was very clear from the . . . Sacklers that if they were going to post up X amount of dollars — and I believe at the time, the settlement framework was somewhere around $3 billion or so — that they were going to seek broad third party releases, and releases from the Debtors, releases of all the estate claims, etc., so that they could be able to put all of that — all of the litigation behind them . . . *it was something that was a prerequisite or a condition to*

[32] Mr. Dubel served as the Chairman of the Special Committee of the Board. He was appointed to the Board in July 2019 and chaired the Special Committee investigating the potential claims of ***Purdue*** or its estates against the Sacklers. (*See* Bankr. Dkt. No. 3433, at ¶1).

> *them posting the amount of money that was in the settlement framework* and then ultimately what is in the plan of organization we were seeking approval of.

(*Id.* at 155:25-156:1-12; *see id.* at 209:1-4, 214:8-19) (emphasis added).

So the Sacklers made it clear well before the Debtors filed for chapter 11 bankruptcy that they would contribute toward ***Purdue***'s bankruptcy estate **[**85]** only if they received blanket releases that would put "all of the litigation behind them." (*Id.* at 155:25-156:1-12). This was reported heavily in the press at the time of the bankruptcy filing.[33]

This pre-petition settlement framework was then imported into the bankruptcy process. As Mr. Dubel testified, once a pre-petition settlement framework was created, the plan was to "Us[e] the Chapter 11 process to enable us to then organize all of the various claimants into one group under . . . the auspices of the Chapter 11 bankruptcy process." (*Id.* at 154:14-18). He further explained that, "It was the framework that would help us continue to bring all of the various creditor groups towards a decision as to whether it was better to litigate against the Sacklers or attempt to come up with a settlement that would be fair and equitable for all the creditors of the Debtor's estates." (*Id.* at 155:2-9). He testified that some 24 states "were supportive of us moving forward in the process of filing a Chapter 11 and using this [bankruptcy] as a means **[**86]** of coalescing all the parties into one organized spot to address the potential claims that the estates would have against the Sacklers." (*Id.* at 157:4-9).

Purdue's bankruptcy was thus a critical part of a strategy to secure for the Sacklers a release from any liability for past and even future opioid-related litigation without having to pursue personal bankruptcy. David Sackler acknowledged as much in his testimony, "I don't know of another forum that would allow this kind of global solution, this kind of equitable solution for all

---

[33] *See e.g.,* ***Purdue Pharma****'s bankruptcy plan includes special protection for the Sackler family fortune*, The Washington Post (Sept. 19, 2019), https://www.washingtonpost.com/business/2019/09/18/***purdue***-pharmas-bankruptcy-plan-includes-special-protection-sackler-family-fortune; *Where did the Sacklers move cash from their opioid maker*?, ABC News (Sept. 5, 2019), https://abcnews.go.com/US/wireStory/sacklers-move-cash-opioid-maker-65407504.

parties." (Confr. Hr'g Tr., Aug. 17, 2021, at 35:4-6).

VIII. The Underlying Bankruptcy

Facing the mounting lawsuits against both ***Purdue*** and members of the Sackler family in the U.S. and abroad, certain U.S. based ***Purdue*** entities (Debtors) filed for bankruptcy relief on September 15, 2019. (Bankr. Dkt. No. 1). Members of the Sackler family and the Sackler entities — such as Rosebay and Beacon — did not file for **[*60]** bankruptcy, despite having been named as defendants in opioid-related lawsuits.

*A. Pending Actions Against **Purdue** and Members of the Sackler Family Are Halted*

Purdue quickly moved on September 18, 2019, before the Bankruptcy Court for an injunction halting **[**87]** all actions against ***Purdue*** as well as "against their current and former owners (including any trusts and their respective trustees and beneficiaries), officers, directors, employees, and associated entities." (Dkt. No. 91-4, at App.1471, 1562). This meant enjoining over 2,900 actions against ***Purdue*** and at least 400 civil suits against the Sacklers. (*Id.*, at App.1562).

Purdue argued that enjoining all litigation was necessary to facilitate the parties' work towards a global settlement in a single forum — the Bankruptcy Court. After an evidentiary hearing, on October 11, 2019, the Bankruptcy Court temporarily halted all such litigation until November 6, 2019 (*Id.* at App.1472), at which point it granted ***Purdue***'s motion enjoining all plaintiffs from continuing or commencing any judicial, administrative, or investigative actions, as well as any other enforcement proceeding, against ***Purdue*** or the non-debtor related parties, including against members of the Sackler family. (*Id.; see* Bankr. Dkt., No. 2983, at 171). This Court affirmed the Bankruptcy Court's grant of the preliminary injunction. *Dunaway v. **Purdue** Pharm. L.P. (In re **Purdue** Pharm. L.P.), 619 B.R. 38 (S.D.N.Y. 2020)*. The expiration date of the preliminary injunction has been extended 18 times, during which period **[**88]** the parties negotiated to come up with the Plan. (*See* Dkt. No. 91-4, at App.1402, 1429, 1472-73; Bankr. Dkt. Nos. 2897, 2488).

B. The Creditor Constituencies in the Bankruptcy

On September 27, 2019, the U.S. Trustee appointed nine creditors to the UCC, an independent fiduciary to represent the interests of all unsecured creditors in the ***Purdue*** bankruptcy. (Dkt. No. 91-1, at App.7).[34] The UCC's appointees are Blue Cross and Blue Shield Association; CVS Caremark Part D Services L.L.C. and CaremarkPCS Health, L.L.C.; Cheryl Juaire; LTS Lohmann Therapy Systems, Corp.; Pension Benefit Guaranty Corporation; Walter Lee Salmons; Kara Trainor; and West Boca Medical Center. (Bankr. Dkt. No. 1294; *see* Dkt. No. 115-1, at 5). The UCC also has several ex-officio, non-voting representatives: (i) Cameron County, Texas, on behalf of the MSGE; (ii) the Cheyenne and Arapaho Tribes, on behalf of certain Native American Tribes and Native American-affiliated creditors; and (iii) Thornton Township High School District 205, on behalf of certain public school districts. (*See* Bankr. Dkt. No. 1294).

Between September and November 2019, various other creditor groups were formed to represent creditor constituencies **[**89]** in the bankruptcy, including as follows:

- The AHC was formed in September 2019 and is comprised of ten States, six counties, cites, parishes, or municipalities, one federally recognized American Indian Tribe (the Muscogee (Creek) Nation, as well as the court-appointed Co-Lead Counsel on behalf of the Plaintiffs' Executive Committee in the Opioid MDL (*see* Bankr. Dkt. No. 279);

- NAS Children was formed in September 2019 and is comprised of around 3,500 children, who born with "neonatal abstinence syndrome" due **[*61]** to exposure to opioids in utero, and/or their guardians (*see* Bankr. Dkt. No. 1582; Dkt. No. 115-1, at 3);

- The PI Ad Hoc Group was formed in October 2019 and is comprised of 60,761 personal injury claimants, each holding "one or more unsecured, unliquidated, opioid-related personal injury claims against one or more of the Debtors" (*see* Bankr. Dkt. Nos. 3939, 348);

- MSGE was formed in October 2019 and is comprised of 1,317 entities: 1,245 cities, counties and other governmental entities, 9 tribal nations, 13 hospital districts, 16 independent public school districts, 32 medical groups, and 2 funds across 38

[34] See Official Committee of Unsecured Creditors of ***Purdue Pharma*** L.P. and Affiliated Debtors: General Information, KKC, available at http://www.kccllc.net/PurdueCreditors.

states and territories (*see* Bankr. Dkt. No. 1794); certain

- The Ad Hoc Group of **[**90]** Non-Consenting States ("NCSG") was formed in October 2019 and is comprised of 25 states that did not reach a pre-petition agreement with ***Purdue*** or the Sacklers regarding "the general contours of a potential chapter 11 plan" to settle their claims — California, Colorado, Connecticut, Delaware, D.C., Hawaii, Idaho, Illinois, Iowa, Maine, Maryland, Massachusetts, Minnesota, Nevada, New Hampshire, New Jersey, New York, North Carolina, Oregon, Pennsylvania, Rhode Island, Vermont, Virginia, Washington, and Wisconsin (*see* Bankr. Dkt. No. 296);

- The Ratepayer Mediation Participants ("Ratepayers") was formed in October 2019 and is comprised of "proposed representatives of classes of privately insured parties who are plaintiffs and proposed class representatives in their individual and representative capacities in suits brought against [***Purdue***]" in 25 actions in 25 states (*see* Bankr. Dkt. No. 333; Dkt. No. 91-3, at App.1108); and

- The Ad Hoc Group of Hospitals ("Hospitals") was formed in November 2019 and is comprised of hundreds of hospitals that have treated and treat patients for conditions related to the use of opiates manufactured by ***Purdue*** (*see* Bankr. Dkt. 1536).

Other groups that formed **[**91]** during the pendency of the bankruptcy proceedings include:

- The Third-Party Payor Group ("TPP Group"), comprised of certain holders of third-party payor claims (*see* Dkt. No. 91-3, at App.1114);

- The Native American Tribes Group ("Tribes Group"), comprised of the Muscogee (Creek) Nation, the Cheyenne & Arapaho Tribes, an ex officio member of the Creditors' Committee, and other Tribes represented by various counsel from the Tribal Leadership Committee and the Opioid MDL Plaintiffs' Executive Committee (*see id.* at App.1096); and

- The Public School District Claimants ("Public Schools"), comprised of over 60 public school districts in the United States (*see id.* at App.1106; Bankr. Dkt. Nos. 2707, 2304).

Each of these groups was representative of creditor constituencies, whose "members" (there was no certified class) held similar types of claims against ***Purdue***.

C. The Court Sets A Bar Date for Filing of Proof of Claims

On January 3, 2020, ***Purdue*** filed a "Motion for Entry of an Order (I) Establishing Deadlines for Filing Proofs of Claim and Procedures Relating Thereto, (II) Approving **[*62]** the Proof of Claim Forms, and (III) Approving the Form and Manner of Notice Thereof" (the "Bar Date Motion")." **[**92]** (*See* Dkt. No. 91-4, at App.1475). On February 3, 2020, the Bankruptcy Court approved the Bar Date Motion, setting June 30, 2020 as the deadline for all persons and entities holding a prepetition claim against ***Purdue***, as defined in *section 101(5) of the Bankruptcy Code* (a "Claim"), to file a proof of claim. (*Id.*). On June 3, 2020, the Bankruptcy Court entered an order extending the Bar Date to July 30, 2020. (*Id.; see id.* at App.1298).

During the five months while the window for filing proofs of claims was open, over 614,000 claimants did so. Just 10% of the claims so filed would give rise to over $140 trillion in aggregate liability — more than the whole world's gross domestic product. (Dkt. No. 91-4, at App.1421; *see* Dkt. No. 91-1, at App.28).[35] The claimants included the federal government, states and political subdivisions, Native American Tribes, hospitals, third-party payors, ratepayers, public schools, NAS monitoring claims,[36] more than 130,000 personal injury victims, and others. (*See* Dkt. No. 91-4, at App.1425-1429; *see* Dkt. No. 91-1, at App.28).

D. The Court Approves Mediation and Appoints Mediators to Facilitate Resolution

On February 20, 2020, ***Purdue*** filed an unopposed "Motion for Entry of an Order **[**93]** Appointing Mediators," seeking the appointment of mediators and mandating that the various creditor constituencies participate in mediation. (Dkt. No. 91-4, at App.1486). On March 2, 2020, the Bankruptcy Court approved ***Purdue***'s motion and appointed The Honorable Layn Phillips (ret.) and Mr. Kenneth Feinberg as co-mediators (*Id.*; Bankr. Dkt. No. 895). Both are among the most experienced and respected mediators in the country.

IX. The Negotiation of the Bankruptcy Plan

Through mediation, ***Purdue*** and stakeholders worked to negotiate a complex settlement framework that would ultimately direct the Debtors' assets and $4.275 billion from the Sackler families toward abating the opioid crisis and restoring victims of the crisis. (*See* Dkt. No.91-4, at App.1402, 1429; *see* Bankr. Dkt. 2488).

The parties involved in the negotiations included the Debtors and non-debtor related parties (*i.e.*, members of the Sackler family) and the various creditor constituencies. Together, as defined in the court's mediation order, the participating "Mediation Parties" were the Debtors, the UCC, the AHC, the NCSG, the MSGE, the PI Ad Hoc Group, NAS Children, the Hospitals, the TPP group, and the Ratepayers. (Dkt. No. **[**94]** 91-4, at App.1486). The Tribes Group, the Public Schools, the National Association for the Advancement of Colored People, and others also participated in mediation, although not as official Mediation Parties. (*Id.; see* Bankr. Dkt. No. 2548).

The mediation progressed in three phases (*id.* at App.1404), as follows:

[*63] *A. Phase 1: March 2020-September 2020*

Phase one of the mediation addressed "the allocation of value/proceeds available from the Debtors' Estates" as disputed between the "Non-Federal Public Claimants" (the states, federal districts and U.S. territories, political subdivisions, and Native American tribes) and "Private Claimants" (hospitals, private health insurance carriers and third-party payors, and individuals and estates asserting personal injury, including NAS Children). (Dkt. No. 91-4, at App.1487; Bankr. Dkt. No. 855, at 6-7). It proceeded with a "series of rigorous formal mediation sessions during the period from March 6, 2020 to September 11, 2020." (Dkt. No. 91-4, at App.1487).

The mediation resulted in certain resolutions (*see generally* Bankr. Dkt. 1716), the most critical of which included value allocation between and among the

[35] As of October 21, 2021, 628,389 claims have been filed. *See* Bankruptcy Claim Report, *available at* https://restructuring.primeclerk.com/purduepharma/Home-DownloadPDF?id1=MTMwMjM2Mw%3D%3D&id2=0.

[36] NAS monitoring claims are those of legal guardians of children born with neonatal abstinence syndrome due to exposure to opioids in utero. (Dkt. No. 91-4, at App.1404; *see* Dkt. No. 115-1 at 3).

various parties, such as:

> First, the Non-Federal **[**95]** Public Claimants agreed that all value received by them through the Chapter 11 Cases would be exclusively dedicated to programs designed to abate the opioid crisis . . . Second, the Non-Federal Public Claimants addressed and resolved . . . value allocation for all Native American Tribes . . . and a default mechanism that, in the absence of a stand-alone agreement between a State or territory and its political subdivisions, provides a structure and process for applying funds to abate the opioid crisis . . .
> Third, agreement was reached on written term sheets with certain individual Private Claimant groups that addressed allocation of estate value to each Private Claimant group. These agreements provided, among other things, that each class of Private Claimants will receive fixed cash distributions over time, the values and time periods varying for each class. Moreover, the Ad Hoc Group of Hospitals, the Third-Party Payors, and the NAS Committee (with regard to medical monitoring) each agreed to dedicate substantially all the distributions from their respective Private Creditor Trusts to abate the opioid crisis.

(*See* Dkt. No. 91-4, at App.1487). Ultimately, all participants except "the **[**96]** public school districts and the NAS children physical injury group" were able to achieve "agreement *inter se* as to their respective allocations as a result of the mediation process." (Bankr. Dkt. 2548, at 8).

Each of the term sheets with the private plaintiffs was conditioned on the confirmation of a plan of reorganization that includes participation by the Sackler Families in the plan of reorganization. (Bankr. Dkt. 1716, at 5).

However, not all issues were resolved. On September 23, 2020, while phase one of the mediation had reached "substantial completion" (Bankr. Dkt. 2548), the mediators' report indicated that "there remain terms to be negotiated by the parties with respect to each of the term sheets in order to reach final agreements . . ." (Bankr. Dkt. 1716, at 5-6). With several open terms and the estate claims still to be negotiated, on September 30, the Bankruptcy Court entered a Supplemental Mediation Order, authorizing further mediation to resolve the open issues and to mediate the estate claims (phase 2). (Dkt. No. 91-4, at App.1551; Bankr. Dkt. Nos. 1756).

B. Phase 2: October 2020-January 31, 2021

The Bankruptcy Court's Supplemental Mediation Order authorized the mediators **[**97]** "to mediate any and all potential claims or causes of action that may be asserted by the estate or any of the Non-Federal Public **[*64]** Claimants" against the Sackler families and entities "or that may otherwise become the subject of releases potentially granted to" members of the Sackler families and entities (defined as the "Shareholder Claims"). (*See* Bankr. Dkt. Nos. 1756, at 2; 2584, at 1; 518, at 4). This Order also "narrowed the number of mediating parties on the Shareholder Claims aspect of the mediation" to the Debtors, the UCC, the "Consenting Ad Hoc Committee,"[37] the NCSG, the MSGE, and representatives of the Sacklers. (Bankr. Dkt. Nos. 2584, at 1; 2548, at 2).

In phase two, the mediators received presentations from the parties on their positions regarding the estate claims, including a presentation by the UCC of its "views and findings on its investigation of estate causes of action." (Dkt. No. 91-4, at at App.1551-52; Bankr. Dkt. No. 2584).[38] After the presentations, "numerical negotiation began," with offers and counteroffers proposed. However, no "mutually agreed resolution" was reached among all constituencies before the end of the phase two on January 31, 2021. (Bankr. Dkt. **[**98]** No. 2584).

C. Phase 2 Negotiations Continue with the Sackler

---

[37] The Bankruptcy Court did not define what the "Consenting Ad Hoc Committee" was, but the mediators' March 23, 2021 report lists "the Consenting States and the Ad Hoc Committee" as consisting of the AHC plus the various consenting states listed there — notably Texas, Tennessee, and Florida. (*See* Bankr. Dkt. No. 2548, at 2). The Court assumes this is what is meant by the "Consenting Ad Hoc Committee."

[38] Occurring contemporaneously with the mediation was a Special Committee's "comprehensive investigation into potential claims that the Debtors may have against the Sackler Families and Sackler Entities," led by attorneys from Davis Polk, who represent the Debtors in the bankruptcy. (Dkt. No. 91-4, at App.1537-1553). Throughout the mediation, the Special Committee was kept apprised of the "offers and counteroffers that had been communicated through the Mediators by the NCSG, on the one hand, and the Sackler Families, on the other hand." (*Id.* at App.1552).

families: January 2021 to March 2021

Although court-ordered mediation formally ended on January 31, 2021, settlement negotiations continued among the Sackler families and entities, the Debtors, the NCSG, the UCC, the ACH, and the MSGE regarding the "Sackler contribution" to the Debtors' estate. (*See* Bankr. Dkt. No. 2584, at 9; Dkt. No. 91-4, at App.1552- 53). Eight more offers and counteroffers were exchanged between the end of January 2021 and February 18, 2021. (Dkt. No. 91-4, at App.1553).

Ultimately, the Sackler families and entities, the Debtors, the AHC, the "Consenting Ad Hoc Committee," and the MSGE reached an agreement in principle, which settled on a guaranteed amount that the Sackler families would be required to contribute to the Debtors' estate -$4.275 billion over nine years (or ten years if certain amounts were paid ahead of schedule in the first six years). (*Id.* at App.1552-53; *see* Bankr. Dkt. Nos. 2488, 2879). The principal consideration for this payment was the "Shareholder Release" that was to be included in the Debtors' plan of reorganization. (*See* Bankr. Dkt. 2487, at § 10.8). That plan, along with the **[**99]** Debtors' "Disclosure Statement" containing the "Sackler Settlement Agreement Term Sheet" reached in negotiation, were filed with the Bankruptcy Court on March 15, 2021. (*See* Bankr. Dkt. Nos. 2487, 2488).

D. Phase 3: May 7, 2021-June 29, 2021

Phase three of the mediation involved a final push to resolve the dispute of the **[*65]** NCSG[39] over the terms of the agreement reached in phase two of the mediation between and among the Sackler families and entities, the Debtors, the AHC, the "Consenting Ad Hoc Committee," and the MSGE. (Bankr. Dkt. Nos. 2820, 2879). To that end, on May 7, 2021, the Bankruptcy Court asked his colleague, the Honorable Shelley C. Chapman, to preside over a mediation between the NCSG and the Sackler Families with respect to the terms of the settlement. (Bankr. Dkt. No. 2820). Between May 7 and June 29, 2021, Judge Chapman conducted 145 telephone meetings and several in-person sessions between the NCSG and the Sackler families and entities. (*See* Bankr. Dkt. No. 3119).

The result of the mediation was a modified shareholder settlement with the Sackler families and entities, which was agreed to in principle by a fifteen of the twenty-five non-consenting states — specifically, Colorado, **[**100]** Hawaii, Idaho, Illinois, Iowa, Maine, Massachusetts, Minnesota, Nevada, New Jersey, New York, North Carolina, Pennsylvania, Virginia, and Wisconsin. (*Id.* at 2). Those states that reached agreement in principle also agreed to support and/or not object to the Plan.

The remaining non-consenting states — most of which are parties to this appeal — did not agree to the revised settlement. (*Id.*).

The new terms of the settlement included additional payments of $50 million by the Sackler families, and the acceleration of another $50 million in previously agreed settlement payments, resulting in total payments of $4.325 billion. In addition to the money, Judge Chapman induced the parties to agree to several non- monetary terms; specifically, a "material expansion of the scope of the public document repository" to be established under the Plan, and certain prohibitions on Sackler family demands for naming rights in exchange for charitable contributions, together with a few other, minor concessions. (*See* Bankr. Dkt. No. 3119).[40] The Shareholder Release was unchanged. (*See id.*).

On July 7, 2021, **[**101]** ***Purdue*** filed the mediator's report in the bankruptcy proceeding, informing Judge Drain of the result of the mediation.

X. Confirmation of the Plan: Summary of the Order on Appeal

Purdue filed the first version of the Plan on March 15, 2021. (Bankr. Dkt. No. 2487). It has subsequently filed twelve amendments to the Plan, the last of which was

[39] At that time, the non-consenting states included Colorado, Connecticut, Delaware, the District of Columbia, Hawaii, Idaho, Illinois, Iowa, Maine, Maryland, Massachusetts, Minnesota, Nevada, New Hampshire, New Jersey, New York, North Carolina, Oregon, Pennsylvania, Rhode Island, Vermont, Virginia, Washington, and Wisconsin.

[40] The value of the "naming rights" concession is dubious, since institution after institution, both here and abroad, is taking the Sacklers' name off various endowed facilities, including the Louvre and the Metropolitan Museum of Art. *See Louvre Removes Sackler Family Name From Its Walls*, The N.Y. Times (Jul. 17, 2019), https://www.nytimes.com/2019/07/17/arts/design/sackler-family-louvre.html; *Met Museum Removes Sackler Name From Wing Over Opioid Ties*, The N.Y. Times (Dec. 9, 2021), https://www.nytimes.com/2021/12/09/arts/design/met-

museum-sackler-wing.html

dictated by Judge Drain as a condition of confirmation. (*See* Bankr. Dkt. No. 3787).

On August 9, 2021, the Confirmation Hearing began before the Bankruptcy Court (Dkt. No. 91-3, at App.651), a six-day event during which 41 witnesses testified (by declaration or otherwise), after which the parties engaged in extensive oral argument. *See* [In re **Purdue Pharma** L.P., 2021 Bankr. LEXIS 2555, 2021 WL 4240974, at *2]().

[*66] On September 1, 2021, the Bankruptcy Court rendered an oral ruling, stating it would confirm the proposed plan provided certain changes were made to it, the most relevant of which for purposes of this appeal was a modification of the Section 10.7 Shareholder Release:

> I . . . require that the shareholder releases in paragraph 10.7(b) [the release of third-party claims against the shareholder released parties], by the releasing parties, be further qualified than they now are. To apply [only] where . . . a debtor's conduct **[**102]** or the claims asserted against it [are] a legal cause or a legally relevant factor to the cause of action against the shareholder released party.

(Confr. Hr'g Tr., Sept. 1, 2021, at 134:18-135:2); *see also* [In re **Purdue Pharma** L.P., 2021 Bankr. LEXIS 2555, 2021 WL 4240974, at *45](); *see* Plan, at § 10.7(b) (modifying the Plan in accordance with Judge Drain's instructions). ***Purdue*** filed the final version of the Plan the next day (Bankr. Dkt., No. 3726), and on September 17, 2021, Judge Drain issued his edited written decision confirming the Plan.

The salient features of the Plan are as follows:

Trusts to Administer Abatement and Distribution. Under the Plan, the majority of ***Purdue***'s current value will be distributed among nine "creditor trusts" that will fund opioid abatement efforts and compensate personal injury claimants, including the National Opioid Abatement Trust ("NOAT"), which will make distributions to qualified governmental entities. (Bankr. Dkt. No. 3456, at ¶¶ 5-6). Most of the creditor trusts are abatement trusts and may only make distributions for the purpose of opioid abatement or to pay attorneys' fees and associated costs. (*Id.* ¶¶ 5-6). Two trusts — the "PI Trust" and "PI Futures Trust" — are the only exceptions: those creditor trusts will make **[**103]** distributions to qualifying personal injury claimants. (*Id.*)

The Public Document Repository. Under the Plan the Debtors are required to create a public document repository of ***Purdue*** material available for public review. (Bankr. Dkt. No. 3440, at ¶ 7.) The AHC testified at the Confirmation Hearing that the establishment of this public document repository was among their highest priorities. (Confr. Hr'g Tr., Aug. 13, 2021, at 151:17- 152:9 ("[O]f all the aspects of . . . the injunctive relief part of [the Plan], [the public document repository] . . . is extremely important from the standpoint of, not only what it is that we developed in terms of evidence, [but also] lessons to be learned from the conduct that was uncovered and revealed."); Confr. Hr'g Tr., Aug. 16, 2021, at 83:20-22, 84:12-23 ("[I]it could be that the document repository is actually the most valuable piece of this settlement.")). The public document repository will be hosted by an academic institution or library and will include more than 13,000,000 documents (consisting of more than 100,000,000 pages) produced in the chapter 11 case and tens of millions of additional documents, including certain documents currently subject **[**104]** to the attorney client privilege that would not have been produced in litigation. (Bankr. Dkt. No. 3440, at ¶ 7.) The Plan ensures that scholars and the public can have access to all of these materials.

Purdue Pharma Will Cease to Exist. Under the Plan, ***Purdue Pharma*** will cease to exist. Its current business operating assets will be transferred to and operated by a new entity, known as "NewCo" in the Plan (Plan, at 28), but to be named KNOA. (Oral Arg. Tr., Nov. 30, 2021, at 158:1-17). NewCo will be governed by a board of five or seven disinterested and independent managers initially selected by the AHC and the MSGE, in consultation with the **[*67]** Debtors and UCC, subject to a right of observation by the DOJ. (Plan, at §5.4). NewCo will manufacture products, including Betadine, Denokot, Colace, magnesium products, opioids and opioid-abatement medications, and oncology therapies. (*See* Oral Arg. Tr., Nov. 30, 2021, at 157:19-159:23). Additionally, NewCo will continue the Debtors' development of opioid overdose reversal and addiction treatment medications, and it must deliver millions of doses of those medications at low or no cost when development is complete (these will be distributed to groups **[**105]** or entities to be determined post-emergence). (*Id.* at 159:19-160:7). NewCo will be subject to an "Operating Injunction" that prohibits it from, among other things, promoting opioid products and providing financial incentives to its sales and marketing employees that are "directly" (but not indirectly) based on sales volumes or sales quotas for opioid products. (Bankr. Dkt. No. 3456, at ¶10). It also is subject to

"Governance Covenants" that ensure that NewCo provides all its products in a "safe manner," complies with settlement obligations, pursues public health initiatives, and follows pharmaceutical best practices. (*Id.* at ¶11). The Plan provides for the appointment of a monitor to ensure that NewCo complies with the Operating Injunction and Governance Covenants; the monitor will provide the public with regular updates and seek relief from the Bankruptcy Court to the extent necessary to carry out the monitor's obligations. (*Id.* at ¶13). Above all, NewCo is not intended to operate indefinitely: The Plan instruct the managers to use reasonable best efforts to sell the assets of NewCo by December 21, 2024. (*Id.* at ¶15).

<u>Shareholder Settlement Agreement</u>. The Plan incorporates the "Shareholder **[**106]** Settlement Agreement" and the transactions contemplated therein whereby, in exchange for the release of third-party claims against over 1,000 individuals and entities related to the Sackler family ("Shareholder Released Parties"), the Sackler family will give $4.275 billion toward the ***Purdue*** estate. (Plan, at 37; Dkt. No. 91-3, at App.1042, 1045-1046, 1050).

Section 10.7(b) of the Plan sets out the terms of the release that the Sacklers, from the inception of the bankruptcy and earlier, insisted on in exchange for contributing funds to ***Purdue***'s estate. The Plan "releases and discharges" certain claims that third parties (including states and personal injury claimants) have asserted or might in the future assert against the Shareholder Released Parties. The release of claims against the Shareholder Released Parties permanently enjoins third parties from pursuing their current claims against the Shareholder Released Parties and precludes the commencement of future litigation against any of the Sacklers and their related entities, as long as (i) those claims are "based on or related to the Debtors, their estates, or the chapter 11 cases," and (ii) the "conduct, omission or liability of **[**107]** any Debtor or any Estate is the legal cause or is otherwise a legally relevant factor." (Plan § 10.7(b)). The third-party releases under the Plan are non-consensual; they bind the objecting parties as well as the parties who consented. All present and potential claims connected with OxyContin and other opioids would be covered by the Section 10.7 Shareholder Release.

<u>Channeling Injunction</u>. Under the Plan, all enjoined claims against the Debtors and those against the Shareholder Released Parties are to be channeled to the nine creditor trusts for treatment according to the trust documents of each respective trust ("Channeling Injunction"). (Plan, at p. 10 and § 10.8). However — as the U.S. Trustee points out, and the Debtors do not contest (*see* Dkt. No. 91, at 19-20; Dkt. No. 151, at 23-24) — the claims against the Shareholder Released Parties are effectively **[*68]** being extinguished for nothing, even though they are described as being "channeled." (*See e.g.*, Oral Arg. Tr., Nov. 30, 2021, at 37:9-14; 29:16-17). The U.S. Trustee explains that the Plan documents expressly prohibit value being paid based on causes of action (whether pre-or post-petition) against the Sackler family or other non-debtors **[**108]** for opioid-related claims. (Dkt. No. 91, at 19-20; *see, e.g.*, Dkt. No. 91-2, at App.333 ("Distributions hereunder are determined only with consideration to a Non-NAS PI Claim held against the Debtors, *and not to any associated Non-NAS PI Channeled Claim against a non-Debtor party*.") (emphasis added); *id.* at App.392 ("Distributions hereunder are determined only with consideration to an NAS PI Claim held against the Debtors, *and not to any associated NAS PI Channeled Claim against a non-Debtor party*.") (emphasis added); *id.* at App.433 ("A Future PI Claimant may not pursue litigation against the PI Futures Trust for any Future PI Channeled Claim *formerly held or that would have been held against a non-Debtor party*.") (emphasis added)). And to assert any third-party claim against the trust, the claimant must have filed a proof of claim in the bankruptcy prior to the bar dates, but each of the bar dates passed by the time anyone was notified of the claims' extinguishment. (Dkt. No. 91, at 20). And to get an exception for an untimely filing, a party must proceed through multiple steps, after which the Bankruptcy Court — which serves as a gatekeeper — determines, in its discretion, that the **[**109]** untimely claim qualified under the Plan and granted leave to assert the claim. (*Id.*).

Debtors sidestepped the Plan's effective extinguishment of purportedly channeled third-party claims in its brief by not addressing the U.S. Trustee's points; they made no effort to clarify this in oral argument for the Court. (*See* Dkt. No. 151, at 23-27).

XI. Objections to the Plan

On June 3, 2021, the Bankruptcy Court approved ***Purdue***'s disclosure statement. (*See* Bankr. Dkt., No. 2988).

On July 19, 2021, the U.S. Trustee objected to confirmation of the Plan, arguing that the Section 10.7

Shareholder Release was unconstitutional, violates the Bankruptcy Code, and is inconsistent with Second Circuit law. (*See* Bankr. Dkt. No. 3256). Eight states — California, Connecticut, Delaware, Maryland, Oregon, Rhode Island, Washington, Vermont — and D.C. all filed objections, as did the City of Seattle, four Canadian municipalities, two Canadian First Nations and three *pro se* plaintiffs. (Bankr. Dkt. No. 3787, at 28; *see also* Bankr. Dkt. No. 3594). The U.S. Attorney's Office for this District on behalf of the United States of America filed a statement of interest supporting these objections to the Section 10.7 Shareholder **[**110]** Release. (*See* Bankr. Dkt. No. 3268).

The objectors argued, *inter alia* and as applicable to them, that the Section 10.7 Shareholder Release (1) violates the third-party claimants' rights to due process, (2) violates the objecting states' sovereignty and police power, (3) is not permitted under the Bankruptcy Code, and (4) the Bankruptcy Court lacks constitutional, statutory, and equitable authority to approve the Section 10.7 Shareholder Release.

XII. Judge Drain's Decision to Confirm the Plan

Judge Drain's opinion is a judicial *tour de force* — delivered from the bench only days after the end of a lengthy trial, it included extensive findings of fact and addressed every conceivable legal argument in great detail. Sixteen days later, on September 17, the learned bankruptcy judge **[*69]** filed a written version of that oral decision, running to 54 pages on Westlaw, which is the version summarized here. *See* *In re **Purdue Pharma** L.P., 633 B.R. 53, 2021 Bankr. LEXIS 2555, 2021 WL 4240974 (Bankr. S.D.N.Y. Sept. 17, 2021)*.

Judge Drain began by describing the highly unusual and complex nature of the situation before him — a "massive public health crisis," with a potential creditor body that included "every person in the range of the Debtors' opioid products sold throughout the United States" — individuals, local, **[**111]** state and territorial governments, Indian tribes, hospitals, first responders, and the United States itself. *2021 Bankr. LEXIS 2555, [WL] at *1*. He noted that over 618,000 claims, in an amount exceeding two trillion dollars, had been filed in the bankruptcy. And he commended the parties for working in "unique and trailblazing ways to address the public health crisis that underlies those claims." *Id.*

In his opening remarks, Judge Drain also addressed the elephant in the room:

> These cases are complex also because the Debtors' assets include enormous claims against their controlling shareholders, and in some instances directors and officers, who are members of the Sackler family, whose aggregate net worth, though greater than the Debtors', also may well be insufficient to satisfy the Debtors' claims against them and other very closely related claims that are separately asserted by third parties who are also creditors of the Debtors.

Id.

Judge Drain then announced the ultimate result:

First, he concluded that there existed no other reasonably conceivable means to achieve the result that would be accomplished by the Plan in addressing the problems presented by this case. Second, he found that well-established precedent **[**112]** — which he described as "Congress in the Bankruptcy Code and the courts interpreting it" — authorized him to confirm the Plan. *Id.* Insofar as is relevant to this appeal,[41] Judge Drain reached the following conclusions.

A. The Section 10.7 Shareholder Release and Settlement with the Sacklers

The meat of this case, both before Judge Drain and on this appeal, is the Bankruptcy Court's approval of the broad releases that the Plan affords to all members of the Sackler family and to their related entities, including businesses and trusts.

The Plan includes two settlements with every member of the Sackler family — whether or not that individual had anything to do with the management of ***Purdue*** or

[41] Many issues addressed by Judge Drain in his comprehensive opinion are not implicated by any of the appeals to this Court, and so will not be addressed in this decision. These include: objections from insurers that the Plan was not insurance neutral; from the U.S. Trustee to the Plan's treatment of certain attorney fees and expenses; to objections by certain prisoners who filed claims but challenged the sufficiency of notice and what they perceived as a compromising of their rights under the *Mandatory Victims Restitution Act, 18 U.S.C. § 3663A*; objections by certain states to their classification in the same voting class as their political subdivisions; an objection by the State of West Virginia to the allocation plan for states from the NOAT; and objections by certain Pro Se Appellants to the Plan's release of the Sacklers from criminal liability (it does not).

personally exercised any control over ***Purdue*** — and with a variety of entities related to the Sacklers, including various trusts, businesses, and IACs. Taken together these individuals and entities (not all of whom have been or apparently can **[*70]** be identified) are known as the "Shareholder Released Parties." *2021 Bankr. LEXIS 2555, [WL] at *24*.

The first settlement disposed of claims that the Debtors could assert against the Shareholder Released Parties for the benefit its creditors. *Id.* These included claims for (1) breach of fiduciary **[**113]** duty against those members of the Sackler family who were involved in — indeed, who drove — the business decisions that were the basis for ***Purdue***'s criminal and civil liability, and (2) fraudulent conveyance arising out of the Sackler family's removal of nearly $11 billion from the Debtor corporations over the course of a decade. *See 2021 Bankr. LEXIS 2555, [WL] at *31-32*.

The second settlement disposed of certain third-party claims that could not be asserted by the Debtors against the Shareholder Released Parties, but were particularized to others. Chief among these claims are claims asserted by the states — both the consenting states and the objecting states — arising under various unfair trade practices and consumer protection laws that make officers, directors and managers who are responsible for corporate misconduct personally liable for their actions. Judge Drain did not review on a state- by-state basis the various state laws applicable to these objector claims, including laws that might forbid insurance coverage or indemnification and contribution claims by those individuals, such that their personal assets are very much at risk. *2021 Bankr. LEXIS 2555, [WL] at *48*.

In exchange for these releases, the Shareholder Released Parties agreed **[**114]** to contribute $4.325 billion to a fund that would be used to resolve both public and private civil claims as well as both civil and criminal settlements with the federal government. *2021 Bankr. LEXIS 2555, [WL] at *25*. The Sacklers also agreed to the dedication of two charities worth at least $175 million for abatement purposes; to a resolution that barred them from insisting on naming rights in exchange for charitable contributions; to refrain from engaging in any business with NewCo and to dispose of their interest in the non-U.S. ***Purdue*** entities within seven years; to certain "snap back" provisions that were designed to ensure the collectability of their settlement payments; and to the creation of an extensive document repository that would archive in a comprehensive manner the history of the Debtors and their involvement in the development, production and sale of opioids. *Id.*

Judge Drain made three fundamental findings relating to these settlements: that the Sackler Settlements were necessary to the Plan; that they were fair and reasonable; and that it was necessary and appropriate for him to approve the non-consensual release of certain third-party claims against the Sacklers, even though they are not **[**115]** debtors.

B. The Sackler Settlements Were Necessary

Judge Drain concluded that these settlements were necessary to the Plan. He noted that a variety of other settlements that were essential components of the Plan — including agreed-upon allocations of the pot of money to be created by the Debtors' estate and the Sackler contribution — would unravel for lack of funding if the Sacklers did not make their $4.325 billion contribution. And he found that they would not make that contribution unless they obtained broad releases from past and future liability. *2021 Bankr. LEXIS 2555, [WL] at *46-47*.

1. <u>The Sackler Settlements Were Fair and Reasonable in Amount</u>

Judge Drain evaluated the fairness of the settlement in light of the factors laid out by the Second Circuit in *Motorola Inc. **[*71]** v. Official Committee of Unsecured Creditors & JP Morgan Chase Bank, N.A. (In re Iridium Operating LLC), 478 F. 3d 452, 464-66 (2d Cir. 2007)*, which is controlling law in this Circuit on the questions. He made the following findings:[42]

(a) The Sackler settlements were the product of arms-length bargaining conducted by able counsel in two separate mediations presided over by three outstanding mediators and preceded by what he described as the "most extensive discovery process not only I have seen after practicing bankruptcy law since 1984 and being on the bench since 2002, but I believe any court **[**116]** in bankruptcy has ever seen." *In re **Purdue Pharma** L.P., 2021 Bankr. LEXIS 2555, 2021 WL 4240974, at *26-27*. That process led to the production of almost 100 million pages of documents, through which all interested parties could learn "anything suggesting a claim against

[42] Judge Drain considered all of the *Iridium* factors, but not in the order in which they are discussed in *Iridium*. I employ Judge Drain's framework in this decision.

the shareholder released parties." *Id.*

(b) The settlements were negotiated by exceedingly competent counsel who were, as a result of the discovery process described above, well-informed about both the claims they might bring against the Shareholder Released Parties and the difficulties they would have in pursuing those claims. *2021 Bankr. LEXIS 2555, [WL] at *27-28*.

(c) ***Purdue***'s creditors overwhelmingly supported the settlement. *2021 Bankr. LEXIS 2555, [WL] at *28*. Some 120,000 votes were cast on the Plan — a number far exceeding the voting in any other bankruptcy case. *2021 Bankr. LEXIS 2555, [WL] at *3*. Over 95% of those voting in the aggregate favored the Plan: over 79% of the states and territories supported the Plan; over 96% of other governmental entities and tribes; and over 96% of the personal injury claimants; together with a supermajority of all other claimants. *2021 Bankr. LEXIS 2555, [WL] at *28*.

(d) The failure to approve the settlement was likely to result in complex and protracted litigation, with attendant cost and delay, while the settlement offered significant and immediate benefits to **[**117]** the estate and its creditors. *2021 Bankr. LEXIS 2555, [WL] at *28-29*.

(e) Judge Drain focused particularly on the difficulty of collecting any judgments that might be obtained against the Sacklers. *2021 Bankr. LEXIS 2555, [WL] at *29*. Ordinarily this factor would rest on things like the paucity of assets available to satisfy judgments. But in this case the problems with collection were the result of what the Sacklers did with the money that they admittedly took out of the corporations between 2008-2016. The assets of family members are held principally in purportedly spendthrift trusts located in the United States and offshore — many of them on the Bailiwick of Jersey — and many of those assets cannot readily be liquidated. As Judge Drain correctly observed, spendthrift trusts can and often do insulate assets from the bankruptcy process. And while generally applicable law governing U.S. trusts allows those trusts to be invaded when they are funded by fraudulent conveyances, there is a substantial question whether the same is true under Jersey law. Additionally, he noted that many Sackler family members live abroad, raising a barrier to an American court's acquiring personal jurisdiction over them. Although the learned bankruptcy judge did not reach **[**118]** any final conclusion about these complicated issues, he readily drew the conclusion that collectability presented a significant concern, one that was obviated by the settlement.

[*72] (f) Judge Drain also noted that the cost and delay attendant to the pursuit of the Sacklers — which was in and of itself substantial — would be compounded by the unraveling of the other settlements that were baked into the Plan. Judge Drain concluded that the unraveling of the Plan would inevitably result in the liquidation of Debtors under Chapter 7, which would in turn lead to no recovery for the unsecured creditors (including the personal injury plaintiffs), and no money for any abatement programs. *2021 Bankr. LEXIS 2555, [WL] at *30*. This conclusion was reinforced by the fact that, absent confirmation of the Plan, the United States would have a superpriority administrative expense claim in an amount ($2 billion) that would wipe out the value of ***Purdue***'s business as a going concern ($1.8 billion). *2021 Bankr. LEXIS 2555, [WL] at *16*.

(g) Finally, Judge Drain considered the legal risks of the estates' pursuit of claims against the Sacklers against the benefits of settlement. *2021 Bankr. LEXIS 2555, [WL] at *31-33*.

Judge Drain first chronicled the problems ***Purdue*** would have in proving **[**119]** that the admitted conveyances qualified as fraudulent. He noted that over 40% of the purportedly avoidable transfers were used to pay federal and states taxes associated with ***Purdue***, none of which was going to be refunded. *2021 Bankr. LEXIS 2555, [WL] at *31*. He identified various technical defenses that the Sacklers could assert to fraudulent conveyance claims, including statutes of limitations and the impact of prior settlements. *2021 Bankr. LEXIS 2555, [WL] at *32*. And while admitting that at least some of the Sacklers appeared to have been very much aware of the risk of opioid litigation to ***Purdue***'s solvency and their own, he also pointed to evidence that ***Purdue*** may not have been "insolvent, unable to pay its debts when due, or left with unreasonably small capital" — which would be necessary to make a conveyance fraudulent — until as late as 2017 or 2018, by which time most or all of the conveyances had been made. *Id.*

As for alter ego, veil-piercing and breach of fiduciary duty claims, Judge Drain noted that most of the Sackler family members had nothing to do with ***Purdue***'s operations, and that no one had identified any action taken by any of them in their capacity as passive shareholders that would make them liable on such claims. *Id.* He **[**120]** also identified the extensive government oversight of ***Purdue*** after its 2007 Plea Agreement and Settlement with the federal government and certain states, and the fact that neither DHHS nor various state reviews ever identified any improper actions. *2021 Bankr. LEXIS 2555, [WL] at *33*.[43]

Judge Drain made no findings about the actual merit of any of the estates' claims against any member of the Sackler family. But weighing these difficulties against the benefits that would be derived from the settlement, he concluded:

> I believe that in a vacuum the ultimate judgments that could be achieved on the estates' claims . . . might well be higher than the amount that the Sacklers are contributing. But I do not believe that recoveries on such judgments would be higher after taking into account the catastrophic effects on recoveries that would result from pursuing those claims and unravelling the plan's intricate settlements. And as I said at the beginning of this analysis, there is also the serious issue of problems that would be faced in **[*73]** collection that the plan settlements materially reduce.

Id.

Judge Drain ended his discussion of the *Iridium* factors with a deeply personal reflection — dare I say, a *cri de coeur* — that is perfectly **[**121]** understandable coming from one who had labored so long and so hard to try to achieve a better result. Admitting that he had "expected a higher settlement," he said:

> This is a bitter result. B-I-T-T-E-R. It is incredibly frustrating that the law recognizes, albeit with some exceptions, although fairly narrow ones, the enforceability of spendthrift trusts. It is incredibly frustrating that people can send their money offshore in a way that might frustrate U.S. law. It is frustrating, although a long-established principle of U.S. law, that it is so difficult to hold board members and controlling shareholders liable for their corporation's conduct.
>
> It is incredibly frustrating that the vast size of the claims against the Debtors and the vast number of claimants creates the need for this plan's intricate settlements. But those things are all facts that anyone who is a fiduciary for the creditor body would have to recognize, and that I recognize.

Id.

Ultimately, however, the learned bankruptcy judge decided that the perfect was the enemy of the good:

> I am not prepared, given the record before me, to risk [the parties'] agreement. I do not have the ability to impose what I would like on the parties. **[**122]**

*2021 Bankr. LEXIS 2555, [WL] at *34*. And so, albeit with obvious reluctance, he concluded that the settlement was reasonable as that term is understood at law.

2. The Section 10.7 Shareholder Release Was In all Respects Legal

Having concluded that the settlements were fair and reasonable in amount, Judge Drain went on to address a number of challenges to his legal authority to impose the most controversial element of those settlements: The Section 10.7 Shareholder Release. *2021 Bankr. LEXIS 2555, [WL] at *35*. He rejected each such challenge.

[43] Given ***Purdue***'s admissions in connection with its 2020 Plea Agreement, this Court cannot assign much weight to the "oversight" factor.

Subject matter jurisdiction. First, Judge Drain concluded that he had subject matter jurisdiction to impose the third-party releases and injunctions. Citing *Celotex Corp. v. Edwards, 514 U.S. 300, 307-08, 115 S. Ct. 1493, 131 L. Ed. 2d 403 (1995)* and *SPV OSUS, Ltd. v. UBS AG, 882 F. 3d 333, 339-40 (2d Cir. 2018)*, he held that he had the undoubted power to enjoin the claims of third parties that had "any conceivable effect" on the Debtors' estates as part of a Bankruptcy Court's "related to" jurisdiction, conferred by Congress in *28 U.S.C. § 1334(b)*. *In re **Purdue Pharma** L.P., 2021 Bankr. LEXIS 2555, 2021 WL 4240974, at *36-38*. He concluded that the third-party claims covered by the Section 10.7 Shareholder Release would directly affect the *res* of the Debtors' estates in three different ways: insurance rights, the Shareholder Released Parties' right to indemnification and contribution, and the Debtors' ability to pursue its own overlapping claims against **[**123]** the Sacklers. He concluded by saying, "Depending on the kinds of third-party claims covered by a plan's release and injunction of such claims, *I conclude, therefore, that the Court has jurisdiction to impose such relief, based upon the effect of the claims on the estate rather than on whether the claims are 'derivative . . .*" *2021 Bankr. LEXIS 2555, [WL] at *38* (emphasis added).

Due process. Next, Judge Drain concluded that the Section 10.7 Shareholder Release did not violate the third-party **[*74]** claimants' right to due process. *2021*

Bankr. LEXIS 2555, [WL] at *38-39. He rejected the argument that a release constitutes a *de facto* adjudication of the claim, holding that such a release "is part of the settlement of the claim that channels settlement funds to the estate." 2021 Bankr. LEXIS 2555, [WL] at 38. And he held that claimants had been provided with constitutionally sufficient notice of the proposed releases. Uncontroverted testimony that Judge Drain found credible established that messages tailored to reach persons who may have been harmed by Debtors' products had reached roughly 98% of the adult population of the United States and 86% of the adult population of Canada, with supplemental notice reaching an estimated 87% of all U.S. adults and 82% of Canadian adults, **[**124]** as well as audiences in 39 countries, with billions of hits on the internet and social media in addition to notice delivered by TV, radio, publications, billboards and outreach to victim advocate and abatement-centered groups. While references contained in the notices sent readers to complex lawyerly descriptions of the release provisions, the notices themselves were written in plain English and specifically mentioned that the Plan contemplated a broad release of civil (not criminal) claims against the members of the Sackler family and related entities.

Constitutional authority. Judge Drain next concluded that he had constitutional power to issue a final order confirming a plan that contains a third-party claims release. 2021 Bankr. LEXIS 2555, [WL] at *40. He determined that a proceeding to determine whether a chapter 11 plan containing such a release was a "core" proceeding, so ordering the non-debtor releases and enjoining the prosecution of thirdparty claims against non-the Sacklers qualified as "constitutionally core" under Stern v. Marshall, 564 U.S. 462, 131 S. Ct. 2594, 180 L. Ed. 2d 475 (2011) and its progeny.

Statutory authority. Finally, Judge Drain concluded that he had statutory power to confirm and enter the third-party releases. In re **Purdue Pharma** L.P., 2021 Bankr. LEXIS 2555, 2021 WL 4240974, at *40-43. He started from the proposition that the Second **[**125]** Circuit, in Deutsche Bank A.G. v. Metromedia Fiber Network, Inc., (In re Metromedia Fiber Network, Inc.), 416 F. 3d 136, 141 (2d Cir. 2005), had indicated that non-consensual third-party releases of claims against non-debtors could be approved, albeit only in "appropriate, narrow circumstances." In re **Purdue Pharma** L.P., 2021 Bankr. LEXIS 2555, 2021 WL 4240974, at *40. He noted that most of the Circuits were of that view and rejected the reasoning of those courts of appeal that held otherwise. Indeed, he asserted that the view of those Circuits (the Fifth, Ninth, and Tenth Circuits) — which is that Section 524(e) of the Bankruptcy Code precluded the grant of any such release in the context of a settlement — "has been effectively refuted." 2021 Bankr. LEXIS 2555, [WL] at *41. He analogized the enjoining of third-party claims against non-debtors to his undoubted power to impose a preliminary injunction against the temporary prosecution of thirdparty claims in order to facilitate the reorganization process. And he asked rhetorically why such a stay could not become permanent if it was crucial to a reorganization process involving massive numbers of overlapping estate and third-party claims. 2021 Bankr. LEXIS 2555, [WL] at *42.

Having concluded that Section 524(e) was not a statutory impediment to a Bankruptcy Court's approval of third-party releases, the Bankruptcy Judge then addressed the question of exactly what provision or provisions in the Bankruptcy Code conferred the necessary authority over claims **[**126]** against non- debtors on him. 2021 Bankr. LEXIS 2555, [WL] at *42-43. He found such authority in the "necessary or appropriate" power in **[*75]** Section 105(a) of the Bankruptcy Code coupled with Section 1123(b)(6)'s grant of power to "include any other appropriate provision not inconsistent with the applicable provisions of this title" — what the Seventh Circuit referred to in Airadigm Communs., Inc. v. FCC (In re Airadigm Communs., Inc.), 519 F. 3d 640, 657 (7th Cir. 2008) as a bankruptcy court's "residual authority." In re **Purdue Pharma** L.P., 2021 Bankr. LEXIS 2555, 2021 WL 4240974, at *43. He also cited Sections 1123(b)(5) and 1129 of the Bankruptcy Code.

Judge Drain carefully noted that the release in this case extended beyond so-called "derivative" claims — claims that the Debtors could bring against the Sacklers— which claims could assuredly be released by a bankruptcy court exercising *in rem* jurisdiction over the *res* of the estate. But he concluded — largely in reliance on In re Quigley Co., Inc., 676 F.3d 45, 59-60 (2d Cir. 2012) — that he had statutory authority to authorize the release of non-derivative — direct or particularized — claims, because the third party claims to be released in this case were "premised as a legal matter on a meaningful overlap with the debtor's conduct." In re **Purdue Pharma** L.P., 2021 Bankr. LEXIS 2555, 2021 WL 4240974, at *43-47. Such a claim — one that "essentially dovetail[s] with the facts of the claimants' thirdparty claims against the Debtors" — was, in Judge Drain's view, "sufficiently close to the claims against the debtor to be subject to settlement under the debtor's plan if enough **[**127]** other considerations support the settlement." *2021 Bankr. LEXIS 2555, [WL] at *45-46*.

As noted above, Judge Drain did insist that the Section 10.7 Shareholder Release be modified so that it covered only third-party claims in which "a Debtor's conduct, or a claim asserted against the Debtor, must be a legal cause of the released claim, or a legally relevant factor to the third-party cause of action against the shareholder released party." *2021 Bankr. LEXIS 2555, [WL] at *45*. In other words, he insisted that there be substantial factual overlap between the released particularized claims and the derivative claims that no one disputes he had the power to release, such that the released nonderivative claims were "sufficiently close to the claims against the debtor."

Metromedia *analysis*. Having disposed of all constitutional, jurisdictional, and statutory challenges to his authority to enter the Section 10.7 Shareholder Release (as modified), Judge Drain turned finally to whether this was the "unique" case in which it would be was appropriate to impose them. *2021 Bankr. LEXIS 2555, [WL] at *46*. He concluded that it was.

In this regard, he reviewed the law in the various circuits on the subject, viewing with special interest the Third Circuit's conclusion that:

> "To grant non-consensual releases a court **[**128]** must assess 'fairness, necessity to the reorganization' and make specific actual findings to support these conclusions." *Gillman v. Continental Airlines (In re Continental Airlines), 203 F.3d 203, 214 (3d Cir. 2001)*. Relevant consideration might include whether the non-consensual release is necessary to the success of the reorganization; whether the releasees have provided a critical financial contribution to the debtor's plan and whether that financial contribution is necessary to make the plan feasible; and whether the non-consenting creditors received reasonable compensation in exchange for the release, such that the release is fair." *In re Spansion, Inc., 426 B.R. 114, 144 (Bankr. D. Del 2010)*.

In re ***Purdue Pharma*** *L.P., 2021 Bankr. LEXIS 2555, 2021 WL 4240974, at *46*.

Judge Drain also cited with approval the Seventh Circuit's practice of engaging in a **[*76]** factbased inquiry into such matters as whether the release is "narrowly tailored, not blanket" (unlike the Section 10.7 Shareholder Release, which releases all types of conduct, including fraud and willful misconduct); whether the release is an essential component of the plan; and whether it was achieved by the exchange of good and valuable consideration that will enable unsecured creditors to realize distributions (which is in fact going to happen in this case). *2021 Bankr. LEXIS 2555, [WL] at *47*.

Judge Drain also noted that the Fourth, Sixth and Eleventh Circuits apply a multi-factor test **[**129]** in deciding when it is appropriate to impose a non-consensual release of third-party claims. (*2021 Bankr. LEXIS 2555, [WL] at *46*).

Then, while recognizing that "this is not a matter of factors or prongs" (*id.* citing *Metromedia, 416 F. 3d at 142*), Judge Drain made a long list of findings about why this was the "rare" and "unique" case in which a nonconsensual third-party claims release was appropriate. *2021 Bankr. LEXIS 2555, [WL] at *46-49*. These include the following: (i) the ***Purdue*** bankruptcy was exceedingly complex; (ii) the Plan has overwhelming creditor support; (iii) without the Sackler payment the settlements would unravel; (iv) while not every Sackler would be making a specific payment toward the settlement,[44] the aggregate settlement payment hinged on each member of the family's being released; (v) the settlement amount was substantial; (vi) the release "is narrowly tailored;"[45] (vii) the settlement was fundamentally fair to the third parties; and (viii) for the reasons discussed at length *supra*, Background Section XII(B)(1), the cost and likelihood of success on the third party claims against the Sacklers — including both the merits and the impediments to collection of any judgment — was outweighed by the immediate and definite benefits of the settlement.

---

[44] It is actually not clear what members of the Sackler family are contributing to the settlement and in what amounts. The record contains some suggestion that the various trusts that are contributing are for the benefit of all members of the family.

[45] Judge Drain did not explain what he meant by that, except to say that the release would be further narrowed so that it was limited in the manner discussed above. I assume that he meant that the release was limited to claims involving the Debtor's conduct, and claims in which the Debtor's conduct is "a legal cause of the released claim, or a legally relevant factor to the third-party cause of action." *In re* ***Purdue Pharma*** *L.P., 2021 Bankr. LEXIS 2555, 2021 WL 4240974, at *45*.

"Best interests" [130] analysis**. Section 1129 of the Bankruptcy Code requires that a plan of reorganization may be confirmed only if a litany of requirements is met. One such requirement is found in Subsection (a)(7) of Section 1129, which provides that, for any impaired creditor or class of creditors, if all members of the class do not approve the plan, each member of the class "will receive or retain under the plan on account of such claim or interest property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7 of this title on such date." *In re* ***Purdue Pharma*** *L.P., 2021 Bankr. LEXIS 2555, 2021 WL 4240974, at *50*.

Judge Drain applied this so-called "best interests" test to conclude that the holders of claims against non-debtor third parties would receive, on account of the Plan (and taking into account their claims against the Debtors as well as the third parties), materially more than they would receive in a **[*77]** hypothetical chapter 7 liquidation.[46] *2021 Bankr. LEXIS 2555, [WL] at *50-51*.

State police powers. Judge Drain concluded that his ordering of the non-debtor releases did not violate state sovereignty or any state police power. *2021 Bankr. LEXIS 2555, [WL] at *51-53*. He concluded that actions exempted from the automatic stay by virtue of Section 362(b)(4) were nonetheless subject to court-ordered (**[**131]** *i.e.*, not automatic) injunctive relief, and that Congress' express power under the bankruptcy clause of the Constitution to enact uniform bankruptcy laws overrode any state regulatory or sovereignty argument.

The classification of the Canadians. Finally, Judge Drain addressed whether that the Canadian creditor's classification as Class 11(c) creditors, rather than as Class 4 and 5 creditors, was impermissible. Certain Canadian creditor groups objected to the confirmation of the Plan, arguing that they should be classified with the U.S. unsecured creditor groups in Classes 4 and 5 to participate in the opioid abatement trusts created under the Plan for those classes, rather than receiving their pro rata share of the cash payment to Class 11(c). But Judge Drain concluded that, because there were legitimate reasons for separately classifying the Canadian unsecured creditors from there domestic counterparts, the classification was perfectly permissible. First, the Canadian creditors operate under "different regulatory regimes . . . with regard to opioids and abatement" than their domestic counterparts. *In re* ***Purdue Pharma*** *L.P., 2021 Bankr. LEXIS 2555, 2021 WL 4240974, at *12*. And second, "the allocation mediation conducted by Messrs. Feinberg and Phillips that **[**132]** resulted in the plan's division of the Debtors' assets . . . involved only *U.S.-based* public claimants with their own regulatory interests and characteristics." *Id.* (emphasis added).

XIII. The Appeal

The U.S. Trustee, eight states,[47] D.C., certain Canadian municipalities and First Nation groups,[48] and five *pro se* individuals[49] filed notices of appeal of Judge Drain's Confirmation Order in September 2021. (*See* Bankr. Dkt. No. 3724 (amended by Dkt. No. 3812), 3725, 3774 (amended by 3949), 3775 (amended by 3948), 3776 (amended by 3799), 3780 (amended by Dkt. No. 3839), 3784 (amended by Dkt. No. 3818), 3810, 3813, 3832, 3849, 3851, 3853, 3877, 3878). The U.S. Trustee also appealed the Advance Order (Bankr. Dkt. No. 3777) and the Disclosure Order (Dkt. No. 3776).

[*78] Among those who did not appeal the Plan were the UCC, the ACH, MSGE, the PI Ad Hoc Group, and other creditors supporting the Plan.

ISSUES ON APPEAL AND CONCLUSIONS OF LAW

[46] Judge Drain also argued that the best interest test under section 1129(a)(7) requires that the amount that an objecting creditor stands to receive under the plan on account of its claim be at least as much it would receive if the debtor were liquidated under chapter 7. *In re* ***Purdue Pharma*** *L.P., 2021 Bankr. LEXIS 2555, 2021 WL 4240974, at *50*. Thus, he concluded, the best interest test does not require analysis of the claimant's rights against third parties. *Id.* He acknowledged that his reading of the statute was at odds with at least two of his colleagues' reading of the same statute. I mention this fact but it has nothing to do with the ultimate decision on this appeal.

[47] California, Connecticut, Delaware, Maryland, Oregon, Rhode Island, Vermont, and Washington.

[48] The City of Grande Prairie as Representative for a Class Consisting of All Canadian Municipalities, the Cities of Brantford, Grand Prairie, Lethbridge, and Wetaskiwin; the Peter Ballantyne Cree Nation on behalf of All Canadian First Nations and Metis People and on behalf itself and the Lac La Ronge Indian Band.

[49] Ronald Bass, Marie Ecke, Andrew Ecke, Richard Ecke, and

Ellen Isaacs on Behalf of Patrick Ryan Wroblewski.

This Court's answers to the questions that are being decided on appeal are summarized as follows:

1. Does the Bankruptcy Court have subject matter jurisdiction to impose a release of nondebtor claims?

HN2[] Yes. Under the law of this Circuit, as most recently set forth in SPV OSUS Ltd. v. UBS, 882 F.3d 333 (2d Cir. 2018), the **[**133]** Bankruptcy Court has broad "related to" jurisdiction over any civil proceedings that "might have any conceivable effect" on the estate. *Id.* 339-340. Because the civil proceedings asserted against the non-debtor Sackler family members *might have* a conceivable impact on the estate, the Bankruptcy Court has subject matter jurisdiction to approve the Section 10.7 Shareholder Release and release the claims against the non-debtor Shareholder Released Parties.

2. Does the Bankruptcy Court have statutory authority to approve the non-debtor releases?

HN3[] No. The Bankruptcy Code does not authorize a bankruptcy court to order the nonconsensual release of third-party claims against non-debtors in connection with the confirmation of a chapter 11 bankruptcy plan. The Confirmation Order fails to identify any provision of the Bankruptcy Code that provides such authority. Contrary to the bankruptcy judge's conclusion, Sections 105(a) and 1123(a)(5) & (b)(6), whether read individually or together, do not provide a bankruptcy court with such authority; and there is no such thing as "equitable authority" or "residual authority" in a bankruptcy court untethered to some specific, substantive grant of authority in the Bankruptcy Code. Second Circuit law **[**134]** is not to the contrary; indeed, the Second Circuit has not yet taken a position on this question.

3. Did the Bankruptcy Court fail to provide equal treatment between the Canadian Appellants and their domestic unsecured creditor counterparts?

No. Under the Plan, the Canadian Appellants belong to a different class than their domestic, unsecured creditor "counterparts" — the non-federal governmental claimants and tribe claimants — but legitimate reasons are proffered for that differentiation. HN4[] The Code does not require that all creditor classes be treated the same — only that there be a reasonable basis for any differentiation between classes. *See* Boston Post Rd. Ltd. P'ship v. FDIC (In re Boston Post Rd. Ltd. P'ship), 21 F.3d 477, 482-83 (2d Cir. 1994). Here, Judge Drain identified a reasonable basis for differentiating between the Canadian Appellants and the non-federal governmental claimants and tribe claimants. The Plan's classification of the Canadian Appellants thus does not violate the Bankruptcy Code.

It is not necessary to reach any of the other issues that were briefed. The issues identified above are dispositive of all the appeals that have been filed.[50] Nor is it **[*79]** necessary to reach either the various constitutional challenges to the Section 10.7 Shareholder Release (lack of due process, **[**135]** infringement on state police powers), or to decide whether, if there were no other legal impediment to approving the Section 10.7 Shareholder Release, it should be approved on the facts of this particular case.

STANDARD OF REVIEW

HN5[] The Court has jurisdiction to hear bankruptcy appeals pursuant to 28 U.S.C. § 158(a). "Generally in bankruptcy appeals, the district court reviews the bankruptcy court's factual findings for clear error and its conclusions of law *de novo*." R2 Invs., LDC v. Charter Communs., Inc. (In re Charter Communs., Inc.), 691 F.3d 476, 482-83 (2d Cir. 2012) (citing Fed. R. Bankr. P. 8013). Conclusions of law reviewed *de novo* include "rulings as to the bankruptcy court's jurisdiction" and "interpretations of the Constitution." In re Motors Liquidation Co., 829 F.3d 135, 152, 158 (2d Cir. 2016). As to findings of fact, the "clear error standard is a deferential one." *Id. at 158*. A finding of fact is clearly erroneous only if this Court is "left with the definite and firm conviction that a mistake has been committed." In re Lehman Bros. 3 Holdings Inc., 855 F.3d 459, 469 (2d Cir. 2017).

HN6[] The standard of review of findings of act is far less deferential if a bankruptcy court is presented with something it cannot adjudicate to final judgment as a constitutional matter unless the parties consent. Stern v. Marshall, 564 U.S. 462, 131 S. Ct. 2594, 180 L. Ed. 2d

[50] Beyond the above issues, (1) the State Appellants asserts a further issue that the bankruptcy court improperly applied the best interest of creditors test; (2) the Canadian Appellants assert that the Bankruptcy Court does not have personal jurisdiction over their claims, and that the bankruptcy court's approval of the release violated their foreign sovereign immunity and the Foreign Sovereign Immunities Act, 28 U.S.C. § 1602 *et seq.*; and (3) the U.S. Trustee also asserts that the Bankruptcy Court erred by approving the Debtors' disclosure statement and plan solicitation materials and by authorizing the Debtors to advance funds under Advance Order.

475 (2011). In such a circumstance, a bankruptcy judge has authority only to "hear the proceeding and submit proposed findings of fact and conclusions of law to the district court **[**136]** for *de novo* review and entry of judgment." *Exec. Benefits Ins. Agency v. Arkison, 573 U.S. 25, 34-36, 134 S. Ct. 2165, 189 L. Ed. 2d 83 (2014)*. In that case, the findings of fact are reviewed *de novo* as well. If a bankruptcy court issues a final order in the mistaken belief that it has constitutional authority to do so, the district court can treat a bankruptcy court's order as a report and recommendation, but it "must review the proceeding *de novo* and enter final judgment." *Id. at 34*.

In this case, the Bankruptcy Court concluded that it had constitutional authority under *Stern* to enter a final order granting the release, because the issue arose in the context of confirming a plan of reorganization — the most "core" of bankruptcy proceedings. *In re **Purdue** **Pharma** L.P., 2021 Bankr. LEXIS 2555, 2021 WL 4240974, at *40*. Appellants urge that Judge Drain misreads *Stern* and argue that he lacked authority to give final approval to those releases, even though they were incorporated into a plan of reorganization.

I agree with Appellants.

HN7[ ] In *28 U.S.C. §157(a)*, Congress divided bankruptcy proceedings into three types: (1) those that "arise under" title 11; (2) those that "arise in" a title 11 case; (3) and those that are "related to" a title 11 case. Cases that "arise under" or "arise in" a title 11 matter are known as core bankruptcy proceedings, while "related to" proceedings are non-core. *28 U.S.C. § 157(b)(1)-(2)(C)*. Every **[**137]** proceeding pending before a bankruptcy court is either core or non-core.[51]

[*80] The core vs. non-core distinction is critical when assessing a bankruptcy court's constitutional authority to enter a final judgment disposing of that proceeding.[52] In particular, a bankruptcy court lacks the constitutional authority to enter a final judgment in a proceeding over which it has only "related to" subject matter jurisdiction unless all parties consent. Any doubt on that score was put to rest by the United States Supreme Court in *Stern v. Marshall, 564 U.S. 462, 131 S. Ct. 2594, 180 L. Ed. 2d 475 (2011)*. In that case, the Supreme Court held

[51] "Non-core" proceedings are interchangeably referred to as "related to" proceedings.

[52] The core/non-core distinction is also critically important when assessing the bankruptcy court's subject matter jurisdiction, a topic that will be taken in that section.

that a bankruptcy court lacked constitutional power to adjudicate and enter judgment on a counterclaim asserted by a debtor, Vickie Marshall (aka Anna Nicole Smith) in an adversary proceeding that a creditor (her stepson) had filed against her. The counterclaim (for tortious interference with an *inter vivos* gift from the debtor Marshall's late husband, who was also the creditor's father) did not arise under title 11, nor did it arise in a title 11 case. Even though the claim was asserted in the context of a bankruptcy proceeding, it existed prior to and was independent of debtor Marshall's bankruptcy case.

HN8[] The Supreme Court ruled that Congress **[**138]** could not "withdraw from judicial cognizance any matter which, from its nature, is the subject of a suit at common law, or in equity, or in admiralty." *Murray's Lessee v. Hoboken Land & Improvement Co., 59 U.S. 272, 284, 15 L. Ed. 372 (1855)*. Because Marshall's counterclaim for tortious interference was just such a claim, it could only be adjudicated to final judgment by an Article III court; and Congress had no power to alter that simply because the counterclaim might have "some bearing on a bankruptcy case." *Stern, 564 U.S. at 499*.

In this case, the learned Bankruptcy Judge improperly elided his authority to confirm a plan of reorganization (indubitably a core function of a bankruptcy court) with his authority to finally dispose of claims that were non-consensually extinguished pursuant to that plan over which — as he himself recognized — he has only "related to" jurisdiction over the third-party claims against the non-debtor Sacklers. *In re* ***Purdue Pharma*** *L.P., 2021 Bankr. LEXIS 2555, 2021 WL 4240974, at *36-38*. *Stern* itself illustrates that not every issue that is litigated under the umbrella of a core proceeding is, to use Judge Drain's phrase, "constitutionally core." The stepson-creditor's claim against Marshall's estate was properly litigated to judgment by the bankruptcy court in a claims allowance adversary proceeding — a core proceeding — but because the debtor's **[**139]** counterclaim was not a "core" claim, it could not be adjudicated to final judgment by the Bankruptcy Court, even though it would impact how much the creditor was ultimately owed.

Judge Drain reasoned that the non-consensual third-party releases that he was approving were "constitutionally core" under *Stern* because plan confirmation is a "fundamentally central aspect of a Chapter 11 case's adjustment of the debtor/creditor relationship." *2021 Bankr. LEXIS 2555, [WL] at *40*. But nothing in Stern or any other case suggests that a party otherwise entitled to have a matter adjudicated by an Article III court forfeits that constitutional right if the matter is disposed of as part of a plan of reorganization in bankruptcy. Were it otherwise, then parties could manufacture a bankruptcy court's Stern authority simply by inserting the resolution of some otherwise non-core matter into a plan.

[*81] The learned bankruptcy judge relied on the Third Circuit's recent decision in In re Millennium Lab Holdings II, LLC., 945 F.3d 126, 139 (3d Cir. 2019), *cert. denied sub nom. ISL Loan Tr. v. Millennium Lab Holdings II, LLC, 140 S. Ct. 2805, 207 L. Ed. 2d 142 (2020)*. In *Millennium*, the court, like Judge Drain in this case, concluded that the "operative proceeding" for purposes of Stern analysis was the confirmation proceeding, not the underlying third-party claim against a non-debtor that was being released pursuant to the plan. In re Millennium Lab Holdings II, LLC, 591 B.R. 559, 574 (D. Del. 2018) **[**140]** , *aff'd sub nom.* In re Millennium Lab Holdings II, LLC., 945 F.3d 126 (3d Cir. 2019). The Third Circuit read Stern to allow a bankruptcy court to confirm a plan containing such releases "because the existence of the releases and injunctions" are "'integral to the restructuring of the debtor-creditor relationship.'" Millennium Lab Holdings II, LLC., 945 F.3d at 129 (quoting Stern, 564 U.S. at 497).

Perhaps they are, but that is beside the point. ***HN9***[] In Stern, the Supreme Court held that bankruptcy courts have the power to enter a final judgment only in proceedings that "stem[] from the bankruptcy itself or would necessarily be resolved in the claims allowance process." Stern, 564 U.S. at 499. It did not say that a bankruptcy court could finally dispose of non-core proceedings as long as they were "integral to the restructuring of the debtor-creditor relationship." The counterclaim in the lawsuit between debtor Marshall and her stepson-creditor was integral to the restructuring of their debtor-creditor relationship, but it was not a core proceeding, so the bankruptcy court could not finally adjudicate it. The correct constitutional question, and the question on which the Bankruptcy Court should have focused in this case, is whether the thirdparty claims released and enjoined by the Bankruptcy Court either stem from the bankruptcy itself or would necessarily be resolved in the claims allowance process — not whether the release and injunction are "integral to the restructuring of the debtor-creditor relationship."

The third-party claims at issue neither stem from ***Purdue***'s bankruptcy nor can they **[**141]** be resolved in the claims allowance process. Yet those claims are being finally disposed of pursuant to the Plan; they are being released and extinguished, without the claimants' consent and without any payment, and the claimants are being enjoined from prosecuting them. Debtors and their affiliated non-debtor parties cannot manufacture constitutional authority to resolve a non-core claim by the artifice of including a release of that claim in a plan of reorganization. ***HN10***[] As Bankruptcy Judge Bernstein made clear in In re SunEdison, Inc., 576 B.R. 453, 461 (Bankr. S.D.N.Y. 2017), "In assessing a court's jurisdiction to enjoin a third party dispute under a plan, the question is not whether the court has jurisdiction over the settlement that incorporates the third party release, but whether it has jurisdiction over the attempts to enjoin the creditors' unasserted claims against the third party." That proposition applies with equal force to a bankruptcy court's Stern authority.

Appellees' argument that Stern only limits a bankruptcy court's authority to *adjudicate* claims — not its authority to enter judgments that terminate claims without adjudicating them on the merits — is also flawed. As the U.S. Trustee correctly points out, *Stern*'s holding is to the contrary: **[**142]** "The Bankruptcy Court in this case exercised the judicial power of the United States by *entering a final judgment* on a common law tort claim, even **[*82]** though the judges of such courts enjoy neither tenure during good behavior nor salary protection." Stern, 564 U.S. at 469 (emphasis added). ***HN11***[] A bankruptcy court's order extinguishing a non-core claim and enjoining its prosecution without an adjudication on the merits "finally determines" that claim. It is equivalent to entering a judgment dismissing the claim. It bars the claim under principles of former adjudication. Therefore, Congress may not allow a bankruptcy court to enter such an order absent the parties' consent — and consent is lacking here. *See* Stern at 484.

There really can be no dispute that the release of a claim "finally determines" that claim. It does so by extinguishing the claim, so that it cannot be adjudicated on the merits. ***HN12***[] A nonconsensual third-party release is essentially a final judgment against the claimant, in favor of the non-debtor, entered "without any hearing on the merits." In re Aegean Marine Petroleum Network Inc., 599 B.R. 717, 725 (Bankr. S.D.N.Y. 2019) (citing In re Digital Impact, 223 B.R. 1, 13 n. 6 (Bankr. N.D. Okla. 1998)) (noting that a third- party release has "the effect of a judgment — a judgment against the claimant and in favor of the non-debtor, accomplished without due process."). **[**143]** The fact that the releases are being ordered in the overall context of a plan confirmation that "settles" many disputed matters (against the Debtors, not against non-debtors) does not alter this. The Appellants in this case do not want to settle their claims against the non- debtors — at least, not on the terms set forth in the Plan. This "settlement" is non-consensual — which means that, under *Stern*, a bankruptcy court cannot enter the order that finally disposes of their claims against those non-debtors.

Nor is there any doubt that the entry of an order releasing a claim has former adjudication effects, which is a key attribute of a final judgment. ***HN13***[] The Supreme Court has twice held that non-consensual third-party releases confirmed by final order are entitled to *res judicata* claim preclusion barring any subsequent action bringing a released claim: First in *Stoll v. Gottlieb, 305 U.S. 165, 171, 59 S. Ct. 134, 83 L. Ed. 104 (1938)*, and again in *Travelers Indemnity Co. v. Bailey, 557 U.S. 137, 155, 129 S. Ct. 2195, 174 L. Ed. 2d 99 (2009)*.[53]

Because the non-consensual releases and injunction are the equivalent of a final judgment for *Stern* purposes, Judge Drain did not have the power to enter an order finally approving them. To the extent of his approval of the Section 10.7 Shareholder Releases, his opinion should have been tendered as proposed findings of fact **[**144]** and conclusions of law, both of which this court could review *de novo*. *28 U.S.C. § 157(c)(1)*. *Stern, 564 U.S. at 475*. If approved by this Court, those releases would of course be incorporated into the Plan.

So the standard of review in this case is *de novo* as to both the Bankruptcy Court's factual findings and its conclusions of law.[54]

[*83] DISCUSSION

I. The Bankruptcy Court Has Subject Matter Jurisdiction Over Third-Party Claims Against Non-Debtors That Might Have Any Conceivable Effect on the Debtors' Estate.

HN14[] A bankruptcy court is a creature of statute. *See Celotex Corp. v. Edwards, 514 U.S. 300, 307, 115 S. Ct. 1493, 131 L. Ed. 2d 403 (1995)*. Its subject matter jurisdiction is *in rem* and is limited to the *res* of the estate. *Central Virginia Community College v. Katz, 546 U.S. 356, 362, 126 S. Ct. 990, 163 L. Ed. 2d 945 (2006)* ("Bankruptcy jurisdiction, at its core, is *in rem*."). Its jurisdiction is limited to "civil proceedings arising under title 11, or arising in or related to cases under title 11." *28 U.S.C. § 1334(b)*.

A proceeding "arises under" title 11 if the claims "invoke substantive rights created by" that title. *See In re Housecraft Industries USA, Inc., 310 F.3d 64, 70 (2d Cir. 2002)*. A proceeding "arises in" a title 11 case if for example "Parties . . ., by their conduct, submit themselves to the bankruptcy court's jurisdiction" by litigating proofs of claim without contesting personal jurisdiction. *In re Millenium Seacarriers, Inc., 419 F.3d 83, 98 (2d Cir. 2005)*; *see In re S.G. Phillips Constructors, Inc., 45 F.3d 702, 706 (2d Cir. 1995)* ("*a claim filed against the estate . . . could arise only in the context of bankruptcy **[**145]*** ") (emphasis in original) (quotation omitted). And a proceeding is "related to" a title 11 proceeding if its "outcome might have any conceivable effect on the bankrupt estate." *In re Cuyahoga Equip. Corp., 980 F.2d 110, 114 (2d Cir.1992) Parmalat Capital Fin. Ltd. v. Bank of Am. Corp., 639 F.3d 572, 579 (2d Cir. 2011)*; *SPV OSUS Ltd. v. UBS, 882 F.3d 333, 339-340 (2d Cir. 2018)*.

HN15[] The release of most third-party claims against a non-debtor touches the outer limit of the Bankruptcy Court's jurisdiction. *See In re Johns-Manville Corp., 517 F.3d 52, 55 (2d Cir. 2008)* ("*Manville III*"), *rev'd and remanded on other grounds sub nom. Travelers Indem. Co. v. Bailey, 557 U.S. 137, 129 S. Ct. 2195, 174 L. Ed. 2d 99 (2009)*. But the Second Circuit defines that limit quite broadly. *See SPV OSUS Ltd., 882 F.3d at 339-340*. The standard is not that an action's outcome will certainly have, or even that it is likely to have, an effect on the *res* of the estate, as is the case in some other

[53] This court's decision in *Lynch v. Lapidem Ltd. (In re Kirwan Offices S.A.R.L.), 592 B.R. 489 (S.D.N.Y. 2018)* does not stand for the proposition that *Stern* authorizes a bankruptcy court to release non-core claims because a release is not a final judgment on the merits of the third-party claim. In that case, *Stern* was of no moment because, as this court held and the Second Circuit affirmed, all parties had consented to the bankruptcy court's exercise of jurisdiction. *In re Kirwan Offices S.à.R.L, 792 F. App'x 99, 103 (2d Cir. 2019)*.

[54] The practical impact of this holding is non-existent, as no one has challenged any of Judge Drain's findings of fact — only the conclusions he drew from them — and the court has always had the obligation to review those conclusions *de*

novo.

Circuits. It is, rather, whether it *might have any conceivable impact* on the estate. *Id.*

Bound to adhere to this broad standard, which has been consistently followed in this Circuit for almost three decades and was applied most recently in *SPV Osus*, I agree with the Debtors that the Bankruptcy Court had subject matter jurisdiction over the direct (non- derivative) third party claims against the Sacklers, under the "related to" prong of bankruptcy jurisdiction.

A. Governing Law

HN16[] Decades ago, the Second Circuit concluded that the outer limit of a bankruptcy court's *in rem* jurisdiction was defined **[**146]** by whether the outcome of a proceeding asserting a particular claim "might have any conceivable effect" on the *res* of the estate. *See* In re Cuyahoga Equipment Corp., 980 F.2d at 114. In that case, a liquor distillery and its site of operation containing hazardous wastes was sold to a purchaser that subsequently went bankrupt; the bankruptcy court was asked to resolve not only the proceedings in bankruptcy but approve a settlement that released a creditor bank from claims related to separate environmental cleanup litigation (brought by the **[*84]** creditor Environmental Protection Agency (the "EPA")). Id. at 111-112. The original owner of the liquor distillery site - a non-debtor third party and defendant in the environmental cleanup litigation - objected and appealed arguing, *inter alia*, that the court lacked jurisdiction to approve the settlement. The Second Circuit found that the court had related to jurisdiction because the bank's and the EPA's claims against the estate "bring into question the very distribution of the estate's property." Id. at 114. "[Section] 1334(b) undoubtedly vested the district court with the power to approve the agreement between the parties at least to the extent it compromised the bankruptcy claims asserted by the bank and the government." Id. at 115.

HN17[] In Celotex Corp. v. Edwards, 514 U.S. 300, 115 S. Ct. 1493, 131 L. Ed. 2d 403 (1995), the **[**147]** United States Supreme Court decreed that "related to" jurisdiction was "a grant of some breadth" and that "jurisdiction of bankruptcy courts may extend . . . broadly" in "reorganization under Chapter 11." Id. at 308. And while some courts of appeal have circumscribed the scope of "related to" jurisdiction in their circuits, *see e.g.,* In re W.R. Grace & Co., 900 F.3d 126 (3d Cir. 2018), the Second Circuit has never backed away from its broad reading of "related to" jurisdiction. *See, e.g.,* In re Ampal-American Israel Corporation, 677 Fed.Appx. 5, 6 (2d Cir. 2017) (summary order).

The Circuit's most recent discussion of the subject can be found in SPV OSUS Ltd. v. UBS AG, 882 F.3d 333 (2d Cir. 2018). SPV Osus Ltd. ("SPV") had sued UBS AG ("UBS") (among others) in the New York State Supreme Court for aiding and abetting Bernie Madoff ("Madoff") and Bernard L. Madoff Investment Securities LLC ("BLMIS") in perpetrating their massive Ponzi scheme. Id. at 337-338. If UBS was indeed a joint tortfeasor with Madoff, it had a contingent claim for contribution against the Madoff estate. Id. at 340. However, it had not yet asserted such a claim (it was not yet ripe), and the unwaivable bar date for filing claims against the Madoff estate under the Securities Investor Protection Act ("SIPA") had already passed. *Id.* Moreover, there was no realistic possibility that there would be any money available at the end of the day to fund a claim for contribution. **[**148]** *Id.* SPV argued that these facts meant there was no possibility that the outcome of UBS' contribution case "might have any conceivable effect" on the *res* of the Madoff estate. *Id.* It is indeed hard to quarrel with that factual analysis.

But Judge Pooler, writing for a unanimous panel, concluded that UBS's contingent claim for joint tortfeasor contribution against the Madoff estate "might" have an effect on the Madoff estate if there were any "reasonable legal basis" for its assertion. Id. at 340-41 (quotation omitted). She explained that the broad jurisdictional standard reflects Congress' intent "'to grant comprehensive jurisdiction to the bankruptcy courts so that they might deal efficiently and expeditiously with all matters connected with the bankruptcy estate.'" Id. at 340 (quoting Celotex, 514 U.S. at 308). While recognizing that "'related to' jurisdiction is not 'limitless,'" Judge Pooler indicated that "it is fairly capacious." *Id.* And she said, "'An action is related to bankruptcy if the outcome could alter the debtor's rights, liabilities, options, or freedom of action (either positively or negatively) and which in any way impacts upon the handling and administration of the bankrupt estate.'" *Id.* (quoting Celotex, 514 U.S. at 308, n. 6).

The fact that **[**149]** UBS and the debtor (Madoff) were alleged to be joint tortfeasors - who, as a matter of state law, have a right **[*85]** of contribution against one another - provided a "reasonable legal basis" why UBS might someday be able to assert its contingent claim. And while Judge Pooler recognized that ". . . a payout by the estate to defendants may be improbable, it is not impossible." Id. at 342. Since "any claim by defendants potentially alters that distribution of assets among the estates' creditors," *id.*, that was all it took to make the contingent claim "conceivably related" to the Madoff bankruptcy.

Finally - and of particular importance for the case at bar - Judge Pooler found that the "high degree of interconnectedness between this action and the Madoff bankruptcies" supported a finding of "related to" jurisdiction. *Id.* She explained that, "SPV can only proceed on [its claims against UBS] if it establishes that the Madoff fraud occurred" and "it is difficult to imagine a scenario wherein SPV would not also sue Madoff and BLMIS, given that SPV alleges that UBS aided and abetted in their fraud." *Id.*

HN18[] So in this Circuit, it is well settled that the only question a court need ask is whether "the action's outcome **[**150]** *might have* any conceivable effect on the bankrupt estate." *Id.* (emphasis added). If the answer to that question is yes, then related to jurisdiction exists - no matter how implausible it is that the action's outcome actually will have an effect on the estate.

B. Application of the Law to the Facts

Under the broad standard set forth in *SPV Osus*, I find that the Bankruptcy Court had "related to" subject matter jurisdiction to approve the release of direct, non-derivative third-party claims against the Sacklers. There is absolutely no question that the answer to the question of whether the third-party claims *might have* any conceivable impact on the res of the debtors' estate is yes. Moreover, the intertwining of direct and derivative claims against certain members of the Sackler family, as well as the congruence between the only claim that anyone has identified against the other Sacklers and ***Purdue***'s own claim for fraudulent conveyance, justifies the assertion of "related to" jurisdiction under *SPV Osus*'s "interconnectedness" test.

First, the non-derivative third-party claims that are being or might be asserted against the Sacklers are, as in *In re Cuyahoga Equipment Corp.*, the type of claims **[**151]** that "bring into question the very distribution of the estate's property." *980 F.2d at 114*. As the Debtors pointed out in oral argument, and as Judge Drain recognized in his opinion, pursuit of the third-party claims threatens to "unravel[] the plan's intricate settlements" and "recoveries on . . . judgments" against the Sacklers would have a "catastrophic effect" on all parties' possible recovery under the Plan. *See In re **Purdue Pharma** L.P., 2021 Bankr. LEXIS 2555, 2021 WL 4240974, at *33*; (Oral Arg. Tr., Nov. 30, 2021, at 124:14-16 ("Continued litigation against the Sacklers destroys all of the interlocking intercreditor settlements enshrined in the plan.")).

Second, as in *SPV Osus*, the claims raised against the Sacklers might have a conceivable impact on the estate, in that they threaten to alter "the liabilities of the estate" and "change" "the amount available for distribution to other creditors." *SPV Osus, 882 F.3d 341*. This "is sufficient to find that litigation among non-debtors is related to the bankruptcy proceeding." *Id.*

Here, the non-derivative litigation against the Sacklers *might* alter the liabilities and change the amount available for distribution. If, for example, the Appellants were successful in their related claims against the Sacklers, the findings **[*86]** could alter, or even determine, **[**152]** ***Purdue***'s own liability on similar claims, as well as the amount owed to Appellants as creditors. Further, as the Debtors explained at oral argument, there also is the threat that the Appellants' claims could affect "the debtors' ability to pursue the estate's own closely related, indeed, fundamentally overlapping claims against the Sacklers"; this is so because, if the related third-party claims were litigated poorly, the debtor's estate might be less likely to recover on its own claims against the Sacklers, which are worth billions. (*See* Oral Arg. Tr., Nov. 30, 2021, at 123:17- 124:13).

Judge Drain pointed out the conceivable effect that the potential alteration of liabilities and ultimate amounts owed creditors and the estate would have on the *res* in his opinion. *See In re **Purdue Pharma** L.P., 2021 Bankr. LEXIS 2555, 2021 WL 4240974, at *37*. I agree that these potential effects support a finding of "related to" jurisdiction.

Third, as in *SPV Osus*, all the claims in this case have a high degree of interconnectedness with the lawsuits against the debtors and against the Sacklers - especially those members of the family who can be sued derivatively as well as directly.

HN19[] As the *SPV Osus* Court explained, "'The existence of strong interconnections between the third-party **[**153]** action and the bankruptcy has been cited frequently by courts in concluding that the third-party litigation is related to the bankruptcy proceeding.'" *SPV OSUS, 882 F.3d at 342* (quoting *In re WorldCom, Inc.*

Sec. Litig., 293 B.R. 308, 321 (S.D.N.Y. 2003)). Here, the Section 10.7 Shareholder Release only extends to those claims where the "debtor's conduct or the claims asserted against it [are] a legal cause or a legally relevant factor." (Confr. Hr'g Tr., Sept. 1, 2021, at 134:18-135:2); *see In re **Purdue Pharma** L.P., 2021 Bankr. LEXIS 2555, 2021 WL 4240974, at *45*; Plan, at § 10.7(b)). This limitation alone supports a conclusion that any claim that could fall within the scope of the release would necessarily have a high degree of interconnectedness with the debtor's conduct.

Looking at the claims of the Appellants themselves, the interconnectedness of the claims against the Sacklers with those against the Debtors is patent. (*See, e.g.*, Dkt. No. 103-7, at A-1553; Dkt. No. 95-1, at A0008; Dkt. No. 91-7, at App.2598; Dkt. No. 91-8, at App.2661; Dkt. No. 91-9, at App.3153). In fact, the direct and derivative claims against the "insider" or "managerial" Sacklers are essentially congruent. The Appellants have asserted claims in multiple instances against both ***Purdue*** and the Sacklers, and in every case they rely on detailed and virtually identical sets **[**154]** of facts to make the claims. Because various state statutes authorize the assertion of direct claims against certain managerial personnel of a corporation who can be held independently liable for the same conduct that subjects the corporation to liability (and them to liability to the corporation for faithless service in their corporate roles), a determination in one of the State Appellants' cases would likely have preclusive impact on a case alleging derivative liability against the same people - a case over which the Bankruptcy Court has undoubted jurisdiction. As the Debtor pointed out at oral argument, there is an obvious inconsistency in bringing "lawsuits against the Sackler[s] alleging that they controlled ***Purdue***, and that ***Purdue*** did terrible things, and 500,000 people's lives were maybe snuffed out by ***Purdue***'s conduct" yet arguing that those suits "will [not] affect the debtors in any conceivable way." (*See* Oral Arg. Tr., Nov. 30, 2021, at 123:12-17). Some things have not changed since this court decided *Dunaway v. **Purdue** Pharm. L.P. (In re **Purdue** Pharm. L.P.), 619 B.R. 38 (S.D.N.Y. 2020)*; one that has not is this: "Appellants would rely on the same facts to establish **[*87]** the liability of both parties" and there would be "no way for the Appellants to pursue the **[**155]** allegations against Dr. Sackler without implicating ***Purdue***, and vice versa." *Id.* at 51. The acts of the Sacklers that could form the basis of any released claim "are deeply connected with, if not entirely identical to, ***Purdue***'s alleged misconduct." *See id.*

In so holding, I acknowledge that in *In re Johns-Manville Corp., 517 F.3d 52 (2d Cir. 2008)* ("*Manville III*"), *rev'd and remanded on other grounds sub nom. Travelers Indem. Co. v. Bailey, 557 U.S. 137, 129 S. Ct. 2195, 174 L. Ed. 2d 99 (2009)* and *In re Johns-Manville Corporation v. Chubb Insurance, 600 F. 3d 135 (2d Cir. 2010)* ("*Manville IV*"), the Second Circuit said that the existence of shared facts between claims against the debtor and claims against the non-debtor arising out of an independent legal duty that was owed by the non-debtor to a third party was not sufficient to confer "related to" subject matter jurisdiction over the claims against the non-debtors. *Manville III, 517 F.3d at 64-65*. As a result, the Court of Appeals held that the bankruptcy court lacked jurisdiction to enjoin the prosecution of claims asserted by third parties against Travelers, Manville's erstwhile insurer, that arose out of Travelers' alleged failure to alert those third parties to the harmful properties of asbestos, about which Travelers had allegedly learned during its long relationship with Manville. *Id. at 65*. However, while there was a substantial factual overlap between defective product claims against **[**156]** Manville and the failure to disclose claims asserted against its insurer Travelers that were discussed in *Manville III*, there was absolutely no basis for asserting that there could be any impact on the res of Manville's bankruptcy estate if the third party claims were not enjoined. For that reason, *Manville III/IV* is not inconsistent with *SPV/OSUS*.

The fact that the release extends to members of the Sackler family who played no role in running the affairs of the company does not alter the analysis. At the present time, the court is not aware of any lawsuits that have been brought against any of those individuals; and despite months of my asking, no one can identify any claim against them that would be released by the Section 10.7 Shareholder Release, other than as the recipients of money taken out of ***Purdue*** and upstreamed to the family trusts. But any claims relating to those transfers rightfully belong to the Debtors, whose claims against the world either "arise under" or "arise in" the bankruptcy. And those claims are not implicated by the Section 10.7 Shareholder Release.

Fourth, it is more than conceivable that ***Purdue***'s litigation of the question of its indemnification, contribution, or insurance **[**157]** obligations to the director/officer/manager Sacklers could burden the assets of the estate.

Appellants - most particularly the State and Canadian Appellants - insist that their claims lie beyond the "related to" jurisdiction of the Bankruptcy Court in part because their laws bar indemnification, contribution, or insurance coverage for actions like those of the Sacklers (*see* Dkt. Nos. 224, 228-231), and so the claims cannot be extinguished by that court. Without viable claims for indemnification, contribution, or insurance claims, the Appellants argue that their claims against the Sacklers will not have any conceivable effect on the Debtors' estate, thereby depriving the Bankruptcy Court of subject matter jurisdiction.

I begin by noting that this is precisely the type of reasoning that Judge Pooler rejected in *SPV Osus* - a case, I submit, in which the actual possibility that a contingent **[*88]** contribution claim would have any impact on the *res* of the Madoff estate was far less likely than it is in this case. The issue is not whether, at the end of the day, the Sacklers would lose on their contingent claims; it is whether they have a reasonable legal basis for asserting them. (*See* Dkt. Nos. **[**158]** 154, 156).

And the Sacklers do have a reasonable legal basis to assert those claims. The Sacklers named in the State Appellants' suits served as officers, directors or managers of ***Purdue***. As a result, they have claims against ***Purdue*** for indemnification and contribution, as well as a call on any D&O insurance proceeds that cover ***Purdue***'s officer and directors. As this court noted almost two years ago in *Dunaway*, ***Purdue***'s current and former directors and officers of the company are covered by various Limited Partnership Agreements ("LPA"), which provide that ***Purdue*** shall indemnify these directors and officers "so long as the Indemnitee shall be subject to any possible Proceeding by reason of the fact that the Indemnitee is or was . . . a director, officer or Agent of [the ***Purdue*** entities]." (JX-1773; *see also* JX-1806; JX-1049). The various state unfair trade practices laws that have been cited to this court all subject the Sacklers to the potential for liability because of their status as officers, directors or managers of the corporation - even though that liability is direct, not derivative. Moreover, the LPAs are governed by Delaware law, which allows for indemnification (*see* *6 Del. C. § 17-108*; *8 Del. C. § 145*), and the **[**159]** states as a general matter look to the state of incorporation for the availability of indemnity. (*See, e.g.*, Dkt. No. 230, at 3, 8-9, 13, 17). Similarly, the ***Purdue*** insurance policies that cover the Sackler former directors could be depleted, *inter alia*, if a Sackler former director prevailed in litigation or a plaintiff prevailed in litigation on a non-fraud claim. (*See* Dkt. No. 156, at 15).[55] Under various state laws, the Sacklers parties can also seek an advance against defense costs; even if those costs are ultimately recouped, those defense funds will, for at least some time, leave the estate. *See* *CT Gen Stat § 33-776*; *8 Del. C. § 145*. The law governing insurance coverage is generally the law governing the policy - not the law of the objecting state. Only one state has an exception to that - California, whose law specifically prohibits indemnity or insurance coverage for losses resulting from a violation of its false advertising law or unfair competition law, and under which law an insurer has no duty to defend or advance costs. (Dkt. No. 95, at 3-4); *see* *Cal. Ins. Code § 533.5*; *Adir International, LLC v. Starr Indemnity and Liability Co., 994 F.3d 1032, 1045 (9th Cir. 2021)*.

And while each objecting state asserts that its laws would bar one or more of indemnification, contribution or insurance in certain instances, no state's law **[**160]** bars all three - not even California's. (*See* Dkt. Nos. 228-231; *see also* Dkt. No. 224).

Recognizing this, the states argue that there can be no indemnification, contribution, or insurance on these facts, including on public policy grounds, because the Sacklers acted in bad faith. (*See e.g.*, Dkt. No. 230, at 2). However, the question of bad faith in this case is hotly disputed. There is no doubt that the Shareholder Released Parties' right to indemnification, **[*89]** contribution, and/or insurance will be vigorously litigated, as Judge Drain rightly pointed out below. *See* *In re **Purdue Pharma** L.P., 2021 Bankr. LEXIS 2555, 2021 WL 4240974, at *38*. That litigation will cost money. And so it very well *might have* an impact on the estate; in fact, it likely *will have* such an impact.

Given the breadth of the Second Circuit law under *SPV Osus*, I must and I do find that the claims asserted against the Shareholder Released Parties *might have* some conceivable effect on the estate of a debtor, for each of the foregoing reasons, and thus fall within the "related to" jurisdiction of the Bankruptcy Court.

But that only gets us to the next question. And it is the

[55] The debtors clarified at oral argument that for the relevant periods of time "like 2017 when the claims were made and those policies got triggered" there are applicable claims-made insurance policies, as well as "over a billion dollars of general liability policies" and other policy language that "creates the risk that all Sackler-owned entities could assert claims under those policies." (Oral Arg. Tr., Nov. 30, 2021, at 125:21- 12614).

next question that is, in my view, dispositive.

II. The Bankruptcy Court Does Not Have Statutory Power to Release Particularized [161] Third-Party Claims Against Non-Debtors**.

Appellants argue that the Bankruptcy Court has no statutory authority to approve a release of third-party claims against non-debtors.

One would think that this had been long ago settled.

It has not been.

There is a long-standing conflict among the Circuits that have ruled on the question, which gives rise to the anomaly that whether a bankruptcy court can bar third parties from asserting nonderivative claim against a non-debtor- a matter that surely ought to be uniform throughout the country - is entirely a function of where the debtor files for bankruptcy.

And while the Second Circuit long ago identified as questionable a court's statutory authority to do this outside of asbestos cases, *In re Metromedia Fiber Network, Inc., 416 F.3d 136 (2d Cir. 2005)*, it has not yet been required to identify any source for such authority.

Lacking definitive guidance from our own Court of Appeals, Judge Drain consulted the law in every Circuit. He concluded that he was statutorily authorized to approve the Section 10.7 Shareholder Release because it is "subject to *11 U.S.C. 1129(a)(1)*, *1123(a)(5)* & *(b)(6)*, *105*, and *524(e)*." *In re **Purdue Pharma** L.P., 2021 Bankr. LEXIS 2555, 2021 WL 4240974, at *43*. "In other words," he stated, "those releases flow from a federal statutory scheme." *Id.*

I appreciate that this Court has, on a prior occasion, said exactly **[**162]** the same thing, using exactly the same language - albeit in the context of affirming a plan that contained an easily distinguishable injunction that barred third parties (one in particular) from bringing one specific type of claim against non-debtors (his former partners) in order to protect the integrity of bankruptcy court orders. *In re Kirwan Offices S.à.R.L., 592 B.R. 489, 511 (S.D.N.Y. 2018)*, *aff'd sub nom.* *In re Kirwan Offices S.a.R.L., 792 F. App'x 99 (2d Cir. 2019)*. But in *Kirwan*, this Court did not analyze whether there was a statutory (as opposed to a jurisdictional or constitutional) basis for the injunction that was at issue in that case.

Indeed, no statutory argument was made.[56]

In this case, however, Appellants - most particularly, the U.S. Trustee, with the United States Attorney for this District appearing as *amicus* - have mounted a **[*90]** full-throated attack on a court's statutory authority to release third-party claims against non-debtors in connection with someone else's bankruptcy.

With the benefit of full briefing and extensive argument from experienced counsel, it is possible to decide whether a court adjudicating a bankruptcy case has the power to release thirdparty claims against non-debtors. Moreover, it is necessary to reach a conclusion on this subject before delving into constitutional issues **[**163]** that need not be reached if Appellants are correct.

I conclude that the sections of the Code on which the learned Bankruptcy Judge explicitly relied, whether read separately or together, do not confer on any court the power to approve the release of non-derivative third-party claims against non-debtors, including specifically the Section 10.7 Shareholder Release that is under attack on this appeal.

As no party has pointed to any other section of the Bankruptcy Code that confers such authority, I am constrained to conclude that such approval is not authorized by statute.

A Caveat and Some Definitions: I begin this discussion with a caveat. The topic under discussion is a bankruptcy court's power to release, on a non- consensual basis, *direct/particularized* claims asserted *by third parties* against *non-debtors* pursuant to the Section 10.7 Shareholder Release. This speaks to a very narrow range of claims that might be asserted against the Sacklers.

For these purposes, by derivative claims, I mean claims that would render the Sacklers liable because of ***Purdue***'s actions (which conduct may or may not have been committed because of the Sacklers). "Derivative" claims are those seek to recover from **[**164]** the estate indirectly "on the basis of [the debtor's] conduct,"

---

[56] In *Kirwan*, the appellant chalked up his failure to raise the issue of statutory authority to his belief that the U.S. Trustee ought to have done so. *In re Kirwan Offices S.à.R.L., 592 B.R. at 501*. The U.S. Trustee, for perfectly understandable reasons that will be noted when *Kirwan* is discussed below, had no particular interest in using that case as a vehicle to mount such an attack.

as opposed to the non-debtor's own conduct. Manville III, 517 F.3d at 62 (quoting MacArthur Co. v. Johns- Manville Corp., 837 F.2d 89 (2d Cir. 1988)). Derivative claims in every sense relate to the adjustment of the debtor-creditor relationship, because they are claims that relate to injury to the corporation itself. If the creditor's claim is one that a bankruptcy trustee could bring on behalf of the estate, then it is derivative. Madoff, 40 F.3d at 90.

By direct claims, I mean claims that are not derivative of ***Purdue***'s liability, but are based on the Sacklers' own, individual liability, predicated on their own alleged misconduct and the breach of duties owed to claimants other than ***Purdue***. "Direct" claims are based upon a "particularized" injury to a third party that can be directly traced to a non-debtor's conduct. *Id.*

The release of claims against the Sacklers that are derivative of the estate's claims them is effected by Section 10.6(b) of the Plan, which is not attacked as being beyond the power of the Bankruptcy Court.

The Section 10.7 Shareholder Release under attack is different. It releases all members of the Sackler families, as well as a variety of trusts, partnerships and corporations associated with the family and the people **[**165]** who run and advise those entities,[57] from liability for claims that **[*91]** have been brought against them personally by third parties - claims that are not derivative, but as to which ***Purdue***'s conduct is a legally relevant factor. Example: nearly all of the State Appellants have a law under which individuals who serve in certain capacities in a corporation are individually and personally liable for their personal participation in certain unfair trade practices. As Judge Drain recognized (*see* In re **Purdue Pharma** L.P., 2021 Bankr. LEXIS 2555, 2021 WL 4240974, at *44), the liability imposed by these statutes is not derivative; the claims arise out of a separate and independent duty that is imposed by statute on individuals who, by virtue of their positions, personally participated in acts of corporate fraud, misrepresentation and/or willful misconduct. Liability under those laws is limited to persons who occupied the roles of officer, manager or director of a corporation - which means that there is considerable *factual* overlap, perhaps even complete congruence, between those claims and the derivative claims against the same individuals that Judge Drain had undoubted authority to release and enjoin. But it is undisputed that these laws impose liability, and even penalties, **[**166]** on such persons independent of any corporate liability (or lack of same), and independent of any claim the corporation could assert against them for faithless service as a result of those same acts.[58]

The discussion that follows, then, applies only to direct (non-derivative) claims - sometimes referred to as "particularized" claims - that arise out of the Sacklers' own conduct (*In re* ***Purdue Pharma*** *L.P., 2021 Bankr. LEXIS 2555, 2021 WL 4240974, at *45*), and that either have been or could be asserted against the non-debtor members of the Sackler family and their affiliates (the Shareholder Released Parties) by parties other than the Debtors' estate.

The Text of the Bankruptcy Code

As one always should when assessing statutory authority, we turn first to the text of the statute.

HN20[] All parties agree that one and only one section of the Bankruptcy Code expressly authorizes a bankruptcy court to enjoin third party claims against non-debtors without the consent of those third parties. That section is 11 U.S.C. § 524(g), which was passed by Congress in 1994. It provides for such an injunction solely and exclusively in cases involving injuries arising from the manufacture and sale of asbestos. And it sets out a host of conditions that must be satisfied before any such injunction can **[**167]** be entered, including all of the following:

> (i) the injunction is to be implemented in connection with a trust the is to be funded in whole or in party by the securities of the debtor and that the debtor will make future payments, including dividends, to

[57] The Section 10.7 Shareholder Release extends to every Sackler presently alive, to their unborn progeny, and to various trusts, partnerships, corporations, and enterprises with which they are affiliated or that have been formed for their benefit. Exhibit X to the Settlement Agreement, expressly incorporated into the Plan (*see* Dkt. No. 91-3, at App. 1112), identifies over 1,000 separate released parties, either by name or by some "identifying" feature, such as "the assets, businesses and entities owned by" the named released parties. (*See* Dkt. No. 91-3, at App.1041-1069).

[58] While Judge Drain expressly found that these claims were not derivative (*In re* ***Purdue Pharma*** *L.P., 2021 Bankr. LEXIS 2555, 2021 WL 4240974, at *44*), he was quite clear that the congruence between these claims and derivative claims against the same individuals was critically important to his conclusion

that they could be released.

that trust 524(g)(2)(B)(i)(I);

(ii) the extent of such alleged liability of a third party arises by reason of one of four enumerated relationships between the debtor and third party (524(g)(4)(A)(ii));

(iii) as part of the proceedings leading to issuance of such injunction, the court appoints a legal representative for the purpose of protecting the rights of persons that might **[*92]** subsequently assert demands of such kind (524(g)(4)(B)(i)); and

(iv) the court determines the injunction is fair and equitable to persons that might subsequently assert such demands, and, in light of the benefits provided to such trust on behalf of such third parties. § 524(g)(4)(B)(ii)).

HN21[] Section 524(g) injunctions barring third party claims against non-debtors cannot be entered in favor of just any non-debtor. They are limited to enjoin actions against a specific set of non-debtors: those who have a particular relationship to the debtor, including owners, managers, officers, directors, employees, insurers, and financiers. 11 U.S.C. § 524(g)(4)(A).

The language of the **[**168]** statute plainly indicates that Congress believed that Section 524(g) created an exception to what would otherwise be the applicable rule of law. Subsection 524(g)(4)(A)(ii) says: "Notwithstanding the provisions of section 524(e), such an injunction may bar any action directed against a third party who is identifiable from the terms of such injunction (by name or as part of an identifiable group) and is alleged to be directly or indirectly liable for the conduct of, claims against, or demands on the debtor." 11 U.S.C. § 524(g)(4)(A)(ii). Section 524(e) provides: "Except as provided in subsection (a)(3) of this section, discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt." 11 U.S.C. § 524(e). The word "notwithstanding," suggests that the type of injunction Congress was authorizing in § 524(g) would be barred by § 524(e) in the absence of the statute.

A. Legislative History of the Statute

Section 524(g) was passed after the United States Court of Appeals for the Second Circuit had affirmed the entry of an unprecedented injunction barring claims against certain non-debtors in connection with the bankruptcy of the nation's leading manufacturer of asbestos, the Johns Manville Corporation. *MacArthur Co. v. Johns-Manville Corp. (In re Johns-Manville Corp.), 837 F.2d 89, 91 (2d Cir. 1988)* ("*Manville I*"). The permanent injunction in that case extended to actions **[**169]** against Manville's insurers, all of whom had dedicated the entire proceeds of their policies - proceeds on which parties other than Manville were additional insureds and had a call - to a settlement fund into which the claims of asbestos victims would be channeled, valued, and resolved. The Second Circuit concluded that the bankruptcy court could permanently enjoin and channel lawsuits against a debtor's insurer relating to those insurance policies because those policies were "property of the debtor's estate." *Id. at 90*. The Court of Appeals did not cite to a single section of the Bankruptcy Code as authorizing entry of the injunction.

Despite the Second Circuit's affirmance of the *Manville I* injunction, questions continued to be raised about its legality. Congress passed Sections 524(g) and (h) of the Bankruptcy Code to remove any doubt that those injunctions were authorized. *See* H.R. Rep. 103-835 at *41 (noting that Subsection (g) was added to Section 524 "in order to strengthen the Manville and UNR trust/injunction mechanisms and to offer similar certitude to other asbestos trust/injunction mechanisms that meet the same kind of high standard with respect to regard for the rights of claimants, present and future, as displayed in the two pioneering cases"). **[**170]**

HN22[] That Section 524(g) applies only to asbestos cases is clear. The statute explicitly states than the trust that "is to assume the liabilities of a debtor" be set up in connection **[*93]** with "actions seeking recovery for damages allegedly caused by the presence of, or exposure to, asbestos or asbestos-containing products" (11 U.S.C. § 524(g)(2)(B)(i)(I)). If that were not clear enough, Congress passed another section to provide that injunctions that had previously been entered *in asbestos cases* - not in any other kind of case - would automatically be deemed statutorily compliant, even if those injunctions did not have all the features required by § 524(g). *See*, 11 U.S.C. § 524(h) ("Application to Existing Injunctions"). The limitation of § 524(h) to asbestos injunctions is important because, prior to the statute's passage, injunctions releasing third party claims against non-debtors had been entered by a few courts in cases involving other industries. *See e.g., In re Drexel Burnham Lambert Grp., Inc., 960 F. 2d 285 (2d Cir. 1992)* (securities); *In re A.H. Robins Co., Inc., 880 F.2d 694 (4th Cir. 1989)* (medical devices). The revisions to the Bankruptcy Code neither extend to those injunctions nor deem them to be statutorily compliant.

At the same Congress passed Sections 524(g) and (h), it passed Public Law 111, which provided a rule of construction for Section 524(g). It states that nothing in the 1994 amendments to the Bankruptcy **[**171]** Code, including 524(g), "shall be construed to modify, impair, or supersede any other authority the court has to issue injunctions in connection with an order confirming a plan of reorganization." Pub. L. 103-394 § 111(b) (uncodified). Congress made this statement because the parties in non-asbestos bankruptcy cases took the position that Sections 524(g) and (h) were unnecessary, in that bankruptcy courts already authorized the entry of such injunctions and corresponding approval of non- debtor releases - viz, *Robins* and *Drexel*. But the passage of Public Law 111 did not mean that Congress agreed with that position. As the House Committee on the Judiciary noted in the legislative history of these new provisions:

> Section 111(b) . . . make[s] clear that the special rule being devised for the asbestos claim trust/injunction mechanism is not intended to alter any authority bankruptcy courts *may* already have to issue injunctions in connection with a plan [of] reorganization. Indeed, [asbestos suppliers] Johns-Manville and UNR firmly believe that the court in their cases had full authority to approve the trust/injunction mechanism. And other debtors in other industries are reportedly beginning to experiment with similar mechanisms. *The Committee expresses no **[**172]** opinion as to how much authority a bankruptcy court may generally have under its traditional equitable powers to issue an enforceable injunction of this kind*.

Vol. E., *Collier on Bankruptcy*, at App. Pt. 9-78 (reprinting legislative history pertaining to the 1994 Code amendments) (emphasis added). P.L. 111 was not incorporated into the Bankruptcy Code.

Congress' used of the word "may" indicates that a bankruptcy court's authority to enter such an injunction was at best uncertain. And in light of the last sentence - in which the Committee made it clear that Congress expressed no opinion on that subject - one cannot read this tidbit of legislative history as indicating that Congress had concluded that a bankruptcy court already had such authority under its "traditional equitable powers."

During the course of this appeal, it has been suggested that P.L. 111 expresses Congress' intent to pass a limited law and then allow the courts to work out the contours of whether and how to extend § 524(g)-style authority outside the asbestos context.[59] The very next sentence from **[*94]** that statute's legislative history reveals that nothing could be further from the truth:

> The Committee has decided to provide explicit **[**173]** authority in the asbestos area because of the singular cumulative magnitude of the claims involved. How the new statutory mechanism works *in the asbestos area* may help the Committee judge whether the concept should be extended into other areas.

Id. (Emphasis added)

Plainly, Congress made a decision to limit the scope of the experimenting that was "reportedly" to be happening (and that was in fact happening) in other industries. And it left to itself, not the courts, the task of determining whether and how to extend a rule permitting nondebtor releases "notwithstanding the provisions of section 524(e)" into other areas.

Since 1994, Congress has been deafeningly silent on this subject.

B. Survey of the Relevant Case Law

1. Supreme Court Law

The United States Supreme Court has never specifically considered whether the nonconsensual release of non-derivative claims asserted by third parties against non-debtors can be approved in the context of a debtor's bankruptcy. Indeed, on *certiorari* to the Second Circuit from one of its orders in the ongoing *Manville* saga, the High Court announced that its opinion did "not resolve whether a bankruptcy court, in 1986 or today, could properly enjoin claims against nondebtor **[**174]** insurers that are not derivative of the debtor's wrongdoing." Travelers Indem. Co. v. Bailey, 557 U.S. at 155.

The Court has, however, spoken on several occasions about issues that are germane to the consideration of

[59] I can only assume that this argument derives from Congress' mention of the fact that courts dealing with nonasbestos bankruptcies were "reportedly beginning to experiment with similar mechanism."

that question.

For one thing, the Court has indicated that the Bankruptcy Code was intended to be "comprehensive." *See* RadLAX Gateway Hotel, LLC v. Amalgamated Bank, 566 U.S. 639, 645, 132 S. Ct. 2065, 182 L. Ed. 2d 967 (2012) ("Congress has enacted a comprehensive scheme and has deliberately targeted specific problems with specific solutions") (quoting Varity Corp. v. Howe, 516 U.S. 489, 519, 116 S. Ct. 1065, 134 L. Ed. 2d 130 (1996) (Thomas, J., dissenting)).

For another, it has held that **HN23**[] the "traditional equitable power" of a bankruptcy court "can only be exercised within the confines of the Bankruptcy Code." Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 206, 108 S. Ct. 963, 99 L. Ed. 2d 169 (1988).

HN24[] And in two recent cases, the Supreme Court has held, albeit in contexts different from the one at bar, that a bankruptcy court lacks the power to award relief that varies or exceeds the protections contained in the Bankruptcy Code - not even in "rare" cases, and not even when those orders would help facilitate a particular reorganization.

For example, in Law v. Siegel, 571 U.S. 415, 134 S. Ct. 1188, 188 L. Ed. 2d 146 (2014), the Supreme Court unanimously held the bankruptcy court does not have "a general, equitable power" to order that a debtor's statutorily exempt assets be made available to cover attorney's fees incurred by an estate's trustee in the course of the **[**175]** chapter 7 bankruptcy case. Section 522 of the Bankruptcy Code, by reference to applicable state law, entitled the debtor in **[*95]** that case to exempt equity in his home from the bankruptcy estate. *See* 11 U.S.C. § 522(b)(3)(A). A dispute arose between the debtor and the trustee of the estate, causing the trustee to incur substantial legal fees, purportedly as a result of the debtor's "abusive litigation practices." Law v. Siegel, 571 U.S. at 415-16. Seeking to recoup the cost of resolving the dispute with the debtor, the trustee asked the bankruptcy court to order that the otherwise exempt assets be made available to cover his attorney's fees. He argued that such an order was authorized by the "inherent power" of the Bankruptcy Court and by Section 105(a) of the Bankruptcy Code, which provides:

> The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

11 U.S.C. § 105(a).

HN25[] The High Court disagreed, stating flatly, "A bankruptcy court may not exercise its authority to 'carry **[**176]** out' the provisions of the Code" by taking an action inconsistent with its other provisions. Law v. Siegel, 571 U.S. at 425. It announced that there is "no authority for bankruptcy courts to deny an exemption on a ground not specified in the Code," because the Bankruptcy Code was intended to be a *comprehensive* statement of the rights and procedures applicable in bankruptcy. Id. at 416. The Code explicitly exempts certain debtor assets from the bankruptcy estate and provides a finite number of exceptions and limitations to those asset exemptions. *See* 11 U.S.C. § 522. To the Supreme Court, "comprehensive" means precisely that: "The Code's meticulous - not to say mind-numbingly detailed - enumeration of exemptions and exceptions to those exemptions confirms that courts are not authorized to create additional exceptions." Law v. Siegel, 571 U.S. at 424.

More recently, in Czyzewski v. Jevic Holding Corp., 137 S. Ct. 973, 197 L. Ed. 2d 398 (2017), the Court held that the protections explicitly afforded by the Bankruptcy Code could not be overridden in a "rare" case, even if doing so would carry out certain bankruptcy objectives. **HN26**[] In chapter 11 bankruptcies, a plan that does not follow normal priority rules cannot be confirmed over the objection of an impaired class of creditors. 11 U.S.C § 1129(b). Notwithstanding that, the bankruptcy court in Jevic approved the structured **[**177]** dismissal[60] of a chapter 11 case in which unsecured creditors were prioritized over non-consenting judgment creditors - a violation of ordinary priority rules. The bankruptcy court and the proponents of the structured dismissal argued that the Bankruptcy Code did not specifically state whether normal priority rules had to be followed in chapter 11 (as opposed to chapter 7) cases - that is, the statute was "silent" on the subject - so the court could exercise such authority in "rare" cases in which there were "sufficient reasons" to disregard priority. But the Supreme Court disagreed that any such power existed.

---

[60] In a structured dismissal, the debtor obtains an order that simultaneously dismisses its chapter 11 case and provides for

the administration and distribution of its remaining assets.

It observed that the priority system applicable to those distributions had long been considered fundamental to the Bankruptcy **[*96]** Code's purposes and held that the "importance of the priority system leads us to expect more than simply statutory silence if, and when, Congress were to intend a major departure." *Jevic Holding Corp., 137 S. Ct. at 984*. To the argument that a bankruptcy court could disregard priority if there were "sufficient reasons" to do so, Justice Breyer aptly noted: "It is difficult to give precise content to the concept 'sufficient reasons.' That fact threatens to turn a 'rare case' exception into a **[**178]** more general rule." *Id. at 986*.

It is with these holdings in mind that I examine the law in the various Circuits on the subject of non-consensual release of third-party claims against non-debtors.

I begin, of course, with our own.

2. Second Circuit Law

Manville I: The relevant law in the Second Circuit begins with *Manville I*, which has already been discussed. *Manville's I*'s injunction was subsequently codified in *§§ 524(g)* and *(h)*[61] - which, as noted above, are plainly in the Bankruptcy Code, and are limited to the asbestos context, and have never been extended by Congress to other areas of endeavor. It is, moreover, significant that the injunction authorized by the Second Circuit in *Manville I* extended only to claims against parties (insurance companies) holding property that was indisputably part of the *res* of the debtor's estate (policies covering Manville for the manufacture and sale of asbestos). As will be seen when we get to *Manville III/IV*, when the non-debtor was seeking a release in exchange for contributing property to the debtor's estate - as opposed to surrendering property that already was part of the debtor's estate - the result, even in a statutorily authorized asbestos case, was different.

Drexel: The debtor in *In re Drexel Burnham Lambert Grp., Inc., 960 F. 2d 285 (2d Cir. 1992)* was the investment bank Drexel Burnham Lambert Group ("DBL"), which filed for bankruptcy in 1990. DBL's principal creditor was the Securities and Exchange Commission, which was owed $150 million pursuant to a prior settlement. But over 15,000 creditors filed proof of claims against the estate, alleging fraud in connection with four different types of securities transactions.

Judge Milton Pollack of this district withdrew all of these securities claims from the bankruptcy court pursuant to *28 U.S.C. § 157(d)* in order to facilitate their settlement. The parties negotiated a settlement that had as its key feature the certification of all the securities claimants into a single, mandatory, non-opt-out class (*Rule 23(b)(1)(B)*), which was itself divided into two subclasses: A and B. The members of Subclass B - comprised of securities fraud class action plaintiffs - were, as part of the settlement, enjoined from bringing any future actions against the former officers and directors of DBL; while not themselves debtors, those individuals had contributed to DBL's estate.

The district court certified the classes and approved the settlement over the objections of 8 of the 850 proposed class members. Three of the **[**180]** objectors filed appeals, contending in relevant part that the district court had erred by approving the settlement with it the mandatory injunction against the pursuit of third-party claims by non-consenting plaintiffs.

The Second Circuit affirmed the settlement of the securities fraud cases. It noted **[*97]** in passing that, "In bankruptcy cases, a court may enjoin a creditor from suing a third party, provided this injunction plays an important part in the debtor's reorganization plan." *Drexel, 960 F. 2d at 293* (citing *In re A.H. Robins Co., 880 F.2d 694, 701 (4th Cir.)*). But it cited no section of the Bankruptcy Code that authorized this proposition. In its brief discussion of the objectors' challenge to the provision in the settlement agreement that barred members of subclass B from bringing or maintaining suits against DBL's officers and directors, the Court of Appeals, reasoning tautologically, said this:

> The Settlement Agreement is unquestionably an essential element of Drexel's reorganization. In turn, the injunction is a key component of the Settlement Agreement. As the district court noted, the injunction limits the number of lawsuits that may be brought against Drexel's former directors and officers. This enables the directors and officers to settle those **[**181]** suits without fear that future suits will be filed. Without the injunction, the directors and officers would be less likely to settle. Thus, we hold that the district court did not abuse its discretion in approving the injunction.

[61] The Court is advised that the *Manville I* injunction did not conform in every particular to the rules set out in *Section 524(g)*, and that *Section 524(h)* was included in the Bankruptcy Code to be sure that the *Manville* ***[**179]*** *I* injunction was deemed to be Code-compliant notwithstanding that fact.

In re Drexel Burnham Lambert Grp., Inc., 960 F. 2d at 293. In other words, the Circuit held that the district court had discretion to approve non-debtor releases as part of the settlement of numerous securities fraud class actions in the context of a bankruptcy, simply and solely because funds were being funneled to the estate that would not otherwise be contributed.

There are numerous reasons why Drexel does not answer the question about a court's statutory authority under the Bankruptcy Code to release non-debtors over the objection of third parties who have direct claims against them. Two, however, are dispositive.

First and foremost, the Second Circuit simply did not address this question in *Drexel. Drexel* mentioned in passing something about a bankruptcy court's power to enjoin claims but did not identify any source of that power in the Bankruptcy Code. It appears to have assumed *sub silentio* that such authority existed.

Second, Drexel was decided two years before Congress passed Sections 524(g) and (h). The opinion's passing mention of a **[**182]** bankruptcy court's power to enjoin a creditor from suing a non-debtor became far less persuasive after Congress (1) amended the Bankruptcy Code to authorize such injunctions, but only in asbestos cases; (2) expressed agnosticism about whether any such authority existed outside of its new legislation; and (3) indicated its intent to consider at some later time whether to extend this authority to industries that were "reportedly experimenting" with such injunctions - which it never has.[62]

There are other reasons to question the continuing viability of Drexel. Whether its reasoning can be extended to mass tort cases like this one is highly dubious. Seven years after the Second Circuit's opinion in Drexel, the Supreme Court expressed grave doubt about whether the Rule 23(b)(1)(B) "limited fund class action" device that was employed in Drexel could ever be employed in the mass tort context like this one, Ortiz v. Fibreboard Corp., 527 U.S. 815, 119 S. Ct. 2295, 144 L. Ed. 2d 715 (1999). Subsequent to Ortiz, courts have consistently rejected attempts to apply the limited fund mandatory class action **[*98]** device to mass torts. *See, e.g.,* In re Simon II Litig., 407 F.3d 125, 137-38 (2d

---

[62] It bears reiterating that Drexel was one of those cases to which the Judiciary Committee referred when it said that debtors in other industries were "reportedly experimenting" with non-debtor injunctions in the years prior to the passage of Section 524(g). *See supra*, note 59.

Cir. 2005) (tobacco punitive damages litigation); Doe v. Karadzic, 192 F.R.D. 133, 140-44 (S.D.N.Y. 2000) (actions by victims of war crimes committed by Bosnia-Herzegovina brought under the Alien Tort Claims Act).

Moreover, the Supreme Court **[**183]** also said in Ortiz that a fund which is "limited" only because the contributing party keeps a large portion of its wealth (*a la* the Sacklers) is "irreconcilable with the justification of necessity in denying any opportunity for withdrawal of class members whose jury trial rights will be compromised, whose damages will be capped, and whose payments will be delayed." Ortiz v. Fibreboard Corp., 527 U.S. at 860. The exact same thing could be said of the third parties whose claims are being extinguished as part of the Debtors' Plan.

Subsequent Second Circuit law in the *Manville* cases also casts doubt on a bankruptcy court's subject matter jurisdiction to authorize the release of third-party claims against the officers and directors of DBL simply because they would not otherwise have made a contribution to the debtor's estate. Manville III, 517 F.3d at 66. **HN27**[ ] In Manville III/IV, the Second Circuit concluded that "a bankruptcy court only has jurisdiction to enjoin third-party non-debtor claims that directly affect the *res* of the bankruptcy estate," and held that claims asserted against non-debtors that sought "to recover directly from [the] debtor's insurer for the insurer's own independent wrongdoing" did not have such impact. Manville III, 517 F.3d at 65-66. In so ruling the Second Circuit held it of no moment **[**184]** for jurisdictional purposes that the non-debtor was making made a financial contribution to a debtor's estate (*id.*), saying: "It was inappropriate for the bankruptcy court to enjoin claims brought against a third-party non-debtor *solely on the basis of that third-party's financial contribution to a debtor's estate*." *Id.* (Emphasis added) For this proposition, the *Manville III* panel cited with approval the Third Circuit's warning from *In re Combustion Engineering*, where the court had observed that:

> a debtor could create subject matter jurisdiction over any on-debtor third-party [simply] by structuring a plan in such a way that it depended upon third party contribution. **HN28**[ ] As we have made clear, subject matter jurisdiction cannot be conferred by consent of the parties. Where a court lacks subject matter jurisdiction over a dispute, the parties cannot create it by agreement even in a plan of reorganization.

In re Combustion Engineering, 391 F. 3d 190, 228 (3d

Cir. 2004).

Finally, changes in class action law since Drexel was decided have rendered its facile analysis of the Rule 23(a) factors, especially commonality and typicality, highly suspect. Amchem Products, Inc., v. Windsor, 521 U.S. 591, 117 S. Ct. 2231, 138 L. Ed. 2d 689 (1997); Ortiz v. Fibreboard Corp., 527 U.S. 815, 119 S. Ct. 2295, 144 L. Ed. 2d 715 (1999). I strongly suspect that the Drexel class certification, and so the Drexel settlement, would not and could not be approved today.[63]

But one **[**185]** thing is clear: Drexel sheds no light whatsoever on the issue of whether releases like the one at bar are authorized *by the Bankruptcy Code*. That statute was never mentioned.

New England Dairies/Metromedia: In New England Dairies, Inc. v. **[*99]** Dairy Mart Convenience Stores, Inc. (In re Dairy Mart Convenience Stores, Inc.), 351 F. 3d 86, 92 (2d Cir. 2003), the Court of Appeals for this circuit definitively rejected the argument that § 105(a) of the Bankruptcy Code (*see supra*, at p. 101-102) could "create substantive rights that are otherwise unavailable under applicable law." As the author of the opinion (Judge Jacobs) recognized:

> **HN29**[] The equitable power conferred on the bankruptcy court by section 105(a) is the power to exercise equity in carrying out the *provisions* of the Bankruptcy Code, rather than to further the purposes of the Bankruptcy Code generally, or otherwise to do the right thing. This language "suggests that an exercise of section 105 power be tied to another Bankruptcy Code section and not merely to a general bankruptcy concept or objective." 2 Collier on Bankruptcy ¶ 105.01[1].[64]

In re Dairy Mart Convenience Stores, Inc., 351 F. 3d at 92.

In re Dairy Mart did not involve the confirmation of a plan containing non-debtor releases of third-party claims, so technically it did not speak to the question pending before this Court. But two years later, Judge Jacobs authored In re Metromedia Fiber Network, Inc., 416 F.3d 136 (2d Cir. 2005), which did.

Metromedia Fiber Network, Inc. and its subsidiaries declared bankruptcy. **[**186]** *See* Metromedia, 416 F.3d 136, 138 (2d. Cir. 2005). The company's founder, John W. Kluge, did not. However, as part of the plan of reorganization, Kluge, as grantor, established the "Kluge Trust." Id. at 141 n.4. Under the plan of reorganization proposed to the court, the Kluge Trust was to make "a 'material contribution' to the estate" in the bankruptcy, (id. at 143), by "[i] forgiv[ing] approximately $150 million in unsecured claims against Metromedia; [ii] convert[ing] $15.7 million in senior secured claims to equity in the Reorganized Debtors; [iii] invest[ing] approximately $12.1 million in the Reorganized Debtors; and [iv] purchas[ing] up to $25 million of unsold common stock in the Reorganized Debtors' planned stock offering." Id. at 141. Metromedia itself would continue to exist after its reorganization - albeit under a new name, AboveNET - and to engage in the business of providing high bandwidth telecommunications circuits, which was its historic business model.

In exchange for the Kluge Trust's contributions, the Kluge Trust and certain "Kluge Insiders" were to receive 10.8% of the Reorganized Debtors' common stock and something called the "Kluge Comprehensive Release." *Id.* The Kluge Comprehensive Release provided:

> the Kluge Trust **[**187]** and each of the Kluge Insider shall receive a full and complete release, waiver and discharge from . . . any holder of a claim of any nature . . . of any and all claims, obligations, rights, causes of action and liabilities arising out of or in connection with any matter related to [Metromedia] or one or more subsidiaries . . . based in whole or in part upon any act or omission or transaction taking place on or before the Effective Date.

Id.

The release was broad and did not carve out any exception - even for claims that could not be discharged against a debtor in **[*100]** bankruptcy, such as those predicated on fraud or willful misconduct.

Following confirmation of the plan, appellant creditors Deutsche Bank AG (London Branch) and Bear, Stearns

[63] It is, of course, for the Second Circuit to make that call - not a district court in the Second Circuit.

[64] *In re Dairy Mart* was hardly the first time this settled principle had been recognized by the Second Circuit. *See, e.g.,* FDIC v. Colonial Realty Co., 966 F.2d 57, 59 (2d Cir. 1992) ("105(a) limits the bankruptcy courts equitable powers, which 'must and can only be exercised within the confines of the Bankruptcy Code") (quoting Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 206, 108 S. Ct. 963, 99 L. Ed. 2d 169, (1988)).

& Co., Inc. challenged the "largely implemented" plan of reorganization and argued that the releases in the plan of reorganization "improperly shield certain non-debtors from suit by the creditors." Id. at 138. On appeal, the district court both affirmed the plan of reorganization and ruled that the relief sought by the two banks was not "barred by the doctrine of equitable mootness because effective relief could have been afforded without 'unraveling the plan.'" **[**188]** Id. at 139.

The Second Circuit vacated the district court's affirmance of the plan, on the ground that the bankruptcy court had failed to make certain findings necessary to a determination that the non-consensual third-party releases should be approved. Id. at 143. But the plan had been substantially consummated by the time the appeal was heard, so the Circuit concluded that the matter was indeed equitably moot. As a result, it declined to remand so that a lower court could make the missing findings and reconsider the propriety of the releases. Id. at 145.

Before reaching this result, the panel discussed whether non-debtor releases were available in connection with someone else's bankruptcy. The Circuit identified "two considerations that justify . . . reluctance to approve non-debtor releases." Id. at 141. It noted that such releases were not specifically authorized outside of the asbestos context:

> [T]he only explicit authorization in the Bankruptcy Code for nondebtor releases is 11 U.S.C. § 524(g), which authorizes releases in asbestos cases when specified conditions are satisfied, including the creation of a trust to satisfy future claims . . .

Metromedia Fiber Network, Inc., 416 F.3d at 142. And it held, consistent with *In re Dairy Mart*, that Section 105(a) of the Bankruptcy Code did not authorize the approval of such releases: **[**189]**

> True, **HN30**[] 11 U.S.C. § 105(a) authorizes the bankruptcy court to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Bankruptcy Code]"; but section 105(a) does not allow the bankruptcy court "to create substantive rights that are otherwise unavailable under applicable law." New England Dairies, Inc. v. Dairy Mart Convenience Stores, Inc. (In re Dairy Mart Convenience Stores, Inc.), 351 F.3d 86, 92 (2d Cir.2003) (quotations and citation omitted). Any "power that a judge enjoys under § 105 must derive ultimately from some other provision of the Bankruptcy Code." Douglas G. Baird, Elements of Bankruptcy 6 (3d ed.2001); accord Dairy Mart, 351 F.3d at 92 ("Because no provision of the Bankruptcy Code may be successfully invoked in this case, section 105(a) affords [appellant] no independent relief.").

Metromedia, 416 F. 3d at 142.

The panel also cautioned that courts should be careful about approving a non-consensual non-debtor release because the device "lends itself to abuse." *Id.* One particular form of abuse identified by the panel manifests when the release, in effect, "operate[s] as a bankruptcy discharge arrange without a filing and without the safeguards of the Bankruptcy Code." *Id.* Indeed, "The potential for abuse is heightened when releases afford blanket immunity." *Id.*

After observing that, "No case has tolerated nondebtor releases absent a finding of circumstances that **[**190]** may be characterized **[*101]** as unique,." *Id.*, the panel listed circumstances in which such releases had been authorized in the past, and identified factors that a court should consider when evaluating such releases in the future: (1) the release is important to the plan, (2) the enjoined claims would be channeled to a settlement fund rather than extinguished, (3) the estate receives substantial consideration in return, (4) the released claims would otherwise indirectly impact the debtors' reorganization by way of indemnity or contribution, and (5) the plan otherwise provided for the full payment of the enjoined claims. Id. at 141-42. However, the Circuit insisted that the ultimate decision about whether to authorize such releases was "not a matter of factors and prongs." Id. 142.

Having said all that, the Metromedia court did not rule on whether any or all of the factors it had identified were satisfied in the particular case before it. Nor did it conclude that a non-debtor release should be approved if the factors were satisfied, or consider whether, in the case before it, there might be other reasons why the proposed non-debtor releases should not be approved. Instead, as noted above, the Circuit vacated approval of **[**191]** the plan and declined to remand for further consideration because the matter had become equitably moot - thereby guaranteeing that those open questions - including the question about whether there was statutory authority for such releases - would not be answered.

So to summarize: No third-party releases were approved in *Metromedia*. The Court of Appeals did not conclude that such releases were consistent with or authorized by the Bankruptcy Code. It did not conclude that the case before it was one of the "unique" instances in which a court's reluctance to approve such releases might (assuming they were authorized) be overcome. And it did not decide whether the Kluge releases measured up to the level that might justify approving them if the case qualified as "unique." *In re Metromedia Fiber Network, 416 F.3d at 142-143*.

In other words, while *Metromedia* said a great deal, the case did not hold much of anything.[65] Its relevance, for present purposes, is that Judge Jacobs cautioned that statutory authority for non-consensual non-debtor releases outside of the asbestos context was at best uncertain - and then disposed of the case on other grounds, without identifying what section or sections of the Bankruptcy Code might actually authorize such relief in non-asbestos **[**192]** bankruptcy.[66]

No subsequent Second Circuit case has filled in the blank.

[*102] **Manville III/IV and In re Quigley**[67] : These were asbestos cases, in which a court's statutory authority to impose such non-debtor injunctions is undoubted, as long as all the conditions listed in *§ 524(g)* are met.

As discussed above, in *Manville III/IV*, the Second Circuit concluded that the bankruptcy court lacked subject matter jurisdiction over third party claims against Manville's non-debtor insurer that arose out of an alleged independent duty owed by the insurer to those third parties, rather than out of its contractual relationship as Manville's insurer. The court did not discuss any issue of statutory authority.

And in *Quigley*, the Circuit held that certain claims against the debtor's parent—claims based on the use of the parent's name on the debtors' asbestos products— could not be enjoined pursuant to *§ 524(g)* because the alleged liability was not "by reason of" any of the four "statutory relationships" identified in that section. *Quigley, 676 F.3d at 49, 60-61*. Had the proposed injunction fallen within one of the express statutory relationships, it would have been authorized because the case involved asbestos.

Madoff: *In re Bernard L. Madoff Inv. Securities LLC, 740 F.3d 81 (2d Cir. 2014)* involved a chapter 7 liquidation under the *Securities Investor Protection Act (SIPA)*. The debtor, **[**193]** Bernie L. Madoff Investment Securities ("BLMIS"), was an investment enterprise created to effect the Ponzi scheme of its principal, Bernie Madoff. The bankruptcy estate settled its claims against the estate of Jeffry M. Picower, an alleged Madoff co-conspirator, releasing its claims in exchange for a $5 billion dollar contribution to Madoff bankruptcy estate. In addition to approving that settlement and release, the bankruptcy court permanently enjoined two of the debtor's customers from pursuing putative state tort law class actions against the estate of Jeffry M. Picower in the United States District Court for the Southern District of Florida, to the extent those claims arose from or related to the Madoff Ponzi scheme.

The Second Circuit affirmed the non-debtor injunction because the customer's complaints were predicated on secondary harms flowing from to them from BLMIS, and so were derivative claims that a bankruptcy court had power to discharge pursuant to *Section 105(a)*. The *Madoff* court explained that the Florida plaintiffs had not alleged any direct claim against Picower's estate, because they failed to allege that Picower took any actions aimed at BLMIS customers (such as making misrepresentations **[**194]** to them) that caused particularized injury to those customers. *Id. at 93*.

However, the Second Circuit was careful to note that factual congruence between an estate's claim and an

---

[65] I disagree with Appellants that *Metromedia*'s discussion of non-consensual third-party releases is dictum. (*See id.*). The actual holding in the case is that the bankruptcy court failed to make the findings in order to justify approval of such a release. *Metromedia, 416 F.3d at 143*. A discussion of what type of findings would be necessary to approve a non-consensual third-party release was, at least arguably, a necessary predicate to that holding. The court's equitable mootness ruling only justified the decision not to remand so that the missing findings could be made. The court did not vacate approval of the releases on equitable mootness grounds, so it was not the actual holding in the case.

[66] Further to the discussion of *Drexel* - the case was cited by a Second Circuit in *Metromedia*, but only for the proposition that a contribution to a debtor's estate from a released third party was one factor that had in the past been relied on by a court to justify a non-debtor release. That is true as a matter of simple fact. As far as this Court can tell, that is about all that can be said to be left of *Drexel*.

[67] *Manville III, 517 F.3d at 66*; *Manville IV, 600 F. 3d at 152*; *In re Quigley Co., 676 F.3d 45 (2d Cir. 2012)*.

individual creditor's claim against the same non-debtor was not what rendered the asserted claims derivative. It held that, "there is nothing illogical or contradictory" about factual overlap between the allegations asserted in direct claim and a derivative claim; a non-debtor "might have inflected direct injuries on both the [estate's creditors] and [the debtor estate] during the course of dealings that form the backdrop of both sets of claims." Id. at 91 (quoting In re Seven Seas Petroleum, Inc., 522 F.3d 575, 587 (5th Cir. 2008)). A creditor could, therefore, bring a direct claim against a non-debtor, even though the debtor might have **[*103]** suffered an identical injury - provided the creditor was not seeking to recover for injuries suffered by the debtor, but for injuries it suffered *directly. Id.*

Significantly for our purposes, the Second Circuit did not simply sweep away the Florida class actions; it permitted the creditors to amend their Florida complaints to assert direct claims if they could identify some direct injury that Picower caused them, as there was "conceivably some particularized **[**195]** claim" that the customers could assert against the non-debtor that could not also be asserted or released by the estate. Id. at 94.

Tronox: Tronox Inc. v. Kerr-McGee Corp. (In re Tronox Inc.), 855 F.3d 84 (2d Cir. 2017) was not an asbestos case, but it adds nothing to the above discussion, for two reasons. First and foremost, the Court of Appeals dismissed the appeal for lack of appellate jurisdiction. Second, in that case, the claims asserted against the non-debtors by the third party were again derivative, not direct, claims (*e.g.*, alter ego, piercing the corporate veil, and successor liability) - as in *Madoff*, the plaintiff alleged "no particularized injury" to the claimant. *Id.* Because success on a derivative claim benefits all creditors of the estate, the Circuit held that the bankruptcy "trustee is the proper person to assert the claim, and the creditors are bound by the outcome of the trustee's action." In re Tronox Inc., 855 F.3d at 103 (internal quotation omitted).

But the court went on to say that, "when creditors have a claim for injury that is particularized as to them, they are exclusively entitled to pursue that claim, and the bankruptcy estate is precluded from doing so." Id. at 99 (internal citation omitted). There was no discussion of enjoining such particularized claims, let alone any discussion of statutory **[**196]** authority for doing so.

Kirwan (Lynch v. Lapidem): And so we come to Lynch v. Mascini Holdings Ltd. (In re Kirwan Offices S.à.r.L.), 792 Fed. Appx. 99 (2d Cir. 2019) ("Kirwan").

In Kirwan, the Second Circuit affirmed a bankruptcy court injunction that was included in a plan of reorganization in order to prevent collateral attacks on prior orders of that court. The appellant in Kirwan (Lynch) was one of three shareholders in the bankrupt enterprise. He challenged the *bona fides* of the bankruptcy filed by his former partners but lost after trial. The dissident shareholder then absented himself from the hearing on the plan of reorganization, of which he had notice. He did so in the (mistaken) belief that he could avoid any *res judicata* effect of the bankruptcy court's orders as long as he did not participate. *See* Lynch v. Lapidem Ltd. (In re Kirwan Offices S.A.R.L.), 592 B.R. 489, 501 (S.D.N.Y. 2018), *aff'd sub nom.* In re Kirwan Offs. S.à.R.L., 792 F. App'x 99 (2d Cir. 2019).

Anticipating that the dissident shareholder would try to mount a collateral attack on the bankruptcy court's order confirming the plan, the other two shareholders had included therein a provision enjoining any person, including Lynch, from suing anyone in any forum on a claim arising out of the bankruptcy proceeding and the court-approved reorganization. Judge Drain confirmed the plan containing that provision. At the time he entered the order confirming the plan, the Bankruptcy **[**197]** Judge made it clear that Lynch's "opposition to any reasonable restructuring . . . scurried, if not crossed the line, over into bad faith" (Kirwan, 592 B.R. at 499), and said it was "in that context . . . that I am prepared to approve the exculpation and injunction provisions of the plan." *Id.* He specifically found that the provision was narrowly tailored and necessary in order to forestall "back-door attacks and collateral litigation for their activities related to **[*104]** those things," which would impact the reorganized debtor as well the non- debtors who had proceeded in good faith throughout the bankruptcy. *Id.*

In short, the injunction affirmed in Kirwan was plainly one designed to preserve and protect the authority of the bankruptcy court and the integrity of its actions *vis a vis* the debtor's estate. Unlike the third-party claims in this case, Lynch's claims against his erstwhile partnership inherently involved the property of the estate - the relief sought would have redistributed *post hoc* the estate following the bankruptcy court's confirmation of the plan.

As noted earlier (*see* footnote 56), Lynch did not argue, either in this Court or in the Second Circuit, that the injunction was not statutorily authorized by **[**198]** the

Bankruptcy Code. The grounds asserted and decided were jurisdictional and constitutional, not statutory. Neither this Court nor the Second Circuit analyzed the question of statutory authority, even in the context of the very limited and specially targeted injunction that was included in the debtor's plan.

Summary of Second Circuit Law: The only fair characterization of the law on the subject of statutory authority to release and enjoin the prosecution of third-party claims against non-debtors in a bankruptcy case is: unsettled, except in asbestos cases, where statutory authority is clear. Because the Court of Appeals has decided every other case on non-statutory grounds, its only clear statement is that *Section 105(a)*, standing alone, does not confer such authority on the bankruptcy court outside the asbestos context.

3. The Law in Other Circuits

All but three of the other Circuits have spoken directly to the issue of statutory authority. They have reached conflicting results - a most unfortunate circumstance when dealing with a supposedly uniform and comprehensive nationwide scheme to adjust debtor-creditor relations.

Three of the eleven Circuits - the Fifth, Ninth, and Tenth - reject entirely **[**199]** the notion that a court can authorize non-debtor releases outside the asbestos context. *See In re Pacific Lumber Co., 584 F.3d 229, 252 (5th Cir. 2009)*; *In re Lowenschuss, 67 F.3d 1394, 1401-02 (9th Cir. 1995)*; *In re W. Real Estate Fund, 922 F.2d 592, 600 (10th Cir. 1990)*. Those courts read *§ 524(e)* as barring the granting of such relief - put otherwise, they under Congress' use of the phrase "Notwithstanding the provisions of *§ 524(e)*" in *§ 524(g)* as creating an exception to an otherwise applicable rule.

The Third Circuit also has not identified any section of the Bankruptcy Code that authorizes such non-debtor releases. Judge Drain points to *In re Millennium Lab Holdings II, LLC, 945 F.3d 126, 133-40 (3d Cir. 2019)* (*In re* ***Purdue Pharma*** *L.P., 633 B.R. 53, 2021 Bankr. LEXIS 2555, 2021 WL 4240974, at *40*), but as in the Second Circuit cases like *Manville III/IV* and *Tronox*, the Third Circuit does not discuss statutory authority in that case. Instead, the *Millennium* court concluded that the bankruptcy court had *constitutional* authority to extinguish certain third-party claims by confirming a chapter 11 plan. *In re Millennium Lab Holdings II, LLC, 945 F.3d 139-40*.

On those occasions when the Third Circuit did address a bankruptcy court's *statutory* authority to impose non-debtor releases, it overturned bankruptcy court orders granting them. For example, in *In re Continental Airlines, 203 F.3d 203 (3d Cir. 2000)*, the Court of Appeals *rejected as extra-statutory* the provision in a plan of reorganization that released claims against current and former directors of Continental, and that permanently enjoined shareholder actions against them, finding that the Bankruptcy Code "does **[*105]** not **[**200]** explicitly authorize the release and permanent injunction of claims against non-debtors, except in one instance not applicable here" - that being asbestos cases. *Id. at 211*; *11 U.S.C. § 524(g)*. And in *In re Combustion Engineering, Inc., 391 F.3d 190 (3d Cir. 2004)*, the Third Circuit, like the Second Circuit in *Metromedia*, held that *Section 105(a)* does not give the court the power to create substantive rights that would otherwise be unavailable under the Bankruptcy Code, and vacated the channeling injunction. *Id. at 238*. Neither *Continental Airlines* nor *Combustion Engineering* has ever been overruled by the Third Circuit.

The First, Eighth, and D.C. Circuits have yet to weigh in on the question of whether statutory authority to impose non-debtor releases exists. Judge Drain contends that the First Circuit did decide that issue, in *Monarch Life Ins. Co. v. Ropes & Gray, 65 F. 3d 973 (1st Cir 1995)*, but again, the First Circuit did not identify any statutory authority to impose non-debtor releases in that case. It declined to decide whether *Section 105(a)* authorized the imposition of a non-debtor release; and it did not cite any other section of the Bankruptcy Code as conferring that authority. *Id. at 983-84*.

Judge Drain cited *In re AOV Indus., Inc., 792 F.2d 1140, 1153, 253 U.S. App. D.C. 186 (D.C. Cir. 1986)* for the proposition that the D.C. Circuit has approved the non-consensual release of third-party claims against non-debtors. But that is wrong. The *AOV Industries* court did not say a word about whether such relief was authorized by **[**201]** statute. The court simply found that the issue before it - whether the bankruptcy court had *constitutional* authority to enter an order releasing non- debtor claims - was equitably moot. *Id.*

The Fourth and Eleventh Circuits have concluded that *Section 105(a)*, without more, authorizes such releases. *See Nat'l Heritage Found., Inc. v. Highbourne Found., Inc., 760 F.3d 344, 350 (4th Cir. 2014)*; *In re Seaside Eng'g & Surveying, 780 F.3d 1070, 1076-79 (11th Cir. 2015)*. After *In re Dairy Mart* and *Metromedia*, we know that is not the law in the Second Circuit. So Fourth and

Eleventh Circuit law contradict Second Circuit law, and cannot be relied on as authority for the proposition that such releases are statutorily authorized.

That leaves the Sixth and Seventh Circuits, both of which have concluded that Sections 105(a) and 1123(b)(6) of the Bankruptcy Code, read together, codify something that they call a bankruptcy court's "residual authority," and hold that a bankruptcy court can impose non-consensual releases of third-party claims against non-debtors in connection with a chapter 11 plan pursuant to that "residual authority."[68] As discussed in my summary of his opinion, Judge Drain adopted the reasoning of these courts, and added two other sections of the Bankruptcy Code to buttress the analysis.

Summary of Extra-Circuit Law: A majority of the Circuits that have spoken to the statutory authority question either dismiss the **[**202]** idea that such authority exists or, as with the Second Circuit, (i) reject the notion that such authority can be found by looking solely to Section 105(a) and then (ii) fail to answer the question of where such authority can be found. Two Circuits rely solely on Section 105(a), and so have law that conflicts with the Second Circuit's pronouncement. Only two Circuits support the position taken by the learned Bankruptcy Judge.

[*106] It is against that backdrop of higher court authority that I turn to the order on appeal.

C. The Statutory Provisions Upon Which the Bankruptcy Court Relied

Judge Drain was quite explicit about the statutory provisions that he believed gave him authority to approve these releases as "necessary or appropriate" to carry out the provisions of the Bankruptcy Code: Sections 105(a), 1123(a)(5) and (b)(6), and 1129, together with "residual authority." *In re* ***Purdue Pharma*** L.P., 2021 Bankr. LEXIS 2555, 2021 WL 4240974, at *43.

The question that arises is whether any of the sections other than Section 105(a) confers some substantive right such that a release to enforce that right could be

[68] They get the phrase "residual authority" from *United States v. Energy Res. Co., 495 U.S. 545, 549, 110 S. Ct. 2139, 109 L. Ed. 2d 580 (1990)*, which I discuss in detail below.

entered pursuant to *Section 105(a)*. I conclude that they do not.

Rather, each of the cited sections, like *Section 105(a)*, confers on the Bankruptcy Court only the power to enter orders that carry out other, substantive provisions of the Bankruptcy Code. None of them **[**203]** creates any substantive right; neither do they create some sort of "residual authority" that authorizes the action taken by the Bankruptcy Court.

Section 1123(b)(6): *Subsections (a)* and *(b)* of *11 U.S.C. § 1123*, entitled "Contents of Plan," lay out in considerable detail what a plan of reorganization *must* (*subsection (a)*) and *may* (*subsection (b)*) contain in order to be confirmed.

We can quickly dispense with the notion that *Section 1123(b)(6)* provides the substantive authority for a *Section 105(a)* injunction or approval of a release.

HN31[] *Section 1123(b)(6)* provides that a plan may "include any other appropriate provision not inconsistent with the applicable provisions of this title." *11 U.S.C § 1123(b)(6)*. In form, *Section 1123(b)(6)* is substantively analogous to *Section 105(a)*'s authorization of "any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." *11 U.S.C. § 105(a)*. If the latter does not confer any substantive authority on the bankruptcy court - and that proposition is well settled, at least in this Circuit - then the former can in no way be read to do so.

That alone would be reason to conclude that *Section 1123(b)(6)* does not provide the statutory authorization we are seeking. But as Appellants point out, various aspects of the non-consensual Section 10.7 Shareholder Release are indeed inconsistent with certain other provisions of title 11.

First **[**204]** and foremost, the Section 10.7 Shareholder Release is inconsistent with the Bankruptcy Code because it discharges a non-debtor from debts that Congress specifically said could not be discharged by a debtor in bankruptcy. The Section 10.7 Shareholder Release does not carve out or exempt claims for fraud or willful and malicious conduct, liabilities from which ***Purdue*** cannot be discharged in its own bankruptcy. *See 11 U.S.C. §§ 523(a)(2)*, *(4)*, *(6)*. Reading the Bankruptcy Code as authorizing a bankruptcy court to discharge a non-debtor from fraud liability - something it is strictly forbidden from doing for a debtor - cannot be squared with the fact that Congress intended that the Bankruptcy Code "ensure that all debts arising out of fraud are excepted from discharge no matter what their form." Archer v. Warner, 538 U.S. 314, 321, 123 S. Ct. 1462, 155 L. Ed. 2d 454 (2003) (internal citation omitted). In other cases in which the releases at issue called for relief from suit that encompassed otherwise non-dischargeable claims, courts either ensured fraud claims were exempt from the releases before approving them, **[*107]** Airadigm Communs., Inc. v. FCC (In re Airadigm Communs., Inc.), 519 F.3d 640, 657 (7th Cir. 2008), or simply refused to approve the releases because they included otherwise non-dischargeable claims. *See e.g.,* United States v. Fusion Connect, Inc. (In re Fusion Connect, Inc.), No. 20-05798, 634 B.R. 22, 2021 U.S. Dist. LEXIS 167103, 2021 WL 3932346, at *7 (S.D.N.Y. Sept. 2, 2021) (reversing the bankruptcy court's decision to discharge a debtor from **[**205]** an outstanding civil penalty because liability "arising from fraud on consumers" and payable to a governmental entity is "nondischargeable" in a chapter 11 bankruptcy under *Section 523(a)(2)*). Aside from Drexel - which, for all the reasons discussed above, is probably no longer good law - the Second Circuit has never approved a non-consensual release of claims against non-debtors of this sort, nor has it ever explained what provision of the Bankruptcy Code authorizes a bankruptcy court to do so.

HN32[] Second, as the State Appellants point out, a debtor's discharge cannot relieve him of "any debt . . . to the extent such debt is for a fine, penalty, or forfeiture payable to and for the benefit of a governmental unit, and is not compensation for actual pecuniary loss, other than a tax penalty. . ." *11 U.S.C. § 523(a)(7)*. At least some of the claims asserted by the State Appellants seek relief in the nature of non-dischargeable civil penalties payable to and for the benefit of governmental units. Such claims could not be discharged if the Sacklers had filed for personal bankruptcy.

To the extent that Judge Drain held that the Section 10.7 Shareholder Release was not inconsistent with these sections, I respectfully disagree.

Appellants also **[**206]** argue that the Section 10.7 Shareholder Release and corresponding injunctions are inconsistent with Section 524(e) of the Bankruptcy Code, which provides that "discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt." 11 U.S.C. § 524(e). On the facts of this case, I cannot agree with that argument - but not because the Code is silent on the subject.

Section 524(e) says, in sum and substance, that releasing a debtor on a debt owed to a creditor does not affect the liability that a non-debtor may have for the same debt. But the claims that would be released by the Section 10.7 Shareholder Release are not claims on which the Sacklers are jointly liable with ***Purdue***. The various state statutes being invoked by Appellants give rise to Sackler liability *independent* of ***Purdue***'s liability - albeit for the very same violations of the very same laws - because those laws impose an independent duty on persons who occupy certain managerial positions in a corporation. We would not have this appeal if the Sackler debts being eliminated by the Section 10.7 Shareholder Release were also debts owed by ***Purdue***; we would be back in Section 10.6 land, dealing with derivative claims, where the **[**207]** Bankruptcy Court's power is unchallenged.

It is true that, when passing Section 524(g), Congress stated explicitly that the non-debtor releases therein authorized were being allowed "notwithstanding the provisions of sect. 524(e)." 11 U.S.C. § 524(g). It is hard to read that phrase and not conclude that Congress thought it was creating an exception to Section 524(e) by authorizing the release of third-party claims against non-debtors in certain limited circumstances.

However, back when Congress was considering § 524(g), it had before it a specific situation: the claims being released were against non-debtor insurance companies whose liability was premised on the conduct of their insureds that fell within the terms of the policies they had issued. Everything **[*108]** that was being released was part and parcel of the bankruptcy estate; the debts owed by Manville and its insurers were the same debts; § 524(e) was obviously implicated. There is no indication, either in the text of the statute or in the legislative history, that Congress ever envisioned that a bankruptcy court could discharge the debts of non-debtors that were not also debts of the debtor. That being so, I cannot read the "notwithstanding" language to create an inconsistency on the facts of this case.

[208]** I am, therefore, constrained to conclude that the Section 10.7 Shareholder Release is not inconsistent with § 524(e), because it contains the discharge of debts that are not contemplated by § 524(e).

HN33[] ***Section 1123(a)(5)***: Section 1123(a)(5) of the Bankruptcy Code provides that a plan of reorganization must "provide adequate means for [its] implementation." 11 U.S.C. § 1123(a)(5). That section contains a laundry list of things that a plan can include in order to make sure that resources are available to implement the plan - any of which can be ordered by a bankruptcy court.

Injunctions against the prosecution of third-party claims against non-debtors, and the release of such claims, are nowhere to be found on that list. Every single example listed in Subsections 5(A) through (J) authorizes the court to do something with the *debtor's assets* (retaining estate property; transfer of property; sale of property; satisfaction or modification of a lien; cancellation or modification of an indenture or similar instrument; curing or waiving defaults; extension of maturity dates; issuing securities; even amending the debtor's charter). Since the bankruptcy court has *in rem* jurisdiction over the *res* of the debtor's estate, none of that should be surprising. **HN34**[] It is equally unsurprising that none of the types of relief listed in Section 1123(a)(5) involves disposing of property belonging to someone other than the debtor **[**209]** or a creditor of the debtor. That is because it is the debtor's resources - not the resources of some third party - that are supposed to be used to implement a plan that will adjust the debtor's relations with its creditors.

Of course, this is not the first case in which the resources of non-debtors are being used to implement a plan; and § 1123(a)(5) does not pretend to contain an exhaustive list of all ways that a plan can provide means for its implementation. The Section begins, after all, with the words "such as." In this case, Debtors argue that the only way to get the resources necessary to implement a viable plan was to agree to the Sacklers' demand for broad releases in exchange for their contribution of money to the bankruptcy estate. They insist that the Section 10.7 Shareholder Release and corresponding injunctions carry out the requirements of Section 1123(a)(5) by ensuring that the Plan has the funding it needs - and if that funding was obtained from some third-party funder on condition of a release and an injunction, then those forms of relief are authorized because the money is needed to fund the Plan.

But the fact that ***Purdue*** needs the Sacklers to give the money back does not mean that Section 1123(a)(5) confers on **[**210]** the Debtors or the Sacklers any right to have the non-debtors receive a release from non-derivative third-party claims in exchange for a contribution to ***Purdue***'s estate. The Debtors' suggestion that this Section confers some substantive right is exactly the sort of circular reasoning that was rejected by Judge Jacobs where Section 105(a) was concerned. *See* In re Dairy Mart, 351 F.3d at 92 (any such power conferred by Section 105(a) must "be tied **[*109]** to another Bankruptcy Code section and not merely to a general bankruptcy concept or objective") (quoting 2 Collier on Bankruptcy ¶ 105.01[1]). Getting to a confirmable plan is the general bankruptcy objective, nothing more.

Nor does Section 1123(a)(5) confer any special power on the Bankruptcy Court. A court does not propose the plan; the debtor and its creditors put the plan together and present it to the court, which cannot approve the plan unless it contains the required provisions and need not approve it even then. To the extent that any court order is contemplated by Section 1123(a), it is the Confirmation Order - not an injunction and release of claims against non-debtors in order to obtaining funding for a plan, which is essentially what Debtors are proposing.

Finally, and most important, Section 1123(a)(5) does not authorize a court to give its imprimatur to something the Bankruptcy **[**211]** Code does not otherwise authorize, simply because doing so would ensure funding for a plan. Nothing in Section 1123(a)(5) suggests that a debtor has the right to secure sufficient funds for implementation by any means necessary. Section 1123(a)(5) would not, for example, authorize a court to enter an order enjoining a bank from suing a nondebtor employee who embezzled funds and then offered them to her bankrupt brother's estate in exchange for a release of all claims a third party could assert against her. That example is silly, of course, but the point is simple: the mere fact that the money is being used to fund implementation of the plan does give a bankruptcy court statutory authority to enter an otherwise impermissible order in order to obtain that funding. As was the case with Section 1123(b)(6), Judge Drain's reliance on Section 1123(a)(5) begs the ultimate question that must be answered: whether the court has some *independent* statutory authority to issue the non-debtor releases and enjoin third party claims against the Sacklers, such that the Bankruptcy Court can enter a "necessary and appropriate" order to obtain the funding.

Section 1129(a)(1)**:** Finally, Section 1129(a)(1) does not provide the substantive authority for a Section 105(a) injunction or approval of a release. **HN35**[] Section 1129 is entitled "Confirmation **[**212]** of plan," and Subsection 1129(a)(1) provides that a bankruptcy court "shall confirm a plan only if . . . the plan complies with the applicable provisions of this title." 11 U.S.C.A. §

1129. Like the cited sections of §1123, §1129(a) confers no substantive right that could be used to undergird a § 105(a) injunction. One highly general provision simply does not confer substantive authority that is required to invoke another highly general provision.

Lack of Any Statutory Prohibition: Having exhausted the statutory provisions on which Judge Drain relied and finding that none of them confers any substantive right as required by Metromedia, our exercise should be at an end. But it is not. The Debtors argue that the Bankruptcy Court must be statutorily authorized to approve these releases because no provision of the Bankruptcy Code - including but not limited to § 524(e) - expressly prohibits them.

The notion that statutory authority can be inferred from Congressional silence is counterintuitive when, as with the Bankruptcy Code, Congress put together a "comprehensive scheme" designed to target "specific problems with specific solutions." RadLAX Gateway Hotel, 566 U.S. at 645. In this particular case, a number of red flags suggest that Congressional silence (if indeed Congress **[*110]** was silent) was not intended **[**213]** to mean consent.

HN36[] The first is that silence is inconsistent with comprehensiveness, and the Bankruptcy Code "provides a *comprehensive* federal system . . . to govern the orderly conduct of debtors' affairs and creditors' rights." E. Equip. & Servs. Corp. v. Factory Point Nat. Bank, Bennington, 236 F.3d 117, 120 (2d Cir. 2001) (emphasis added). "Comprehensive" means "complete, including all elements." Reading elements that do not appear in the text of the Code into the Code is the antithesis of comprehensiveness.

Then-District Judge Sullivan recognized as much in In re Lehman Bros. Holdings Inc., 508 B.R. 283 (S.D.N.Y. 2014). There, the bankruptcy court granted a certain creditor's application for reimbursement of post-petition counsel fees over the U.S. Trustee's objection that the Bankruptcy Code only permitted reimbursement of post-petition administrative expenses. On appeal, Judge Sullivan was not persuaded by appellees' argument that reimbursement for professional fees was authorized by the Bankruptcy Code simply because nothing in the Bankruptcy Code expressly forbade it. He held that, "no such explicit prohibition is necessary" because the requested reimbursement clearly goes against the *purpose* of a reorganization - "Reorganization plans exist to pay claims . . . [the] professional fee expenses were all incurred post-petition, and thus **[**214]** cannot be treated as 'claims.'" Id. at 293. He further noted that the federal bankruptcy scheme "cannot remain comprehensive if interested parties and bankruptcy courts in each case are free to tweak the law to fit their preferences." In re Lehman Bros. Holdings Inc., 508 B.R. 283, 294 (S.D.N.Y. 2014) (internal citations omitted).

As I noted above, Justice Breyer recently wrote when discussing the priority scheme set out in the Bankruptcy Code, the importance of certain critical aspects of the bankruptcy scheme "leads us to expect more than simple statutory silence if, and when, Congress were to intend a major departure." Jevic Holding Corp., 137 S. Ct. at 984. Granting releases to non-debtors for claims that could not be released in favor of the debtors themselves is so far outside the scope of the Bankruptcy Code and the purposes of bankruptcy that the "silence does not necessarily mean consent" principle applies with equal force.

Second, it is hard to infer consent from silence in circumstances when one would not expect Congress to speak. The Code was intended "to free the debtor of his personal obligations *while ensuring that no one else reaps a similar benefit*" Green v. Welsh, 956 F.2d 30, 33 (2d Cir. 1992) (emphasis added). It is counterintuitive to imagine that Congress would have thought it necessary to include language specifically **[**215]** forbidding things that that ran counter to that purpose. As one of Judge Drain's colleagues recently reminded us, the ordering of an involuntary release of third-party claims against non-debtors is "an extraordinary thing" that is "different . . . from what courts ordinarily do." In re Aegean Marine Petroleum Network Inc., 599 B.R. 717, 723 (S.D.N.Y. 2019). That is especially true where, as is proposed here, we find ourselves in what Judge Wiles called "the odd situation where we are being asked to use an unwritten authority to release non-debtor officers and directors from claims when the Bankruptcy Code would bar us from giving similar relief to those persons if they were debtors in their own cases." Id. at 726 (citing Metromedia, 416 F.3d at 142).

Third, Congress has in fact spoken on this subject, and what it has said suggests that it intended Sections 524(g) and (h) to preempt the field where non-debtor releases **[*111]** were concerned. I will not repeat the extensive discussion about the law and its legislative history that appears above, except to say that Congress in its wisdom elected to limit Code-based authority to release third party claims against non-debtors to asbestos litigation - and it declined either to agree with those who argued that bankruptcy courts already had a broader power to authorize such releases. **[**216]** Congress was not unaware that there were non-asbestos bankruptcies with thousands of claimants and nationwide implications in the early 1990s. Other mass tort bankruptcies with thousands upon thousands of potential claimants were pending (*i.e.*, in *A.H. Robins/Dalkon Shield*), as was the highly publicized bankruptcy of a major investment bank (*Drexel*). The Judiciary Committee mentioned the "experimentation" with *Manville*-like relief that was beginning in other industries.

Yet Congress declined to make this extraordinary form of relief - relief that ran counter to the fundamental purpose of the Bankruptcy Code - available in circumstances other than asbestos bankruptcies. And it reserved for itself the right to change that.

So the silence that speaks volumes is not Congress' failure to say, "And you can't give involuntary non-debtor releases to anyone except in an asbestos case." The silence that speaks volumes is the twenty-seven years of unbroken silence that have passed since Congress said, "We are limiting this to asbestos for now, and maybe, when we see how it works in that context, we will extend it later."

HN37[ ] Fourth, but by no means least, "it is a commonplace of statutory construction that **[**217]** the specific governs the general." *RadLAX Gateway Hotel, 566 U.S. at 640*. The Supreme Court of the United States has relied on that principle on multiple occasions in refusing to allow generalized provisions of the Bankruptcy Code to override specific directives on a particular subject.

Take, for example, *RadLAX* itself. The plan proposed by the debtors in *RadLAX* provided for the sale of unencumbered assets securing a bank creditor's claim free and clear of all liens. But, in contravention of the provision governing such a "cram down" plan under the Bankruptcy Code, the bid procedures proposed by the debtors precluded the bank holding the mortgage on the property from credit-bidding the amount of its claim, which the Bankruptcy Code specifically authorized the bank to do. *11 U.S.C. § 1129(b)(2)(A)(ii)*. Nonetheless, the bankruptcy court approved the plan. It agreed with the debtors that the bank did not need to be permitted to bid on the property as long as it was provided with the "indubitable equivalent" of its claim in some other fashion - in this particular case, the cash generated by the auction. *11 U.S.C. § 1129(b)(2)(A)(i)-(iii)*.

The Supreme Court rejected the debtors' justification, holding that the "indubitable equivalents" subclause (subclause iii) was a general subclause that could not **[**218]** be used to circumvent the specific requirement of subclause (ii) that the bank be permitted to credit-bid at the sale. The Court stated that the debtors' reading of the statute - that clause (iii) permits precisely what clause (ii) proscribes - is "hyperliterally contrary to common sense." *RadLAX Gateway Hotel, 566 U.S. at 640*. The Court called it "axiomatic" that specific statutory provisions control over general provisions and emphasized that the "general/specific canon" applies with particular force in bankruptcy, because "Congress has enacted a comprehensive scheme and has deliberately targeted specific problems with specific solutions." *Id.*

[*112] Where, as here, Congress has deliberately limited a specific targeted solution (the release of third- party claims against non-debtors) to a specific identified problem (asbestos bankruptcies) - and has even denominated that solution as an exception to the usual rule - *RadLAX* strongly suggests that the general/specific canon should apply with particular force.

Ginsberg & Sons v. Popkin, 285 U.S. 204, 52 S. Ct. 322, 76 L. Ed. 704 (1932) is a pre-Code case, but it illustrates the same principle. There, petitioner argued that *Clause 15 of Section 2 of the Bankruptcy Act* empowered district judges to issue orders directing the arrest of the former officers and directors of the debtor. Clause 15 **[**219]** provided, "The courts of bankruptcy are hereby invested with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in bankruptcy proceedings . . . [t]o] make such orders, issue such process, and enter such judgments in addition to those specifically provided for as may be necessary for the enforcement of the provisions of this title." Section 2, *11 USCA s 11(15)*. The reader will immediately appreciate that *Clause 15 is the Bankruptcy Act*'s equivalent of *Section 105(a) of the Bankruptcy Code* - it was the "necessary and appropriate" clause in the old statutory scheme.

But Section 9(a) of the Bankruptcy Act specifically precluded "a court of bankruptcy" from directing the arrest of former directors and officers, except for contempt or disobedience of its lawful orders. And Section 9(b) prescribed in great detail the conditions to and procedures for invoking the exception under which the court could direct the arrest and detention of such former directors and officers who posed a flight risk.

The Supreme Court refused to read Clause 15 of Section 2 in a way that would render the specific prohibitions and procedures enumerated in Sections 9(a) and (b) superfluous: "In view of the general exemption of bankrupts from arrest under section 9a and the carefully guarded exception made by section 9b as to those about to **[**220]** leave the district to avoid examination, there is no support for petitioner's contention that the general language of section 2(15) is a limitation upon section 9(b) or grants additional authority in respect of arrests of bankrupts." *D. Ginsberg & Sons v. Popkin, 285 U.S. at 207-08*.

The Supreme Court's holdings in these cases old and new are instructive in the present context. Here, Debtors and their allies seek to apply general provisions - *Sections 105(a)* and *1123(a)(5)* and *(b)(6)* - to justify expanding the express authority conferred by Congress under *§524(g)* into a situation that is manifestly not comprehended by that statute. Because the specific controls the general, that reliance is misplaced.

For all these reasons, I cannot conclude that Congressional "silence" should be deemed consent to an expansion of *Section 524(g)*. In fact, I do not believe that Congress has been silent at all. But to the extent it has, its silence supports the Appellants' position, not the Debtors'.

Residual Authority: Finally, I turn to the concept of "residual statutory authority." In these circumstances, I conclude that such authority simply does not exist.

Judge Drain framed the question before him as, "whether the court has statutory *or other power* to confirm a plan with a third-party claim release," and, if so, "what is the **[**221]** statutory *or other source of power* for such a release?" *In re **Purdue Pharma** L.P., 2021 Bankr. LEXIS 2555, 2021 WL 4240974, at *40, *43* (emphasis added). He identified the "other source of power" as the residual power of bankruptcy courts.

[*113] But such power, if it even exists, is of no help where, as here, it is being exercised in contravention of specific provisions of the Bankruptcy Code.

Debtors rely heavily on the Supreme Court's decision in *In re Energy Resources Co, 495 U.S. 545, 110 S. Ct. 2139, 109 L. Ed. 2d 580 (1990)* for the proposition that a bankruptcy court has "residual authority" to approve reorganization plans that includes all "necessary and appropriate" provisions, as long as those provisions are not inconsistent with title 11. In that case, the Court concluded that two bankruptcy courts - which were forbidden by the Bankruptcy Code from discharging a tax debt[69] and required not to confirm a plan unless satisfied that the IRS would in all likelihood be able to collect taxes owed within six years[70] - had not "transgressed one of the limitations on their equitable power" by directing in a plan of reorganization that certain tax payments be credited in the first instance to so-called "trust fund" tax debt, and only when that debt was satisfied to so-called "non-trust fund" tax debt. *In re Energy Resources Co., 495 U.S. at 549-50*. Trust fund tax debt is guaranteed by third parties; **[**222]** an order directing that the guaranteed debt be paid first meant that if there were any unpaid taxes at the end of the plan period, the IRS could probably not look to third parties for payment. The IRS argued that this provision of the plan was inconsistent with the Bankruptcy Code, because requiring the debtor to pay non-trust fund taxes first would give the IRS a greater chance of recovering 100 cents on the dollar.

But the Supreme Court ruled that the Bankruptcy Code did not require that a plan of reorganization be structured so that the unsecured tax debt was paid first. The bankruptcy court had found (as required by the Bankruptcy Code) that the plan of reorganization proposed by the debtors was likely to succeed. It further found that, if the plan did succeed, all taxes would be fully paid within six years. The express terms of the Bankruptcy Code required nothing more. Therefore, the order directing that tax payments be credited first to back taxes secured by the trust fund, and then to unsecured back taxes, was not inconsistent with any applicable provision of title 11. All the substantive guarantees that the Bankruptcy Code afforded to the IRS were baked into the court's approval **[**223]** of the plan.

No reference in *Energy Resources* to a bankruptcy court's "residual power" authorizes the learned Bankruptcy Judge's approval of the Section 10.7 Shareholder Release under any "residual power" theory. Just two years prior to the *In re Energy Resources* decision, the same Supreme Court - made up of the same nine justices - held that the bankruptcy court's residual equitable authority was bounded by the provisions of the Bankruptcy Code. *Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 206, 108 S. Ct.*

[69] *11 U.S.C. §§ 507(a)(7)*, ***523(a)(1)(A)***.

[70] *11 U.S.C. § 1129(a)(9)(C)*.

963, 99 L. Ed. 2d 169 (1988) (holding "whatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code"). Energy Resources is consistent with this principle. Congress legislated a particular right into the Bankruptcy Code; the Supreme Court refused to allow lower courts to expand that right and held that the Bankruptcy Court had the power to authorize anything that was not inconsistent with that right. But the Bankruptcy Code conferred a specific right. In this case, there is nothing in the Bankruptcy Code that specifically authorizes the Section 10.7 Shareholder Release; **[*114]** the Bankruptcy Court (and this Court) is being asked to insert a right that does not appear in the Bankruptcy Code in order to achieve a bankruptcy objective. That **[**224]** is precisely what *In re Dairy Mart* and Metromedia prohibit.

Additionally, the Energy Resources Court, echoing its own holding of two years earlier, recognized that any residuary power enjoyed by a bankruptcy court must be exercised in a way that "is not inconsistent with the applicable provisions of this title." I have become convinced, for the reasons discussed in great detail above, that the Section 10.7 non-debtor releases are in fact inconsistent with applicable provisions of title 11 - with Sections 524 (g) and (h), with *Section 523*, and with Section 1141(d), and possibly even with Section 524(e). Therefore, no residual power can authorize such an order.

As a corollary to the "residual authority" argument, several Appellees argue the release of claims against the non-debtor Sacklers and their related entities are proper because the Bankruptcy Code, taken as a whole, creates a "special remedial scheme" in which certain legal proceedings may terminate preexisting rights if the scheme is otherwise consistent with due process. They cite Martin v. Wilks, 490 U.S. 755, 109 S. Ct. 2180, 104 L. Ed. 2d 835 (1989) for their proposition.

In Martin v. Wilks, the Supreme Court announced that, as a general rule, "A judgment or decree among parties to a lawsuit resolves issues as among them, but it does not conclude the rights of strangers to those proceedings." **[**225]** It affirmed the Eleventh Circuit's judgment allowing certain individuals who were *not* parties to an original action to challenge consent decrees entered in that original case. Id. at 762. But, in a footnote, the Court acknowledged an exception to the general rule exists "where a special remedial scheme exists expressly foreclosing successive litigation by nonlitigants, as for example in bankruptcy or probate, legal proceedings may terminate preexisting rights if the scheme is otherwise consistent with due process." Id. at 762, n. 2.

Judge Drain did not adopt this reasoning or rest his view about his statutory authority on the Bankruptcy Code's "special remedial scheme" - and rightly so, because it is contrary to Second Circuit law. **HN38**[] The "special remedial scheme" contemplated by the Bankruptcy Code addresses the rights of persons who have claims against a debtor in bankruptcy - not claims against other non-debtors. The Code lays out a claims allowance process so that creditors can file their claims against someone who has invoked the protection of the Bankruptcy Code; it provides a mechanism for those parties to litigate those claims against the debtor and to determine their value. In order to take advantage of **[**226]** this "special remedial scheme," debtors have to declare bankruptcy, disclose their assets, and apply them - all of them, with *de minimis* exceptions - to the resolution of the claims of their creditors.

Non-debtors have no such obligations, and so do not have any rights at all under the "special remedial scheme" that is bankruptcy - certainly not the "right" to have claims that are being asserted against them outside the bankruptcy process released. As the Second Circuit held in *Manville III*, the "special remedial scheme" due process exception relating to *in rem* bankruptcy proceedings simply does not give a bankruptcy court subject matter jurisdiction to release *in personam* third-party claims against a non-debtor. In re Johns-Manville Corp., 600 F. 3d 135, 158 (2d Cir. 2010).

[*115] **Conclusion: No Statutory Authority**. In Metromedia, the Second Circuit signaled that a Bankruptcy Code could not order the non-consensual release of third-party claims against non-debtors unless some provision of the Bankruptcy Code aside from Section 105(a) authorized it to do so. For the reasons stated above, I conclude that there is no such section, and so no such authority.

It is indeed unfortunate that that this decision comes very late in a process that, from its earliest days in 2019, has proceeded **[**227]** on the assumption that releases of the sort contemplated in Section 10.7 of the Debtors' Plan would be authorized - this despite the language of the Bankruptcy Code and the lack of any clear ruling to that effect. I am sure that the last few years would have proceeded in a very different way if the parties had thought otherwise. But that is why the time to resolve this question for once and for all is now - for this bankruptcy, and for the sake of future bankruptcies. It should not be left to debtors and their creditors to guess whether such releases are statutorily authorized; and it most certainly should not be the case that their availability, or lack of same, should be a function of where a bankruptcy filing is made.

I also acknowledge that the invalidating of these releases will almost certainly lead to the undoing of a carefully crafted plan that would bring about many wonderful things, including especially the funding of desperately needed programs to counter opioid addiction. ***HN39***[] But just as, "A court's ability to provide finality to a third-party is defined by its jurisdiction, not its good intentions" (*Manville III, 517 F.3d at 66*), so too its power to grant relief to a non- debtor from non-derivative third **[**228]** party claims "can only be exercised within the confines of the Bankruptcy Code." *Norwest Bank Worthington, 485 U.S. at 206*.

Because the Bankruptcy Code confers no such authority, the order confirming the Plan must be vacated. Because the Advance Order is an adjunct of and follows from the Confirmation Order, it, too, must be vacated.[71]

III. The Plan's Classification and Treatment of the Canadian Appellants' Claims Does Not Violate the Bankruptcy Code.

Because the court reverses on the ground that there is no statutory authorization in the Bankruptcy Code for the Bankruptcy Court to impose a non-voluntary release of third-party claims against non-debtors, I do not reach the Canadian Appellants' separate attack on the Section 10.7 Shareholder Release. But part of the Canadian Appellants' argument on appeal is that the Plan as confirmed violates the Bankruptcy Code by treating the Canadian Appellants' unsecured claims unfavorably as compared to the claims of their domestic counterpart creditors. The Canadian Appellants explained at Oral Argument that this "inequality" issue must be decided, regardless of how the court ruled on the Section 10.7 Shareholder Release. (*See* Oral Arg. Tr., Nov. 30, 2021, at 71:6-21).

Pursuant to the Plan, **[**229]** the Canadian Appellants are entitled to a share of the **[*116]** $15 million dollars distributed to a trust that will be divided among all of the general unsecured creditors of the Debtor. (Dkt. No. 59, at 47). At the same time, domestic government and tribe unsecured creditors are not classified as "general" unsecured creditors but are placed in classes 4 and 5 as "Non-Federal Domestic Governmental" claimants and "Tribe" claimants respectively. (*See* Plan, at 2). The Canadian Appellants argue that the Bankruptcy Code contains an "equal-treatment mandate" in *Section 1129(a)(4)* requiring that "all creditors within the same class enjoy the same 'opportunity' to recover." (Dkt. No. 59, at 47). Because, they argue, the domestic non-federal government claims (Class 4) and tribal claims (Class 5) are "indistinguishable" from theirs (*id.*), the Canadian Appellants posit that they are "similarly situated" to their "domestic counterparts" and thus should be part of the same creditor "class." Since the Plan does not allow the Canadian Appellants to "enjoy shares in trusts seeded with $4.5 billion—300 times as much" as would be available to the general unsecured creditors of ***Purdue*** (*Id.*) - the Canadian Appellants argue that **[**230]** there exists "an inequality that is independently fatal to the Plan's treatment of the Canadian Appellants' claims." (*Id.*).

The Court disagrees. Under the Plan, the Canadian Appellants belong to a different class than their domestic, unsecured creditor "counterparts" for perfectly legitimate reasons. ***HN40***[] The Code does not require that all creditor classes be treated equally, only that there be a reasonable basis for any differentiation. *See Boston Post Rd. Ltd. P'ship v. FDIC (In re Boston Post Rd. Ltd. P'ship), 21 F.3d 477, 482-83 (2d Cir. 1994)*.

First, the Bankruptcy Code expressly permits differentiation *between* classes of creditors and the Canadian Appellants rightly recognize that their "equal-treatment mandate" applies only to claims of "all creditors within the same class." (*See* Dkt. No. 59, at 47). The Canadian Appellants' argument that they are of the same "class" as the non-federal government and tribe claimants is unconvincing. ***HN41***[] It does not matter that the Canadian Appellants' claims are purportedly "indistinguishable" from those held by the domestic unsecured creditors in Classes 4 and 5; a

[71] The U.S. Trustee has also appealed from the Disclosure Order, asserting that it was inaccurate in certain respects. (Dkt. No. 91, at 10; Dkt. No. 191, at 10). As the Confirmation Order has been vacated without reaching the notice/due process constitutional issues that were raised by the U.S. Trustee, I do not understand that any substantive ruling is needed with respect to the Disclosure Order. Like everything else connected with the Plan, it simply falls by the wayside.

chapter 11 plan may separately classify similar claims so long as the classification scheme has a reasonable basis for doing so. *See* In re Boston Post Rd. Ltd. P'ship, 21 F.3d at 482-83.

In Boston Post Rd. Ltd. P'ship, the chapter 11 plan classified unsecured claims against **[**231]** the insolvent Debtor, the Boston Post Road Limited Partnership ("BRP"), differently between the Federal Deposit Insurance Corporation ("FDIC") and BPR's other trade creditors. The classification treated the unsecured trade creditors more favorably than FDIC, while FDIC was BPR's largest unsecured creditor and an anticipated objector to the plan; the differentiation between these classes was done to achieve a "cramdown" of the plan over FDIC's objections. *Id. at 479*. The bankruptcy court denied confirmation of a chapter 11 plan on the basis that the plan impermissibly separately classified similar claims, holding that FDIC's unsecured claims should have been placed in the same class with other unsecured creditors, and the District Court affirmed. *Id.* On appeal, the Second Circuit found that the "Debtor was unable and failed to adduce credible proof of any legitimate reason for segregating the FDIC's unsecured claim from the unsecured claims of BPR's trade creditors." *Id. at 483*. The Debtor's only reasons were that the FDIC's claim purportedly "were created from different circumstances" and "BPR's future viability as a business depends on treating its trade **[*117]** creditors more favorably than the FDIC." *Id.* These **[**232]** reasons were "availing" to the Circuit. *Id.* In particular, the Circuit took issue with classifying similar claims differently "in order to gerrymander an affirmative vote on a reorganization plan." *Id. at 482-83* (quotation omitted). The Circuit explained, "approving a plan that aims to disenfranchise the overwhelmingly largest creditor through artificial classification is simply inconsistent with the principles underlying the Bankruptcy Code." *Id.*

In this case, unlike in Boston Post Rd. Judge Drain identified a reasonable basis for separately classifying the Canadian Appellants from the domestic unsecured creditors: First, Judge Drain explained that the Canadian creditors operate under "different regulatory regimes . . . with regard to opioids and abatement" than their domestic counterparts. *In re* ***Purdue Pharma*** *L.P., 2021 Bankr. LEXIS 2555, 2021 WL 4240974, at *12*.
Second, Judge Drain explained that "the allocation mediation conducted by Messrs. Feinberg and Phillips that resulted in the plan's division of the Debtors' assets . . . involved only *U.S.-based* public claimants with their own regulatory interests and characteristics." *Id.* (emphasis added). As the Debtors point out, the Canadian Appellants themselves differentiate themselves from the other classes in this manner, explaining **[**233]** (i) "[t]he Canadian Appellants are in Canada, [(ii)] the bulk of their legal claims arise in Canada, [(iii)] those claims concern the operations of ***Purdue*** Canada," and (iv) the Canadian Appellants' claims "bear no relation to the Shareholder Released Parties' control, direction, and oversight of the Debtors or their U.S. operations." (Dkt. No. 59, at 17-18; Dkt. No. 151, at 120-121). That very classification on the part of the Canadian Appellants accords with Judge Drain's findings that there is a reasonable basis for the separate classifications. And there is no argument that such separate classification was done for the purpose of disenfranchising a particular group in a manner inconsistent with the Bankruptcy Code, to engineer an assenting impaired class; or manipulate class voting, all of which must be carefully scrutinized by the court. Indeed, it was not.

Under the Plan, the Canadian creditors are classified in Class 11(c), while the domestic municipalities and domestic Indian tribes are classified as Class 4 and 5 creditors. These are perfectly legitimate classifications and the proffered reasons for doing so are reasonable. And the Canadian Appellants do not (and cannot) argue **[**234]** that under the Plan their claims will receive unequal treatment as compared to other claims in their class, Class 11(c), as indeed all claims classified as Class 11(c) are treated equally under the Plan. (Dkt. No. 59, at 44, 47-48).

Finally, Canadian Appellants *cannot* argue that their Class 11(c) claims are treated unfavorably as compared the other creditor classes (like Class 4 and/or Class 5) because their class, Class 11(c), voted to accept the Plan. **HN42**[] Under the Bankruptcy Code, only creditors of a *dissenting* class can object to the confirmation of a plan on the grounds that the plan discriminates against its creditor class. Pursuant to section 1129(b)(1) of the Bankruptcy Code, a plan shall be confirmed "if the plan does not discriminate unfairly . . . with respect to each class of claims or interests that is impaired under, and has not accepted, the plan." 11 U.S.C. § 1129(b)(1). Because the Canadian creditors - as part of Class 11(c) - voted to accept the Plan, the Canadian Appellants cannot contend that they are being treated unfavorably.

The classification and treatment of the Canadian Appellants' claims under the **[*118]** Plan does not violate the Bankruptcy Code.

CONCLUSION

For the foregoing reasons, the Bankruptcy Court's Confirmation Order and related **[**235]** Advance Order must be vacated.

This decision leaves on the table a number of critically important issues that were briefed and argued on appeal - principal among them, whether the Section 10.7 Shareholder Release can or should be approved on the peculiar facts of this case, assuming all the other legal challenges to their validity were resolvd in Debtors' favor.

But sufficient unto the day. This and the other issues raised by the parties can be addressed if they need to be addressed - which is to say, if this ruling is reversed.

This constitutes the decision and order of the court. This is a written opinion.

Dated: December 16, 2021

/s/ Colleen McMahon

U.S.D.J.

End of Document

Hearing Date and Time: March 9, 2022 at 1:00 p.m. (prevailing Eastern Time)
Objection Date and Time: March 8, 2022 at 7:00 p.m. (prevailing Eastern Time)
Reply Date and Time: March 9, 2022 at 11:00 a.m. (prevailing Eastern Time)

DAVIS POLK & WARDWELL LLP
450 Lexington Avenue
New York, New York 10017
Telephone: (212) 450-4000
Facsimile: (212) 701-5800
Marshall S. Huebner
Benjamin S. Kaminetzky
Eli J. Vonnegut
Christopher S. Robertson

Counsel to the Debtors
and Debtors in Possession

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re:	**Chapter 11**
PURDUE PHARMA L.P., ***et al.*****,**	**Case No. 19-23649 (RDD)**
Debtors.[1]	**(Jointly Administered)**

NOTICE OF HEARING REGARDING MOTION OF DEBTORS PURSUANT TO 11 U.S.C. § 105(a) AND 363(b) FOR ENTRY OF AN ORDER AUTHORIZING AND APPROVING SETTLEMENT TERM SHEET

PLEASE TAKE NOTICE that on March 3, 2022, the above-captioned debtors and debtors in possession in these proceedings (collectively, the "**Debtors**") filed the *Motion of*

[1] The Debtors in these cases, along with the last four digits of each Debtor's registration number in the applicable jurisdiction, are as follows: Purdue Pharma L.P. (7484), Purdue Pharma Inc. (7486), Purdue Transdermal Technologies L.P. (1868), Purdue Pharma Manufacturing L.P. (3821), Purdue Pharmaceuticals L.P. (0034), Imbrium Therapeutics L.P. (8810), Adlon Therapeutics L.P. (6745), Greenfield BioVentures L.P. (6150), Seven Seas Hill Corp. (4591), Ophir Green Corp. (4594), Purdue Pharma of Puerto Rico (3925), Avrio Health L.P. (4140), Purdue Pharmaceutical Products L.P. (3902), Purdue Neuroscience Company (4712), Nayatt Cove Lifescience Inc. (7805), Button Land L.P. (7502), Rhodes Associates L.P. (N/A), Paul Land Inc. (7425), Quidnick Land L.P. (7584), Rhodes Pharmaceuticals L.P. (6166), Rhodes Technologies (7143), UDF LP (0495), SVC Pharma LP (5717) and SVC Pharma Inc. (4014). The Debtors' corporate headquarters is located at One Stamford Forum, 201 Tresser Boulevard, Stamford, CT 06901.

Debtors Pursuant to 11 U.S.C. § 105 and 363(B) for Entry of an Order Authorizing and Approving Settlement Term Sheet (the "**Motion**"). A hearing on the Motion will be held on **March 9, 2022 at 1:00 p.m. (prevailing Eastern Time)** (the "**Hearing**") before the Honorable Robert D. Drain, United States Bankruptcy Judge, United States Bankruptcy Court for the Southern District of New York, at the United States Bankruptcy Court for the Southern District of New York, 300 Quarropas Street, White Plains, New York 10601 (the "**Bankruptcy Court**"), or at such other time as the Bankruptcy Court may determine.

PLEASE TAKE FURTHER NOTICE that the Hearing may be continued or adjourned thereafter from time to time without further notice other than an announcement of the adjourned date or dates at the Hearing or a later hearing. The Debtors will file an agenda before the Hearing, which may modify or supplement the motions to be heard at the Hearing.

PLEASE TAKE FURTHER NOTICE that pursuant to General Order M-543, dated March 20, 2020 (Morris, C.J.) ("**General Order M-543**"), the Hearing will be conducted **via Zoom for Government**® so long as General Order M-543 is in effect or unless otherwise ordered by the Bankruptcy Court.[2]

PLEASE TAKE FURTHER NOTICE that parties wishing to **participate in** the Hearing are required to register their appearance by 4:00 p.m. (prevailing Eastern Time) the day before the Hearing at https://ecf.nysb.uscourts.gov/cgi-bin/nysbAppearances.pl.

PLEASE TAKE FURTHER NOTICE that any responses or objections (the "**Objections**") to the Motion shall be in writing, shall conform to the Federal Rules of Bankruptcy

[2] A copy of General Order M-543 can be obtained by visiting http://www.nysb.uscourts.gov/news/court-operations-under-exigent-circumstances-created-covid-19.

Procedure and the Local Bankruptcy Rules for the Southern District of New York, shall be filed with the Bankruptcy Court (a) by attorneys practicing in the Bankruptcy Court, including attorneys admitted *pro hac vice*, electronically in accordance with General Order M-399 (which can be found at http://www.nysb.uscourts.gov), and (b) by all other parties in interest, on a CD-ROM, in text-searchable portable document format (PDF) (with a hard copy delivered directly to Chambers), in accordance with the customary practices of the Bankruptcy Court and General Order M-399, to the extent applicable, and shall be served in accordance with the *Second Amended Order Establishing Certain Notice, Case Management, and Administrative Procedures* entered on November 18, 2019 [ECF No. 498], so as to be filed and received no later than **March 8, 2022 at 7:00 p.m. (prevailing Eastern Time)** (the "**Objection Deadline**"). Any replies shall be filed by **March 9, 2022 at 11:00 a.m. (prevailing Eastern Time)**.

PLEASE TAKE FURTHER NOTICE that any objecting parties are required to attend the Hearing, and failure to appear may result in relief being granted upon default; *provided* that objecting parties shall attend the Hearing via Zoom for Government so long as General Order M-543 is in effect or unless otherwise ordered by the Bankruptcy Court.

PLEASE TAKE FURTHER NOTICE that if no Objections are timely filed and served with respect to the Motion, the Debtors may, on or after the Objection Deadline, submit to the Bankruptcy Court an order substantially in the form of the proposed order annexed to the Motion, which order may be entered without further notice or opportunity to be heard.

PLEASE TAKE FURTHER NOTICE that copies of the Motion may be obtained free of charge by visiting the website of Prime Clerk LLC at https://restructuring.primeclerk.com/purduepharma. You may also obtain copies of any pleadings by visiting the Bankruptcy Court's website at http://www.nysb.uscourts.gov in accordance with the procedures and fees set forth therein.

Dated: March 3, 2022
New York, New York

DAVIS POLK & WARDWELL LLP

By: */s/ Eli J. Vonnegut*

DAVIS POLK & WARDWELL LLP
450 Lexington Avenue
New York, New York 10017
Telephone: (212) 450-4000
Facsimile: (212) 701-5800
Marshall S. Huebner
Benjamin S. Kaminetzky
Eli J. Vonnegut
Christopher S. Robertson

Counsel to the Debtors
and Debtors in Possession

DAVIS POLK & WARDWELL LLP
450 Lexington Avenue
New York, New York 10017
Telephone: (212) 450-4000
Facsimile: (212) 701-5800
Marshall S. Huebner
Benjamin S. Kaminetzky
Eli J. Vonnegut
Christopher S. Robertson

Counsel to the Debtors
and Debtors in Possession

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re:	**Chapter 11**
PURDUE PHARMA L.P., ***et al.*****,**	**Case No. 19-23649 (RDD)**
Debtors.[1]	**(Jointly Administered)**

MOTION OF DEBTORS PURSUANT TO 11 U.S.C. § 105(a) AND 363(b) FOR ENTRY OF AN ORDER AUTHORIZING AND APPROVING SETTLEMENT TERM SHEET

Purdue Pharma L.P. ("**PPLP**") and its affiliated debtors in the above-captioned chapter 11 cases (the "**Cases**"), as debtors and debtors in possession (collectively, the "**Debtors**"), file this motion (the "**Motion**") seeking entry of an order, substantially in the form attached hereto as

[1] The Debtors in these cases, along with the last four digits of each Debtor's registration number in the applicable jurisdiction, are as follows: Purdue Pharma L.P. (7484), Purdue Pharma Inc. (7486), Purdue Transdermal Technologies L.P. (1868), Purdue Pharma Manufacturing L.P. (3821), Purdue Pharmaceuticals L.P. (0034), Imbrium Therapeutics L.P. (8810), Adlon Therapeutics L.P. (6745), Greenfield BioVentures L.P. (6150), Seven Seas Hill Corp. (4591), Ophir Green Corp. (4594), Purdue Pharma of Puerto Rico (3925), Avrio Health L.P. (4140), Purdue Pharmaceutical Products L.P. (3902), Purdue Neuroscience Company (4712), Nayatt Cove Lifescience Inc. (7805), Button Land L.P. (7502), Rhodes Associates L.P. (N/A), Paul Land Inc. (7425), Quidnick Land L.P. (7584), Rhodes Pharmaceuticals L.P. (6166), Rhodes Technologies (7143), UDF LP (0495), SVC Pharma LP (5717) and SVC Pharma Inc. (4014). The Debtors' corporate headquarters is located at One Stamford Forum, 201 Tresser Boulevard, Stamford, CT 06901.

Exhibit A (the "**Order**"), in furtherance of the agreement set forth in the proposed settlement term sheet (the "**Term Sheet**")[2] attached hereto as **Exhibit B** among (i) certain Sackler family members and trusts (the "**Sackler Mediation Parties**"), (ii) the Eight States and the District of Columbia that appealed the Confirmation Order (as defined in the Term Sheet and herein, the "**Nine**") and (iii) the Debtors that was negotiated in mediation (the "**Mediation**") before The Honorable Shelley C. Chapman (the "**Mediator**"). In further support of this Motion, the Debtors respectfully represent as follows:

Preliminary Statement[3]

1. On January 3, 2022, this Court ordered the Nine and the Sackler Mediation Parties back to mediation to explore settlement of the Nine's objections to the Plan in light of the December 16, 2021 decision (the "**District Court Decision**") of the United States District Court for the Southern District of New York ("**District Court**") vacating the Confirmation Order. The Mediation has been a notable success. With the critical assistance of the Mediator, the Nine and the Sackler Mediation Parties have reached an agreement, memorialized in the Term Sheet, that secures an additional $1.175 billion in guaranteed payments, up to $500 million in contingent payments, and several material and meaningful noneconomic concessions from the Sackler Mediation Parties contingent on the approval of this Court and consummation of the Plan. Under

[2] Capitalized terms used but not otherwise defined herein shall have the meaning ascribed to such terms in the Term Sheet, the *Twelfth Amended Joint Chapter 11 Plan of Reorganization of Purdue Pharma L.P. and its Affiliated Debtors* (the "**Plan**"), the *Order Appointing the Honorable Shelley C. Chapman as Mediator*, dated January 3, 2022 [ECF No. 4260] (the "**Appointment Order**") or the *Order Establishing the Terms and Conditions of Mediation Before the Honorable Shelley C. Chapman*, dated January 3, 2022 [ECF No. 4261] (the "**Mediation Terms and Conditions Order**"), as applicable.

[3] The description of the Term Sheet set forth in this Motion is qualified in its entirety by reference to the Term Sheet attached hereto as **Exhibit B**.

the settlement reached, the Nine will not oppose the appeal of the District Court Decision currently being prosecuted by the Debtors and the many other supporters of the Plan, given that authorization to consummate the Plan is necessary for implementation of the settlement contemplated by the Term Sheet.

2. Under the Term Sheet, the Sackler Mediation Parties would commit to pay an additional (i) $723,111,111.13, with potential further payments of up to an additional $500 million from the net proceeds of the sale of the IACs, to the Master Disbursement Trust (to be distributed pursuant to the Plan to abate the opioid crisis), (ii) $175 million to the Master Disbursement Trust on the Effective Date in lieu of the requirements with respect to the Foundations provided for in the Plan, also enhancing Plan distributions to abate the opioid crisis, and (iii) $276,888,888.87, which will similarly be devoted exclusively to opioid-related abatement, including support and services for survivors, victims and their families, to a supplemental opioid abatement fund (the "**SOAF**") established, structured, and administered by the Nine (and also benefiting New Hampshire), in each case following consummation of the Plan and on the schedule and terms described in more detail in the Term Sheet. The Sackler Mediation Parties have also agreed to material and meaningful non-monetary terms and concessions and the Debtors have agreed to further supplement the Public Document Repository described in the Plan.

3. These $1.175–$1.675 billion in Sackler commitments are in addition to the $4.325 billion to be paid under the current Shareholder Settlement Agreement (and substitute for their current commitment to replace the controlling members of Foundations having at least $175 million in assets). As a result, the aggregate payments by the Sackler Mediation Parties would total $5.5 to $6.0 billion, with all creditors receiving the same or better recoveries than under the

current Plan. $5.5 billion is approximately 97% of the total amount of all non-tax cash distributions that Purdue made to the Sacklers since January 1, 2008, nearly 12 years prior to the Petition Date. *See Declaration of Richard A. Collura* [ECF No. 3410] Appendix A (*Cash Transfers of Value Analysis*) at 11.

4. There are also material non-financial terms. The Sackler Mediation Parties have agreed to allow any institution or organization in the United States to remove the Sackler name from physical facilities and academic, medical, and cultural programs, scholarships, endowments, and the like, subject to certain conditions regarding the procedure for announcing such removal set forth in the Term Sheet. The Sackler Mediation Parties have also agreed that a spokesperson will issue the statement annexed to the Term Sheet as Attachment C on their behalf, which includes an expression that they "sincerely regret that OxyContin, a prescription medicine that continues to help people suffering from chronic pain, unexpectedly became part of an opioid crisis that has brought grief and loss to far too many families and communities." For their part, the Debtors have agreed to supplement the Public Document Repository with additional privileged materials, including additional material related to lobbying, public relations, compliance and prior advice from certain parties related to marketing.

5. In addition, the final report of the Mediator strongly recommends and requests, while stating that the Mediator is of course aware that the conduct of the hearing on this Motion is entirely in the Court's discretion, that the Court set aside substantial time during the hearing on this Motion to hear from personal injury victims (including those who have lost loved ones, as well as children born with NAS and/or their parents/guardians), selected pursuant to such process as the Court finds appropriate, as representatives of those affected by the opioid crisis, and that at

least one member of the Side A and Side B branches of the Sackler Families also attend the full hearing by Zoom. The Mediator further recommends that no other participant in the hearing on this Motion, including the members of the Sackler Families in attendance, be expected or permitted to respond to or comment on the statements made by such individuals. The Debtors strongly support this recommendation and accordingly request that the Court grant the Mediator's request.

6. Under the Term Sheet, each member of the Nine will agree to withdraw its opposition to the appeal of the District Court Decision (the "**Appeal**") currently being prosecuted by the Debtors and the other Plan supporters, and (along with New Hampshire) to consensually grant the releases provided under the Plan upon its effectiveness. Accordingly, the Plan will no longer be opposed by any state in the country and no release will be imposed on any state over its objection.

7. The deadline for the Nine to file their appellees' briefs in the Appeal is March 11, 2022. It is critical that the Term Sheet be approved before that time, which is why the Debtors—constrained by court-ordered confidentiality until a final settlement was reached—have filed this Motion on shortened notice, something they have very rarely done in these Cases.

8. This extraordinary achievement offers the best chance to preserve—and in fact materially increase—the provision of billions of dollars of value and to dedicate that value to desperately needed opioid abatement efforts as soon as possible. Effectuating the agreements

reflected in the Term Sheet is profoundly in the best interest of the estates and the American people. The Debtors respectfully request that the Court approve the Motion.

Relief Requested

9. By this Motion, and pursuant to sections 105(a) and 363(b) of title 11 of the United States Code (the "**Bankruptcy Code**"), the Debtors request entry of an Order, substantially in the form attached hereto as **Exhibit A**, authorizing the Debtors to take any actions that may be necessary or desirable in furtherance of the agreement reflected in the Term Sheet attached hereto as **Exhibit B** among the Covered Parties, the Nine and the Debtors, and to pay or reimburse certain reasonable and documented fees and expenses of outside counsel of the Nine as contemplated by the Term Sheet in accordance with the procedures with respect to authorization of payment of the fees and expenses of the professionals of the Debtors and the Creditors' Committee set forth in the *Order Establishing Procedures for Interim Compensation and Reimbursement of Expenses for Retained Professionals* [ECF No. 529] (the "**Interim Compensation Order**").

Jurisdiction and Venue

10. The United States Bankruptcy Court for the Southern District of New York (the "**Court**") has jurisdiction to consider this matter pursuant to 28 U.S.C. §§ 157 and 1334 and the Amended Standing Order of Reference M-431, dated January 31, 2012 (Preska, C.J.). This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2) and, pursuant to Bankruptcy Rule 7008, the Debtors consent to entry of a final order by the Court in connection with this Motion to the extent that it is later determined that the Court, absent consent of the parties, cannot enter a final order or judgment consistent with Article III of the United States Constitution.

11. Venue is proper before the Court pursuant to 28 U.S.C. §§ 1408 and 1409.

General Background

12. On September 15, 2019 (the "**Petition Date**"), the Debtors each commenced with this Court a voluntary Case under chapter 11 of the Bankruptcy Code. The Debtors are authorized to operate their businesses and manage their properties as debtors in possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code. On September 27, 2019, the United States Trustee for the Southern District of New York appointed the official committee of unsecured creditors. No trustee has been appointed in these Cases.

13. These Cases are being jointly administered pursuant to Bankruptcy Rule 1015(b) and the *Order Directing Joint Administration of Chapter 11 Cases* [ECF No. 59] entered by the Court in each of the Cases.

14. Additional information regarding the Debtors and the Debtors' Plan can be found in the *Modified Bench Ruling* [ECF No. 3786] (the "**Modified Bench Ruling**"), the Confirmation Order, and the record of the hearing regarding confirmation of the Plan (the "**Confirmation Hearing**"), which the Debtors hereby incorporate by reference.

The Appeals

15. On September 17, 2021, this Court issued the Confirmation Order confirming the Plan, an integral component of which was the agreement reached among the Debtors' creditors and the Sackler Mediation Parties (the "**Shareholder Settlement**")—reached following three separate mediations before highly capable mediators—that provided for (among other things) $4.325 billion in aggregate settlement payments to be funded by the Sackler families and be

distributed pursuant to the Plan and the replacement of the controlling members of Foundations with at least $175 million in assets.

16. The Nine, among other parties, appealed the Confirmation Order to the District Court. On December 16, 2021 the District Court issued the District Court Decision vacating the Confirmation Order.

17. Upon motion by the Debtors and other Plan proponents, the District Court certified the District Court Decision for immediate appeal to the United States Court of Appeals for the Second Circuit (the "**Second Circuit**"). The Second Circuit granted the petitions for leave to appeal and requests to expedite the appeals, setting the following briefing schedule: (i) appellants' briefs due by February 11, 2022, (ii) appellees' briefs due by March 11, 2022, (iii), reply briefs due by March 24, 2022, (iv) appendices and final briefs due by March 28, 2022, and (v) oral argument to be scheduled for the week of April 25, 2022, or as soon thereafter as practicable.

The Mediation

18. On January 3, 2022, this Court entered the Appointment Order [ECF No. 4260] and the Mediation Terms and Conditions Order [ECF No. 4261]. On January 13, 2022, this Court entered an order [ECF No. 4286] initially extending the Termination Date of the mediation to and including February 1, 2022.

19. On January 31, 2022, the Mediator filed the *Mediator's Interim Report* [ECF No. 4316], which noted that the Mediation to such date had included approximately 100 telephonic meetings that had been held with the Nine and the Covered Parties, as well as dozens of additional telephonic meetings, including with staff of the Nine, certain Attorneys General of the Nine, and certain other parties, including the Debtors and counsel to various ad hoc groups. As further

detailed in such report, the Mediator conducted an in-person Mediation on January 25, 2022 (from approximately 8:30 a.m. until approximately 10:00 p.m.), and on January 26, 2022 (from approximately 8:30 a.m. until approximately 9:00 p.m.), with additional discussions continuing thereafter. By order dated February 1, 2022 [ECF No. 4319], the Court further extended the Termination Date of the mediation to February 7, 2022 at 11:59 p.m.

20. On February 8, 2022, the Mediator filed the *Mediator's Second Interim Report* [ECF No. 4338], detailing, among other efforts, upwards of 150 telephonic meetings with the Nine and the Covered Parties, and extensive negotiations undertaken by certain Attorneys General and staff of the Nine, as well as the Covered Parties. By order dated February 8, 2022 [ECF No. 4339], the Court further extended the Termination Date of the mediation to February 16, 2022 at 5:00 p.m.

21. On February 18, 2022, the Mediator filed the *Mediator's Third Interim Report* [ECF No. 4369], stating that the Mediator designated certain Additional Parties and detailing dozens of telephonic and Zoom meetings between and among the Nine as well as countless email exchanges and telephone calls between and among these parties. Such report also stated that the Sackler Families had authorized disclosure that they had made a settlement proposal that included "$1.175 billion in total committed cash and up to an additional $500 million of cash consideration contingent on the net proceeds of IAC sales." By order dated February 18, 2022 [ECF No. 4370], the Court further extended the Termination Date of the mediation to February 28, 2022 at 8:00 p.m.

22. On March 2, 2022, the Mediator filed the *Mediator's Notice of Extension of Mediation* Sine Die [ECF No. 4403], stating that pursuant to Paragraph 2 of the Mediation Terms

and Conditions Order, the Mediator has determined to extend and has extended the Termination Date sine die.

23. On March 3, 2022, the Mediator filed the *Mediator's Fourth Interim Report*, which stated, among other things, that the Mediation Parties had reached agreement on the Term Sheet, a copy of which is attached thereto.

The Term Sheet

24. The Term Sheet provides that the Sackler Mediation Parties will pay an additional (i) $723,111,111.13 to the MDT on the schedule attached to the Term Sheet, (ii) up to an additional $500 million, consisting of 90% of the amount by which specified net proceeds from the sale of the IACs exceed $4.3 billion, to the MDT, (iii) $175 million to the MDT on the Effective Date in lieu of the requirements with respect to the Foundations under the Plan, and (iv) $276,888,888.87 to the SOAF, with the allocation of the SOAF funds as set forth in the Term Sheet. The schedule on which such payments are due, ranging from the Effective Date through June 30, 2039, and which payments are due from Sackler family A-Side Payment Parties and which payments are due from the Sackler family B-Side Payment Parties, are set forth on Attachment A to the Term Sheet.

25. The Sackler Mediation Parties have also agreed, upon occurrence of the Effective Date of the Plan, to allow any institution or organization in the United States to remove the Sackler name from physical facilities and academic, medical, and cultural programs, scholarships, endowments, and the like, subject to certain conditions including that any statements issued by the institution in connection with or substantially concurrent with such renaming will not

disparage the Sacklers (while providing that such condition will not restrict any academic or similar work at such institution or organization).

26. The Term Sheet makes clear that the Nine may cite any unsealed or public trial testimony or Sackler public statements, including any expressions of regret, by members of the Sackler families, including when announcing the settlement, and provides that the statement annexed to the Term Sheet as Attachment C will be issued by a spokesperson for the Sackler families within two days of filing of a Mediator's report indicating acceptance of the Term Sheet.

27. The Term Sheet also provides that certain additional privileged materials, including additional material related to lobbying, public relations, compliance and prior advice from certain parties related to marketing, which is specified on Attachment B to the Term Sheet, will be provided by the Debtors to the Public Document Repository.

28. Under the Term Sheet, the Nine agree to take a variety of actions indicating their non-objection to the Appeal at the Second Circuit and non-pursuit of their appeal of the Confirmation Order, subject to a carve-out allowing for amicus briefs only at the merits stage in the Supreme Court should the Supreme Court grant certiorari with respect to the Appeal. Importantly, it is critical that these provisions become effective prior to March 11, 2022, which is the deadline for the Nine to file appellees' briefs with the Second Circuit.

29. In order to implement the agreement provided for in the Term Sheet (and of course all conditioned entirely on one or more orders from the District Court for the Southern District of New York or the Court of Appeals for the Second Circuit allowing for consummation of the Plan), the Shareholder Settlement Agreement will be revised to reflect the additional MDT payments and non-economic terms provided for therein, and a new direct settlement agreement among the

Sacklers and the Nine (the "**Direct Settlement Agreement**") will be entered into with respect to the payments by the Sacklers to the SOAF. The MDT and SOAF will enter into customary intercreditor arrangements that will provide that SOAF is secured on a *pari passu* basis with MDT and that in the event that any of the payments under the Direct Settlement Agreement set forth on Attachment A to the Term Sheet are not made when due, SOAF (as governed by an intercreditor agreement) will have the same enforcement rights on account of such payments as would be available to the MDT on account of missed payments under the Shareholder Settlement Agreement. The covenants in favor of the MDT in the existing Shareholder Settlement Agreement will not change, other than to allow for the Direct Settlement Agreement (and will not be incorporated into the Direct Settlement Agreement).[4]

30. The Term Sheet also contemplates that the Debtors will pay or reimburse certain reasonable and documented fees and expenses of outside counsel of the Nine, subject to approval by this Court and compliance with the procedures with respect to authorization of payment of the fees and expenses of the professionals of the Debtors and the Creditors' Committee set forth in the Interim Compensation Order. The Debtors agree to pay or reimburse the reasonable and documented fees and expenses of outside counsel of the Nine in the Cases (including any adversary proceedings, and any appeals thereunder) (the "**Specified Payments**"), in each case accrued through the date of entry of the Order and thereafter in furtherance of the agreements set

[4] The Proposed Order authorizes the Debtors to (i) revise the Shareholder Settlement Agreement as needed to provide for the incremental payments agreed to by the Sackler Mediation Parties under the Term Sheet and allow for the Direct Settlement Agreement, (ii) provide the additional documents specified in the Term Sheet to the Public Document Repository once established and (iii) take such other steps as may be necessary or desirable in furtherance of the agreements reflected in the Term Sheet and this Order and finds that the agreements reflected in the Term Sheet are in the best interests of the Debtors, their estates, creditors and all parties in interest and do not contravene any prior orders of the Court in these Cases or any provision of the Bankruptcy Code.

forth in the Term Sheet. These payments and reimbursements, which total less than $4 million in the aggregate as of the date hereof, are in addition to, and distinct from, any payments to which States or their professionals may be entitled under section 5.8 of the Plan, which shall be without duplication of any amounts approved and paid pursuant to the relief requested by this Motion.

Basis for Relief Requested

31. The Debtors' decision to seek authorization to effectuate the agreement in the Term Sheet, including the authority to pay or reimburse the Specified Payments, is a sound exercise of their business judgment under section 363(b) of the Bankruptcy Code. Section 363(b)(1) of the Bankruptcy Code empowers the Court to authorize a debtor to "use, sell, or lease, other than in the ordinary course of business, property of the estate." To approve the use of estate property under section 363(b)(1) of the Bankruptcy Code, the Second Circuit requires a debtor to show that the decision to use the property outside of the ordinary course of business was based on the debtor's sound business judgment in light of "all salient factors" relating to the bankruptcy case. *Comm. of Equity Sec. Holders v. Lionel Corp. (In re Lionel Corp.)*, 722 F.2d 1063, 1070–71 (2d Cir. 1983) ("The rule we adopt requires that a judge determining a § 363(b) application expressly find from the evidence presented before him at the hearing a good business reason to grant such an application."); *In re Ionosphere Clubs, Inc.*, 100 B.R. 670, 675 (Bankr. S.D.N.Y. 1989); *see also In re Hostess Brands, Inc.*, 2013 WL 82914, at *4 (Bankr. S.D.N.Y. Jan. 7, 2013) (RDD) (noting that, *inter alia*, motions to authorize the "sale of property outside the ordinary course," involve "the exercise, as a final call, of the bankruptcy judge's judgment as to the propriety of the action to be taken") (citing *In re Orion Pictures Corp.*, 4 F.3d 1095 (2d Cir.1993)); *In re MF Global Inc.*, 467 B.R. 726, 730 (Bankr. S.D.N.Y. 2012) ("Although not

specified by section 363, the Second Circuit requires that transactions under section 363 be based on the sound business judgment of the debtor or trustee.").

32. The relief sought herein is also well within the Court's equitable powers. Section 105(a) provides that a bankruptcy court may "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Bankruptcy Code]." 11 U.S.C. § 105(a). As the Second Circuit has explained, section 105(a) of the Bankruptcy Code "grants broad equitable power to the bankruptcy courts to carry out the provisions of the Bankruptcy Code so long as that power is exercised within the confines of the Bankruptcy Code." *Adelphia Bus. Sols., Inc. v. Abnos*, 482 F.3d 602, 609 (2d Cir. 2007) (internal citations omitted). Further, "[a] bankruptcy court has equitable authority under § 105(a) 'to assure the orderly conduct of the reorganization proceedings.'" *Kagan v. Saint Vincents Catholic Med. Ctrs. (In re Saint Vincents Catholic Med. Ctrs.)*, 581 Fed. App'x 41, 43 (2d Cir. 2014) (citing *In re Baldwin-United Corp. Litig.*, 765 F.2d 343, 348 (2d Cir. 1985)).

33. The Court determined that the Shareholder Settlement is "in the best interests of the Debtors, their estates, and the Holders of Claims and Interests" and is "fair, equitable, reasonable" on the basis of the extensive record of the confirmation hearing and these chapter 11 cases. *See* Confirmation Order ¶ KK(c); *see generally Modified Bench Ruling* [ECF No. 3786] at 71-103. That conclusion has not been disturbed on appeal, and no further approval of the Shareholder Settlement is necessary or is being requested herein. However, implementation of the resolution provided for in the Term Sheet is predicated upon consummation of the Plan—which requires that the District Court Decision no longer bar consummation of the Plan. The Debtors therefore seek authorization to enter into the agreements contemplated under the Term

Sheet and to take any other actions that may be necessary or desirable to effectuate the settlement encompassed in the Term Sheet in advance of restoration of authorization to consummate the Plan. Of course, none of this will be relevant or of any effect unless the Court of Appeals for the Second Circuit or the District Court, as applicable, issue orders or rulings allowing the consummation of the Plan as materially enhanced by the Term Sheet.

34. The resolution provided for in the Term Sheet is manifestly in the best interest of the Debtors, their Estates, and all of their stakeholders. The benefits are myriad and all in favor of the estates. First, the Term Sheet provides for substantial additional payments from the Sackler Mediation Parties that would materially increase the value of the Debtors' estates and the amount of funds that will be dedicated to opioid abatement. Under that resolution, there will be no change to the amount or payment schedule for the amounts to be paid under the Shareholder Settlement Agreement that the Court has already approved. All of the incremental payments that the Sackler Mediation Parties have agreed to under the Term Sheet are in addition to the previously agreed settlement payments. Term Sheet at 1. Second, the Term Sheet does not relieve the Sackler Mediation Parties of any obligations under the existing Shareholder Settlement (except with respect to the obligations concerning the Foundations under the Plan, in lieu of which $175 million will be paid in cash to the MDT on the Effective Date and represents an improvement to the Plan as it eliminates the contingency of obtaining IRS and other approvals, which in turn, will permit consummation of the Plan and the deployment of abatement resources immediately upon satisfaction of all other conditions). *Id*; *see* Plan at Section 5.7(l), 12.3(c). Third, the Debtors have agreed to supplement the Public Document Repository, which this Court has described as an important feature of the Plan that would "guide legislatures and regulators" in the future, with

specified additional documents. Term Sheet at 2 & Attachment B; Modified Bench Ruling at 156. The contemplated expansion of the scope of documents to be provided does not require Court approval. Fourth, the Term Sheet will resolve a number of objections to the Plan and Shareholder Settlement, which will increase the likelihood of the effectiveness of the Plan and an expeditious resolution of these Cases. *See* Term Sheet at 3-4. Fifth, the non-economic concessions by the Sacklers are of great importance to many parties in the cases.

35. Authorization to take actions in furtherance of an agreement that resolves the issues that this Court directed the parties to address in Mediation and that provides very significant additional value to the Estates, falls well within the Court's broad equitable powers under Section 105(a) of the Bankruptcy Code as an appropriate order in furtherance of the prior order authorizing the Mediation and for purposes of assuring the orderly and efficient conduct of the reorganization proceedings.

36. Furthermore, a sound business purpose clearly exists for the Debtors' agreement to pay or reimburse the Specified Payments. The Nine have facilitated, and are making ongoing efforts to finalize and implement, the settlement reflected in the Term Sheet, which would bring significant additional value into the Debtors' estates. This Court and other courts have approved the payment of professional fees of unsecured creditors pursuant to section 363(b) under similar circumstances. *See, e.g., In re Purdue Pharma L.P.*, Case No. 19-23649 (RDD) (Bankr. S.D.N.Y. Dec. 2, 2019) [ECF No. 553] (approving payment of certain fees and expenses of the Ad Hoc Committee); *Id.* [ECF No. 2695] (approving the payment of certain fees and expenses of the MSGE Group); *Id.* [ECF No. 4184] (approving the payment of certain fees and expenses of the Non-Consenting States Group, the Ad Hoc Committee, and the MSGE Group); *In re AMR Corp.*,

No. 11-15463 (SHL) (Bankr. S.D.N.Y. Sept. 21, 2012) [ECF No. 4652] (approving payment of an ad hoc group of unsecured creditors' professional fees pursuant to a fee letter approved under section 363(b)); *In re ASARCO, L.L.C.*, 650 F.3d 593 (5th Cir. 2011) (affirming the ruling of the district court and bankruptcy court to approve payment of bidders' due diligence and work fees requested pursuant to section 363); *U.S. Trustee v. Bethlehem Steel Corp.*, Case No. 02 Civ. 2854 (MBM), 2003 WL 21738964, at *10 (S.D.N.Y. July 28, 2003) (affirming bankruptcy court's approval of reimbursement of creditors' counsel's costs and expenses pursuant to sections 363(b) and 105(a)).

37. The Debtors respectfully submit that this Court authorize the Debtors to take any actions that may be necessary or desirable in furtherance of the agreement reflected in the Term Sheet pursuant to Bankruptcy Code sections 105(a) and 363(b)(1), including the payment or reimbursement of the Specified Payments.

Notice

38. Notice of this Motion will be provided to (a) the entities on the Master Service List (as defined in the *Second Amended Order Establishing Certain Notice, Case Management, and Administrative Procedures* entered on November 18, 2019 [ECF No. 498] and available on the Debtors' case website at https://restructuring.primeclerk.com/purduepharma) and (b) any other person or entity with a particularized interest in the subject matter of this Motion (the "**Notice Parties**"). The Debtors respectfully submit that, in view of the facts and circumstances, such notice is sufficient and no further notice is required. Moreover, on March 1, 2022, the Debtors provided the then current copy of this motion to counsel the UCC, AHC, and former members of

the Non-Consenting States Group other than the Nine, all of whom had become Additional Mediation Parties.

No Previous Request

39. No previous request for the relief sought herein has been made by the Debtors to this or any other court.

WHEREFORE, the Debtors respectfully request entry of the Proposed Order granting the relief requested herein and such further relief as the Court may deem just and appropriate.

Dated: March 3, 2022
New York, New York

DAVIS POLK & WARDWELL LLP

By: */s/ Eli J. Vonnegut*

DAVIS POLK & WARDWELL LLP
450 Lexington Avenue
New York, New York 10017
Telephone: (212) 450-4000
Facsimile: (212) 701-5800
Marshall S. Huebner
Benjamin S. Kaminetzky
Eli J. Vonnegut
Christopher S. Robertson

Counsel to the Debtors
and Debtors in Possession

Exhibit A

Proposed Order

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re:	**Chapter 11**
PURDUE PHARMA L.P., ***et al.*****,**	**Case No. 19-23649 (RDD)**
Debtors.[1]	**(Jointly Administered)**

ORDER PURSUANT TO 11 U.S.C. § 105 AND 363(B)
AUTHORIZING AND APPROVING SETTLEMENT TERM SHEET

Upon the motion (the "**Motion**")[2] of Purdue Pharma L.P. and its affiliates that are debtors and debtors in possession in these proceedings (collectively, the "**Debtors**"), for entry of an order, pursuant to sections 105(a) and 363(b) of title 11 of the United States Code (the "**Bankruptcy Code**") approving the agreement set forth in Term Sheet attached to the Motion as **Exhibit B**, as more fully set forth in the Motion; and the Court having jurisdiction to consider the matters raised in the Motion pursuant to 28 U.S.C. §§ 157 and 1334 and the Amended Standing Order of Reference M-431, dated January 31, 2012 (Preska, C.J.); and consideration of the Motion and the requested relief being a core proceeding pursuant to 28 U.S.C. § 157(b); and venue being proper before the Court pursuant to 28 U.S.C. §§ 1408 and 1409; and due and proper notice of the Motion having been provided to the Notice Parties; and such notice having

[1] The Debtors in these cases, along with the last four digits of each Debtor's registration number in the applicable jurisdiction, are as follows: Purdue Pharma L.P. (7484), Purdue Pharma Inc. (7486), Purdue Transdermal Technologies L.P. (1868), Purdue Pharma Manufacturing L.P. (3821), Purdue Pharmaceuticals L.P. (0034), Imbrium Therapeutics L.P. (8810), Adlon Therapeutics L.P. (6745), Greenfield BioVentures L.P. (6150), Seven Seas Hill Corp. (4591), Ophir Green Corp. (4594), Purdue Pharma of Puerto Rico (3925), Avrio Health L.P. (4140), Purdue Pharmaceutical Products L.P. (3902), Purdue Neuroscience Company (4712), Nayatt Cove Lifescience Inc. (7805), Button Land L.P. (7502), Rhodes Associates L.P. (N/A), Paul Land Inc. (7425), Quidnick Land L.P. (7584), Rhodes Pharmaceuticals L.P. (6166), Rhodes Technologies (7143), UDF LP (0495), SVC Pharma LP (5717) and SVC Pharma Inc. (4014). The Debtors' corporate headquarters is located at One Stamford Forum, 201 Tresser Boulevard, Stamford, CT 06901.

[2] Capitalized terms used but not otherwise defined herein shall have the meanings ascribed to them in the Motion.

been adequate and appropriate under the circumstances, and it appearing that no other or further notice need be provided; and the Court having reviewed the Motion; and the Court having held a hearing to consider the relief requested in the Motion on a final basis (the "**Hearing**"); and the Court having determined that the legal and factual bases set forth in the Motion and at the Hearing establish just cause for the relief granted herein; and the Court having determined that the relief requested is in the best interests of the Debtors, their estates, creditors and all parties in interest; and upon all of the proceedings had before the Court and after due deliberation and sufficient cause appearing therefor,

IT IS HEREBY ORDERED THAT:

1. The Motion is granted as provided herein.

2. The Court finds that the agreements reflected in the Term Sheet are in the best interests of the Debtors, their estates, creditors and all parties in interest, and that such agreements do not contravene any prior orders of the Court in these Cases or any provision of the Bankruptcy Code and that the actions taken by members of the Sackler families and the Nine or their related parties in accordance with the Term Sheet are taken in connection with the Chapter 11 Cases for purposes of Section 10.7 of the Plan.

3. Pursuant to section 105(a) and 363(b) of the Bankruptcy Code, and in all events effective only upon the entry of one or more orders by the Court of Appeals for the Second Circuit or the United States District Court for the Southern District of New York permitting the consummation of the Plan as enhanced by the Term Sheet, the Debtors are authorized to (i) revise the Shareholder Settlement Agreement as needed to provide for the incremental payments agreed to by the Sackler Mediation Parties under the Term Sheet and allow for the Direct Settlement Agreement, (ii) provide the additional documents specified in the Term Sheet to the

Public Document Repository once established and (iii) take such other steps as may be necessary or desirable in furtherance of the agreement reflected in the Term Sheet and this Order.

4. The Debtors' agreement to pay or reimburse the Specified Payments upon consummation of the Plan as enhanced by the Term Sheet is approved and the Debtors are authorized to make such payments at such time in accordance with the terms and conditions of the Term Sheet and this Order. The authorization of the Debtors to make such payments shall be subject, *mutatis mutandis*, to the procedures with respect to authorization of payment of the fees and expenses of the professionals of the Debtors and the Creditors' Committee set forth in the *Order Establishing Procedures for Interim Compensation and Reimbursement of Expenses for Retained Professionals* [ECF No. 529] (as may be modified or amended by any subsequent order of the Court with respect thereto, the "**Interim Compensation Order**") including, for the avoidance of doubt, the filing of Monthly Fee Statements and Applications (in each case as defined in the Interim Compensation Order), Interim Fee Hearings (as defined in the Interim Compensation Order), the expiration of the Objection Deadline (as defined in the Interim Compensation Order) or resolution of any Objections (as defined in the Interim Compensation Order) with respect to each Monthly Fee Statement, and the 20% holdback with respect to fees until further order of the Court; *provided* that the standard for authorization of payment of the attorneys' fees and expenses of each of the Nine shall be whether such fees and expenses are (a) reasonable and documented and (b) reimbursable under the Term Sheet; *provided further* that, for the avoidance of doubt, the attorneys of the Nine shall not be considered retained professionals of the Debtors or Creditors' Committee and the retention of the attorneys of the Nine shall not be required to satisfy the standards for retention set forth in sections 327-328 or 1103 of the Bankruptcy Code.

5. The Court shall retain jurisdiction to hear and determine all matters arising from or related to the implementation, interpretation and enforcement of this Order, including the Term Sheet and the definitive documents to be entered into pursuant thereto (including the Direct Settlement Agreement).

Dated: ________________________, 2022
New York, New York

____
THE HONORABLE ROBERT D. DRAIN
UNITED STATES BANKRUPTCY JUDGE

<u>Exhibit B</u>

Term Sheet

SETTLEMENT PROPOSAL[1]

Incremental Economic Consideration and Accommodations	1) On the terms and schedule set forth on **<u>Attachment A</u>** hereto, $1 billion in incremental cash shall be paid by the Sackler family members or trusts as follows: a) $112,236,111.11 is allocated to California, of which amount California elects that $21,222,222.22 shall be paid to the SOAF (defined below) and allocated to California, with the remainder to be paid to the Master Disbursement Trust as additional consideration under the Shareholder Settlement Agreement. b) $785,652,777.78 is allocated collectively to Connecticut, Delaware, Maryland, Oregon, Rhode Island, Vermont, and the District of Columbia, of which amount $148,555,555.54 will be paid to the SOAF ($21,222,222.22 allocated to each of Connecticut, Delaware, Maryland, Oregon, Rhode Island, Vermont, and the District of Columbia) with the remainder to be paid to the Master Disbursement Trust as additional consideration under the Shareholder Settlement Agreement. c) $93,111,111.11 is allocated to Washington, which elects to retain control of such full amount through the SOAF. d) $14,000,000 is allocated and will be paid to New Hampshire (which is not a party hereto but has confirmed its support for this agreement) from the SOAF. e) Cumulatively, (i) $723,111,111.13 in incremental cash consideration shall be paid to the Master Disbursement Trust as additional consideration under the Shareholder Settlement Agreement and (ii) $276,888,888.87 shall be paid by the Sackler family members or trusts directly to a fund established, structured, and administered by the Nine[2] (the "Supplemental Opioid Abatement Fund" or "SOAF") on the terms and schedule set forth on Attachment A hereto and otherwise on the same payment terms as under the Shareholder Settlement Agreement. Of the first $200,000,000 paid to the SOAF, 95.5% will be allocated equally among the Nine, and 4.5% will be allocated to New Hampshire. Funds in the SOAF shall be devoted exclusively to opioid-related abatement, including support and services for survivors, victims and their families and each member of the Nine shall have the right to direct allocation of the SOAF funds for such purposes in the amounts and as set forth on **<u>Attachment D</u>** hereto. 2) The Nine acknowledge and confirm that the Sackler family members and trusts had no role in determining the allocation of settlement consideration between the SOAF and the Master Disbursement Trust or the allocation of the SOAF funds among the Nine or to any other State as set forth in this Term Sheet. 3) In addition, (i) $175 million in incremental cash shall be paid by the Sackler family members or trusts under the Shareholder Settlement Agreement to the Master Disbursement Trust on the Effective Date in lieu of any obligations relating to the Foundations, including appointment of the Continuing Foundation Members as members of the Foundations and (ii) as further incremental cash consideration under the Shareholder Settlement Agreement, the Sackler family members or trusts shall pay to the Master Disbursement Trust, up to a maximum of $500 million, 90% of the amount by which aggregate Net Proceeds (without giving effect to the deduction of Unapplied Advanced Contributions) with respect to all IAC Payment Parties exceeds $4.3 billion. 4) All amounts paid to the Master Disbursement Trust will be further distributed in accordance with the terms of the Plan. 5) The Direct Settlement Agreement (hereinafter defined) shall benefit from, and be *pari passu* with, the same collateral applicable to the existing Shareholder Settlement Agreement. In the event that any of the payments under the Direct Settlement Agreement set forth on

[1] Capitalized terms used but not defined herein shall have the meanings ascribed to such terms in the *Twelfth Amended Joint Chapter 11 Plan of Reorganization of Purdue Pharma L.P. and its Affiliated Debtors* [ECF No. 3726] (the "Plan") or the Shareholder Settlement Agreement attached as Exhibit AA to the *Notice of Filing of Seventeenth Plan Supplement Pursuant to the Eleventh Amended Joint Chapter 11 Plan of Reorganization of Purdue Pharma L.P. and Its Affiliated Debtors* [ECF No. 3711].
[2] The "Nine" means the eight states and the District of Columbia that appealed the Bankruptcy Court's order confirming the Plan.

	Attachment A hereto are not made when due, SOAF will have the same enforcement rights on account of such payments as would be available to the Master Disbursement Trust on account of missed payments under the existing Shareholder Settlement Agreement. 6) There shall not be additional covenants or changes to the credit support arrangements related to the existing Shareholder Settlement Agreement as a result of the additional payments described above. 7) The Sacklers shall procure all necessary corporate and judicial approvals to authorize the applicable Sackler payment parties to enter into the Direct Settlement Agreement and the modified Shareholder Settlement Agreement and all ancillary arrangements and shall execute and deliver these Agreements to the other Term Sheet Parties as soon as is reasonably practicable or as otherwise expressly provided herein. 8) This Term Sheet summarizes the principal terms of the settlement among the parties. 9) Notwithstanding anything herein to the contrary, no legally binding obligations will be created unless and until (i) the Direct Settlement Agreement shall be in agreed execution form and the Nine and the Sackler family shall be satisfied with the proposed procedures, mechanics and remedies for any signature pages not theretofor delivered, and (ii) court authorization (as set forth below) has been obtained, in each case on or before March 10, 2022. This term sheet and any documents implementing the agreements set forth in this term sheet shall be governed in all respects by the laws of New York, *provided* that matters internal to each member of the Nine shall be governed by the laws of such member's jurisdiction. 10) Upon and after acceptance of this Settlement Proposal by all of the Term Sheet Parties, the Term Sheet Parties shall immediately commence and pursue the negotiation of the definitive agreements documenting and implementing the Direct Settlement Agreement (the "Definitive Documents") in good faith. 11) As part of this settlement, and subject to it becoming effective and not terminated, the Nine will agree they will not seek incremental settlement consideration from the Sackler family members or trusts in excess of the foregoing amounts or to directly or indirectly support any party in seeking any such incremental consideration.
Naming Rights	1) The Sackler family (including Sackler family foundations) will agree upon occurrence of the Effective Date of the Plan to allow any institution or organization in the United States to remove the Sackler name from (i) physical facilities and (ii) academic, medical, and cultural programs, scholarships, endowments, and the like, provided that: a) The institution provides the Sackler family with 45 days' confidential notice of its intention to remove the Sackler name; b) The removal of the Sackler name would be disclosed or announced by any such institution (if the institution in its discretion determines such an announcement is necessary) in a statement that indicates that the removal of the Sackler name is pursuant to an agreement reached in the Mediation in the Purdue bankruptcy case; and c) Any statements issued by the institution in connection with or substantially concurrent with such renaming will not disparage the Sacklers, *provided* that such prohibition shall not restrict any academic or similar work at such institution or organization. d) These name removal rights are in addition to, and do not limit, any rights that the institution or organization otherwise has.
Additional Terms	1) The Debtors have agreed to supplement the Public Document Repository as described on **Attachment B** hereto. 2) The Debtors shall promptly file a motion seeking the entry of the Approval Order (as defined below). Among other things, the Approval Order shall authorize the payment of the reasonable and documented attorneys' fees of each of the Nine in the Purdue bankruptcy case (including any adversary proceedings, and any appeals thereunder), accrued to the date of the entry of the Approval Order and thereafter in furtherance of the agreements set forth herein, in each case subject to compliance with procedures applicable to the fees and expenses of the Ad Hoc Committee.

Statement	1) Nothing in this Settlement Proposal shall restrict the ability of the Nine to cite any unsealed or public trial testimony or public statements, including any expressions of regret, by members of the Sackler families. 2) No later than two days after the filing with the Bankruptcy Court of a Mediator's Report that indicates the acceptance by the Nine of the terms of this Settlement Proposal, a statement in the form of **<u>Attachment C</u>** hereto will be issued by a spokesperson for the Sackler families. It is expressly understood that such statement is not an admission of any wrongdoing or liability and that the Sackler families reaffirm that they have always acted lawfully.
Acceptance/ Effectiveness	1) By the deadline communicated by the Mediator, each of the Nine, Sackler Side A and Sackler Side B (collectively, the "Term Sheet Parties") and the Debtors shall write independently and directly only to the Mediator by email, c/o Jamie Eisen at Jamie_Eisen@nysb.uscourts.gov, indicating whether it accepts the Settlement Proposal.[3] 2) The effectiveness of the agreement is subject to the condition precedent of the entry of an order by the Bankruptcy Court (the "Approval Order") that provides necessary approvals of this settlement, and all documents contemplated hereunder, including a finding that the Direct Settlement Agreement does not contravene any provision of the Bankruptcy Code. 3) "Acceptance" by a member of the Nine, or by the Sacklers, as the case may be, shall constitute an agreement by such Term Sheet Party to promptly engage in good faith negotiations of the Definitive Documents. 4) Each of the Term Sheet Parties agrees to support the entry of the Approval Order and to defend it against any appeal therefrom. 5) The Debtors agree to seek the entry of the Approval Order, to support the settlement and related transactions contemplated hereunder, to participate in the negotiation of the Definitive Documents, and to seek the support of the other parties appealing the District Court's decision for the settlement and related transactions contemplated hereunder and to defend the Approval Order against any appeal therefrom. 6) Upon the effectiveness of this settlement and subject to the settlement not having been terminated, each Member of the Nine agrees: (i) that all issues raised in the Nine's appeals of the Bankruptcy Court's order confirming the Plan have been resolved by this settlement and that each of them consents to and grants the releases to be provided under the terms of the Plan upon the effectiveness thereof; (ii) that after the filing of a joint notice by the Nine and the Debtors advising the Court of Appeals for the Second Circuit that the Nine's non-opposition to the Appeal is contingent upon the terms of this settlement and subject to potential termination if the Approval Order is reversed by a final non-appealable order of a court of competent jurisdiction and that the parties will not argue in such circumstance that by failing to file briefs or present arguments that the Nine no longer have standing as appellees, it will not file any brief with or present any argument to the Second Circuit panel hearing the appeal of the District Court's Decision and Order issued on December 16, 2021 currently being prosecuted by the Debtors and the other supporters of the Plan (the "Appeal") or in any en banc proceeding or panel rehearing that may subsequently take place in the Second Circuit in the Appeal; (iii) that if the Appeal is decided in the Debtors' favor, it will not (a) file a party or amicus curiae brief at the petition stage in the Supreme Court of the United States, asking that court to grant certiorari with respect to the Appeal or (b) file a party brief at the merits stage in the Supreme Court should the Supreme Court grant certiorari with respect to the Appeal; (iv) that it will not object to the continuation of the Preliminary Injunction through a

[3] Each party's acceptance of the Settlement Proposal shall be conditioned on (i) acceptance of the Settlement Proposal by all members of the Nine, Sackler Side A and Sackler Side B, (ii) the allocation of the funds in the SOAF set forth in Attachment D and (iii) that none of the Nine shall have received from the Sackler family or trusts or the Debtors actual or promised consideration not provided for hereunder or under the Plan.

	ruling by the Court of Appeals for the Second Circuit on the Appeal and (v) to execute any other documentation and make any court filings reasonably necessary to implement any of the foregoing agreements. 7) The Nine shall be permitted to file a motion with the Court of Appeals for the Second Circuit to excuse the filing of appellate briefs by the current deadline of March 11, 2022 or thereafter and/or a statement (separate from the joint notice provided for herein) as has been agreed by the parties consistent with this Term Sheet explaining that the Nine are foregoing the filing of appellate briefs in connection with this settlement, which motion and/or statement shall not seek, suggest, or otherwise support any modification of the current Appeal schedule. 8) Subject to the Approval Order becoming final and non-appealable, each Member of the Nine will, upon the conclusion of the Appeal resulting in reversal or vacatur of the District Court's Decision and Order on Appeal issued on December 16, 2021, promptly file a notice and/or motion withdrawing and requesting dismissal of its appeal to the District Court of the Bankruptcy Court's order confirming the Plan. 9) If certiorari has been granted by the United States Supreme Court, members of the Nine may file amicus curiae briefs at the merits stage in the Supreme Court with respect to the Appeal, provided that such brief shall note that said member of the Nine withdrew its objections to the Plan in connection with this settlement and is not subject to a non-consensual release under the Plan. 10) For the avoidance of doubt, the agreement will not include the requirement to file any other pleadings or present argument in support or in favor of the Plan, and nothing in this agreement limits the ability of the Nine to write, to speak, or to participate fully in any judicial or other proceeding unrelated to Purdue or the Sacklers other than as expressly prohibited by this settlement. 11) If any payments or consideration or amounts allocated to any of the Nine under this Settlement Proposal cannot be effectuated because the Approval Order is reversed by a final order of a court of competent jurisdiction, the Sackler family members or trusts shall instead pay such consideration pursuant to one or more alternative mechanisms acceptable to each of the Nine in their sole discretion, that are permitted by or not inconsistent with such final order and also consistent with any subsequent governing court orders (which mechanism may include, without limitation, consent or stipulated judgments satisfactory to the Sackler family members or trusts and in favor of the Nine to be filed in the courts of their respective jurisdictions, with the form of such judgments to be attached to the Definitive Documents on or before the Effective Date of the Plan), provided that all such funds shall continue to be used for opioid-related abatement, including support and services for survivors, victims and their families, and provided further that such alternative mechanisms shall not be adverse to the Sackler family members or trusts as compared to the mechanisms set forth herein (it being agreed and understood that modest additional administrative or similar burdens, including the provision of consent or stipulated judgments satisfactory to the Sackler Family members or trusts as referenced above or a redirection of payments consistent with the allocation set forth herein, shall not be considered adverse). Each member of the Nine shall have the right to terminate the Agreement on and after a period of seven business days (or a shorter period if the full seven-day period would be unduly prejudicial) if the Nine after good faith consultation with one another do not identify and agree upon any such alternative mechanisms. 12) Each of the Nine and New Hampshire will voluntarily consent to grant the releases to be provided by it under the terms of the Plan as currently formulated in Section 10.7 thereof upon the effectiveness of the Plan as modified by this settlement and will therefore be voluntarily bound thereby. Each of the Nine and New Hampshire fully reserves its right to object to and litigate non-consensual third-party releases in all other bankruptcy cases. 13) Any Plan supporter that has agreed to support the transactions contemplated by this Term Sheet may note in its briefs in the Appeal that, subject to the conditions hereof, the Nine and New Hampshire do not object to, and will consensually be bound to, the releases contained in the Plan. However, any Plan supporter that notes in its briefs in the Appeal that the Nine and New Hampshire are not objecting to, or are being consensually bound to, the releases

	contained in the Plan must note that such consent is not an indication that the Nine or New Hampshire agree with the legality of the Plan or of the non-consensual third party releases included in the Plan. 14) The Debtors will advise the Court of Appeals for the Second Circuit that: (a) all states have agreed to be consensually bound by the third party releases in the Plan; (b) that the appeal therefore no longer presents the question of whether claims brought by states against third parties can be non-consensually released in bankruptcy, either generally or under the facts of this case; and (c) and that therefore the following portions of the identified briefs are withdrawn as moot: Section III.B. of the Debtors' page proof brief at pgs. 79-84 and Section III.B. of the Mortimer-side Initial Covered Sackler Persons page proof brief at pgs. 63-67.
Implementation	1) The Shareholder Settlement Agreement shall be amended to reflect the additional Master Disbursement Trust payments and non-economic terms herein, and a new settlement agreement (the "Direct Settlement Agreement") among the Term Sheet Parties shall be entered into to reflect the payments to the SOAF, together with customary intercreditor arrangements between the Master Disbursement Trust and SOAF that shall provide that SOAF is pari passu with the Master Disbursement Trust, in each case subject to receipt by the Mediator of acceptances by Sackler Side A, Sackler Side B, the Debtors, and all of the members of the Nine, with consummation of the Shareholder Settlement Agreement so modified and the Direct Settlement Agreement contingent upon entry of the Approval Order by the Bankruptcy Court[4] and consummation of the Plan. 2) Other than as provided in the provision beginning "If any payments" above, this agreement shall be void and have no effect on the rights of the parties if the settlement described herein or consummation of the Plan is barred by a final, non-appealable order of a court of competent jurisdiction, if a court of competent jurisdiction determines in a final, non-appealable order that any essential element of the settlement (including, without limitation, the Direct Settlement Agreement) or the Plan is invalid, or if the Plan otherwise becomes incapable of being consummated. 3) The parties acknowledge and agree that upon the Effective Date of the Plan all parties are bound by the terms thereof unless the confirmation order is subsequently vacated.

[4] Any order or definitive documents effectuating the terms of this Settlement Proposal shall provide that the actions taken by members of the Sackler family or trust or their related parties in accordance with the terms of this Settlement Proposal are taken in connection with the Chapter 11 Cases for purposes of Section 10.7 of the Plan.

Attachment A

Payment Date[5][6]	Payment Amount to Master Disbursement Trust	Direct Payment Amount to SOAF
Effective Date	$175 million	$25 million
Second Funding Deadline	$0.00	$25 million
Third Funding Deadline	$0.00	$25 million
Fourth Funding Deadline	$0.00	$25 million
Fifth Funding Deadline	$0.00	$0.00
Sixth Funding Deadline	$0.00	$0.00
Seventh Funding Deadline	$0.00	$0.00
Eighth Funding Deadline	$0.00	$0.00
Ninth Funding Deadline	$0.00	$0.00
Tenth Funding Deadline	$0.00	$0.00
6/30/2031	$80 million	$20 million
6/30/2032	$80 million	$20 million
6/30/2033	$80 million	$20 million
6/30/2034	$80 million	$20 million
6/30/2035	$80 million	$20 million
6/30/2036	$80,777,777.78	$19,222,222.22
6/30/2037	$80,777,777.78	$19,222,222.22
6/30/2038	$80,777,777.78	$19,222,222.22
6/30/2039	$80,777,777.78	$19,222,222.22

[5] The Funding Deadlines are set forth in Section 2.01(b)(i) of the Shareholder Settlement Agreement and are subject to adjustment pursuant to Section 2.01(b)(ii) thereof.

[6] The $175 million of incremental amounts paid in lieu of appointment of the Continuing Foundation Members as the sole members of the Foundations shall be funded $62.5 million by the Sackler family A-Side Payment Parties and $112.5 million by the Sackler family B-Side Payment Parties. The first $400 million chronologically of all other incremental amounts shall be funded 50% by the Sackler family A-Side Payment Parties and 50% by the Sackler family B-Side Payment Parties. Other incremental amounts above $575 million in the aggregate shall be funded exclusively by the Sackler family B-Side Payment Parties.

Attachment B

Agreed Amendments to the Debtors' Privilege Waiver Section of Plan

(1) <u>Lobbying</u>

Revised subsection (I) – Legal advice regarding advocacy before the United States Congress or a state legislative branch with respect to (i) any opioid product sold by Purdue, including OxyContin; and (ii) any public policies regarding the availability and accessibility of opioid products.

(2) <u>Public Relations</u>

New Subsection – Legal advice provided to Purdue's public relations department regarding the promotion, sales, or distribution of Purdue's opioid products, including but not limited to their safety, efficacy, addictive properties, or availability of opioid products.

(3) <u>Compliance</u>

Legal advice to the Compliance department regarding the organizational structure of the Compliance Department, including its processes for implementing order monitoring systems, suspicious order monitoring programs, and abuse deterrence and detection programs.

<u>Subsection (ii)(B)</u>

Documents created before February 2018 reflecting legal review and advice with respect to recommendations received from McKinsey & Company, Razorfish, and Publicis, related to the sale and marketing of opioids.

Attachment C

Sackler Family Statement

The Sackler families are pleased to have reached a settlement with additional states that will allow very substantial additional resources to reach people and communities in need. The families have consistently affirmed that settlement is by far the best way to help solve a serious and complex public health crisis. While the families have acted lawfully in all respects, they sincerely regret that OxyContin, a prescription medicine that continues to help people suffering from chronic pain, unexpectedly became part of an opioid crisis that has brought grief and loss to far too many families and communities.

Attachment D

Allocation of SOAF

Attachment D

Allocation of SOAF

Payment Date	Direct Payment Amount to SOAF	CA	CT	DE	MD	OR	RI	VT	WA	DC	NH	Total
Effective Date	$25,000,000.00	$2,652,777.78	$2,652,777.78	$2,652,777.78	$2,652,777.78	$2,652,777.78	$2,652,777.78	$2,652,777.78	$2,652,777.78	$2,652,777.78	$ 1,125,000.00	$25,000,000
Second Funding Deadline	$25,000,000.00	$2,652,777.78	$2,652,777.78	$2,652,777.78	$2,652,777.78	$2,652,777.78	$2,652,777.78	$2,652,777.78	$2,652,777.78	$2,652,777.78	$ 1,125,000.00	$25,000,000
Third Funding Deadline	$25,000,000.00	$2,652,777.78	$2,652,777.78	$2,652,777.78	$2,652,777.78	$2,652,777.78	$2,652,777.78	$2,652,777.78	$2,652,777.78	$2,652,777.78	$ 1,125,000.00	$25,000,000
Fourth Funding Deadline	$25,000,000.00	$2,652,777.78	$2,652,777.78	$2,652,777.78	$2,652,777.78	$2,652,777.78	$2,652,777.78	$2,652,777.78	$2,652,777.78	$2,652,777.78	$ 1,125,000.00	$25,000,000
Fifth Funding Deadline	$0.00											
Sixth Funding Deadline	$0.00											
Seventh Funding Deadline	$0.00											
Eighth Funding Deadline	$0.00											
Ninth Funding Deadline	$0.00											
Tenth Funding Deadline	$0.00											
6/30/2031	$20,000,000.00	$2,122,222.22	$2,122,222.22	$2,122,222.22	$2,122,222.22	$2,122,222.22	$2,122,222.22	$2,122,222.22	$2,122,222.22	$2,122,222.22	$ 900,000.00	$20,000,000
6/30/2032	$20,000,000.00	$2,122,222.22	$2,122,222.22	$2,122,222.22	$2,122,222.22	$2,122,222.22	$2,122,222.22	$2,122,222.22	$2,122,222.22	$2,122,222.22	$ 900,000.00	$20,000,000
6/30/2033	$20,000,000.00	$2,122,222.22	$2,122,222.22	$2,122,222.22	$2,122,222.22	$2,122,222.22	$2,122,222.22	$2,122,222.22	$2,122,222.22	$2,122,222.22	$ 900,000.00	$20,000,000
6/30/2034	$20,000,000.00	$2,122,222.22	$2,122,222.22	$2,122,222.22	$2,122,222.22	$2,122,222.22	$2,122,222.22	$2,122,222.22	$2,122,222.22	$2,122,222.22	$ 900,000.00	$20,000,000
6/30/2035	$20,000,000.00	$2,122,222.22	$2,122,222.22	$2,122,222.22	$2,122,222.22	$2,122,222.22	$2,122,222.22	$2,122,222.22	$2,122,222.22	$2,122,222.22	$ 900,000.00	$20,000,000
6/30/2036	$19,222,222.22								$17,972,222.22		$ 1,250,000.00	$19,222,222
6/30/2037	$19,222,222.22								$17,972,222.22		$ 1,250,000.00	$19,222,222
6/30/2038	$19,222,222.22								$17,972,222.22		$ 1,250,000.00	$19,222,222
6/30/2039	$19,222,222.22								$17,972,222.22		$ 1,250,000.00	$19,222,222
Total		$21,222,222.22	$21,222,222.22	$21,222,222.22	$21,222,222.22	$21,222,222.22	$21,222,222.22	$21,222,222.22	$93,111,111.10	$21,222,222.22	$14,000,000.00	$276,888,889

**UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK**

In re:	**Chapter 11**
PURDUE PHARMA L.P., ***et al.*****,**	**Case No. 19-23649 (RDD)**
Debtors.[1]	**(Jointly Administered)**

**ORDER PURSUANT TO 11 U.S.C. §§ 105 AND 363(b)
AUTHORIZING AND APPROVING SETTLEMENT TERM SHEET**

Upon the motion (the "**Motion**")[2] of Purdue Pharma L.P. and its affiliates that are debtors and debtors in possession in these cases (collectively, the "**Debtors**"), for entry of an order, pursuant to sections 105(a) and 363(b) of title 11 of the United States Code (the "**Bankruptcy Code**") authorizing and approving the agreement set forth in the Term Sheet attached to the Motion as **Exhibit B**, as more fully set forth in the Motion; and the Court having jurisdiction to consider the matters raised in the Motion pursuant to 28 U.S.C. §§ 157(a)-(b) and 1334(b) and the Amended Standing Order of Reference M-431, dated January 31, 2012 (Preska, C.J.); and consideration of the Motion and the requested relief being a core proceeding pursuant to 28 U.S.C. § 157(b) that the Court can decide by a final order; and venue being proper before the Court pursuant to 28 U.S.C. §§ 1408 and 1409; and due and proper notice of the Motion having

---

[1] The Debtors in these cases, along with the last four digits of each Debtor's registration number in the applicable jurisdiction, are as follows: Purdue Pharma L.P. (7484), Purdue Pharma Inc. (7486), Purdue Transdermal Technologies L.P. (1868), Purdue Pharma Manufacturing L.P. (3821), Purdue Pharmaceuticals L.P. (0034), Imbrium Therapeutics L.P. (8810), Adlon Therapeutics L.P. (6745), Greenfield BioVentures L.P. (6150), Seven Seas Hill Corp. (4591), Ophir Green Corp. (4594), Purdue Pharma of Puerto Rico (3925), Avrio Health L.P. (4140), Purdue Pharmaceutical Products L.P. (3902), Purdue Neuroscience Company (4712), Nayatt Cove Lifescience Inc. (7805), Button Land L.P. (7502), Rhodes Associates L.P. (N/A), Paul Land Inc. (7425), Quidnick Land L.P. (7584), Rhodes Pharmaceuticals L.P. (6166), Rhodes Technologies (7143), UDF LP (0495), SVC Pharma LP (5717) and SVC Pharma Inc. (4014). The Debtors' corporate headquarters is located at One Stamford Forum, 201 Tresser Boulevard, Stamford, CT 06901.

[2] Capitalized terms used but not otherwise defined herein shall have the meanings ascribed to them in the Motion.

been provided to the Notice Parties and such notice having been adequate and appropriate under the circumstances, and it appearing that no other or further notice need be provided; and upon each of the pleadings filed in response to the Motion and the Debtors' reply; and upon the record of, including the representations made at, the hearing held by the Court on the Motion on March 9, 2022 (the "**Hearing**") and upon all of the proceedings had before the Court; and, after due deliberation and for the reasons stated by the Court in its bench ruling at the Hearing, the Court having determined that the legal and factual bases set forth in the Motion and at the Hearing establish just cause for the relief granted herein, in that the relief requested in the Motion and granted herein is in the best interests of the Debtors, their estates, creditors and all other parties in interest in the light of the risks, costs and delay of continued litigation and is consistent with the applicable provisions of the Bankruptcy Code; and sufficient cause appearing therefor,

IT IS HEREBY ORDERED THAT:

1. The Motion is granted as provided herein.

2. The Court finds that the agreements reflected in the Term Sheet are in the best interests of the Debtors, their estates, creditors and all parties in interest, and that such agreements do not contravene the *Twenty-Sixth Amended Order Pursuant to 11 U.S.C. § 105(a) Granting Motion for a Preliminary Injunction*, Adv. Pro. No. 19-08289 [ECF No. 338] or any provision of the Bankruptcy Code and that the actions taken by members of the Sackler families and the Nine or their related parties in accordance with the Term Sheet are taken in connection with the Chapter 11 Cases for purposes of Section 10.7 of the Plan.

3. Pursuant to sections 105(a) and 363(b) of the Bankruptcy Code, and in all events effective only upon the entry of one or more orders by the Court of Appeals for the Second Circuit or the United States District Court for the Southern District of New York permitting the

consummation of the Plan as enhanced as provided for by the Term Sheet agreements, the Debtors are authorized to (i) revise the Shareholder Settlement Agreement as needed to provide for the incremental payments agreed to by the Sackler Mediation Parties under the Term Sheet and allow for the Direct Settlement Agreement, (ii) provide the additional documents specified in the Term Sheet to the Public Document Repository once established and (iii) take such other steps as may be necessary or desirable in furtherance of the agreements reflected in the Term Sheet and this Order.

4. The Debtors' agreement to pay or reimburse the Specified Payments as set forth in the Term Sheet is approved and the Debtors are authorized to make such payments at such time in accordance with the terms and conditions of the Term Sheet and this Order. The foregoing authorization of the Debtors to make such payments shall be subject, *mutatis mutandis*, to the procedures with respect to authorization of payment of the fees and expenses of the professionals of the Debtors and the Creditors' Committee set forth in the *Order Establishing Procedures for Interim Compensation and Reimbursement of Expenses for Retained Professionals* [ECF No. 529] (as may be modified or amended by any subsequent order of the Court with respect thereto, the "**Interim Compensation Order**") including, for the avoidance of doubt, the filing of Monthly Fee Statements and Applications (in each case as defined in the Interim Compensation Order), Interim Fee Hearings (as defined in the Interim Compensation Order), the expiration of the Objection Deadline (as defined in the Interim Compensation Order) or resolution of any Objections (as defined in the Interim Compensation Order) with respect to each Monthly Fee Statement, and the 20% holdback with respect to fees until further order of the Court; *provided* that the standard for authorization of payment of the attorneys' fees and expenses of each of the Nine shall be whether such fees and expenses are (a) reasonable and

documented and (b) reimbursable under the Term Sheet; *provided further* that, for the avoidance of doubt, the attorneys of the Nine shall not be considered retained professionals of the Debtors or Creditors' Committee and the retention of the attorneys of the Nine shall not be required to satisfy the standards for retention set forth in sections 327-328 or 1103 of the Bankruptcy Code.

5. The Court shall retain jurisdiction to hear and determine all matters arising from or related to the implementation, interpretation and enforcement of this Order, including the Term Sheet and the definitive documents to be entered into pursuant thereto (including the Direct Settlement Agreement).

Dated: March 10, 2022
White Plains, New York

/s/Robert D. Drain
THE HONORABLE ROBERT D. DRAIN
UNITED STATES BANKRUPTCY JUDGE

S.2497 - Nondebtor Release Prohibition Act of 2021

117th Congress (2021-2022) | Get alerts

Sponsor: Sen. Warren, Elizabeth [D-MA] (Introduced 07/28/2021)
Committees: Senate - Judiciary
Latest Action: Senate - 07/28/2021 Read twice and referred to the Committee on the Judiciary. (All Actions)
Tracker: Introduced | Passed Senate | Passed House | To President | Became Law

Summary (1) | **Text (1)** | Actions (1) | Titles (2) | Amendments (0) | Cosponsors (4) | Committees (1) | Related Bills (1)

There is one version of the bill.

Text available as: XML/HTML (18KB) | XML/HTML (new window) (15KB) | TXT (11KB) | PDF (253KB) !

Shown Here:
Introduced in Senate (07/28/2021)

117TH CONGRESS
1ST SESSION

S. 2497

To amend title 11, United States Code, to prohibit nonconsensual release of a nondebtor entity's liability to an entity other than the debtor, and for other purposes.

IN THE SENATE OF THE UNITED STATES

JULY 28, 2021

Ms. WARREN (for herself, Mr. DURBIN, and Mr. BLUMENTHAL) introduced the following bill; which was read twice and referred to the Committee on the Judiciary

A BILL

To amend title 11, United States Code, to prohibit nonconsensual release of a nondebtor entity's liability to an entity other than the debtor, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Nondebtor Release Prohibition Act of 2021".

SEC. 2. PROHIBITION OF NONDEBTOR RELEASES.

(a) In General .—Chapter 1 of title 11, United States Code, is amended by adding at the end the following:

“§113. Prohibition of nondebtor releases

“(a) Except as provided in subsection (b) of this section, subsections (a)(3), (g), (h), or (i) of section 524, section 1201, and section 1301, the court may not—

“(1) with respect to the liability of an entity other than the debtor or the estate on, or the liability of property of an entity other than the debtor or the estate for, a claim or cause of action of an entity other than the debtor or the estate—

“(A) approve any provision, in a plan of reorganization or otherwise, for the discharge, release, termination, or modification of such liability; or

“(B) order the discharge, release, termination, or modification of such liability; or

“(2) with respect to a claim or cause of action of an entity other than the debtor or the estate against an entity other than the debtor or the estate, or against property of an entity other than the debtor or the estate, enjoin—

“(A) the commencement or continuation (including the issuance or employment of process) of a judicial, administrative, or other action or proceeding to assert, assess, collect, recover, offset, recoup, or otherwise enforce such claim or cause of action; or

“(B) any act to assert, assess, collect, recover, offset, recoup, or otherwise enforce such claim or cause of action.

“(b) Nothing in subsection (a) of this section shall affect any power the court may have —

“(1) to authorize a sale, transfer, or other disposition of property free and clear of claims or interests;

“(2) to prevent an entity other than the debtor or the estate from exercising control over or otherwise interfering with a right or interest (including a claim or cause of action) that is property of the estate;

“(3) to bar a claim or cause of action for indemnity, reimbursement, contribution, or subrogation against an entity that the estate has released from a claim or cause of action for which the holder of the barred claim or cause of action also is or may be liable or has or may have secured;

“(4) under applicable nonbankruptcy law, title 28, or the Federal Rules of Bankruptcy Procedure, with respect to any claim or cause of action the court is hearing under section 157(a) or 1334(b) of title 28;

“(5) to approve any disposition of a claim or cause of action of an entity other than the debtor or the estate to which such entity expressly consents in a signed writing provided that—

"(A) such consent is given only after clear and conspicuous notice to such entity of the proposed disposition in language appropriate for the typical holder of such claim or cause of action;

"(B) such consent cannot be given by—

"(i) accepting a proposed plan; or

"(ii) failing to accept or reject a proposed plan, failing to object to a proposed plan, or any other silence or inaction; and

"(C) treatment of such entity, and any claims or interests of such entity, under a plan cannot be more or less favorable by reason of such entity's consent or failure to consent; or

"(6) to enjoin the commencement or continuation (including the issuance or employment of process) of a judicial, administrative, or other action or proceeding against an entity appointed or employed (or whose appointment or employment was approved) by or under the auspices of the court, in another court and without leave of the court, with respect to acts or omissions for which the entity was so appointed or employed.

"(c) In a case under chapter 11 of this title, no order or decree temporarily staying or enjoining, pursuant to this title, the commencement or continuation (including the issuance or employment of process) of a judicial, administrative, or other action or proceeding to assert, assess, collect, recover, offset, recoup, or otherwise enforce a claim or cause of action against an entity other than the debtor or the estate against an entity other than the debtor or the estate, or against property of an entity other than the debtor or the estate, shall extend (or be extended) beyond 90 days after the date of the order for relief without the express consent of the entity whose claim or cause of action is stayed or enjoined.

"(d) Nothing in subsection (b) or (c) shall be construed to authorize relief within the scope of subsection (b) or (c).".

(b) CLERICAL AMENDMENT.—The table of sections for chapter 1 of title 11, United States Code, is amended by adding at the end the following:

"113. Prohibition of nondebtor releases.".

SEC. 3. APPEAL OF NONDEBTOR STAYS.

Section 158 of title 28, United States Code, is amended—

(1) in subsection (a), by striking "The" and inserting "Except as provided in subsection (d)(3), the"; and

(2) by inserting after subsection (d)(2) the following:

"(3) (A) The appropriate court of appeals shall have jurisdiction of appeals from all orders and decrees (whether interlocutory or final) temporarily staying or enjoining (or increasing the duration of any temporary stay or injunction of) the commencement or continuation (including the issuance or employment of process) of a judicial, administrative, or other action or proceeding to assert, assess, collect, recover, offset, recoup, or otherwise enforce a claim or cause of action of an entity other than the debtor or the estate against an entity other than the debtor or the estate, or against property of an entity other than the debtor or the estate, entered in a case under chapter 11 of title 11 by—

"(i) a bankruptcy judge under section 157 of this title; or

"(ii) a district court under section 1334 of this title.

"(B) If an appeal is taken under subparagraph (A), the stay order or decree shall immediately terminate and dissolve and be of no further force or effect 90 days after its issuance by the bankruptcy judge or district court, unless the appeal is dismissed or the court of appeals affirms the stay order or decree before that date.".

SEC. 4. DIVISIONAL MERGERS.

Section 1112 of title 11, United States Code, is amended—

(1) by redesignating subsection (f) as subsection (g); and

(2) by inserting after subsection (e) the following:

"(f) On a request of a party in interest, and after notice and a hearing, the court shall dismiss a case under this chapter if the debtor or a predecessor of the debtor was the subject of, or was formed or organized in connection with a divisional merger or equivalent transaction or restructuring that—

"(1) had the intent or foreseeable effect of—

"(A) separating material assets from material liabilities of an entity eligible to be a debtor under this title; and

"(B) assigning or allocating all or a substantial portion of those liabilities to the debtor, or the debtor assuming or retaining all or a substantial portion of those liabilities; and

"(2) occurred during the 10-year period preceding the date of the filing of the petition.".

SEC. 5. RULE OF CONSTRUCTION.

Nothing in this Act, or the amendments made by this Act, shall be construed to independently grant the court authority to issue nondebtor releases, injunctions, or stays in connection with an order for relief under chapter 11 of title 11, United States Code, or in connection with an order confirming a plan of reorganization, nor shall anything in this Act or such amendments be construed to imply that any other provision of title 11 of such Code or of nonbankruptcy law grants such authority.

SEC. 6. EFFECTIVE DATE.

(a) IN GENERAL.—Except as provided in subsection (b), this Act and the amendments made by this Act shall take effect on the date of the enactment of this Act and shall apply to any case under title 11, United States Code, that is—

(1) pending in bankruptcy as of the date of the enactment of this Act; or

(2) filed or reopened on or after the date of the enactment of this Act.

(b) VALIDITY OF FINAL ORDERS.—Nothing in this Act, or the amendments made by this Act, shall affect the validity of any final judgment, order, or decree as applied under section 158 of title 28, United States Code, entered before the date of the enactment of this Act.

Sigmund J. Beck Advanced Bankruptcy Roundtable
Indiana Continuing Legal Education Forum
August 19 and 20, 2022

Kayla Britton and Ian Finley
Faegre Drinker Biddle & Reath LLP
Indianapolis, Indiana
kayla.britton@faegredrinker.com

Texas Two-Step:
Good Faith Filing in the LTL Management (Johnson & Johnson) Case

I. Introduction

Determining whether a debtor filed in good faith is often a complicated, fact-intensive inquiry, and the use of the Texas Two-Step to manage mass tort liabilities in bankruptcy has made that inquiry even more complicated. The Texas Two-Step is a divisional merger under Texas law which divides one entity into two new entities. One entity holds the original entity's assets, and the other holds the liabilities. The latter then files for bankruptcy. A creditors' committee called this practice into question in the recent *In re LTL Management, LLC*[1] case. In that case, the court ruled that the debtor's filing was in good faith according to section 1112(b) of the Bankruptcy Code.[2]

II. Texas Two-Step

The Texas Two-Step is a two-step process under chapter 10 of the Texas Business Organization Code and chapter 11 of the Bankruptcy Code.[3] First, a company undergoes a

[1] *In re LTL Management, LLC*, 21-30589 (Bankr. D.N.J. 2017). All citations to court documents in this paper refer to court documents from this case.
[2] Mem. Op. 2, Feb. 25, 2022, ECF No. 1572.
[3] *See id.* at 42; *see also* Tex. Bus. Orgs. Code Ann. §§ 10.001, 10.002, 10.003, 10.008.

divisional merger under Texas law. One company ("the dividing entity") splits into two companies, company A and company B. Then, according to the plan of the merger, assets of the dividing entity are allocated to company A, and liabilities of the dividing entity are allocated to company B. As a result, company B is exclusively liable for the transferred liabilities. After the divisional merger, company B completes the second step of the Texas Two-Step by commencing a chapter 11 bankruptcy case.

Companies have been using the Texas Two-Step for over thirty years.[4] A recent case that gained attention for the use of the Texas Two-Step was *In re LTL Management, LLC*.

III. *In re LTL Management, LLC*

1. Background

Johnson & Johnson Consumer Inc. ("Old JJCI"), a former subsidiary of Johnson & Johnson ("J&J"), manufactured and sold Johnson's Baby Powder. In recent years, Old JJCI was facing a rising number of tort plaintiffs alleging that Johnson's Baby Powder contained amphibole asbestos and fibrous talc. The plaintiffs further alleged that exposure to the product caused them to develop cancer. In 2013, a jury found for one plaintiff, and subsequently, tens of thousands of talc-related cases have been filed against Old JJCI. In a recent case, the jury awarded the plaintiff a $4.69 billion verdict, which was eventually reduced to $2.25 billion on appeal. The increased litigation and associated costs dramatically increased Old JJCI's expenses. As a result, Old JJCI's business segment reported a $1.1 billion loss in 2020, after experiencing a $2.1 billion profit in 2019.

[4] In its opinion, the court cites the following examples: *In re Garlock Sealing Tech., LLC*, 10-31607 (Bankr. W.D.N.C. 2017); *In re Mid Valley, Inc.*, No. 03-25592 (Bankr. W.D. Pa. 2003); *In re Babcock & Wilcox Co*. No. 00-10992-10995 (Bankr. E.D. La, 2002). Mem. Op. 45, Feb. 25, 2022, ECF No. 1572.

2. Old JJCI's use of the Texas Two-Step

In 2021, Old JJCI engaged in a corporate restructuring with the purpose of "globally resolv[ing] talc-related claims through a chapter 11 reorganization without subjecting the entire Old JJCI enterprise to a bankruptcy proceeding."[5] A key component of the restructuring was the Texas Two-Step.

First, the parent of Old JJCI formed a new parent for Old JJCI, Curahee Holding Company Inc. ("Curahee"). Curahee then formed a new wholly owned subsidiary, Chenango Zero LLC. This new subsidiary was a Texas limited liability company governed by Texas law. Old JJCI then merged with Chenango Zero LLC. Chenango Zero LLC then divided into Chenango One LLC and Chenango Two LLC. Chenango Two LLC held the assets that Old JJCI owned prior to the restructuring. Chenango Two LLC then merged with Curahee, which changed its name to Johnson & Johnson Consumer Inc. ("New JJCI").

Chenango One LLC held the talc-related liabilities that Old JJCI held prior to the restructuring. Chenango One LLC then became a North Carolina limited liability company. Finally, it changed its name from Chenango One LLC to LTL Management, LLC ("LTL"). LTL then filed for chapter 11 bankruptcy.

3. Settlement Trust

Another key component of LTL's bankruptcy was the establishment of a settlement trust in accordance with sections 524(g) and 105 of the Bankruptcy Code. Congress created section 524(g) to efficiently deal with mass tort cases, specifically asbestos-related cases. Through this section, debtors may establish a settlement trust to provide the funding to resolve mass tort claims without having to continually resort to state court litigation. Instead, the trust provides a

---

[5] Mem. Op. 5, Feb. 25, 2022, ECF No. 1572. (quoting *Kim Decl.* ¶ 21, ECF No. 5).

more streamlined process through which claimants can receive compensation without the costs of repeated litigation. It also ensures funding for both present and future claimants and creates common parameters for how to receive funds. Section 524(g) provides the creditors with significant leverage through the high requirement to confirm a plan – a 75% super majority class voting requirement.

In this case, LTL established a 524(g) trust, which obligated J&J and New JJCI to the following:

> Without any corresponding repayment obligation, the Funding Agreement obligates New JJCI and J&J, on a joint and several basis, to provide funding, up to the full value of New JJCI, to pay for costs and expenses of the Debtor incurred in the normal course of its business (a) at any time when there is no bankruptcy case and (b) during the pendency of any chapter 11 case, including the costs of administering the chapter 11 case, in both situations to the extent that any cash distributions received by the Debtor from Royalty A&M[6] are insufficient to pay such costs and expenses. Declaration of John K. Kim in Support of First Day Pleadings ¶ 27, ECF No. 5. In addition, the Funding Agreement requires New JJCI and J&J to, up to the full value of New JJCI, fund amounts necessary (a) to satisfy the Debtor's talc-related liabilities at any time when there is no bankruptcy case and (b) in the event of a chapter 11 filing, to provide the funding for a trust, in both situations to the extent that any cash distributions received by the Debtor from Royalty A&M are insufficient to pay such costs and expenses and further, in the case of the funding of a trust, the Debtor's other assets are insufficient to provide that funding. Id.

4. Court rules the LTL case was not filed in bad faith.

The United States Bankruptcy Court for the District of New Jersey rejected the Committee's[7] motion to dismiss LTL's bankruptcy case pursuant to section 1112(b).[8] The court rejected the Committee's argument that LTL had not filed for bankruptcy in good faith.

[6] Royalty A&M is a North Carolina limited liability company established during the restructuring. LTL is a direct parent of Royalty A&M, which owns a portfolio of royalty revenue streams and had a fair market value of over $350 million as of the petition date.
[7] The Original Committee of Talc Claimants and the law firm of Arnold & Itkin, LLP each filed a motion to dismiss. Two other law firms that represented talc claimants also filed joinders to these motions. For ease of reference, this paper will refer to the parties collectively as the "Committee."
[8] *Id.* at 2.

A good faith standard is intended to ensure the proper balancing between the interests of the debtor and the creditors. For instance, it prevents the debtor from delaying the claims of the creditors without providing any additional benefit to the creditors.

After an allegation of bad faith, the initial burden lies on the debtor to prove good faith by a preponderance of the evidence. In determining good faith, "the general focus must be '(1) whether the petition serves a valid bankruptcy purpose and (2) whether the petition is filed merely to obtain a tactical litigation advantage.'"[9] The court must engage in a fact-intensive analysis that considers the totality of the circumstances, including a variety of factors relating to any abuse of the bankruptcy system. In this case, the court ruled that LTL filed in good faith.

a. Bankruptcy versus tort system for resolving personal injury mass tort cases

The bankruptcy court began its analysis by noting that bankruptcy is the most appropriate available venue for personal injury mass tort cases. The court highlighted the pitfalls of the alternative: the tort system. In general, this route would lead to substantial delays. At the time of the decision, only forty-nine of the thousands of present and future potential cases had received a verdict. Additionally, these verdicts have produced a wide range of results. So far, "[d]efendants prevailed in 18 cases; plaintiffs prevailed in 17 cases; eight cases resulted in mistrials; and six cases settled during trial."[10] While one of the cases resulted in a multibillion-dollar award, other cases resulted in no award for the plaintiff. Based on this wide range of results, there is little predictability to guide either the plaintiffs or LTL, making trial a risky option for all claimants. There is also a risk that available funds could be exhausted by the time the future claimants are able to bring their claims.

[9] *Id.* at 12 (quoting *15375 Mem'l Corp. v. BEPCO, L.P. (In re 15375 Mem'l Corp.)*, 589 F.3d 605, 618 (3d Cir. 2009).
[10] *Id.* at 26.

The court also noted specific shortcomings of class action claims and multidistrict litigation. For instance, the factual variations among the claimants' personal injury claims would be difficult to address through class action litigation. Although multidistrict litigation could efficiently address pretrial work, the cases would eventually return to the original courts for individual trials. The need to litigate causation, damages, and liability in potentially thousands of cases would create an unnecessary financial burden on the plaintiffs, LTL, and the courts. The court summarized its views by stating that "the tort system produces an uneven, slow-paced race to the courthouse, with winners and losers. Present and future talc claimants should not have to bear the sluggish pace and substantial risk if there exists another viable option."[11]

In the court's opinion, bankruptcy provides multiple benefits for mass tort cases. For example, the bankruptcy court could supervise and hold LTL accountable. Additionally, bankruptcy provides a global resolution of claims in one forum. A global resolution would mitigate unfair differences in awards provided to all claims. It would also consider the interests of future claimants, which would help ensure that available funds are not exhausted before future claimants' claims mature.

The court noted that addressing mass tort cases in bankruptcy also furthers the Congressional intent behind creating the 524(g) trust. The purpose of section 524(g) was "to ensure meaningful, timely recoveries for present and future suffering parties and their families."[12] Specifically, Congress wanted to prevent present claimants from exhausting available funds before future claimants could bring their claims. Additionally, 524(g) trusts can still provide the tort victims a choice to pursue recovery via a jury trial instead. The court concluded that LTL was the successor in interest to the debt of Old JJCI and therefore was in the

[11] *Id.* at 27.
[12] *Id.* at 20.

proper position to use a 524(g) trust to resolve these claims. According to the court, this process allows LTL to manage its mass tort exposure while also providing equitable treatment for all present and future claimants.

b. LTL's financial distress.

After establishing that bankruptcy is an appropriate venue in general, the court turned to the propriety of LTL's filing in particular. The court ruled that LTL is in financial distress. LTL is facing a significant amount of present and future talc-related liability. It already spent significant funds in litigating these cases, including paying a multibillion-dollar award, and anticipated billions of dollars in future defense costs. Although Old JJCI had been profitable in the past, the continuing costs of litigation had significantly impacted its bottom line.

The Committee argued that LTL was not in financial distress and pointed to the superb credit rating and $450 billion market capitalization of its indirect parent, J&J. The court dismissed this argument. J&J had "no legal duty to satisfy the claims against its wholly owned subsidiaries."[13] Additionally, there is no evidence that J&J was going to provide funding outside of a bankruptcy context.

Furthermore, the existence of the funding agreement does not preclude financial distress. The fact that the funding agreement obligates J&J and New JJCI to provide funding according to provisions of the agreement does not mean that they must provide that funding before LTL is able to file bankruptcy. The Bankruptcy Code does not take the presence of the funding agreement into consideration when calculating insolvency.

[13] *Id.* at 35.

Finally, the existence of prepetition sales and rising profits throughout the years did not prove a lack of financial distress. In the court's view, LTL had suffered a loss primarily due to talc-related liabilities, which it will likely face for years to come.

c. Filing bankruptcy was not undertaken to secure a tactical advantage.

The court rejected the Committee's arguments that the Texas Two-Step was an improper tactic meant to hinder or delay the talc claimants from reaching Old JJCI's assets. In the court's opinion, the Texas Two-Step is a valid legal option that has more than thirty years of precedent. Furthermore, LTL followed all the requirements under Texas law.

Additionally, J&J had been transparent about its intentions to complete the Texas Two-Step and file for bankruptcy. The court also stated that the creditors should be happy about this filing. Rather than delay recovery, the global resolution provided by the bankruptcy court will speed up recovery for many claimants. Additionally, the added court oversight of the debtor that bankruptcy provides will help protect all claimants.

Finally, if the court required Old JJCI to file bankruptcy, there would be harm to thousands of employees and shareholders as well disruptions in global supply chains. All this cost would come with no added benefit to the creditors. The same assets would have been available to creditors if Old JJCI had applied for bankruptcy.

With all this in mind, the court did not see this filing as a tactical advantage for the debtor or an abuse of the bankruptcy system. The court viewed this filing as an efficient way to deal with claims and avoid larger social harm without prejudicing the present and future creditors as a whole.

d. No concern of opening the floodgates

The court did not accept the Committee's argument that denying its motion to dismiss would lead to an increase in the use of the Texas Two-Step in dealing with mass tort cases. The court cited to the low number of these type of cases filed in the last forty years (less than 100 filings) and noted that most companies lack the capability to perform this type of complex corporate restructuring. Furthermore, as previously stated, the court viewed bankruptcy as the preferred venue for dealing with mass tort cases. Therefore, the court did not view an increase of the use of the Texas Two-Step as an issue that the court must mitigate.

IV. Conclusion

LTL Management provides another example of a company employing the Texas Two-Step. The bankruptcy court ultimately decided that the use of the Texas Two-Step and other tools available in bankruptcy, such as a 524(g) settlement trust, did not amount to a bad faith filing on the part of the debtor LTL when dealing with talc-related liability.

Exculpate This!
Plan Exculpation Provisions for Debtor's Counsel

Bruce A. Markell
Sigmund J. Beck Advanced Chapter 11 Bankruptcy Roundtable
West Baden Springs Resort
West Baden Springs, Indiana
August 19-20, 2022

Materials:

1. *Examining Exculpation's Ethics: Rethinking the Ethical Duties of a Debtor's Attorney in Reorganization,* BANKRUPTCY LAW LETTER (Thomson Reuters; June 2022)
2. *Local Rule B-9010-3(a)* (Bankr. S.D. Ind.): "The Rules of Professional Conduct, as adopted by the Indiana Supreme Court, and the District Court's Local Rules of Disciplinary Enforcement, govern the conduct of those practicing in this Court.
3. *Local Rule B-9010-1(d)* (Bankr. N.D. Ind.): "The provisions of N.D. Ind. L.R. 83-5(a)(3), (d), and **(e)** are applicable to all matters pending in the bankruptcy court. [*Local Rule 83-5(e)* (N.D. Ind.): "Indiana's Rules of Professional Conduct and the Seventh Circuit Standards of Professional Conduct (an appendix to these rules) govern the conduct of those practicing in the court."]
4. *Ind. R. Prof. Conduct* 1.8(h) (2022):

   A lawyer shall not:

   > (1) make an agreement prospectively limiting the lawyer's liability to a client for malpractice unless the client is independently represented in making the agreement; or
   >
   > (2) settle a claim or potential claim for such liability with an unrepresented client or former client unless that person is advised in writing of the desirability of seeking and is given a reasonable opportunity to seek the advice of independent legal counsel in connection therewith.

Questions:

1. Does Rule 1.8 limit the bankruptcy court's power to approve a plan that has an exculpation clause protecting all professionals in a case excluding debtor's counsel? Including debtor's counsel?

2. Is a confirmed plan with an exculpation clause enforceable against a debtor who correctly contends its lawyer committed malpractice before the case? During the case? Does it matter?

3. Does Rule 1.8 permit the Indiana Supreme Court Disciplinary Commission to discipline a debtor's attorney who drafts and obtains confirmation of a plan containing an exculpation clause benefitting that attorney if that attorney did not advise the client about (maybe) getting another attorney to look at the provision?

Bankruptcy Law Letter

JUNE 2022 | VOLUME 42 | ISSUE 6

EXAMINING EXCULPATION'S ETHICS: RETHINKING THE ETHICAL DUTIES OF A DEBTOR'S ATTORNEY IN REORGANIZATION

*By Bruce A. Markell**

I. INTRODUCTION

Chapter 11 reorganizations often are long, drawn-out and messy. Good attorneys use this chaos to their client's advantage by strategically assembling coalitions of stakeholders aligned with their client's interests, and by isolating those opposed.

Chapter 11 cases also often proceed with speed. Time erodes value, and devil take the hindmost (or allocates to the laggers nothing or next to nothing). The extraordinary reorganization powers contained in chapter 11 leaven this mix, allowing the deft and adroit to forge a viable reorganized debtor.

This process often foments disgruntlement. Time and reflection can turn promising deals into ugly ones, and clients often blame their lawyers for the fallout. Often this is unjustified.

But sometimes it is not. Lawyers make mistakes. And in the reorganization cauldron, where speed, power and scarcity intermix, small mistakes can have outsized consequences.

Reorganization is not unique in this respect. The sad fact is mistakes by lawyers are not unusual. In the world outside of reorganization, the tort of legal malpractice provides rough compensation for victims of malpractice. But, as my mother used to say, an ounce of prevention is worth a pound of cure. Every state promulgates and curates rules of conduct for lawyers designed in part to lessen the incidence of harmful mistakes. Often referred to as rules of professional responsibility, these rules tell lawyers how they must act to retain the privilege of representing (and charging) clients.

*The issues discussed in this article were inspired by the author's consultations with Ogborn Mihm LLP in relation to SC SJ Holdings LLC, Case No. 21-10549 (Bankr. D. Del.). Neither Ogborn Mihm or any other entity related to SC SJ Holdings, requested, reviewed or approved this article, or provided compensation or reimbursement for its writing or publication.

IN THIS ISSUE:

For this issue of the *Bankruptcy Law Letter*, I want to look at the rules related to a lawyer's conduct when lawyers seek to erase the mistakes they make in reorganization. In reorganization circles, this practice is often referred to as "exculpation."

Not to put too fine a point on it, but my basic point is that the process and effect of exculpation as reported in the cases is contrary to established rules of professional conduct. And most courts are letting lawyers get away with it.

I realize that these are bold and inflammatory statements. But by the end of this article, I hope to show their truth, and to suggest how the problem might be avoided.

PUBLISHER: Katherine E. Freije

MANAGING EDITOR: Kathryn E. Copeland, J.D.

BANKRUPTCY LAW LETTER (USPS 674-930) (ISSN 0744-7871) is issued monthly, 12 times per year; published by Thomson Reuters, 610 Opperman Drive, P.O. Box 64526, St. Paul, MN 55164-0526. Periodicals postage paid at St. Paul, MN, and additional mailing

Subscription Price: For subscription information call (800) 221-9428, or write West, Credit Order Processing, 620 Opperman Drive, P.O. Box 64833, St. Paul, MN 55164-9754.

POSTMASTER: Send address changes to: *Bankruptcy Law Letter,* 610 Opperman Drive, P.O. Box 64526, St. Paul, MN 55164-0526.

II. EXCULPATION

Exculpation arises in the context of a confirmed chapter 11 plan. The plan proponent will place language in the plan which exculpates—excuses—a certain class of entities from liability for their actions with respect to the debtor. If the court confirms the plan, the order confirming the plan will incorporate the exculpatory language, making it binding upon anyone who is bound by the order confirming the plan. Further, the plan will also typically contain language enjoining the commencement of any action covered by the exculpation clause.[1]

A. THE NATURE OF EXCULPATION

Much confusion arises over exactly what exculpation is. Start first, however, with what it is *not*: a release of claims *against* the debtor. Rather it is the converse: the *debtor's* release of claims it (or the estate) has against third parties.[2] As a result, exculpation does not interfere or implicate with the statutory discharge granted by Section 524.

As exculpation is not a discharge or release of claims against a debtor, it is also not a third-party release, which has been the subject of notoriety of late.[3] Rather, exculpation is an agreement by the estate, backed by a court order, giving up claims the debtor or the estate has against a class of entities. In short, the estate, for reasons explored below, is abandoning or settling a contingent asset—claims held against the exculpated entities. As a consequence, exculpation affects monetary rights the debtor's estate may have against the exculpated entities.

Some courts, however, view this differently. They state that exculpatory provisions do not release or relinquish property of the estate.[4] Rather these courts state these clauses "establish the standard of care that will trigger liability in future litigation by a non-releasing party against an exculpated party for acts arising out of a debtor's restructuring."[5] As no claims are affirmatively released or settled, there is no transfer of estate property.

Such an argument, however, is pure casuistry. Changing the standard of liability excludes some actions from recompense; it changes what was compensable into something noncompensable. That is a loss of a right for those actions. Stripped of legalize, exculpation clauses eliminate negligence claims against attorneys. As malpractice is grounded in negligence, malpractice claims are thus prohibited.[6] In any sane world, that is a loss of a chose in action, an intangible item of property.[7]

B. PREVALENCE

Who are the entities benefitting from exculpation? Not surprisingly, the class of entities exculpated in any plan is varied and may differ from case to case. In most cases, however, the estate agrees not to seek recourse against its professionals—its investment bankers, its accountants and, the focus of this article, its attorneys.

While there is a temporal aspect to exculpations in practice—many only relate to claims arising during the pendency of the debtor's case—that limitation is not universal. Many cases have permitted, for example, exculpations that extend to prepetition activities.[8]

And although early cases categorized exculpations as fit only for extraordinary cases, the extraordinary has become ordinary. As the Ninth Circuit recently noted, exculpatory clauses are "a commonplace provision in Chapter 11 plans."[9]

C. ATTORNEYS AND EXCULPATION

Many instances of commercial exculpation are unexceptional. Much like a plumber discounting her bill because her installation was not quite up to snuff, investment bankers might take less than their bill if they make a mistake or are found not to be credible.[10] In both cases, the service providers expect that to be the end of the matter. The dispute is compromised and settled. In a sense, that type of give-and-take is typical of all reorganizations.

But lawyers are not plumbers or even investment bankers. Lawyers are subject to codes of professional conduct. And these codes have bite: unlike aspirational codes of good behavior,[11] violation of attorney codes of professional responsibility can lead to the loss of one's license to practice.

III. ATTORNEY EXCULPATION OUTSIDE OF BANKRUPTCY

Given the disparity in knowledge and experience between lawyers and most of their clients, it is not surprising that these codes of professional conduct speak to the limitation and settlement of disputes over the quality of a lawyer's services. The main repositories of these principles are Rule 1.8(h) of the American Bar Association's Model Rules of Professional Responsibility,[12] and Section 54 of the American Law Institute's *Restatement (Third) of the Law Governing Lawyers*.[13] The ABA's Model Rules have been adopted (with relatively minor changes) by most state regulatory bodies as applicable to attorneys within that state.[14]

A. ABA RULE 1.8(h)

The Model Rules cover a lawyer's ability to regulate her relationship with her client. This regulation covers not only any contractual attempt to limit liability for future actions, but also attempts to compromise and settle claims against the lawyer for past actions.

The operative rule is Rule 1.8 of the Model Rules. It states:

> (h) A lawyer shall not:
> (1) make an agreement prospectively limiting the lawyer's liability to a client for malpractice unless the client is independently represented in making the agreement; or
> (2) settle a claim or potential claim for such liability with an unrepresented client or former client unless that person is advised in writing of the desirability of seeking and is given a reasonable opportunity to seek the advice of independent legal counsel in connection therewith.[15]

Rule 1.8(h)(1) is fairly simple. A lawyer cannot limit his liability to a client at the initiation of a representation unless the client is independently represented. This includes capping liability for malpractice to fees earned or paid, liquidated damages clauses, and the like.[16]

It does, however, permit contractual selection of the means to determine such liability. Arbitration clauses in retainer agreements are be permitted.[17] The rule also permits the limitation of the scope of services provides through so-called "bundling" arrangements,[18] as well as a firm's efforts to protect itself from the errors of individual attorneys through the use of limited liability entities, so long as various disclosure rules are met.[19]

Rule 1.8(h)(2) is somewhat more complex. It imposes requirements on the lawyer in order to resolve or settle "claim[s] or potential claim[s]" for malpractice the client may have against the lawyer. There are basically two such requirements: the lawyer must advise, in writing, of the "desirability" of seeking separate and independent counsel regarding such settlement and must give the client "a reasonable opportunity" to obtain such advice.

Rule 1.8(h)(2) exists to protect clients "in view of the danger that a lawyer will take unfair advantage of an unrepresented client or former client."[20]

B. ALI'S RESTATEMENT THIRD OF THE LAW GOVERNING LAWYERS

In 2000, the American Law Institute completed its third restatement of the *Law Governing Lawyers*. Written against the background of the ABA Model Rules, it contains greater burdens for lawyers who wish to contractually limit or reduce client claims.

Section 54 of the *Restatement* provides, in relevant part:

> (2) An agreement prospectively limiting a lawyer's liability to a client for malpractice is unenforceable.
>
> (3) The client or former client may rescind an agreement settling a claim by the client or former client against the person's lawyer if:
>
> (a) the client or former client was subjected to improper pressure by the lawyer in reaching the settlement; or
>
> (b) (i) the client or former client was not independently represented in negotiating the settlement, and (ii) the settlement was not fair and reasonable to the client or former client.
>
> (4) For purposes of professional discipline, a lawyer may not:
>
> (a) make an agreement prospectively limiting the lawyer's liability to a client for malpractice; or
>
> (b) settle a claim for such liability with an unrepresented client or former client without first advising that person in writing that independent representation is appropriate in connection therewith.

In addition to restating the basic requirements of Rule 1.8(h), section 54(4) of the *Restatement* adds substantive law consequences to failure to comply with the rules on settlement.[21] It grants to the client the ability to avoid a settlement in two circumstances: (1) if the client was unrepresented and the resulting settlement was not "fair and reasonable" to the client;[22] or (2) if the lawyer "subjected [the client] to improper pressure" in obtaining the settlement.[23]

What is a claim under the *Restatement*? Does it include any request to reduce fees? No. Comment *c* makes it clear that while "a claim includes requests for damages, fee forfeiture . . . or the like," it does not include "disputes as to disposition of documents or the amount of a lawyer's fee."[24]

C. KEY POINTS

From the above, it is an easy conclusion that the typical exculpation clause as reported in the cases qualifies as an attempt to settle any claim for malpractice. It seeks to preclude a client—the revested debtor—from bringing any action based on the professional's work rendered to the debtor or the estate. While there might be some exclusions—some exculpations exclude malpractice, others exclude willful misconduct or gross negligence[25]—the basic negligence action based on failure to adhere to duties owed to the debtor are terminated. Moreover, the typical plan will also combine exculpation with a plan injunction against even bringing an action based on the claims exculpated by the plan.

As such, were the exculpation provision presented to the client outside of bankruptcy, it is beyond cavil that attorneys would have to meet the requirements of the applicable version of Rule 1.8(h). Although the issue has been occasionally raised, usually by the Office of the United States Trustee,[26] there appear to be zero cases which apply the rule to confirmation of a chapter 11 plan. That is, no case has required separate counsel to advise the debtor. No case has required explicit written disclosure of that potential malpractice claims are being extinguished. No case has questioned why law firms do not discount their fees in return for exculpation (or question whether the debtor was informed of the intended inclusion of any exculpation clause when the law firm was initially retained).

In part, this failure can be explained by the somewhat mongrel basis for exculpation clauses in the first instance. Courts grapple with whether a plan may include such clauses, and that effort seems to overshadow the ethical nuances of their inclusion once authorized. The effort to legitimize exculpation clauses follows.

IV. PLANS AND EXCULPATION

The initial question is whether the Bankruptcy Code even authorizes exculpation clauses. Most courts have found that it does, albeit with some grumbling. The progress of provisions once deemed to be extraordinary to the commonplace has been described as "an example of the Lake Wobegon effect whereby many ordinary and average things are postured as extraordinary, causing the very concept of extraordinariness to lose meaning."[27]

A. THE JUSTIFICATIONS

Courts have used many bases to justify exculpation clauses. Cases from Delaware and the Third Circuit analogized such clauses to rights trustees and others have under common law;[28] such fiduciaries enjoy certain immunities and indemnification rights at common law. These courts thus viewed the exculpation clauses as somewhat redundant, sort of a match on a burning blaze.

The problem with this justification is that it can only reach fiduciaries such as the debtor, its lawyers and creditors' committees. It will not extend to other professionals, such as investment bankers and other financiers who undoubtedly contribute to the success of a confirmed plan. So other grounds have been explored.

In this search, courts have often relied on two "catch all" provisions to justify exculpation. As one might expect, Section 105(a), with its language giving the court the power to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title,"[29] has been a prime candidate for justification.[30] So too has Section 1123(b)(6), which permits a plan to include "any other appropriate provision not inconsistent with the applicable provisions of this title."[31] Although sweeping, invocation of these provisions requires answering other questions—what are the specific provisions that Section 105 is being used to "carry out"? Why are exculpation clauses "appropriate" provisions in a plan?

A more satisfactory basis might be Section 1123(b)(3)(A), which permits plan provisions that "provide for—(A) the settlement or adjustment of any claim or interest belonging to the debtor or to the estate."[32] After all, exculpation affects contingent claims the estate holds against those exculpated, and thus it, at a minimum, "adjusts" those claims.

At this point, however, uniformity of justification dissolves. Not all circuits employ the same standard for approving settlements and their concomitant releases in plans.[33] Some use the so-called "*Master Mortgage* factors, which require the court to examine (1) an identity of interest between the debtor and nondebtor such that a suit against the nondebtor will deplete the estate's resources; (2) a substantial contribution to the plan by the nondebtor; (3) the necessity of the release to the reorganization; (4) the overwhelming acceptance of the plan and release by creditors and interest holders; and (5) the payment of all or substantially all of the claims of the creditors and interest holders under the plan."[34] Others permit a debtor to release or exculpate claims in a plan if the provision is a valid exercise of the debtor's business judgment, is fair, reasonable, and in the best interests of the estate.[35] Still others adopt the general requirements of Bankruptcy Rule 9019.[36]

More recently, a district court has proposed a new test under which an exculpation clause "(a) . . . must be limited to the fiduciaries who have performed necessary and valuable duties in connection with the bankruptcy case; (b) is limited to acts and omissions taken in connection with the bankruptcy case; (c) does not purport to release any prepetition claims; (d) contains a carve out for gross negligence, actual fraud or willful misconduct; and, (e) contains a gatekeeper function."[37]

B. REASONABLENESS AND REWARD?

The lack of an agreed standard for approval of exculpation clauses is largely due to the lack of any statutory basis for such clauses combined with a lack of consensus as to their construction. Nonetheless, exculpation clauses are routinely approved, especially if confined to post petition activities (although there is some recent doubt there).[38]

The demand for such clauses is easy to understand. As stated by one court, "exculpation provisions are included so frequently in chapter 11 plans because stakeholders all too often blame others for failures to get the recoveries they desire; seek vengeance against other parties; or simply wish to second guess the decisionmakers in the chapter 11 case."[39]

As a result, court often point to the contributions to the reorganization effort made by those receiving the benefit of such clauses and intone that such effort would not have been made (or made with less vigor) if the promise of a lawsuit-free future were not made. They also point to the inclusion of such clauses as part of the grand bargains that usually produce confirmed plans, and the creditor approval of such plans as further justification for their approval.[40]

This may be acceptable for non-lawyers; this article makes no argument for or against exculpation of investment bankers and other non-lawyer professionals. Those professionals have their own codes of conduct for dealing with their clients, and that may be fodder for a future article.

But lawyers are different. They operate under defined rules that procedurally and substantively affect the settlement of any claim for misconduct in their representation. The pro forma extension of exculpation to lawyers presents issues in its very banality. Courts occasionally rail against this unthinking extension of exculpation and releases. As one court put it, "releases are not a merit badge that somebody gets in return for making a positive contribution to a restructuring. They are not a participation trophy, and they are not a gold star for doing a good job. Doing positive things in a restructuring case—even important positive things—is not enough."[41]

That sentiment echoes the purpose of Rule 1.8 and the *Restatement Third*. Application of these ethical and substantive authorities make deals between lawyers, even run-of-the mill settlements consistent with deals offered to non-lawyers, subject to procedural and substantive checks to ensure fairness and disincentivize overreaching.[42]

This has significant repercussions in reorganizations. If, for example, a lawyer enters into a restructuring engagement with a debtor expecting or requiring exculpation on confirmation, that raises issues regarding Rule 1.8(h)(1) and the ban on limiting liability for future acts. If the plan exculpates lawyers with written notice to their clients and an independent review of the legal effect of the exculpation clause, that raises issues under Rule 1.8(h)(2). Both acts raise issues as to whether the exculpation, if not independently reviewed, was "fair and equitable" under Section 54 of the *Restatement Third*.

But many would assert that any state regulation, including regulation of professional responsibility, is preempted by the federal nature of bankruptcy proceedings. That question takes up the next section.

V. ARE ETHICAL RULES PREEMPTED?

Courts categorize and conceptualize confirmed reorganization plans as contracts between the affected parties.[43] That categorization is appropriate for a plan's use of exculpation clauses; such clauses act as a part of a more general contract under which the debtor's estate releases any claim it may have against those exculpated. If the parties exculpated include the estate's and the debtor's lawyers, then the effect is as if the estate settled or abandoned all contingent claim it may have had against its lawyers, including claims for malpractice. On its face then, Rule 1.8 should apply.

But it hasn't.[44] One obvious argument against applying Rule 1.8 is that bankruptcy courts are federal courts, and that the Bankruptcy Code is federal law, and these two points require preemption of Rule 1.8 and the substantive law principles outlined in the *Restatement*. A deeper review of this argument shows its frailties.

A. PREEMPTION GENERALLY

The Supremacy Clause of the United States Constitution prohibits states from enacting laws that are contrary to the laws of our federal government: "This Constitution and the Laws of the United States . . . shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding."[45] It is through this clause that the United States Congress may preempt state law.

There are three ways in which a state law may be preempted. First, state law may be preempted where the United States Congress enacts a provision which expressly preempts the state enactment. Likewise, preemption may be found where Congress has legislated in a field so comprehensively that it has implicitly expressed an intention to occupy the given field to the exclusion of state law. In these two instances, Congress can be said to have preempted the field; that is, the field defined by the scope of the congressional action.

Even if the field regulated is not completely occupied by federal action, a state enactment will still be preempted when it conflicts with a federal law. This conflict is usually found in one of two situations: when it is impossible to comply with both federal and state law,[46] or when the state law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."[47]

The line between conflict and frustration has often been difficult to draw. As the Court recently stated in *Kansas v. Garcia*,[48] "[i]n all cases, the federal restrictions or rights that are said to conflict with state law must stem from either the Constitution itself or a valid statute enacted by Congress. 'There is no federal preemption in vacuo,' without a constitutional text, federal statute, or treaty made under the authority of the United States."[49]

Nevertheless, *Kansas v. Garcia* reiterated that it has long been established that preemption may also occur by virtue of restrictions or rights that are inferred from statutory law.[50]

B. NO FIELD PREEMPTION

In determining whether a state regulation is preempted by federal law, courts start "with the assumption that the historic police powers of the States [are] not to be superseded by . . . Federal Act unless it [is] the clear and manifest purpose of Congress."[51] In the area of professional responsibility, most courts have found that, even in areas of exclusive federal jurisdiction, the field of state regulation is not preempted.

Bankruptcy is not the only federal practice area. Specialized courts often have their own rules. For example, there are special rules for attorneys practicing in the patent and trademark area, in immigration courts, and in military tribunals.[52] Although case law is thin, no case has held that the establishment of specialized courts preempts all manner of state attorney regulation.

Bankruptcy practice presents an even easier case for dismissing field preemption. Although Congress did establish a separate bankruptcy court system, it did not provide any statutory guidance as to the lawyer regulation in those courts. Indeed, many (if not all) bankruptcy courts will adopt or incorporate state rules of professional responsibility into bankruptcy court practice.

C. NO CONFLICT PREEMPTION: INCORPORATION

When Congress has not preempted the field, conflict analysis is appropriate. But even before that analysis is undertaken, there is good reason to believe Rule 1.8 should apply in every reorganization. Why? Because most every bankruptcy court has, by its local rules, adopted the relevant state rules of professional responsibility as applicable to their court.

Delaware Local Bankruptcy Rule 1001-1(f),[53] for example, incorporates the District Court rules, and Rule 83.6(d) of those rules state:

> (d) Standards for Professional Conduct. Subject to such modifications as may be required or permitted by federal statute, court rule, or decision, all attorneys admitted or authorized to practice before this Court, including attorneys admitted on motion or otherwise, shall be governed by the Model Rules of Professional Conduct of the American Bar Association ("Model Rules"), as amended from time to time.[54]

No local rule exempts Rule 1.8.

The same appears to be true for the Southern

District of New York. The Second Circuit has indicated that New York's Rules of Professional Conduct "govern[] the conduct of attorneys in federal courts sitting in New York as well as in New York state courts."[55] The District Court explicitly refers to discipline for violation of these rules.[56]

As a result, no preemption analysis should be required. Bankruptcy courts should enforce Rule 1.8 as written, which would mean that they should require disclosure and separate representation for plans that contain attorney exculpation and should question or sanction attorneys who do not comply. It is simply a matter of enforcing their own rules.

Of course, adoption of the Model Rules only affects attorney discipline. No bankruptcy court seems to have adopted anything like Section 54 of the *Restatement*. To the extent that a court approves an exculpation clause propounded in violation of Rule 1.8, a knotty problem arises with respect to the validity of that clause. Outside of bankruptcy, Section 54 would require a finding that the clause is "fair and equitable" and that the debtor was separately represented; otherwise, the debtor could avoid the clause. If the bankruptcy court is acting pursuant to its powers to approve transfers under Section 1123(b)(3), there would seem to be power and ability to effectuate that transfer. As stated in the comments to Section 54, "[w]hatever the nature of the claim, once a settlement has been implemented in court through such means as entry of a judgment, it can be challenged only as permitted by applicable procedural rules."[57]

D. NO CONFLICT PREEMPTION: STATE INTEREST IN ATTORNEY REGULATION VS FEDERAL INTEREST IN FACILITATING REORGANIZATION

Even if bankruptcy courts had not bound themselves to follow the Model Rules, the issue would arise as to whether attorneys practicing in those courts would still be subject to Rule 1.8. The issue is one of conflict preemption; that is, whether there is a conflict with a federal statutory or regulatory scheme. Conflict, in turn, requires comparison; a conflict exists only to the extent that compliance with a state scheme impairs the ability of the federal scheme to achieve its purposes.

The comparison starts with traditional deference in preemption analysis to state exercise of police powers, especially with respect to regulation of the legal profession. When a court is presented with a matter that by long tradition has been left to state regulation, federal preemption will be found only if intervening events demonstrate that "that [is] the clear and manifest purpose of Congress."[58] As the Supreme Court has noted with respect to lawyer regulation:

> Since the founding of the Republic, the licensing and regulation of lawyers has been left exclusively to the States and the District of Columbia within their respective jurisdictions. The States prescribe the qualifications for admission to practice and the standards of professional conduct. They also are responsible for the discipline of lawyers.[59]

This deference requires a strong and explicit federal interest before state regulation is preempted. And that is not the case with professional responsibility and bankruptcy. A lawyer's conduct rarely impacts the validity of any adjustments to the debtor-creditor relationship.[60] In short, how an attorney behaves rarely impacts the enforceability of liability adjusted by a plan of reorganization.

This distinction between how an attorney acts and the enforceability of her client's debts should apply with respect to Rule 1.8 and its application to reorganization attorneys. Exculpation, as explored above, has no specific authorization in the Bankruptcy Code. Indeed, many courts approve such clauses under "catch-all" provisions such as Sections 105(a) and 1123(b)(6). But even when justified under the settlement provisions of Section 1123(b)(3), the various standards for approving settlements indicate a role for state rules governing the lawyers' actions. This can be seen under either Rule 1.8(h)(1) regarding future liability, and Rule 1.8(h)(2) regarding settlement.

The federal interest in exculpation, if any, would seem to be in ensuring that debtors and other professionals paid by the estate have competent and experienced counsel. But the tradeoff between increased competency and loss of recourse is difficult to measure. It is not unlike removing warranty protection for a car or its parts—the manufacturer has done all it can, and it remains to be seen whether time can verify quality.

But the tradeoff can be taken too far; I doubt any court would approve a law firm's retention if they conditioned their representation on placing the debtor's president's mother in chains, and holding her in a basement, until all fees were paid. Indeed, there is a perverse reverse incentive here: since Rule 1.8(h)(1) otherwise prohibits limiting liability as a condition of retention, allowing an exception to that rule for bankruptcy would draw those who would rely on such a provision, thereby either reducing the incentive and consequences for competent practice, or increasing the risks the lawyer might be willing to take.

The same analysis applies to Rule 1.8(h)(2). The genesis of Rule 1.8(h)(2) lies in the asymmetry of knowledge and experience between lawyer and client. That imbalance is, if anything, greater in reorganization, given reorganization's—hopefully—once in a lifetime occurrence. As a result, the need for intelligent and well-informed decisions regarding releases of contingent assets is heightened.

A lawyer's ability to dispose of any existing claims of malpractice without compliance with Rule 1.8 presents another example of perverse incentives. It removes the risk of a subsequent dispute (especially if the exculpation clause is backed by plan injunctions), and deprives the reverted debtor (and, depending on the reorganization, its creditors) of a potential recovery without the examination Rule 1.8(h)(2) requires.

E. CONSEQUENCES

It should be stated that Rule 1.8 and the *Restatement* rules do not affect a bankruptcy court's power to confirm plans with exculpation clauses. The reason is simple: they cannot. States do not have the power granted Congress under the Bankruptcy Clause of the Constitution so long as title 11 is law. By the same token, however, by simply enacting the Bankruptcy Code, Congress has not preempted the states' ability to regulate attorneys practicing in bankruptcy law in bankruptcy tribunals. This lack of preemption should not be surprising as there is ample precedent for states to apply their rules of professional responsibility to local attorneys practicing in other federal tribunals.[61]

Indeed, in criminal prosecutions in federal court, Congress has reaffirmed the primacy and application of state regulation through the McDade Act,[62] which requires that "[a]n attorney for the Government shall be subject to State laws and rules, and local Federal court rules, governing attorneys in each State where such attorney engages in that attorney's duties, to the same extent and in the same manner as other attorneys in that State." Regulations under this statute state that it "should not be construed in any way to alter federal substantive, procedural, or evidentiary law."[63] This has caused the Justice Department to challenge state rules of professional responsibility for certain practices, albeit with limited success.[64] The general result, however, is that state ethics rules can be "enforced by the state defendants against federal prosecutors."[65]

Moreover, if there is perceived conflict between the state rules and federal practice, Congress or federal agencies can always attempt to specifically invoke preemption.[66] And this has occurred. The Army, for example, has noted that Rule 1.8 is inconsistent with congressional limitation on malpractice claims against Army attorneys, and has chosen not to adopt it with respect to Army attorneys practicing in military tribunals.[67]

Unlike practice before patent, immigration and military tribunals, there are no national rules regulating attorney conduct in bankruptcy court. Indeed, as shown above, most bankruptcy courts have simply adopted the rules of the state in which they sit. This relationship underscores the continued applicability of state rules of responsibility, and state rules regarding the law of lawyers, in bankruptcy court practice.

The recent Third Circuit case of *In re Boy Scouts of America*[68] is not contrary to this analysis. There, an insurance company contended that a law firm which represented it had violated Rule 1.7 regarding conflicts of interest when that law firm took on the representation of a debtor it insured.[69] Based on this contention—which the lower counts declined to determine[70]—the insurance company contended the law firm should be disqualified under Section 327 from representing the debtor.

The Third Circuit, speaking through Judge

Ambro, rejected the claim. Judge Ambro focused on Section 327 and its concern that lawyers should not have conflicts with the estate. That was a different focus from conflicts between creditors of the estate. On that point—conflicts with other creditors—Judge Ambro indicated Section 327 was indifferent, and so long as there were no disqualifying conflicts *with the estate*, Section 327 would not support disqualification.[71] And the lower courts had not decided that there was such a conflict.[72]

Judge Ambro did go on to indicate that Section 327 would not interfere with disputes between the debtor's counsel and the insurance company over the law firm's bankruptcy representation of the debtor, which apparently were subject to a pending arbitration.[73] That recognition impliedly assumed that there was no preemption. As a result, the opinion is consistent with the notion that bankruptcy does not preempt the field of regulating attorneys' conduct in bankruptcy proceedings and consistent with the point that state regulation of such conduct is only an issue when, as *Kansas v. Garcia* indicates, there is a federal text—regulation, statute or constitutional provision—which conflicts with the state regulation.

VI. CONCLUSION

Bankruptcy courts have been strangely silent on the applicability and effect of Rule 1.8 to exculpation clauses. This silence is odd given the relatively straightforward application of Rule 1.8's terms: lawyers cannot limit their liability prospectively and can't terminate their contingent liability for malpractice without giving their clients written notice of what's going on, and a realistic opportunity to obtain separate counsel to assess the fairness of the proposal. Although less clear, the failure to adhere to these rules, or to obtain specific findings compliant with non-bankruptcy law as restated in the *Restatement* runs the risk that such exculpation clauses will be avoided and for naught.

I acknowledge that compliance would be sticky and time-consuming. Two solutions, however, suggest themselves. The first is that plans could exempt malpractice from the scope of any proposed exculpation.[74] The second is that lawyers could try to justify exculpation by seeking findings that their value as reorganization lawyers exceeds the cost to the revested debtor of exculpation (that is, the benefit of any malpractice litigation).[75] Since the former essentially guts the value of exculpation to lawyers, and the latter requires a reduction of fees to reflect the benefit of being freed of malpractice risk, these solutions are not likely to be implemented any time soon.

ENDNOTES:

[1]This article only examines the interplay between exculpation clauses and professional responsibility rules. The effect of such rules on plan injunctions and upon claim and issue preclusion issues in final fee orders is not addressed and is reserved for future articles.

[2]In this article, I used "debtor" and "estate" interchangeably. Exculpation clauses seek to deprive the estate of claims the estate would have against third parties. These claims are typically claims arising during case administration, and thus are property of the estate under 11 U.S.C.A. § 541(a)(7). Some aggressive uses of exculpation additionally also seek to reach claims held by the debtor prepetition, and these claims would be property of the estate under 11 U.S.C.A. § 541(a)(1). As a result, at confirmation, the issue is over the fate of claims for relief or choses in action held by the estate. After confirmation, however, to the extent that such claims are not dealt with by the confirmed plan, they would usually revert to the reorganized debtor, and pursued by that entity. My analysis does not depend on when exculpation is challenged, and thus the interchangeability of the reference to the claim's owner.

[3]See, e.g., Lindsey Simon, Bankruptcy Grifters, 131 Yale L.J. 1154 (2022) (discussing abuse of nonconsensual nondebtor releases); Adam J. Levitin, Purdue's Poison Pill: The Breakdown of Chapter 11's Checks and Balances, 100 Tex. L. Rev. 1079, 1155 n.103 (2022).

Of course, the Bankruptcy Law Letter's fearless leader, Ralph Brubaker, has long decried the legitimacy of such releases, Ralph Brubaker, Bankruptcy Injunctions and Complex Litigation: A Critical Reappraisal of Non-Debtor Releases in Chapter 11 Reorganizations, 1997 U. Ill. L. Rev. 959, and recently renewed his objections in these pages, Ralph Brubaker, An Incipient Backlash Against Nondebtor Releases? (Part I): The "Necessary to Reorganization" Fallacy, Bankruptcy Law Letter (Feb. 2022). There is some recent indication of judicial backlash consistent with these critiques. See, e.g., Patterson v. Mahwah Bergen Retail Group, Inc., 636 B.R. 641 (E.D. Va. 2022); In re Purdue Pharma, L.P., 635 B.R. 26 (S.D.N.Y. 2021).

[4]See, e.g., In re Murray Metallurgical Coal Holdings, LLC, 623 B.R. 444 (Bankr. S.D. Ohio 2021). Such statements seem to be contrary to the plain nature of such claims for relief. See note 1 supra.

[5]In re Murray Metallurgical Coal Holdings, LLC, 623 B.R. 444 (Bankr. S.D. Ohio 2021); In re Health Diagnostic Laboratory, Inc., 551 B.R. 218, 232 (Bankr. E.D. Va. 2016) ("The practical effect of a proper exculpation provision is not to provide a release for any party, but to raise the standard of liability of fiduciaries for their conduct during the bankruptcy case.").

[6]"[L]egal malpractice is essentially an application of general tort law to particular contexts that happen to involve lawyers." Geoffrey C. Hazard, Jr., W. William Hodes & Peter R. Jarvis, The Law of Lawyering § 5.01 (4th ed. 2014).

[7]As stated by Justice Douglas, "[i]t has been commonly accepted in the federal courts that 'property' within the meaning of this [Bankruptcy Act § 77(a)] includes intangibles such as choses in action." Baker v. Gold Seal Liquors, Inc., 417 U.S. 467, 476, 94 S. Ct. 2504, 2510, 41 L. Ed. 2d 243 (1974).

[8]See. e.g., In re Murray Metallurgical Coal Holdings, LLC, 623 B.R. 444 (Bankr. S.D. Ohio 2021).

[9]Blixseth v. Credit Suisse, 961 F.3d 1074, 1085, 68 Bankr. Ct. Dec. (CRR) 224 (9th Cir. 2020), cert. denied, 141 S. Ct. 1394, 209 L. Ed. 2d 132 (2021).

[10]See, e.g., In re Las Vegas Monorail Co., 462 B.R. 795, 804, 55 Bankr. Ct. Dec. (CRR) 231 (Bankr. D. Nev. 2011) (finding investment banker's testimony not credible).

[11]See, e.g., Morgan Stanley, Code of Conduct 2022, available at morganstanley.com/about-us-governance/code-of-conduct; Paul Clark, Bad behaviour is integral to an investment banking career—and this isn't changing, efinancialcareers (Nov. 29, 2013), available at https://www.efinancialcareers.com/news/2013/11/bad-behaviour-is-integral-to-an-investment-banking-career-and-this-isnt-changing.

[12]Model Rules of Pro. Conduct (Am. Bar Ass'n 2020), available at https://www.americanbar.org/groups/professional_responsibility/publications/model_rules_of_professional_conduct/model_rules_of_professional_conduct_table_of_contents/. This article cites the rules contained in this code as "Rule X.X." The Model Rules replaced the earlier Model Code of Professional Responsibility and its Disciplinary Rules. Model Code of Pro. Resp. (Am. Bar Ass'n 1980).

[13]Restatement (Third) of the Law Governing Lawyers § 54 (2000). This article cites the sections contained in the Restatement as "Res3d § X."

[14]See George W. Kuney, Unethical Protection? Model Rule 1.8(H) and Plan Releases of Professional Liability, 83 Am. Bankr. L.J. 481, 484 n.4 (2009). Professor Kuney's article was one of the first to note the problems mentioned in this article but seems to have fallen on deaf ears since its publication. See also Kurt F. Gwynne, Indemnification and Exculpation of Professional Persons in Bankruptcy Cases, 10 Am. Bankr. Inst. L. Rev. 711, 725 (2002).

[15]Rule 1.8.

[16]See, e.g., Feacher v. Hanley, 2014 WL 119382 (D. Utah, Jan. 13, 2014) (lawyer contract with client cannot limit liability to amount of fees charged or include liquidated damages clause for particular breaches).

[17]Rule 1.8, cmt. 17 ("This paragraph does not, however, prohibit a lawyer from entering into an agreement with the client to arbitrate legal malpractice claims, provided such agreements are enforceable and the client is fully informed of the scope and effect of the agreement.").

[18]Rule 1.8, cmt. 17 ("Nor does it prohibit an agreement in accordance with Rule 1.2 that defines the scope of the representation, although a definition of scope that makes the obligations of representation illusory will amount to an attempt to limit liability.").

[19]Rule 1.8, cmt. 17 ("Nor does this paragraph limit the ability of lawyers to practice in the form of a limited-liability entity, where permitted by law, provided that each lawyer remains personally liable to the client for his or her own conduct and the firm complies with any conditions required by law, such as provisions requiring client notification or maintenance of adequate liability.").

[20]Rule 1.8, cmt. 18.

[21]The comment indicates that an agreement limiting liability prospectively is "against public policy because it tends to undermine competent and diligent legal representation. Also, many clients are unable to evaluate the desirability of such an agreement before a dispute has arisen or while they are represented by the lawyer seeking the agreement" Res3d § 54, cmt. b.

[22]Illustrative cases cited by the *Restatement* include Swift v. Choe, 242 A.D.2d 188, 674 N.Y.S.2d 17 (1st Dep't 1998) (release invalid when client had severe vision problem and lawyer failed to explain); Ames v. Putz, 495 S.W.2d 581 (Tex. Civ. App. Eastland 1973), writ refused, (Sept. 19, 1973) (release invalid when client not informed of its legal consequences and did not know of lawyer's malpractice);

[23]Improper pressure can include the "refusal to return documents or funds except upon release of the malpractice claim." Res3d § 54, cmt. c. This pressure exists "even if the client was independently represented, because representation does not necessarily dispel improper pressure." *Id*.

[24]Res3d § 54, cmt. c.

[25]See Sally McDonald Henry, Ordin on Contest-

ing Confirmation § 18.11 Exculpation Clauses (7th Edition 2022-1 Supplement). See also In re Reader's Digest Ass'n, No. 09-23529 (RDD), 2010 Bankr. LEXIS 5550, at *35-36 (Bankr. S.D.N.Y. Jan. 19, 2010); In re Extended Stay Inc., No. 09-13764, 2010 WL 6561113 (Bankr. S.D.N.Y. July 20, 2010).

[26]See, e.g., In re Stearns Holdings, LLC, 607 B.R. 781 (Bankr. S.D.N.Y. 2019); In re Winn-Dixie Stores, Inc., 356 B.R. 239 (Bankr. M.D. Fla. 2006).

[27]In re Astria Health, 623 B.R. 793, 801 n.25, 69 Bankr. Ct. Dec. (CRR) 195 (Bankr. E.D. Wash. 2021).

[28]See In re Washington Mutual, Inc., 442 B.R. 314, 350-51 (Bankr. D. Del. 2011) ("The exculpation clause must be limited to the fiduciaries who have served during the chapter 11 proceeding: estate professionals, the Committees and their members, and the Debtors' directors and officers.").

[29]11 U.S.C.A. § 105(a).

[30]In re Airadigm Communications, Inc., 519 F.3d 640, 657, 49 Bankr. Ct. Dec. (CRR) 179, Bankr. L. Rep. (CCH) P 81123 (7th Cir. 2008) (describing section 1123(b)(6) as working in tandem with section 105(a) to ensure "a bankruptcy court is also able to exercise [its] broad equitable powers within the plans of reorganization themselves").

[31]11 U.S.C.A. § 1123(b)(6). See, e.g., U.S. v. Energy Resources Co., Inc., 1990-2 C.B. 263, 495 U.S. 545, 549, 110 S. Ct. 2139, 109 L. Ed. 2d 580, 20 Bankr. Ct. Dec. (CRR) 840, 22 Collier Bankr. Cas. 2d (MB) 1093, Bankr. L. Rep. (CCH) P 73381, 90-1 U.S. Tax Cas. (CCH) P 50281, 65 A.F.T.R.2d 90-1078 (1990) (explaining that then section 1123(b)(5)—currently section 1123(b)(6)—provides "residual authority" for bankruptcy courts to approve plans containing features that are not explicitly authorized by statute "consistent with the traditional understanding that bankruptcy courts, as courts of equity, have broad authority to modify creditor-debtor relationships"); In re Adelphia Communications Corp., 441 B.R. 6, 19, 53 Bankr. Ct. Dec. (CRR) 267 (Bankr. S.D. N.Y. 2010) ("Section 1123(b)(6), by its terms, is plainly a broad grant of authority. As previously noted, reorganization plans, after they get the requisite assent, may allocate and distribute the value of debtors' estates by a broad array of means.").

[32]11 U.S.C.A. § 1123(b)(3)(A).

[33]See 7 Collier on Bankruptcy ¶ 1123.02[3] (Henry Sommer & Richard Levin, eds., 16th ed. 2022) for a collection of cases.

[34]In re Master Mortg. Inv. Fund, Inc., 168 B.R. 930, 937, 31 Collier Bankr. Cas. 2d (MB) 240 (Bankr. W.D. Mo. 1994). See, e.g., *In re rue21, inc.,* 575 B.R. 314, 324, 64 Bankr. Ct. Dec. (CRR) 168 (Bankr. W.D. Pa. 2017) (if the release is so intertwined within the plan terms that it is not easy to distinguish where the settlement ends and the plan begins, it should be evaluated under the Master Mortgage factors).

[35]In re Spansion, Inc., 426 B.R. 114, 143 (Bankr. D. Del. 2010) (section 1123(b)(3)(A) permits a debtor to release claims in a plan if the release is a valid exercise of the debtor's business judgment, is fair, reasonable, and in the best interests of the estate); In re DBSD North America, Inc., 419 B.R. 179, 217 (Bankr. S.D. N.Y. 2009), aff'd, 2010 WL 1223109 (S.D. N.Y. 2010), judgment aff'd in part, rev'd in part, 627 F.3d 496 (2d Cir. 2010), opinion issued, 634 F.3d 79, 65 Collier Bankr. Cas. 2d (MB) 201, Bankr. L. Rep. (CCH) P 81933 (2d Cir. 2011) (1123(b)(3) permits a debtor to include a settlement of any claims it might own as a discretionary provision in its plan); In re Hercules Offshore, Inc., 565 B.R. 732, 755-56 (Bankr. D. Del. 2016) (release of secured lender appropriate when lender agreed to concessions under a settlement that provided for the payment in full of all unsecured claims, consideration to equity holders and a reduction in estate liabilities).

[36]In re Astria Health, 623 B.R. 793, 800, 69 Bankr. Ct. Dec. (CRR) 195 (Bankr. E.D. Wash. 2021) ("In the Ninth Circuit, bankruptcy courts reviewing settlements are generally to consider (1) the probability of success in potential litigation; (2) the difficulties, if any, to be encountered in the matter of collection; (3) the complexity of the litigation involved, and the expense, inconvenience and delay necessarily attending it; and (4) the paramount interest of the creditors and a proper deference to their reasonable views in the premises.").

[37]Patterson v. Mahwah Bergen Retail Group, Inc., 636 B.R. 641, 702 (E.D. Va. 2022). See also In re Health Diagnostic Laboratory, Inc., 551 B.R. 218, 234 (Bankr. E.D. Va. 2016) (exculpation provision approved if it "(a) is narrowly tailored to meet the needs of the bankruptcy estate; (b) is limited to parties who have performed necessary and valuable duties in connection with the case (excluding estate professionals); (c) is limited to acts and omissions taken in connection with the bankruptcy case; (d) does not purport to release any pre-petition claims; and (e) contains a gatekeeper function by which the Court may, in its discretion, permit an action to go forward against the exculpated parties.").

[38]See, e.g., In re Murray Metallurgical Coal Holdings, LLC, 623 B.R. 444, 504 (Bankr. S.D. Ohio 2021) ("exculpation need not be limited to postpetition conduct.").

[39]In re Chemtura Corp., 439 B.R. 561, 610 (Bankr. S.D. N.Y. 2010).

[40]See, e.g., In re Winn-Dixie Stores, Inc., 356 B.R. 239, 257 (Bankr. M.D. Fla. 2006). Indeed, the acceptability of such justifications lead the American Bankruptcy Institute's Commission to Study the Reform of Chapter 11 to suggest changes to the

Bankruptcy Code to specifically authorize exculpation clauses in Chapter 11 plans. Am. Bankr. Inst. Comm'n to Study the Reform of Chapter 11, 2012—2014 Final Report and Recommendations, 23 Am. Bankr. Inst. L. Rev. 1, 271–79 (2015).

[41]In re Aegean Marine Petroleum Network Inc., 599 B.R. 717, 726-27 (Bankr. S.D. N.Y. 2019).

[42]Comment c to Res3d § 54 lists several illustrative cases, such as Cohen v. Surrey, Karasik & Morse, 427 F.Supp. 363 (D.D.C. 1977) (upholding release by wealthy and sophisticated clients, one a lawyer, given in exchange for reduction in unpaid fee); Donnelly v. Ayer, 228 Cal. Rptr. 764 (Cal.Ct.App.1986) (upholding release given after client-lawyer relationship ended and client consulted malpractice lawyer); Ames v. Putz, 495 S.W.2d 581 (Tex. Civ. App.1973) (release invalid when client not informed of its legal consequences and did not know of lawyer's malpractice); Marshall v. Higginson, 813 P.2d 1275 (Wash. Ct. App.1991) (release set aside despite compliance with Rule 1.8(h), because lawyer obtained release by saying he would not testify for former client without it).

[43]See, e.g., Harper v. Oversight Comm. (In re Conco, Inc.), 855 F.3d 703, 711 (6th Cir. 2017) ("In interpreting a confirmed plan, courts use contract principles, since the plan is effectively a new contract between the debtor and its creditors. … State law governs those interpretations." (quoting In re Dow Corning, Corp., 456 F.3d 668, 674-75 (6th Cir. 2006). See also 7 Collier on Bankruptcy ¶ 1129.01 (Henry Sommer & Richard Levin, eds., 16th ed., 2022).

[44]Courts have rebuffed efforts to apply Rule 1.8 to plan confirmations. See, e.g., In re Stearns Holdings, LLC, 607 B.R. 781, 791 (Bankr. S.D.N.Y. 2019) ("the Court declines to grant the UST's request that the Amended Plan be modified to include a caveat that the exculpation provision is consistent with Rule 1.8(h)(1), as such caveat is neither warranted nor required."); In re Fraser's Boiler Service, Inc., 593 B.R. 636, 641 (Bankr. W.D. Wash. 2018). This issue is not new. It was flagged over a decade ago by Professor George Kuney. George W. Kuney, Unethical Protection? Model Rule 1.8(H) and Plan Releases of Professional Liability, 83 Am. Bankr. L.J. 481 (2009).

[45]U.S. Const. art. VI, cl.2.

[46]Florida Lime & Avocado Growers, Inc. v. Paul, 373 U.S. 132, 142-43, 83 S. Ct. 1210, 10 L. Ed. 2d 248 (1963).

[47]Hines v. Davidowitz, 312 U.S. 52, 67, 61 S. Ct. 399, 85 L. Ed. 581 (1941).

[48]Kansas v. Garcia, 140 S. Ct. 791, 206 L. Ed. 2d 146 (2020).

[49]Kansas v. Garcia, 140 S. Ct. 791, 801, 206 L. Ed. 2d 146 (2020) (quoting Puerto Rico Dept. of Consumer Affairs v. Isla Petroleum Corp., 485 U.S. 495, 503, 108 S. Ct. 1350, 99 L. Ed. 2d 582 (1988)).

[50]Kansas v. Garcia, 140 S. Ct. 791, 801, 206 L. Ed. 2d 146 (2020) (citing Osborn v. Bank of U.S., 22 U.S. 738, 865, 6 L. Ed. 204, 1824 WL 2682 (1824) (rejecting argument that a federal exemption from state regulation "not being expressed, ought not to be implied by the Court"), as well as Arizona v. U.S., 567 U.S. 387, 400-408, 132 S. Ct. 2492, 183 L. Ed. 2d 351, 115 Fair Empl. Prac. Cas. (BNA) 353, 95 Empl. Prac. Dec. (CCH) P 44539 (2012); Kurns v. Railroad Friction Products Corp., 565 U.S. 625, 630-631, 132 S. Ct. 1261, 182 L. Ed. 2d 116, 33 I.E.R. Cas. (BNA) 577, Prod. Liab. Rep. (CCH) P 18789, 78 A.L.R. Fed. 2d 677 (2012); PLIVA, Inc. v. Mensing, 564 U.S. 604, 617-618, 131 S. Ct. 2567, 180 L. Ed. 2d 580, Prod. Liab. Rep. (CCH) P 18642 (2011).

[51]Cipollone v. Liggett Group, Inc., 505 U.S. 504, 516, 112 S. Ct. 2608, 120 L. Ed. 2d 407, Prod. Liab. Rep. (CCH) P 13199, 17 U.C.C. Rep. Serv. 2d 1087 (1992) (citing Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 230, 67 S. Ct. 1146, 91 L. Ed. 1447 (1947)). See also Office Of Disciplinary Counsel v. Marcone, 579 Pa. 1, 855 A.2d 654, 664 (2004).

[52]See, e.g., 35 U.S.C.A. § 2(b)(2)(D) (authorizing rules for practice before patent tribunals); 37 C.F.R. § § 11.101-.901 (2013) (promulgated rules for practice before patent tribunals); 8 U.S.C.A. § 1103 (authorizing rules for practice in immigration tribunals); 8 C.F.R. § 1003.101-.111 (2017) (rules applicable to attorneys practicing in immigration courts); 32 C.F.R. § 776.18-.71 (2022) (rules of professional responsibility for military tribunals).

[53]Bankr. D. Del. R. 1001-1(f)(2021).

[54]D. Del. R. 83.6(d) (2016).

[55]See S.E.C. v. Gibraltar Global Securities, Inc., 2015 WL 2258173 at *2 (S.D. N.Y. 2015); see also In re Bruno, 327 B.R. 104, 108 (Bankr. E.D. N.Y. 2005) ("Bankruptcy courts in New York apply New York's Code of Professional Responsibility to ethical disputes.") (citing Kittay v. Kornstein, 230 F.3d 531, 537, 36 Bankr. Ct. Dec. (CRR) 259, 48 Fed. R. Serv. 3d 429 (2d Cir. 2000)).

[56]Local Civil Rule 1.5(5) of the Local Rules of the United States District Courts for the Southern and Eastern Districts of New York, state:

> Discipline or other relief . . . may be imposed, by the Committee on Grievances . . . if any of the following grounds is found by clear and convincing evidence: [¶] (5) In connection with activities in this Court, any attorney is found to have engaged in conduct violative of the New York State Rules of Professional Conduct as adopted from time to time by the Appellate Divisions of the State of New York.

[57]Res3d § 54, cmt. c.

[58]Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 230, 67 S. Ct. 1146, 91 L. Ed. 1447 (1947). See also

Barnett Bank of Marion County, N.A. v. Nelson, 517 U.S. 25, 31, 116 S. Ct. 1103, 134 L. Ed. 2d 237 (1996) (noting that such intent may be expressed explicitly in the language of a statute, or implicitly through passage of a statutory scheme that extensively occupies the field, or where the purpose and objectives of federal law would be frustrated by state law).

[59]Leis v. Flynt, 439 U.S. 438, 442, 99 S.Ct. 698, 58 L.Ed.2d 717 (1979). See also Bradwell v. Illinois, 16 Wall. 130, 83 U.S. 130, 139, 21 L.Ed. 442 (1872) ("[U]nless we are wholly and radically mistaken . . ., the right to control and regulate the granting of license to practice law in the courts of a State is one of those powers which are not transferred for its protection to the Federal government . . . .") See also Castellanos-Bayouth v. Puerto Rico Bar Ass'n, 483 F. Supp. 2d 167, 175-76 (D.P.R. 2007)

[60]A comparison might be made to 29 U.S.C.A. § 959(b) and its requirement that a debtor in possession observe all non-bankruptcy laws. Of course, the section only applies to debtors in possession, and not their attorneys, but it would be odd to continue state law restrictions on debtors but suspend them for its counsel.

[61]In Attorney Grievance Comm'n of Maryland v. Tatung, 476 Md. 45, 258 A.3d 234 (2021), for example, a Maryland court applied the Maryland rules of professional responsibility to actions taken by a lawyer in Maryland with respect to an immigration proceeding before a federal tribunal in Texas. And, in Max-Planck-Gesellschaft ZUR Foerderung Der Wissenschaften E.V. v. Wolf Greenfield & Sacks, PC, 661 F. Supp. 2d 125, 128 (D. Mass. 2009), the court stated that "the authority of states to punish attorneys who violate ethical duties under state law" extended to actions of attorneys appearing before federal patent tribunals. Id. (quoting Kroll v. Finnerty, 242 F.3d 1359, 1364 (Fed. Cir. 2001). See also State ex rel. York v. West Virginia Office of Disciplinary Counsel, 231 W.Va. 183, 44 S.E.2d 293 (2013) (holding that federal law authorizing the United States Patent and Trademark Office to regulate the conduct of patent attorneys did not preempt state's attorney disciplinary proceeding against attorney).

[62]28 U.S.C.A. § 530B(a).

[63]28 C.F.R. § 77.1(b).

[64]Compare United States v. Colo. Supreme Court, 189 F.3d 1281, 1288-89 (10th Cir. 1999) (holding that Colorado's Rule of Professional Responsibility 3.8 regarding compelled lawyer testimony prescribed "broad normative principles of attorney self-conduct," and that "the rule in its current incarnation is a rule of ethics applicable to federal prosecutors by the McDade Act," and that that Rule 3.8 could be "enforced by the state defendants against federal prosecutors") with United States v. Supreme Court of New Mexico, 839 F.3d 888 (10th Cir. 2016) (finding *Colorado Supreme Court* was limited to application of Rule 3.8 to trial subpoenas, and holding it preempted as to grand jury subpoenas).

[65]United States v. Colo. Supreme Court, 189 F.3d 1281, 1288-89 (10th Cir. 1999).

[66]While it is doubtful that a single bankruptcy judge could invoke conflict preemption regarding exculpation in a single chapter 11 case, that doubt itself becomes doubtful were Congress or even the Bankruptcy Rules Committee to promulgate such a rule. No doubt that is why the American Bankruptcy Institute's Commission suggested Congress address the exculpation issue. Am. Bankr. Inst. Comm'n to Study the Reform of Chapter 11, 2012—2014 Final Report and Recommendations, 23 Am. Bankr. Inst. L. Rev. 1, 279 (2015).

[67]Although the Army has adopted most of the American Bar Association's Model Rules, it specifically has excluded Rule 1.8. See Comment 14 to Rule 1.8, Rules of Professional Conduct for Lawyers, Army Regulation 27–26, at 37 (June 2018) ("ABA Model Rule 1.8(h) is not adopted into Army Rule 1.8 because it is doubtful that Army lawyers would find it necessary to obtain prospective malpractice liability releases from clients such as the ones provided for in ABA Model Rule 1.8(h).").

[68]In re Boy Scouts of Am., No. 21-2035, 2022 WL 1634643 (3d Cir. May 24, 2022).

[69]In re Boy Scouts of Am., No. 21-2035, 2022 WL 1634643, at *1-*3 (3d Cir. May 24, 2022).

[70]In re Boy Scouts of Am., No. 21-2035, 2022 WL 1634643, at *2-*3 (3d Cir. May 24, 2022).

[71]"Save the "any other reason" catchall, the focus dead ends at the debtor and especially its estate." In re Boy Scouts of Am., No. 21-2035, 2022 WL 1634643, at *4 (3d Cir. May 24, 2022). See also id. at *8 ("In holding that the Bankruptcy Court permissibly allowed BSA to retain Sidley as its restructuring counsel, our concern is primarily whether it could effectively represent BSA in its bankruptcy case.").

[72]"Century [the insurance company] has not meaningfully challenged the Bankruptcy Court's factual finding that Sidley [debtor's counsel] did not have an interest adverse to the estate." In re Boy Scouts of Am., No. 21-2035, 2022 WL 1634643, at *5 (3d Cir. May 24, 2022).

[73]"In holding that the Bankruptcy Court permissibly allowed BSA to retain Sidley as its restructuring counsel, our concern is primarily whether it could effectively represent BSA in its bankruptcy case. Whether it did so in Century's reinsurance matters is a separate question that Century can independently challenge in its arbitration proceeding with Sidley." In re Boy Scouts of Am., No. 21-2035, 2022 WL 1634643, at *8 (3d Cir. May 24, 2022).

[74]Indeed, that is what some plans have provided.

See, e.g., In re Reader's Digest Ass'n, No. 09-23529 (RDD), 2010 Bankr. LEXIS 5550, at *35-36 (Bankr. S.D.N.Y. Jan. 19, 2010); In re Extended Stay Inc., No. 09–13764, 2010 WL 6561113 (Bankr. S.D.N.Y. July 20, 2010).

[75]Given the multiplicity of standards for approving exculpation explored above, it would not seem to add much to the mix to require lawyers comply with Rule 1.8 at the disclosure statement stage. This was the early suggestion of Professor Kuney. George W. Kuney, Unethical Protection? Model Rule 1.8(h) and Plan Releases of Professional Liability, 83 Am. Bankr. L.J. 481 (2009).

https://legal.thomsonreuters.com/

Status of the Law of Preferences

Judge Robyn L. Moberly
United States Bankruptcy Court, Southern District of Indiana

HHGREGG, INC., and Official Committee of Unsecured Creditors v

D & H Distributing Company

17-50282

January 13, 2022

As most of us know, HHGregg was a major retailer of electronics, appliances, home products and consumer tablets in their brick-and-mortar stores in 19 states and online. On March 6, 2017, hhgregg, Inc., Gregg Appliances, Inc. and HHG Distributing, LLC ("the Debtors") filed voluntary Chapter 11 bankruptcy petitions in the U.S. Bankruptcy Court for the Southern District of Indiana. Some 4 days later, the United States Trustee appointed the Official Committee of Unsecured Creditors (the "Committee"). Judge Graham presided.

The facts of this case, which is typical in a Preference action, are important. The Preference Period in this case was from December 6, 2016 to March 6, 2017. During this time, Debtors made 61 transfers to D & H in the aggregate amount of $4,687,308. Debtors relied upon product bought from D & H and considered it a major product line which attracted customers for other products Debtors sold.

Debtors' financial reports for the fiscal quarter ending December 31, 2015 showed Debtors' sales had fallen significantly below analysts' projections. Several of Debtors' vendors cut back or eliminated Debtors' credit line in response to the poor sales report. This decrease in Debtors' borrowing base resulted in a "liquidity crisis" and ultimately the filing of the bankruptcy.

D & H maintained a general credit limit with Debtors which dropped from between $10 to $12 million in 2014, to just $1 million between January 2016 and April 2017. During the Preference Period, Debtors' credit terms with D & H went from net 60 until November of 2015, to net 30 from November 2015 to February

2016 and .25% 15, net 16 from February of 2016 through the petition date. Debtors requested the last change in terms due to a shift in how the Debtors sourced Dell computers. The final decrease, to .25% 15, net 16 resulted in Debtors being able to purchase more product. To receive the volume of product Debtors needed, they negotiated the discounted term and paid every 15 days allowing them to buy $2 million in product rather than just $1 million in any given month.

Generally, there was a certain degree of tolerance from D & H toward Debtors in terms of late payment and payments outside of the stated payment terms. Several emails from D & H to Debtors prior to the Preference Period requested payment or confirmation of a payment schedule. These emails went from D & H's credit department to Debtor's account payable department. Some of these emails expressed frustration with past-due invoices. Just prior to Black Friday of 2016, D & H threatened to cut off all shipments unless Debtors confirmed a payment schedule with D & H. After some emails applying pressure upon Debtors in mid to late December 2016, Debtors sent D & H a $500,000 payment on December 20, 2016. Debtors also sent an additional payment of $491,971 to D & H on December 22. In response, D & H's credit department still expressed a need for an immediate payment schedule so D & H could determine what course of action to take.

The Court found that the Preference Period communications were not "wholly inconsistent with emails sent before the Preference Period", but the tone during the Preference Period was considerably more tense and explicitly stated the dire consequences should Debtors fail to make payments or offer a payment schedule. The Preference Period emails were typically sent by senior executives at D & H to senior executives of Debtors and copied to credit and accounts payable departments, but this was consistent with pre-Preference Period emails. Despite threats, D & H never withheld product from Debtors. Although D & H has an in-house collection agency, it never used these services nor threatened litigation.

D & H did not file a proof of claim in the bankruptcy because it had a credit balance owing to Debtors as of the petition date. D & H and the Debtors eventually reconciled the amounts due and D & H paid Debtors $365,394 on July 3, 2017. On November 17, 2017, the Committee filed the Complaint and on May 6, 2018, the Court issued a partial summary judgment Order establishing that the Committee had made a prima facie case under section 547 (b) of the Bankruptcy Code, but the Court reserved for trial whether the transfers were shielded by the subjective ordinary course defense provided by section 547 (c)(2)(A).

Preferential Transfers and the Ordinary Course of Business Defense

The partial summary judgment Order established the elements of a Preference under section 547(b) of the Bankruptcy Code: it must be proved that the payment was (1) to or for the benefit of a creditor (2) for or on account of an antecedent debt (3) made while the debtor was insolvent (4) on or within 90 days before debtor filed bankruptcy (5) enabled the creditor to receive more than it would have received had debtor not made the payment. *In re Energy Co-op, Inc.*, 832 F.2d 997, 999-1000 (7th Cir 1987). The Committee successfully established these elements at the partial summary judgment stage.

At trial, the parties' evidence addressed whether D & H was entitled to the safe harbor provided by section 547(c)(2)(A), referred to as the subjective ordinary course of business defense. Section 547 (c)(2) provides that the trustee cannot avoid a transfer under section 547(b) to the extent such transfer was in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee and such transfer was (A) made in the ordinary course of business or financial affairs of the debtor and the transferee; or (B) made according to ordinary business terms.

The Court explained that the ordinary course defense was designed to "leave undisturbed normal commercial and financial relationships and protect recurring, customary credit transactions which are incurred and paid in the ordinary course of business of both the debtor and the debtor's transferee. *Citing, Kleven v Household Bank, F.S.B.* 334 F.3d 638, 542 (7th Cir 2003). The burden of proof is on the creditor to establish this defense by a preponderance of the evidence. This burden of proof ultimately was the downfall for the creditor in the HHG case.

Among other relevant and persuasive factors to consider in determining whether this defense has been proven are the length of time the parties were engaged in the transaction at issue, whether the amount or form of tender differed from past practices, whether the debtor or creditor engaged in any unusual collection or payment activity and whether the creditor took advantage of the debtor's deteriorating financial condition. *Kleven,* 334 F.3d at 642 (*citing Barber v Golden Seed Co,* 129 F.3d 382, 390 (7th Cir. 1997)).

The parties' course of dealings before the Preference Period are compared to the dealings during the 90-day Preference Period to evaluate whether they have changed, and more pressure has been brought to bear upon the debtor. Generally, the debtor's payment history is considered to calculate a baseline for the parties' dealings and then comparing them to the Preference Period dealings. *In re Tolona Pizza Products, Corp.* 3 F.3d 1029, 1032 (7th Cir. 1993); *Lovett v St. Johnsbury Trucking*, 931 F.2d 494, 497 (8th Cir. 1991).

In the D & H case, upon motion of D & H, the Court excluded the 10-month Period immediately before the Preference Period because during this time the Debtor was not financially healthy. The Court should look to the normal interactions between the parties during times when the debtor was financially healthy and not during a time of financial stress or disruption. *In Re Carlock, Inc.,* 91 F.3d 811 (6th Cir. 1996); *In re Molded Acoustical Prods., Inc.* 18 F.3d 217 (3rd Cir. 1994); *In re Meredith Hoffman Partners,* 12 F.3d 1549 ((10th Cir. 1993); *Gonzales v DPI Food Prod. Co., (In re Furrs Supermarkets, Inc.),* 296 B.R. 33 (Bankr. D.N.M. 2003).

The D & H case should instruct every lawyer in such a situation to have clear, relevant historical data in summary form to aid the Court in analyzing the historical data accurately. Judge Graham found the evidence lacking, at least in clarity and simplicity to the Court. There was no summary data and payment analysis for the proposed Historical Period. Perhaps the specific inclusive dates of the Historical Period were not set enough in advance of the trial for counsel to develop the best exhibits. Nevertheless, Judge Graham took the average number of days between invoice due date and payment in the exhibits offered and had to assume these would largely be consistent with the actual Historical Period data. The Committee took issue with this approach and argued the Court should compare the interval between invoice date and payment (not due date and payment). The Committee argued that the interval between invoice and payment during the Preference Period were considerably faster than those made during the truncated Historical Period and, therefore, outside the ordinary course. Since the credit terms had changed during the Preference Period (both net 60 and net 30), it was difficult for the Court to adopt the Committee's proposed methodology. *See Montgomery Ward, LLC v OTC Int'l Ltd. (In re Montgomery Ward, LLC),* 348 B.R. 662, 676 (Bankr. D. Del. 2006).

The Committee further argued that the emails from D & H to Debtors immediately before and during the Preference Period reflected a change in collection activity. The shift from the credit team initiating the emails to D & H's vice president of retail sales initiating the emails indicates a step-up in collection efforts. Further the emails weren't sent to members of Debtors' accounts payable department but to Debtors' senior vice president of consumer electronics. In addition, the Preference Period emails contained veiled threats of discontinuing shipments absent payment, although these threats never came to pass. However, while the emails were more insistent, there was no evidence that the payments were made sooner or in larger amounts in response to the veiled threats. *See Marathon Oil Co., v. Flatau (In re Craig Oil Co.,* 785 F.2d 1563, 1566 (11th Cir. 1986).

The judge cited examples of omitted evidence that could have made a difference in the result, such as expert testimony and "granular detail typical of Preference cases". In the end, the Court found that D & H failed to meet the burden of proof by a preponderance of the evidence. Evidence which supported D & H's defense included the fact that D & H never withheld shipments to Debtors, never sought guarantees of Debtors or their officers or principals, never threatened to turnover accounts to collections, and never threatened litigation. D & H continued to do business with Debtors during a Period of financial hardship. On the flip side, D & H consistently sought payments from Debtors in emails that included senior management, threatened to withhold shipments, and limited its credit exposure to Debtors by significantly reducing its credit limit with Debtors. D & H did no more than balance the scales and failed to tip them to its advantage. Therefore, the Court denied them the benefit of the ordinary course defense and ruled there was a $3.5 million Preference to be recovered by the Debtors.

Gregg Appliances Inc. v Curtis International LLC

__B.R.__, 2022 WL 336340 (Bankr.

S.S. Ind. 2022)

Same judge, same debtor, different result. This case in many respects is like the *D&H Distributing* case. *Curtis* was decided just 3 weeks after *D&H* was decided. In general, the facts of this case are that the creditor actively managed the credit file of the debtor and made payment demands via emails to the debtor. However, the number, tone, pattern and practices didn't significantly intensify during the preference period. In both the *Curtis* case and the *H&D* case, the Creditors Committee prevailed on a summary judgment motion on the issue of preferential transfers. Interestingly, the Court used a different "historical period" in *Curtis* than it did in *D&H.* The Committee proposed the period adopted by the Court in *Curtis* despite the varying financial situations of the debtor in the years prior to the preference period.

The Court was guided by the approach of the Bankruptcy Court in the Southern District of Ohio in *Roberds, Inc. Broyhill Furniture (In re Roberds), 315 B.R. 443, (Bankr. S.D. Ohio 2004).* In its analysis of the ordinary course defense, that Court characterized certain creditor behavior as "potentially ordinary" and other behavior as "potentially not ordinary". Communications that expressed increasing concern over payments being made according to the established payment plans and communications from senior management as compared to pre-preference period behavior as potentially ordinary. Not potentially ordinary would include creditor changes to existing or future credit terms, credit limits, shipment terms, product amount or method of payment. The Court cited to multiple examples from other courts citing behavior that was not ordinary, including placing a hold on credit, threatening legal action, repeated and numerous telephone calls, conditioning future shipments on larger payments, and initiating collection litigation, to name a few.

Judge Graham found that the "potentially not ordinary" behavior from Curtis did not exist in this case. Both before and during the preference period, Curtis sent emails regarding payment of unpaid invoices but never threatened any other collection efforts. The Court found these emails to be benign and ordinary. There was one "Outlier Invoice" that was an exception to the Court's summary judgment ruling and it was determined to be outside the ordinary course of business between the parties. Thus, the Committee was entitled to repayment of that invoice plus reasonable interest, the timing and amount to be determined later.

Earmarking Doctrine

In re Chuza Oil Company, 639 B.R. 586 (10th Cir.BAP (N.M.), 2022) dealt with the defense of earmarking. Debtor filed bankruptcy twice. After the first case, insiders who held unsecured notes from the bankrupt debtor loaned money to the debtor, part of which was required to be used to pay off the notes held by the unsecured insiders. The business failed and the debtor later filed a chapter 7 bankruptcy. The Trustee sued the insiders for receiving a preference within one year of the filing of the case. The insiders argued the payment to them was not a preference because it was not estate property that was used to pay them, and the payment did not diminish the bankruptcy estate.

11 U.S.C. § 547(b) states:

> A transfer to an insider is avoidable as a preference if the transfer: (1) is of an interest of the debtor in property; (2) is for the benefit of a creditor; (3) is made for or on account of an antecedent debt owed by the debtor before the transfer was made; (4) is made while the debtor is insolvent; (5) is made on or within one year before the date the bankruptcy petition was filed; and (6) allows the creditor to

receive more than the creditor would otherwise be entitled to receive from a chapter 7 bankruptcy estate.

While the preference period is extended to one year for insiders, the plaintiff must also prove that the debtor was insolvent at the time of the transfer and the transfer was of an interest belonging to the debtor.

The Bankruptcy Court relied on the earmarking defense to hold that the count alleging a preference failed because there was no transfer of an interest of the Debtor in property. The court found that the property was not property of the bankruptcy estate, but rather of the insiders who lent the money to the debtor to repay insiders. The trustee took an appeal to the Tenth Circuit BAP. The parties stipulated that all the elements of a First-Year Transfer satisfied all elements of an insider preference except that each First-Year Transfer be of an interest of the Debtor in property.

The BAP noted that the Code does not define "interest of the debtor in property" but the BAP treated the term to be the same as property of the estate. Property in which a debtor holds only legal title and not an equitable interest becomes property of the estate only to the extent of the debtor's legal title, but not to the extent of any equitable interest the debtor does not hold, the same as property of the estate under section 541. The earmarking doctrine is a court-made interpretation of the statutory requirement that a voidable preference must involve a "transfer of an interest of the debtor in property." Because the Bankruptcy Code and Bankruptcy Act did not define when a transfer of a debtor's property occurs, the definition was left to the courts.

Earmarking is characterized by an "old creditor" (the pre-existing creditor who is paid off during the preference period), a "new creditor" or "new lender" who supplies the funds to pay off the old creditor, and the debtor. Initially, the doctrine entailed a new creditor, typically a guarantor of the debt, providing funds to pay off the old creditor directly. The rationale for finding the payment was not a voidable preference rested upon one of 3 versions: (1) the transfer was of the new creditor's, not the debtor's, property; (2) there was no diminution in the debtor's estate because the transaction merely substitutes one creditor for another; and (3) it would be unfair to the guarantor if his payment were avoided for the benefit of the bankruptcy estate, leaving the guarantor liable to pay a second time.

Courts later used different rationales to come to the same conclusion when the guarantor pays the money to the debtor with specific instructions to use the funds to pay the debtor's obligation to the old creditor. Courts found that the funds are not within the debtor's control, or are held "in trust," the transfer of funds did not diminish the bankruptcy estate, or the courts simply said they would not let form control over substance. There are many cases with different permutations on how the money comes to the debtor, how specific the instructions are on debtor's use of the funds, and whether there is an actual diminution of the estate. All are worth reviewing.

Contemporaneous Exchange for New Value Defense

11 USC §547 (c)(1) states as follows:

The trustee may not avoid under this section a transfer—
(1) to the extent that such transfer was—
(A) intended by the debtor and the creditor to or for whose benefit such transfer was made to be a contemporaneous exchange for new value given to the debtor; and
(B) in fact a substantially contemporaneous exchange;

The § 547(c)(1) defense applies only to payments made during the preference period, so the only relevant contemporaneous exchanges for the defense are those close in time to the payments that occurred in the insider preference period. In other words, for this specific defense, the court should not consider payments or deposits made outside the preference period. Such payments are not "contemporaneous" exchanges to support the § 547(c)(1) defense. *In re Chuza Oil Company,* 639 B.R. 586, 603 (10th Cir.BAP (N.M.), 2022).

Other Statutory Defenses to a Preference Action

11 USC §547(c) spells out other defenses to a preference action:

The trustee may not avoid under this section a transfer- …
(7) to the extent such transfer was a bona fide payment of a debt for a domestic support obligation;

(8) if, in a case filed by an individual debtor whose debts are primarily consumer debts, the aggregate value of all property that constitutes or is affect by such transfer is less than $600; or
(9) if, in a case filed by an individual debtor whose debts are not primarily consumer debts, the aggregate value of all property that constitutes or is affect by such transfer is less than $6,825.

Sigmund J. Beck Advanced Bankruptcy Roundtable
West Baden Springs Resort, West Baden Springs, Indiana
August 19-20, 2022

Melissa M. Root
JENNER & BLOCK LLP
Chicago, Illinois

A Straitjacket is Not a Uniform
Siegel v. Fitzgerald

"The [Bankruptcy] Clause's requirement that bankruptcy laws be 'uniform' is not a straitjacket: Congress retains flexibility to craft legislation that respond to different regional circumstances that arise in the bankruptcy system. "

In *Siegel v. Fitzgerald*, the Supreme Court addressed two questions: (1) whether the provision of the Bankruptcy Judgeship Act of 2017 (the "**2017 Act**") that provided for a temporary increase in the fee rates applicable to chapter 11 cases was subject to the Bankruptcy Clause; and (2) whether, if so, the fact that the 2017 Act yielded different results between the Trustee Program districts and the Bankruptcy Administrator districts violated the Bankruptcy Clause's requirement of uniformity. Answering yes and yes, in a unanimous opinion authored by Justice Sotomayor, the Court held that "Congress' enactment of a significant fee increase that exempted debtors in two States violated the uniformity requirement."

<u>Background</u>

The United States Trustee system is implemented nationwide with the exception of Alabama and North Carolina. The system is self-funded by fees paid to the United States Trustee System Fund. In Alabama and North Carolina, the bankruptcy administrator program is funded by the Judiciary's general budget. In a 1994 Ninth Circuit case, *St. Angelo v. Victoria Farms, Inc.*, 38 F.3d 1525, 1533 (9th Cir. 1994), *amended by* 46 F.3d 969 (9th Cir. 1995), the Ninth Circuit held that the disparity of fees in this dual system—U.S. trustee fees were not due by debtors in Alabama and North Carolina—was not uniform and therefore unconstitutional. After that decision, Congress amended the law to impose fees in non-trustee districts equal to those imposed in trustee districts.

Problem solved—at least until the 2017 Act. The 2017 Act imposed sharp fee increases for chapter 11 cases filed during fiscal years 2018 through 2020. It provides for increases whenever the balance in the U.S. Trustee System Fund falls below $200 million, and because the balance was below $200 million at the time of the amendment, the increased fees applied immediately upon enactment.

The 2017 Act increased fees for chapter 11 debtors in *trustee* districts beginning in January 1, 2018 and applied to pending cases as well as new cases. But the Judicial Conference did not adopt the same fee schedule for the Bankruptcy Administrator districts of Alabama and North Carolina until September 2018, and when it did so, it made the schedule effective as of October 1, 2018 and did *not* apply it retroactively.

The Bankruptcy Clause and the Uniformity Clause

The Bankruptcy Clause—Article I, section 8, clause 4—provides in part that "The Congress shall have power ... [t]o establish … uniform Laws on the subject of Bankruptcies throughout the United States...."

The Uniformity Clause—Article I, section 8, clause 1—provides in part that "The Congress shall have power to lay and collect Taxes, Duties, Imposts and Excises … but all Duties, Imposts and Excises shall be uniform throughout the United States."

The Bankruptcy Court and Fourth Circuit Decisions

Circuit City filed for chapter 11 in 2008 in the Eastern District of Virginia, a Trustee Program district, and its case was still pending in 2017. Although the liquidating trustee initially paid the increased fees, following the *In re Buffets, LLC*, 597 B.R. 588 (Bankr. W.D. Tex. 2019) decision (holding that the 2017 Act is unconstitutional because it creates nonuniform bankruptcy laws and because it is unconstitutionally retroactive, but subsequently reversed by the Fifth Circuit), the liquidating trustee filed for relief against the Acting U.S. Trustee for Region 4, arguing that the fee increase under the 2017 Act was nonuniform across Trustee Program districts and Administrator Program districts and therefore violated the Bankruptcy Clause. To demonstrate the magnitude of the fee increases, the trustee paid $632,542 in quarterly fees for the first three quarters of the fee increase—under the old fee structure, the fees would have been $56,400 for that same period.

The bankruptcy court ruled in favor of the trustee, relying both on the Uniformity Clause and the Bankruptcy Clause, and directed that fees due from January 1, 2018 forward would be at pre-2017 Act levels. The court reserved the question whether the trustee could recover any overpayments already made pursuant to the 2017 Act. On the retroactivity issue, the bankruptcy court held that increased fees did not contravene anti-retroactivity principals because the 2017 Act was "substantially prospective" rather than retroactive.

A divided panel of the Fourth Circuit reversed. It held that the 2017 Act did not violate the Uniformity Clause because U.S. Trustee fees are not taxes. And, although it found that the Bankruptcy Clause applied to the 2017 Act, it interpreted the Clause as forbidding "only 'arbitrary' geographic differences." Because, in its view, there was a legitimate basis to require the Trustee Program districts to fund the United States Trustee system, Congress did not act arbitrarily when it enacted the 2017 Act. Dissenting, Judge Quattlebaum argued that there was nothing "geographically distinct about Alabama or North Carolina that justified a different approach in those states."

The Supreme Court's Opinion

First, the Court rejected the U.S. Trustee's argument that because the 2017 Act is administrative in nature, it did not alter the substance of debtor-creditor relations and thus was not a law "on the subject of Bankruptcies." The Court stated that "[n]othing in the language of the Bankruptcy Clause itself [] suggests a distinction between substantive and administrative law." Moreover, it reasoned, "[i]ncreasing mandatory fees paid out of the debtor's estate decreases the funds available for payment to creditors. As a result, the obligations between creditors and debtors are changed." Similarly, it rejected the U.S. Trustee's argument that bankruptcy fees are exempt from the Bankruptcy Clause's uniformity requirement.

Second, the Court held that the 2017 Act was not a permissible exercise of the Bankruptcy Clause because it was not uniform. The Court revisited its precedent on the Bankruptcy Clause:

- *Hanover National Bank v. Moyses*, 186 U.S. 181 (1902)—the Bankruptcy Clause did not require Congress to eliminate existing state exemptions in bankruptcy laws. The "general operation of the law is uniform although it may result in certain particulars differently in different states."

- *Regional Rail Reorganization Act Cases*, 419 U.S. 102 (1974)—the Bankruptcy Clause did not prohibit a railroad reorganization act that applied only to rail carriers operating within a defined region of the country.

- *Railway Labor Executives' Ass'n v. Gibbons*, 544 U.S. 457 (1982)—the Bankruptcy Clause prohibited an act that altered the priority of claimants in a single railroad's bankruptcy proceeding—"[t]o survive scrutiny under the Bankruptcy Clause, a law must at least apply uniformly to a defined class of debtors."

"In sum, our precedent provides that the Bankruptcy Clause offers Congress flexibility, but does not permit the arbitrary, disparate treatment of similarly situated debtors based on geography."

Applying this precedent to the 2017 Act, the Court held that the 2017 Act violated the Bankruptcy Clause because the fee discrepancy was unrelated to the "needs of, or conditions in," the Bankruptcy Administrator districts versus the Trustee Program districts—the Bankruptcy Clause "does not permit Congress to treat identical debtors differently based on an artificial funding distinction that Congress itself created." The Court remanded the case to the Fourth Circuit to consider the appropriate remedy. On July 20, 2022, the Fourth Circuit remanded the case to the Bankruptcy Court.

Discussion Questions:

1. What is the remedy here and who is footing the $324 million bill? "Whenever government impermissibly treats like cases differently, it can cure the violation by either 'leveling up' or 'leveling down.'" *Comptroller of the Treasury v. Wynn*, 575 U.S. 542, 569 (2016). Should North Carolina and Alabama debtors (or states) be charged retroactively, or should debtors in the Trustee Program districts receive refunds (the approach endorsed by the Second and Tenth Circuits)? *See In re John Q. Hammons Fall 2006, LLC,* 15 F.4th 1011, 1026 (10th Cir. 2021) ("The Second Circuit [in *Clinton Nurseries*] awarded monetary relief to remedy debtors' harms from the 2017 Amendment . . . . We do so as well.") (vacated by the Supreme Court for further consideration in light of *Siegel*); *In re Clinton Nurseries, Inc*., 998 F.3d 56, 69–70 (2d Cir. 2021) ("To the extent that Clinton has already paid the unconstitutional fee increase, it is entitled to a refund of the amount in excess of the fees it would have paid in a BA District during the same time period.") (cert pending).

2. Remember this line from *Stern*?

   "We do not think the removal of counterclaims such as Vickie's from core bankruptcy jurisdiction meaningfully changes the division of labor in the current statute; we agree with the United States that the question presented here is a 'narrow' one. If our decision today does not change all that much, then why the fuss?"

   Sounds kind of like this from *Siegel*:

   "A few observations on the limits of this decision are in order. The Court does not today address the constitutionality of the dual scheme of the bankruptcy system itself, only Congress' decision to impose different fee arrangements in those two systems. The Court's holding today also should not be understood to impair Congress' authority to structure relief differently for different classes of debtors or to respond to geographically isolated problems. The Court holds only that the uniformity requirement of the Bankruptcy Clause prohibits Congress from arbitrarily burdening only one set of debtors with a more onerous funding mechanism than that which applies to debtors in other States."

   So why the fuss?

3. Although the Court was explicit that it was not addressing the constitutionality of the "dual scheme" of the bankruptcy system, how can the non-uniformity between

Trustee Program districts and Administrator Program districts be justified under the Court's analysis? Are there any true geographical differences that justify the dual programs?

<u>Appendices</u>:

1. *Siegel v. Fitzgerald*, 596 U.S. __ (2022)
2. *Siegel v. Fitzgerald (In re Circuit City)*, 996 F.3d 156 (4th Cir. 2021)

Syllabus

NOTE: Where it is feasible, a syllabus (headnote) will be released, as is being done in connection with this case, at the time the opinion is issued. The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States* v. *Detroit Timber & Lumber Co.,* 200 U. S. 321, 337.

SUPREME COURT OF THE UNITED STATES

Syllabus

SIEGEL, TRUSTEE OF THE CIRCUIT CITY STORES, INC. LIQUIDATING TRUST *v.* FITZGERALD, ACTING UNITED STATES TRUSTEE FOR REGION 4

CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

No. 21–441. Argued April 18, 2022—Decided June 6, 2022

Congress created the United States Trustee Program (Trustee Program) as a mechanism to transfer administrative functions previously handled by bankruptcy judges to U. S. Trustees, a component of the Department of Justice. Congress permitted the six judicial districts in North Carolina and Alabama to opt out of the Trustee Program. In these six districts, bankruptcy courts continue to appoint bankruptcy administrators under a system called the Administrator Program. The Trustee Program and the Administrator Program handle the same core administrative functions, but have different funding sources. Congress requires that the Trustee Program be funded in its entirety by user fees paid to the United States Trustee System Fund (UST Fund), largely paid by debtors who file cases under Chapter 11 of the Bankruptcy Code. 28 U. S. C. §589a(b)(5). Those debtors pay a fee in each quarter of the year that their case remains pending at a rate set by Congress and determined by the amount of disbursements the debtor's estate made that quarter. See §1930(a). In contrast, the Administrator Program is funded by the Judiciary's general budget. While initially Congress did not require Administrator Program district debtors to pay user fees at all, Congress permitted the Judicial Conference of the United States to require Chapter 11 debtors in Administrator Program districts to pay fees equal to those imposed in Trustee Program districts. See §1930(a)(7). Pursuant to a 2001 standing order of the Judicial Conference, from 2001 to 2017 all districts nationwide charged similarly situated debtors uniform fees.

In 2017, Congress enacted a temporary increase in the fee rates applicable to large Chapter 11 cases to address a shortfall in the UST

Fund. See 131 Stat. 1229 (2017 Act). The 2017 Act provided that the fee raise would become effective in the first quarter of 2018, would last only through 2022, and would be applicable to currently pending and newly filed cases. The Judicial Conference adopted the 2017 fee increase for the six Administrator Program districts, effective October 1, 2018, and applicable only to newly filed cases.

In 2008, Circuit City Stores, Inc., filed for Chapter 11 bankruptcy in the Eastern District of Virginia, a Trustee Program district. In 2010, the Bankruptcy Court confirmed a joint-liquidation plan, overseen by a trustee (petitioner here), to collect, administer, distribute, and liquidate all of Circuit City's assets. The liquidation plan required petitioner to pay quarterly fees to the U. S. Trustee while the Chapter 11 case was pending. Circuit City's bankruptcy was still pending when Congress increased the fees for Chapter 11 debtors in Trustee Program districts through the 2017 Act. Across the first three quarters of 2018, petitioner paid $632,542 in total fees, significantly more than the $56,400 petitioner would have paid absent the fee increase in the 2017 Act. Petitioner filed for relief against the Acting U. S. Trustee for Region 4 (respondent here) contending that the fee increase was nonuniform across Trustee Program districts and Administrator Program districts, in violation of the Constitution's Bankruptcy Clause. The Bankruptcy Court agreed, and directed that for the fees due from January 1, 2018, onward, the Circuit City trustee pay the rate in effect prior to the 2017 Act. The Bankruptcy Court reserved the question whether the trustee could recover any "overpayments" made under the 2017 Act. The Fourth Circuit reversed, holding that the fee increase did not violate the uniformity requirement of the Bankruptcy Clause because the increase applied only to debtors in Trustee Program districts in order to bolster the dwindling UST Fund, which funded the Trustee Program alone.

Held: Congress' enactment of a significant fee increase that exempted debtors in two States violated the uniformity requirement of the Bankruptcy Clause. Pp. 7–15.

(a) The Bankruptcy Clause's uniformity requirement—which empowers Congress to establish "uniform Laws on the subject of Bankruptcies throughout the United States," U. S. Const., Art. I, §8, cl. 4—applies to the 2017 Act. Respondent contends that the 2017 Act was not a law "on the subject of Bankruptcies" to which the uniformity requirement applies, but instead a law enacted pursuant to the Necessary and Proper Clause, U. S. Const., Art. I, §8, cl. 18, meant to help administer substantive bankruptcy law. Nothing in the language of the Bankruptcy Clause suggests a distinction between substantive and administrative laws, however, and this Court has repeatedly emphasized that the Bankruptcy Clause's language, embracing "laws on the subject of Bankruptcies," is broad. This Court has never distinguished between substantive and administrative bankruptcy laws or suggested that the uniformity requirement would not apply to both. Further, the Court has never suggested that all administrative bankruptcy laws are enacted pursuant to the Necessary and Proper Clause, nor that the Necessary and Proper Clause permits Congress to circumvent the limitations set by the Bankruptcy Clause. To the contrary, Congress cannot evade the "affirmative limitation" of the uniformity requirement by enacting legislation pursuant to other grants of authority. See *Railway Labor Executives' Assn.* v. *Gibbons*, 455 U. S. 457, 468–469. In any event, the 2017 fee provision fits comfortably under the scope of the Bankruptcy Clause: The provision amended a statute titled "Bankruptcy fees," §1930, and the only "subject" of the 2017 Act is bankruptcy. Moreover, the 2017 Act does affect the "substance of debtor-creditor relations" because increasing mandatory fees paid out of the debtor's estate decreases the funds available for payment to creditors. Respondent points to purported historic analogues to argue that the uniformity requirement does not apply where Congress sets different fee structures with different funding mechanisms for debtors in different bankruptcy districts. But the fee increase at issue here is materially different from the examples cited by respondent. Unlike respondent's examples, the 2017 Act does not confer discretion on bankruptcy districts to set regional policies based on regional needs. Rather, Congress exempted debtors in only 2 States from a fee increase that applied to debtors in 48 States, without identifying any material difference between debtors across those States. Pp. 7–10.

(b) The 2017 Act violated the uniformity requirement of the Bankruptcy Clause. The Bankruptcy Clause confers broad authority on Congress with the limitation that the laws enacted be "uniform." The Court's three decisions addressing the uniformity requirement together stand for the proposition that the Bankruptcy Clause does not permit arbitrary geographically disparate treatment of debtors. In *Moyses* v. *Hanover Nat'l Bank*, 186 U. S. 181, the Court rejected a challenge to the constitutionality of the Bankruptcy Act of 1898, which permitted individual debtor exemptions under different state laws, explaining that the "general operation of the law is uniform although it may result in certain particulars differently in different States." *Id.,* at 190. In the *Regional Rail Reorganization Act Cases*, 419 U. S. 102, the Court affirmed the constitutionality of legislation which applied only to rail carriers operating within a defined region of the country, noting the "flexibility inherent" in the Bankruptcy Clause, *id.,* at 158, permits Congress to enact geographically limited bankruptcy laws consistent with the uniformity requirement in response to a geographically limited problem. In *Gibbons*, 455 U. S. 457, the Court struck down legislation in which Congress altered the priority of claimants in a single railroad's bankruptcy proceedings, holding that "[t]o survive scrutiny under the Bankruptcy Clause, a law must at least apply uniformly to a defined class of debtors." *Id.*, at 473.

Here, all agree that the 2017 Act's fee increase was not geographically uniform because the fee increase applied differently to Chapter 11 debtors in different regions. That geographical disparity meant that petitioner paid over $500,000 more in fees compared to an identical debtor in North Carolina or Alabama. While respondent contends that such disparities were a permissible effort to solve the budgetary shortfall in the UST Fund, an arguably geographical problem, that shortfall stemmed not from an external and geographically isolated need, but from Congress' creation of a dual bankruptcy system which allowed certain districts to opt into a system more favorable for debtors. The Clause does not permit Congress to treat identical debtors differently based on artificial distinctions Congress itself created. Pp. 10–14.

(c) The Court remands for the Fourth Circuit to consider in the first instance the proper remedy. Pp. 14–15.

996 F. 3d 156, reversed and remanded.

SOTOMAYOR, J., delivered the opinion for a unanimous Court.

SUPREME COURT OF THE UNITED STATES

No. 21–441

ALFRED H. SIEGEL, TRUSTEE OF THE CIRCUIT CITY STORES, INC. LIQUIDATING TRUST, PETITIONER *v.* JOHN P. FITZGERALD, III, ACTING UNITED STATES TRUSTEE FOR REGION 4

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

[June 6, 2022]

JUSTICE SOTOMAYOR delivered the opinion of the Court.

The Bankruptcy Clause empowers Congress to establish "uniform Laws on the subject of Bankruptcies throughout the United States." U. S. Const., Art. I, §8, cl. 4. The Clause's requirement that bankruptcy laws be "uniform" is not a straitjacket: Congress retains flexibility to craft legislation that responds to different regional circumstances that arise in the bankruptcy system. Nor, however, is this uniformity requirement toothless. The question in this case is whether Congress' enactment of a significant fee increase that exempted debtors in two States violated the uniformity requirement. Here, it did.

I

A

Bankruptcy cases involve both traditional judicial responsibilities and extensive administrative ones. Until 1978, bankruptcy judges handled both. This meant that, in addition to their traditional judicial function of ruling on disputed matters in adversarial proceedings, bankruptcy judges dealt with an array of administrative tasks, such as appointing private trustees where appropriate; organizing creditors' committees; supervising the filing of required reports, schedules, and taxes; and monitoring cases for signs of abuse and fraud. See H. R. Rep. No. 99–764, p. 17 (1986).

Concerned that these dual roles were overloading bankruptcy judges and creating an appearance of bias, particularly because judges were responsible for supervising trustees that they themselves had appointed, Congress in 1978 piloted the United States Trustee Program (Trustee Program) in 18 of the 94 federal judicial districts. See *id.*, at 17–18; Bankruptcy Reform Act of 1978, 92 Stat. 2549. To "rende[r] the separation of administrative and judicial functions complete," the pilot program transferred the administrative functions previously handled by the bankruptcy courts to newly created U. S. Trustees, housed within the Department of Justice rather than the Administrative Office of the U. S. Courts. H. R. Rep. No. 95–595, p. 115 (1977).

In 1986, Congress sought to make the pilot Trustee Program permanent and to expand it nationwide, but met resistance from stakeholders in North Carolina and Alabama. See The United States Trustee System: Hearing on S. 1961 before the Subcommittee on Courts of the Senate Committee on the Judiciary, 99th Cong., 2d Sess., 129 (1986). As a result, Congress opted to expand mandatorily the Trustee Program to all federal judicial districts except for the six judicial districts in North Carolina and Alabama. Congress permitted only those six districts to continue judicial appointment of bankruptcy administrators, referring to that system as the Administrator Program. §§111–115, 302(d)(3), 100 Stat. 3090–3095, 3121–3123. The Administrator Program was scheduled to phase out in 1992, but Congress extended it by 10 years. §317(a), 104 Stat. 5115. At the end of those 10 years, however, Congress did not phase out the Administrator Program. Instead, it eliminated the sunset period and permanently exempted the six districts from the requirement to transition to the Trustee Program, while providing that each district could individually elect to do so. §501, 114 Stat. 2421–2422 (2000 Act); §302(d)(3), 100 Stat. 3121–3123. Each of the six districts continues to participate in the Administrator Program.

The Trustee Program and the Administrator Program handle the same core administrative functions, but have different funding sources. Congress requires that the Trustee Program be funded in its entirety by user fees paid to the United States Trustee System Fund (UST Fund), the bulk of which are paid by debtors who file cases under Chapter 11 of the Bankruptcy Code. 28 U. S. C. §589a(b)(5). Those debtors pay a fee in each quarter of the year that their case remains pending at a rate set by Congress. The fee varies according to the amount of funds paid out ("disbursed") from the bankruptcy estate to creditors, suppliers, and other parties during that quarter. See §1930(a).

In contrast, Congress does not require the Administrator Program to fund itself. Instead, the Administrator Program is funded by the Judiciary's general budget. *In re Circuit City Stores, Inc.*, 996 F. 3d 156, 160 (CA4 2021). Initially, Congress did not require Administrator Program district debtors to pay user fees at all. After the Ninth Circuit held that system unconstitutional, see *St. Angelo* v. *Victoria Farms, Inc.*, 38 F. 3d 1525, 1532–1533 (1994), amended, 46 F. 3d 969 (1995), Congress provided that "'the Judicial Conference of the United States may require the debtor in a case under chapter 11 [filed in an Administrator Program district] to pay fees equal to those imposed'" in Trustee Program districts, 2000 Act §105, 114 Stat. 2412 (enacting 28 U. S. C. §1930(a)(7)). Congress directed that any such fees be deposited into a fund that offsets appropriations to the Judicial Branch. *Ibid.* The Judicial Conference adopted a standing order in 2001 directing Administrator Program districts to charge fees "in the amounts specified in 28 U. S. C. §1930, as those amounts may be amended from time to time." Report of the Proceedings of the Judicial Conference of the United States 46 (Sept./Oct. 2001). Under this standing order, for the next 17 years, the Judicial Conference matched all Trustee Program fee increases with equivalent Administrator Program fee increases, meaning that all districts nationwide charged similarly situated debtors uniform fees.

In 2017, concerned with a shortfall in the UST Fund, Congress enacted a temporary, but significant, increase in the fee rates applicable to large Chapter 11 cases. See Pub. L. 115–72, Div. B, 131 Stat. 1229 (2017 Act). The increase was set to take effect only if the UST Fund balance dropped below $200 million as of September 30 of the most recent fiscal year. If that condition was met, the increase applied on a quarterly basis to any debtors with a disbursement of $1 million or more during that quarter, regardless of whether their case was newly filed or already pending when the increase took effect. For those debtors, the maximum fee was increased from $30,000 a quarter to $250,000 a quarter. §1004(a), *id.*, at 1232. The statute provided that the fee raise would become effective in the first quarter of 2018 and would last only through 2022.

Despite the Judicial Conference's standing order, and unlike with previous fee increases, the six districts in the two States participating in the Administrator Program did not immediately adopt the 2017 fee increase. Only in September 2018 did the Judicial Conference order Administrator Program districts to implement the amended fee schedule. Even then, however, two key differences remained between the fee increase faced by debtors in Trustee Program districts as opposed to those faced by debtors in Administrator Program districts. First, the fee increase took effect for the six Administrator Program districts as of October 1, 2018, while the increase took effect for the Trustee Program districts as of the first quarter of 2018. Second, in Administrator Program districts, the fee increase applied only to newly filed cases, while in Trustee Program districts, the increase applied to all pending cases.

In 2021, Congress amended the statute governing parity of fees between Trustee Program and Administrator Program districts, §1930(a)(7), to replace the word "may" with "shall." See Pub. L. 116–325, 134 Stat. 5088. As a result, the statute now provides that the Judicial Conference "shall require" imposition of fees in Administrator Program districts that are equal to those imposed in Trustee Program districts. §1930(a)(7). This change "confirm[ed] the longstanding intention of Congress that quarterly fee requirements remain consistent across all Federal judicial districts." *Id.*, at 5086.

B

In 2008, Circuit City Stores, Inc., filed for Chapter 11 bankruptcy in the Eastern District of Virginia, a Trustee Program district. In 2010, the Bankruptcy Court confirmed a joint-liquidation plan, overseen by a trustee (petitioner here), to collect, administer, distribute, and liquidate all of Circuit City's assets. The liquidation plan required petitioner to "'pay quarterly fees to the U. S. Trustee until the Chapter 11 Cases are closed or converted.'" *In re Circuit City Stores*, 606 B. R. 260, 263 (2019). In 2010, when the plan was confirmed, the maximum quarterly fee was $30,000.

Circuit City's bankruptcy was still pending when Congress raised the fees for Chapter 11 debtors in Trustee Program districts through the 2017 Act. Across the first three quarters after the fee increase took effect, petitioner paid $632,542 in total fees. *Id.*, at 267, n. 20. Had Congress not increased fees, petitioner would have paid $56,400 over that same period. *Ibid.*

Petitioner filed for relief against the Acting U. S. Trustee for Region 4 (respondent here, represented by the Solicitor General) in the Bankruptcy Court of the Eastern District of Virginia. Petitioner objected that the fee increase under the 2017 Act was nonuniform across Trustee Program districts and Administrator Program districts, in violation of the Constitution's Bankruptcy Clause. The Bankruptcy Court agreed, and directed that for the fees due from January 1, 2018, onward, the trustee pay the rate in effect prior to the 2017 Act. *Id.,* at 270–271. The court reserved the question whether the trustee could recover any "overpayments" made under the 2017 Act. *Ibid.*

A divided panel of the Fourth Circuit reversed. The court agreed that the uniformity requirement of the Bankruptcy Clause applied to the 2017 Act, but it interpreted the Clause as forbidding "only 'arbitrary' geographic differences." 996 F. 3d, at 166. In the court's view, the fee increase permissibly applied only to Trustee Program districts because the UST Fund, which funded that program alone, was dwindling. Therefore, the court reasoned, Congress' effort to remedy that problem was not arbitrary. Judge Quattlebaum dissented in relevant part, interpreting the Bankruptcy Clause to preclude disparate treatment of bankruptcy districts unless the treatment was "aimed at addressing issues that are geographical in nature." *Id.,* at 175. In Judge Quattlebaum's view, the difference between Trustee Program districts and Administrator Program districts was arbitrary, as there was nothing "geographically distinct about Alabama or North Carolina that justified a different approach in those states." *Ibid.*

This Court granted certiorari, 595 U. S. ___ (2022), to resolve a split that had developed in the lower courts over the constitutionality of the 2017 Act.[1]

[1] Compare *In re John Q. Hammons Fall 2006, LLC*, 15 F. 4th 1011

II

A

The Bankruptcy Clause empowers Congress to establish "uniform Laws on the subject of Bankruptcies throughout the United States." U. S. Const., Art. I, §8, cl. 4. The first question before the Court is whether the 2017 Act is subject to the Bankruptcy Clause's uniformity requirement at all.

Respondent contends that the 2017 Act was not a law "on the subject of Bankruptcies" to which the uniformity requirement applies, but, rather, a law meant to help administer substantive bankruptcy law. Respondent interprets the Bankruptcy Clause as extending only to laws that "alter the substance of debtor-creditor relations," such as laws that set priorities for claims or exempt property from an estate. Brief for Respondent 25. In respondent's view, the Necessary and Proper Clause, U. S. Const., Art. I, §8, cl. 18, supplies the authority for Congress to pass a law auxiliary to a substantive bankruptcy law.

Nothing in the language of the Bankruptcy Clause itself, however, suggests a distinction between substantive and administrative laws. This Court has repeatedly emphasized that the Bankruptcy Clause's language, embracing "laws on the subject of Bankruptcies," is broad. For example, the Court has recognized that the "subject of bankruptcies is incapable of final definition," and includes "nothing less than 'the subject of the relations between [a] debtor and his creditors.'" *Wright* v. *Union Central Life Ins. Co.*, 304 U. S. 502, 513–514 (1938). Without purporting to define the full scope of the Clause, the Court has interpreted the Clause to have "granted plenary power to Congress over the

---

(CA10 2021) (2017 Act is unconstitutional); *In re Clinton Nurseries, Inc.*, 998 F. 3d 56 (CA2 2021) (same), with *In re Mosaic Mgmt. Group, Inc.*, 22 F. 4th 1291 (CA11 2022) (2017 Act is constitutional); *In re Circuit City Stores, Inc.*, 996 F. 3d 156 (CA4 2021) (same); *In re Buffets, LLC*, 979 F. 3d 366 (CA5 2020) (same).

whole subject of 'bankruptcies,'" and observed that the "language used" did not "limit" the scope of Congress' authority. *Hanover Nat. Bank* v. *Moyses*, 186 U. S. 181, 187 (1902).

Nor has this Court ever distinguished between substantive and administrative bankruptcy laws or suggested that the uniformity requirement would not apply to both. Respondent argues that each of this Court's prior cases on the uniformity requirement has addressed what he terms "substantive bankruptcy laws," Brief for Respondent 24, but these cases do not establish that the uniformity requirement only applies to such "substantive" laws. This Court has stated that "the powers of the general grant" of the Necessary and Proper Clause must be added to the Bankruptcy Clause's "specific grant" of power to Congress to legislate on the subject of bankruptcies. *Wright*, 304 U. S., at 513. The Court has never suggested, however, that all "administrative" bankruptcy laws, Brief for Respondent 13, are enacted pursuant to the Necessary and Proper Clause, nor that the Necessary and Proper Clause permits Congress to circumvent the limitations set by the Bankruptcy Clause. To the contrary, the Court has held that Congress cannot evade the "affirmative limitation" of the uniformity requirement by enacting legislation pursuant to other grants of authority. *Railway Labor Executives' Assn.* v. *Gibbons*, 455 U. S. 457, 468–469 (1982) (rejecting the contention that Congress could "enact nonuniform bankruptcy laws pursuant to the Commerce Clause," because doing so "would eradicate from the Constitution a limitation on the power of Congress to enact bankruptcy laws").

Not surprisingly, all courts to have considered this question to date (even those that have found the 2017 Act constitutional) have accepted that the statute is subject to the Bankruptcy Clause's uniformity requirement. See *In re Clinton Nurseries, Inc.*, 998 F. 3d 56, 64, and n. 6 (CA2 2021) (collecting cases). The 2017 fee provision amended a statute titled "Bankruptcy fees." 28 U. S. C. §1930. The provision's effect is to set fees that must be paid by a bankruptcy trustee from the debtor's estate in a bankruptcy proceeding. The only "subject" of the 2017 Act is bankruptcy. Moreover, and importantly, the 2017 Act does affect the "substance of debtor-creditor relations": Increasing mandatory fees paid out of the debtor's estate decreases the funds available for payment to creditors. As a result, the obligations between creditors and debtors are changed.

Respondent also argues that historic and modern congressional practice support the notion that bankruptcy fees are wholly exempt from the uniformity requirement. This argument glosses over the nature of the practices at issue. The historic examples respondent cites concern uniform federal laws allowing for local variation by delegating discretion to districts to establish their own procedures for certain bankruptcy matters, including fees, in view of local needs and conditions. See An Act to Establish an Uniform System of Bankruptcy Throughout the United States, §47, 2 Stat. 33 (1800) (providing "[t]hat the district judges, in each district respectively, shall fix a rate of allowance to be made to the commissioners of bankruptcy"); An Act to Establish a Uniform System of Bankruptcy Throughout the United States, §6, 5 Stat. 446 (1841) (establishing that district courts may "prescribe a tariff or table of fees and charges"). Similarly, the contemporary laws respondent cites are uniform laws allowing for local determination of governing rules. See, *e.g.,* 28 U. S. C. §§158(b)(1), (6) (providing that district courts may, but need not, participate in the bankruptcy appellate panel for its circuit if the circuit has created one). As discussed below, see *infra*, at 10–12, the uniformity requirement does not demand that Congress forbid or eliminate such local variation or choice.

The fee increase at issue here is materially different from these laws. It does not confer discretion on bankruptcy districts to set regional policies based on regional needs. Rather, Congress exempted debtors in only 2 States from a fee increase that applied to debtors in 48 States, without identifying any material difference between debtors across those States. The only difference between the States in which the fee increase applied and the States in which it was not required was the desire of those two States not to participate in the Trustee Program. The historical record therefore provides no support for respondent's argument that the uniformity requirement does not apply where Congress sets different fee structures with different funding mechanisms for debtors in different bankruptcy districts.

B

Having determined that the 2017 Act falls within the ambit of the Bankruptcy Clause, the Court must now decide whether the Act was a permissible exercise of that Clause.

1

Although the Bankruptcy Clause confers broad authority on Congress, the Clause also imposes a limitation on that authority: the requirement that the laws enacted be "uniform." The Court has addressed the uniformity requirement on three occasions. Taken together, they stand for the proposition that the Bankruptcy Clause offers Congress flexibility, but does not permit arbitrary geographically disparate treatment of debtors.

The Court first addressed the uniformity requirement in rejecting a challenge to the constitutionality of the Bankruptcy Act of 1898, which permitted individual debtor exemptions, including homestead and wage exemptions under state laws. *Moyses*, 186 U. S. 181. The Court in *Moyses* held that the Bankruptcy Clause's uniformity principle does not require Congress to eliminate existing state exemptions in bankruptcy laws. *Id.*, at 188. The Court explained that the "general operation of the law is uniform although it may result in certain particulars differently in different States." *Id.*, at 190.

Next, in the *Regional Rail Reorganization Act Cases*, 419 U. S. 102 (1974), the Court affirmed the constitutionality of the Regional Rail Reorganization Act of 1973, which applied only to rail carriers operating within a defined region of the country, where "[n]o railroad reorganization . . . was pending outside that defined region." *Id.,* at 159–160. The Court described the "flexibility inherent" in the Bankruptcy Clause, *id.,* at 158, which "does not deny Congress power to take into account differences that exist between different parts of the country, and to fashion legislation to resolve geographically isolated problems," *id.,* at 159. Because the Regional Rail Reorganization Act "operate[d] uniformly upon all bankrupt railroads then operating in the United States," it was consistent with the Bankruptcy Act's uniformity principle. *Id.,* at 160. Put simply, Congress may enact geographically limited bankruptcy laws consistent with the uniformity requirement if it is responding to a geographically limited problem.

While the uniformity requirement allows Congress to account for "differences that exist between different parts of the country," *id.*, at 159, it does not give Congress free rein to subject similarly situated debtors in different States to different fees because it chooses to pay the costs for some, but not others. In *Gibbons*, 455 U. S. 457, the Court struck down the Rock Island Railroad Transition and Employee Assistance Act (RITA), in which Congress altered the order of priority of claimants in a single railroad's bankruptcy proceedings. The Court recognized that the Bankruptcy Clause "contains an affirmative limitation or restriction upon Congress' power," namely, the uniformity requirement. *Id.,* at 468. RITA exceeded this limitation, the Court explained, because it singled out one railroad and did not apply to other similarly situated railroads that were engaged in bankruptcy proceedings. *Id.,* at 470. The Court reasoned that unlike the Regional Rail Reorganization Act, RITA was "not a response either to the particular problems of major railroad bankruptcies or to any geographically isolated problem: it is a response to the problems caused by the bankruptcy of *one* railroad." *Ibid.* For that reason, RITA "cannot be said to apply uniformly even to major railroads in bankruptcy proceedings throughout the United States." *Id.*, at 471. The Court emphasized that its "holding . . . does not impair Congress' ability under the Bankruptcy Clause to define classes of debtors and to structure relief accordingly" and summarized that "[t]o survive scrutiny under the Bankruptcy Clause, a law must at least apply uniformly to a defined class of debtors." *Id.*, at 473.

In sum, our precedent provides that the Bankruptcy Clause offers Congress flexibility, but does not permit the arbitrary, disparate treatment of similarly situated debtors based on geography.

2

Here, there is no dispute that the 2017 Act's fee increase was not geographically uniform. The only remaining question is whether Congress permissibly imposed nonuniform fees because it was responding to a funding deficit limited to the Trustee Program districts. Under the specific circumstances present here, the nonuniform fee increase violated the uniformity requirement.

All agree that the fee increase applied differently to Chapter 11 debtors in different regions. Debtors in Alabama and North Carolina, unlike debtors in the remainder of the country, paid no fee increases for the first three quarters of 2018. Moreover, the fee increase only applied to newly filed cases, and not pending cases, in those two States. That geographical disparity meant that petitioner paid over $500,000 more in fees compared to an identical debtor in North Carolina or Alabama.

Recognizing that the 2017 Act caused such disparities, respondent contends that those disparities were a permissible effort to solve a particular geographical problem: the budgetary shortfall that befell the UST Fund, which supports the Trustee Program but not the Administrator Program. Respondent argues that this problem justified Congress' imposition of fee increases specific to Trustee Program districts in order to replenish the UST Fund's coffers. It is true that Congress' stated goal in raising fees in Trustee Program districts was to address this budgetary shortfall. That shortfall, however, existed only because Congress itself had arbitrarily separated the districts into two different systems with different cost funding mechanisms, requiring Trustee Program districts to fund the Program through user fees while enabling Administrator Program districts to draw on taxpayer funds by way of the Judiciary's general budget.

The problem Congress sought to address here is thus different from the problem facing the debtors in the *Regional Rail Reorganization Act Cases*. There, a "national rail transportation crisis" prompted Congress to respond with the Regional Rail Reorganization Act of 1973. 419 U. S., at 159. That crisis arose when eight major railroads located in the Northeast and the Midwest entered reorganization proceedings. *Id.,* at 108. Congress responded accordingly with legislation tailored to those regions. *Id.*, at 108–109. The problems prompting Congress' disparate treatment in this case, however, stem not from an external and geographically isolated need, but from Congress' own decision to create a dual bankruptcy system funded through different mechanisms in which only districts in two States could opt into the more favorable fee system for debtors.

The Bankruptcy Clause affords Congress flexibility to "fashion legislation to resolve geographically isolated problems," *id.,* at 159, but as precedent instructs, the Clause does not permit Congress to treat identical debtors differently based on an artificial funding distinction that Congress itself created. The Clause, after all, would clearly prohibit Congress from arbitrarily dividing States into two categories and charging different fees to States in different categories unrelated to the needs of, or conditions in, those States. The Clause does not allow Congress to accomplish in two steps what it forbids in one.[2]

A few observations on the limits of this decision are in order. The Court does not today address the constitutionality of the dual scheme of the bankruptcy system itself, only Congress' decision to impose different fee arrangements in those two systems. The Court's holding today also should not be understood to impair Congress' authority to structure relief differently for different classes of debtors or to respond to geographically isolated problems. The Court holds only that the uniformity requirement of the Bankruptcy Clause prohibits Congress from arbitrarily burdening only one set of debtors with a more onerous funding mechanism than that which applies to debtors in other States.

C

The parties dispute the appropriate remedy. Petitioner seeks a full refund of fees that it paid during the nonuniform period. Respondent argues that any remedy should apply only prospectively, or should result in a fee increase for debtors who paid less in the Administrator Program districts. The parties raise a host of legal and administrative concerns with each of the remedies proposed, including the

---

[2] Respondent further argues that any uniformity violation should be attributed to the Judicial Conference and not to Congress, because Congress expected the Judicial Conference to implement the 2017 Act's fee increase in Administrator Program districts. As respondent sees it, it is the Judicial Conference's failure to implement the fee increase that is responsible for the disparate fees, not the 2017 Act itself. Respondent provides ample evidence that Congress likely understood, when it passed the 2017 Act, that the Judicial Conference would impose the same fee increase. That said, prior to the 2021 amendment, the fee statute did not *require* the Judicial Conference to impose an equivalent increase. It is that congressional decision that led to the disparities at issue here.

practicality, feasibility, and equities of each proposal; their costs; and potential waivers by nonobjecting debtors. The court below, however, has not yet had an opportunity to address these issues or their relevancy to the proper remedy. "[M]indful that we are a court of review, not of first view," *Cutter* v. *Wilkinson*, 544 U. S. 709, 718, n. 7 (2005), this Court remands for the Fourth Circuit to consider these questions in the first instance.

* * *

For these reasons, the judgment of the Court of Appeals for the Fourth Circuit is reversed, and the case is remanded for further proceedings consistent with this opinion.

It is so ordered.

dant, Garlock's, asbestos was a substantial cause of the decedent's mesothelioma. The Sixth Circuit held that the plaintiff had not made this showing:

> While [the decedent's] exposure to Garlock gaskets may have contributed to his mesothelioma, the record simply does not support an inference that it was a *substantial* cause of his mesothelioma. Given that the Plaintiff failed to quantify [the decedent's] exposure to asbestos from Garlock gaskets and that the Plaintiff concedes that [the decedent] sustained massive exposure to asbestos from non-Garlock sources, there is simply insufficient evidence to infer that Garlock gaskets probably, as opposed to possibly, were a substantial cause of [the decedent's] mesothelioma.

Id. (emphasis in original). The *Moeller* court concluded by analogizing that "saying that exposure to Garlock gaskets was a substantial cause of [the decedent's] mesothelioma would be akin to saying that one who pours a bucket of water into the ocean has substantially contributed to the ocean's volume." *Id.* Because the evidence demonstrating that Mr. Connor was exposed to Appellee's asbestos is so weak -- especially when compared to the evidence of Mr. Connor's asbestos exposure at Norfolk Southern -- we reach a similar conclusion here.

IV.

For the reasons set forth herein, the judgment of the district court is

AFFIRMED.

IN RE: CIRCUIT CITY STORES, INCORPORATED; Circuit City Stores West Coast, Incorporated; InterTAN, Inc.; Ventoux International, Inc.; Circuit City Purchasing Company, LLC; CC Aviation, LLC; CC Distribution Company of Virginia, Inc.; Circuit City Properties, LLC; Kinzer Technology, LLC; Abbott Advertising Agency, Incorporated; Patapsco Designs, Inc.; Sky Venture Corp.; PRAHS, Inc. (N/A); XSStuff, LLC; Mayland MN, LLC; Courchevel, LLC; Orbyx Electronics, LLC; Circuit City Stores PR, LLC, Debtors.

Alfred H. Siegel, Trustee of the Circuit City Stores, Inc. Liquidating Trust, Plaintiff – Appellee,

v.

John P. Fitzgerald, III, Acting United States Trustee for Region 4, Defendant – Appellant.

Acadiana Management Group, LLC; Albuquerque-AMG Specialty Hospital, LLC; Central Indiana-AMG Specialty Hospital, LLC; LTAC Hospital of Edmond, LLC; Houma-AMG Specialty Hospital, LLC; LTAC of Louisiana, LLC; Las Vegas-AMG Specialty Hospital, LLC; Warren Boegel; Boegel Farms, LLC; Three Bo's, Inc., Amici Supporting Appellee.

In re: Circuit City Stores, Incorporated; Circuit City Stores West Coast, Incorporated; InterTAN, Inc.; Ventoux International, Inc.; Circuit City Purchasing Company, LLC; CC Aviation, LLC; CC Distribution Company of Virginia, Inc.; Circuit City Properties, LLC; Kinzer Technology, LLC; Abbott Advertising Agency, Incorporated; Patapsco Designs, Inc.; Sky Venture

Corp.; PRAHS, Inc. (N/A); XSStuff, LLC; Mayland MN, LLC; Courchevel, LLC; Orbyx Electronics, LLC; Circuit City Stores PR, LLC, Debtors.

Alfred H. Siegel, Trustee of the Circuit City Stores, Inc. Liquidating Trust, Plaintiff – Appellant,

v.

John P. Fitzgerald, III, Acting United States Trustee for Region 4, Defendant – Appellee.

Acadiana Management Group, LLC; Albuquerque-AMG Specialty Hospital, LLC; Central Indiana-AMG Specialty Hospital, LLC; LTAC Hospital of Edmond, LLC; Houma-AMG Specialty Hospital, LLC; LTAC of Louisiana, LLC; Las Vegas-AMG Specialty Hospital, LLC; Warren Boegel; Boegel Farms, LLC; Three Bo's, Inc., Amici Supporting Appellant.

No. 19-2240, No. 19-2255

United States Court of Appeals, Fourth Circuit.

Argued: December 8, 2020

Decided: April 29, 2021

Background: Trustee of liquidating trust established under debtors' confirmed Chapter 11 plan filed motion to determine extent of liability for post-confirmation quarterly United States Trustee fees, asking the court to order that, notwithstanding amendment of governing statute by the Bankruptcy Judgeship Act of 2017, the amount of such fees be determined based on statutory rates in effect as of petition date in this case. United States Trustee moved for summary judgment. The United States Bankruptcy Court for the Eastern District of Virginia, No. 3:08-bk-35653, Kevin R. Huennekens, J., 606 B.R. 260, granted motion to determine and denied motion for summary judgment, and parties sought leave to appeal directly to the Court of Appeals.

Holdings: The Court of Appeals, King, Circuit Judge, held that:

(1) quarterly fees owed by certain debtors to fund the United States Trustee program were not "taxes," of kind subject to Uniformity Clause of the United States Constitution;

(2) legislation that required the payment of increased quarterly fees in large Chapter 11 cases only in judicial districts in which the United States Trustee program was in effect did not violate the uniformity requirement of the Bankruptcy Clause;

(3) application of legislation in pending Chapter 11 cases to the quarterly fees that accrued thereafter would not have impermissible retroactive effect.

Affirmed in part, reversed in part, and remanded.

Quattlebaum, Circuit Judge, filed opinion concurring in part and dissenting in part.

1. Bankruptcy ⚷3782, 3786

Court of Appeals generally reviews a bankruptcy court's factual findings for clear error and its legal rulings de novo.

2. Internal Revenue ⚷3022

Uniformity Clause of the United States Constitution applies only to taxes. U.S. Const. art. 1, § 8, cl. 1.

3. Bankruptcy ⚷3152

Internal Revenue ⚷3022

Quarterly fees owed by certain debtors to fund the United States Trustee program were not "taxes," of kind subject to Uniformity Clause of the United States Constitution. U.S. Const. art. 1, § 8, cl. 1; 28 U.S.C.A. § 1930(a)(6).

4. Bankruptcy ⚷2014, 3152

Legislation that required the payment of increased quarterly fees in large Chapter 11 cases only in judicial districts in which the United States Trustee program was in effect, in order to fund shortfall in this program, and not in judicial districts that had a Bankruptcy Administrator, permissibly differentiated between geographic areas to solve a funding shortfall that existed only in judicial districts in which the United States Trustee program was in effect, and thus did not violate the uniformity requirement of the Bankruptcy Clause. U.S. Const. art. 1, § 8, cl. 4.; 28 U.S.C.A. § 1930(a)(6).

5. Bankruptcy ⚷2014

To be constitutionally uniform, a law enacted pursuant to the Bankruptcy Clause must apply uniformly to a defined class of debtors and must also be geographically uniform. U.S. Const. art. 1, § 8, cl. 4.

6. Bankruptcy ⚷2014

Uniformity requirement of the Bankruptcy Clause is not straitjacket that forbids Congress from distinguishing among classes of debtors. U.S. Const. art. 1, § 8, cl. 4.

7. Bankruptcy ⚷2014

Bankruptcy law may be constitutionally uniform, as required by the Bankruptcy Clause, and yet may recognize state laws in certain particulars, though such recognition may lead to different results in different states. U.S. Const. art. 1, § 8, cl. 4.

8. Bankruptcy ⚷2014

In proper circumstances, Congress, without violating the uniformity requirement of the Bankruptcy Clause, may take into account differences that exist between different parts of the country and fashion bankruptcy legislation to resolve geographically isolated problems. U.S. Const. art. 1, § 8, cl. 4.

9. Bankruptcy ⚷2014

Uniformity requirement of the Bankruptcy Clause forbids only arbitrary geographic differences. U.S. Const. art. 1, § 8, cl. 4.

10. Constitutional Law ⚷3907

Applying a statute to events occurring before it was enacted gives rise to Fifth Amendment due process concerns by potentially depriving a party of adequate notice and undermining settled expectations. U.S. Const. Amend. 5.

11. Statutes ⚷1556(1)

Courts utilize a two-step analysis on retroactivity challenge to legislation, under which they first apply ordinary tools of statutory construction and ask whether Congress has expressly prescribed the statute's proper reach.

12. Statutes ⚷1555, 1556(1)

If Congress has expressly prescribed the proper temporal reach of statute, then that is the end of the matter, and court does not proceed to second step of retroactivity analysis; only if there is no express Congressional command does court proceed to second step of analysis and decide whether applying the new provision results in an impermissible retroactive consequence by affecting substantive rights, liabilities, or duties on the basis of conduct arising before its enactment.

13. Bankruptcy ⚷2023, 3152

Legislation that required payment of increased quarterly fees in large Chapter 11 cases in attempt to make up funding deficiency in the United States Trustee program, by its clear and unambiguous terms, applied in Chapter 11 cases that were pending when the legislation went into effect to require payment of increased quarterly fees going forward by debtors that met the requirements for payment of increased fees; language in statute, providing that increased fees would be paid "in each case" and "for each quarter," with no limitation based on when the case was filed, sufficiently manifested an intent that the legislation should apply in pending cases. 28 U.S.C.A. § 1930(a)(6).

14. Bankruptcy ⚷2023, 3152

Even assuming that legislation that required payment of increased quarterly fees in large Chapter 11 cases was ambiguous as to whether these increased fees applied in Chapter 11 cases that were pending when the legislation went into effect, application of legislation in pending Chapter 11 cases to the quarterly fees that accrued thereafter would not have retroactive effect, as not impairing rights that a party possessed when legislation went into effect, increasing a party's liability for past conduct, or imposing new duties with respect to transactions already completed. 28 U.S.C.A. § 1930(a)(6).

15. Statutes ⚷1557

While there is a presumption against the retroactive application of statutes, that presumption only applies if there is a possibility that a statute attaches new legal consequences to events completed before its enactment.

Appeals from the United States Bankruptcy Court for the Eastern District of Virginia, at Richmond. Kevin R. Huennekens, Bankruptcy Judge. (3:08-bk-35653)

ARGUED: Jeffrey E. Sandberg, UNITED STATES DEPARTMENT OF JUSTICE, Washington, D.C., for Appellant/Cross-Appellee. Andrew William Caine, PACHULSKI STANG ZIEHL & JONES LLP, Los Angeles, California, for Appellee/Cross-Appellant. ON BRIEF: Joseph H. Hunt, Assistant Attorney General, Mark B. Stern, Civil Division, Ramona D. Elliott, Deputy Director/General Counsel, P. Matthew Sutko, Associate General Counsel, Beth Levene, Executive Office for United States Trustees, UNITED STATES DEPARTMENT OF JUSTICE, Washington, D.C., for Appellant/Cross-Appellee. Lynn L. Tavenner, Paula S. Beran, David N. Tabakin, TAVENNER & BERAN, PLC, Richmond, Virginia, for Appellee/Cross-Appellant. Bradley L. Drell, Heather M. Mathews, GOLD, WEEMS, BRUSER, SUES & RUNDELL, Alexandria, Lousiana, for Amici Acadiana Management Group, LLC, Albuquerque-AMG Specialty Hospital, LLC, Central Indiana-AMG Specialty Hospital, LLC, LTAC Hospital of Edmond, LLC, Houma-AMG Specialty Hospital, LLC, LTAC of Louisiana, LLC, Las Vegas-AMG Specialty Hospital, LLC, Warren Boegel, Boegel Farms, LLC, and Three Bo's, Inc.

Before KING and QUATTLEBAUM, Circuit Judges, and TRAXLER, Senior Circuit Judge.

Affirmed in part, reversed in part, and remanded by published opinion. Judge KING wrote the majority opinion, in which Senior Judge TRAXLER joined. Judge QUATTLEBAUM wrote a separate opinion concurring in part and dissenting in part.

KING, Circuit Judge:

These consolidated appeals present two constitutional issues concerning changes made to the bankruptcy laws nearly four years ago. Alfred H. Siegel, Trustee of the Circuit City Stores, Inc., Liquidating Trust (the "Circuit City Trustee"), sought a ruling in 2019 on his liability for quarterly fees assessed under a 2017 Amendment to the bankruptcy fees provisions of the United States Code (the "2017 Amendment"). In response, the Bankruptcy Court for the

Eastern District of Virginia ruled that the fees aspect of the 2017 Amendment is unconstitutional. *See In re Circuit City Stores, Inc.*, 606 B.R. 260 (Bankr. E.D. Va. 2019), ECF No. 2 (the "Bankruptcy Opinion"). That ruling was based on a perceived lack of uniformity between quarterly fees in the two types of bankruptcy court districts, that is, U.S. Trustee districts and Bankruptcy Administrator districts.

John P. Fitzgerald, III, the Acting U.S. Trustee for Region 4 (the "U.S. Trustee"), maintains that the Bankruptcy Opinion erred in its uniformity ruling and has appealed. The Circuit City Trustee, on the other hand, has cross-appealed a separate aspect of the Opinion that rejected his claim concerning retroactive application of the 2017 Amendment. In November 2019, the Circuit City Trustee and the U.S. Trustee jointly certified these appeals to this Court.[1] We granted their joint petition for permission to appeal and consolidated the appeals. The U.S. Trustee's appeal is designated as No. 19-2240, and the Circuit City Trustee's cross-appeal is designated as No. 19-2255.

As explained below, we rule in favor of the U.S. Trustee in each appeal. That is, we reverse the Bankruptcy Opinion's uniformity decision challenged by the U.S. Trustee, and we affirm the Opinion's retroactivity decision challenged by the Circuit City Trustee. As a result, we remand to the bankruptcy court for such other and further proceedings as may be appropriate.

I.

A review of the pertinent background and operations of the bankruptcy courts is essential to an understanding of these proceedings. Before addressing the legal issues presented, we will discuss some historical context of those courts, as well as the factual background of these proceedings.

A.

The bankruptcy courts operate under two distinct programs for the handling of their proceedings — the Trustee program and the Bankruptcy Administrator program. Congress initiated this two-program system in 1978 when it launched the Trustee pilot program within the Department of Justice. The Trustee pilot program was successful and became a permanent fixture in 1986. Eighty-eight of the 94 judicial districts operate with U.S. Trustees. The other districts — in Alabama and North Carolina — utilize the Bankruptcy Administrator program, which is overseen by the Judicial Conference of the United States.[2]

These bankruptcy court programs utilize distinct funding sources. The judiciary's general budget, overseen by the Judicial Conference, funds the Bankruptcy Administrator program. On the other hand, the bankruptcy debtors in Trustee districts primarily fund the Trustee program. Although annual congressional appropriations provide support for the Trustee pro-

1. The U.S. Trustee and the Circuit City Trustee jointly sought permission to appeal from this court, pursuant to 28 U.S.C. § 158(d)(2)(A). That provision confers jurisdiction on a court of appeals to consider a direct appeal from a bankruptcy court, bypassing the district court, if the statutory conditions are satisfied.

2. The exclusion of Alabama and North Carolina from the Trustee program was intended to be temporary. More than twenty years later, however, Congress confirmed the special status of the six judicial districts in those two states as Bankruptcy Administrator districts. *See* Federal Courts Improvement Act of 2000, Pub. L. No. 106-518 § 501, 114 Stat. 2410, 2421-22 (2000).

gram, Congress anticipated that debtor-paid fees would completely offset the program's cost. Debtor fees include Chapter 11 quarterly fees, which are based on quarterly "disbursements" that debtors make to their creditors until the cases are "converted or dismissed." *See* 28 U.S.C. § 1930(a)(6)(A).

At their inception, the Bankruptcy Administrator districts were not required to pay quarterly fees. In 1994, however, the Ninth Circuit ruled this distinction unconstitutional, explaining that the statutory imposition of such quarterly fees in certain districts but not in others was without justification and thus contravened the Bankruptcy Clause of the Constitution. *See St. Angelo v. Victoria Farms, Inc.*, 38 F.3d 1525, 1529, 1531-32 (9th Cir. 1994), *amended by* 46 F.3d 969 (9th Cir. 1995). In reaction to that decision, Congress empowered the Judicial Conference to fix and assess quarterly fees in the Bankruptcy Administrator districts that were "equal to those imposed" in the Trustee districts. *See* 28 U.S.C. § 1930(a)(7) ("In districts that are not part of a United States trustee region . . ., the Judicial Conference may require the debtor in a case under chapter 11 of title 11 to pay fees equal to those imposed by paragraph (6) of this subsection.").[3] In 2002, the Judicial Conference began to impose quarterly fees in the Administrator districts that were consistent with the fees specified for the Trustee districts. The Administrator districts' quarterly fees are then deposited into a fund that offsets the general judicial branch appropriations rather than Trustee operations. *Id.* Until January 1, 2018, all Chapter 11 debtors, regardless of district, paid quarterly fees consistent with the same disbursement formula. At that point in time, a funding deficit in the Trustee program disrupted the status quo.

For several decades, Congress's annual appropriations to the Trustee program were entirely offset by the quarterly fees. The mid-2010s witnessed a decline in bankruptcy filings, however, and the Trustee program was no longer self-sustaining. Fueled by concerns that the financial burden might shift to taxpayers, Congress enacted the 2017 Amendment.[4] That Amendment altered the quarterly fees formula and increased the fees due in large Chapter 11 bankruptcy cases, on a temporary basis, during fiscal years 2018 through 2022. This fee increase is conditional, and it is only applicable if the Trustee Fund contains a balance of less than $200 million as of September 30 of the most recent fiscal year. The quarterly fee increase only applies to those bankruptcy debtors with disbursements of $1,000,000 or more in any quarter. If those criteria are satisfied, the quarterly fee is then the lesser of 1 percent of such disbursements, or $250,000. This potential fee is a substan-

3. As discussed further in footnote 10, in January 2021 — after this appeal was argued — Congress amended § 1930(a)(7) of Title 28, replacing the word "may" with the word "shall." *See infra* note 10.

4. The 2017 Amendment provision at issue in these appeals is codified in § 1930(a)(6)(B) of Title 28 and provides in pertinent part as follows:

> During each of fiscal years 2018 through 2022, if the balance in the United States Trustee System Fund as of September 30 of the most recent full fiscal year is less than $200,000,000, the quarterly fee payable for a quarter in which disbursements equal or exceed $1,000,000 shall be the lesser of 1 percent of such disbursements or $250,000.

See 28 U.S.C. § 1930(a)(6)(B). Congress specified that the 2017 Amendment "shall apply to quarterly fees payable under section 1930(a)(6) . . . for disbursements made in any calendar quarter that begins on or after the date of enactment." *See* Bankruptcy Judgeship Act of 2017, Pub. L. No. 115-72, § 1004, 131 Stat. 1224, 1232 (2017).

tial increase from the previous maximum fee of $30,000.

Initially, only those bankruptcy debtors in the Trustee districts incurred fee increases as a result of the 2017 Amendment. Several Trustee district bankruptcy courts applied the increased fees to quarterly disbursements that postdated the Amendment. As a result, large Chapter 11 debtors with bankruptcy cases pending on January 1, 2018, incurred increased fees for disbursements beginning in the first quarter of 2018. The bankruptcy debtors in the Administrator districts, however, were not subjected to increased quarterly fees. The Judicial Conference adopted an amended fee schedule in September 2018 and applied the increased fees to those bankruptcy cases filed in the six Bankruptcy Administrator districts on or after October 1, 2018. Consequently, any debtor in an Administrator district that filed for bankruptcy prior to October 1, 2018, does not owe increased quarterly fees, regardless of how long the bankruptcy case remains pending.

B.

1.

Circuit City Stores, Inc., and its affiliates (collectively "Circuit City") operated a chain of consumer electronic retail stores throughout the United States. In 2008, Circuit City filed for Chapter 11 bankruptcy protection in the Eastern District of Virginia, which is a Trustee district. In 2010, the bankruptcy court in eastern Virginia confirmed Circuit City's Chapter 11 liquidation plan. That plan provides, with respect to "fees that become due and payable" under 28 U.S.C. § 1930, that the Circuit City Trustee "shall pay [those] fees to the U.S. Trustee until the Chapter 11 Cases are closed or converted and/or the entry of the final decrees." *See* J.A. 110.[5] Circuit City's bankruptcy proceedings remained pending on January 2018, after the 2017 Amendment went into effect.

The Circuit City Trustee initially paid the increased quarterly fees. His willingness to pay those fees diminished, however, when the bankruptcy court in the Western District of Texas ruled in February 2019 that the 2017 Amendment is unconstitutional because it creates nonuniform bankruptcy laws in contravention of the Bankruptcy Clause, and also because it is unconstitutionally retroactive. *See In re Buffets, LLC*, 597 B.R. 588 (Bankr. W.D. Tex. 2019).[6] On March 28, 2019, the Circuit City Trustee filed for similar relief in the Eastern District of Virginia, seeking to limit his liability for quarterly fees assessed under 28 U.S.C. § 1930(a)(6). *See generally* J.A. 348-63. The Circuit City Trustee maintained that he was excused from complying with the revised quarterly fee schedule for the reasons adopted by the *Buffets* bankruptcy court decision in Texas — that is, the 2017 Amendment impermissibly created nonuniform bankruptcy laws that are unconstitutionally retroactive.[7] The U.S. Trustee opposed Circuit City's requests, maintaining that Congress's temporary, prospective in-

5. Citations herein to "J.A. ——" refer to the contents of the Joint Appendix filed by the parties in this appeal.

6. As explained more fully below, in November 2020, the Fifth Circuit reversed the February 2019 *Buffets* decision of the bankruptcy court. *See Matter of Buffets, L.L.C.*, 979 F.3d 366 (5th Cir. 2020).

7. In explaining his retroactivity contention, the Circuit City Trustee asserts, *inter alia*, that the 2017 Amendment's application to pending cases contravenes the Due Process Clause of the Fifth Amendment, in that it deprived bankruptcy debtors of fair notice.

crease in quarterly fees for a subset of Chapter 11 cases is not retroactive and does not implicate any constitutional uniformity issues.

2.

a.

By its Bankruptcy Opinion of July 15, 2019, the bankruptcy court in eastern Virginia granted Circuit City's request for relief. The court ruled that the quarterly fees imposed could be classified either as a tax or as a user fee under the Bankruptcy Code and, under either designation, the 2017 Amendment contravenes both the Bankruptcy Clause and the Uniformity Clause of the Constitution. *See* Bankruptcy Opinion 14.[8] If the quarterly fees are a tax, according to the Opinion, the 2017 Amendment contravenes the Uniformity Clause because such fees are not applied in a geographically uniform manner. *Id.* Alternatively, if the quarterly fees are Chapter 11 user fees, the Opinion ruled that the 2017 Amendment is yet unconstitutional because it violates the Bankruptcy Clause, which empowers Congress to establish uniform laws for bankruptcy in the United States. *Id.* For support, the Opinion relied on the fact that, for the first three quarters of 2018, the Judicial Conference did not increase quarterly fees in the Bankruptcy Administrator districts. *Id.* at 12. As the Opinion explained, the Bankruptcy Administrator districts imposed the amended quarterly fee schedule for bankruptcy cases filed after on or October 1, 2018. With these underpinnings, the Opinion ruled that the quarterly fees owed by the Circuit City Trustee under the 2017 Amendment "since January 1, 2018, [are unconstitutional and] must be determined based on the prior version of the statute." *Id.* at 14.

b.

The Bankruptcy Opinion also addressed Circuit City's retroactivity contention. As the Opinion explained, Congress had not explicitly defined the 2017 Amendment's temporal reach. *See* Bankruptcy Opinion 10. It was thus for the courts to decide whether the 2017 Amendment applied to bankruptcy cases pending when the Amendment became effective. The Opinion then ruled that the increased quarterly fees in Trustee districts do not contravene any anti-retroactivity principles of the Constitution because, despite the variance in expectations, the 2017 Amendment is "substantively prospective" rather than retroactive. *Id.* at 11 (citing *Landgraf v. USI Film Prods.*, 511 U.S. 244, 269 n.24, 114 S.Ct. 1483, 128 L.Ed.2d 229 (1994) ("Even uncontroversially prospective statutes may unsettle expectations and impose burdens on past conduct: a new property tax or zoning regulation may upset the reasonable expectations that prompted those affected to acquire property.")).

c.

In August 2019, the U.S. Trustee appealed to the district court, challenging the Bankruptcy Opinion's ruling that the 2017 Amendment is unconstitutional due to a lack of uniformity. The Circuit City Trustee then cross-appealed the Opinion's ruling on retroactivity. The parties jointly sought permission for direct appeals, bypassing the district court and urging that the constitutional issues relating to the

8. The Bankruptcy Clause of the Constitution provides, in pertinent part, that Congress may "establish … uniform Laws on the subject of Bankruptcies throughout the United States." *See* U.S. Const. art. I, § 8, cl. 4. The Uniformity Clause, on the other hand, relates only to taxation and empowers Congress to "lay and collect [t]axes …; but all Duties, Imposts, and Excises shall be uniform throughout the United States." *See id.* at cl. 1.

2017 Amendment present questions of law "as to which there [are] no controlling decision[s] of [this Court] or of the Supreme Court" and involve matters of "public importance." *See* J.A. 413-16 (citing 28 U.S.C. § 158(d)(2)(A)(i) (authorizing certification to court of appeals by "all the appellants and appellees ... acting jointly")). By Order of November 6, 2019, we granted the joint petition for these appeals, and we possess jurisdiction pursuant to that Order.

II.

[1] We generally review a bankruptcy court's factual findings for clear error and its legal rulings de novo. *See In re Birmingham*, 846 F.3d 88, 92 (4th Cir. 2017). Because the relevant facts underlying these appeals are undisputed, the applicable standard of review is de novo.

III.

In his appeal, the U.S. Trustee maintains that the 2017 Amendment is constitutional and lawful in all respects. He thus challenges the Bankruptcy Opinion's ruling that the 2017 Amendment is unconstitutionally nonuniform and contravenes the Bankruptcy Clause and the Uniformity Clause. The Circuit City Trustee, on the other hand, maintains that the bankruptcy court ruled correctly on the uniformity issue being challenged by the U.S. Trustee. The Circuit City Trustee urges in his cross-appeal, however, that the 2017 Amendment's increased fee schedule constitutes an unconstitutional retroactive imposition of quarterly fees. We will assess these appeals in turn.

A.

[2, 3] The U.S. Trustee maintains that the bankruptcy court in eastern Virginia erroneously ruled that that 2017 Amendment's fee increase is unconstitutional. In making that ruling, the Bankruptcy Opinion relied on both the Bankruptcy Clause and the Uniformity Clause. With respect to his Uniformity Clause challenge, the U.S. Trustee finds support in the Fifth Circuit's ruling last year — reversing the decision of the Texas bankruptcy court relied on in the Bankruptcy Opinion — that Chapter 11 quarterly fees are user fees. *See Matter of Buffets, L.L.C.*, 979 F.3d 366, 376 n.7 (5th Cir. 2020). Put succinctly, because the Uniformity Clause only applies to taxes, as the U.S. Trustee maintains and as the Fifth Circuit correctly ruled, that Clause is inapplicable here. *Id.* (citing U.S. Const. art. I, § 8, cl. 1 ("Congress may 'lay and collect [t]axes ...; but all Duties, Imposts, and Excises shall be uniform throughout the United States.' ")).

[4] Because the Bankruptcy Opinion incorrectly relied on the Uniformity Clause, the uniformity ruling is left with only one other basis — that the 2017 Amendment violates the Bankruptcy Clause. The Bankruptcy Clause relates to the uniformity issue because Congress is empowered therein to establish uniform bankruptcy laws throughout the United States. The Bankruptcy Opinion, relying on that Clause and the Uniformity Clause, and drawing support from the now reversed decision of the Texas bankruptcy court, ruled that the 2017 Amendment is constitutionally flawed.

The U.S. Trustee contends that the quarterly fees being challenged here fail to implicate either the Uniformity Clause or the Bankruptcy Clause, because the 2017 Amendment is not a substantive bankruptcy law. Accordingly, he maintains that the 2017 Amendment is not subject to either of the uniformity requirements. Of importance, the Fifth Circuit has reversed the Texas bankruptcy court decision on which the Bankruptcy Opinion relied, stating that "every bankruptcy court dealing with a challenge to the 2017 Amendment" has rejected the contention that the Amendment is not a law "on the subject of Bankruptcies." *See Buffets*, 979 F.3d at 377. We are persuaded to the Fifth Circuit's view, in that — as explained further below — there is no constitutional uniformity problem posed by the 2017 Amendment.

[5–8] To be constitutionally uniform, "[a] law enacted pursuant to the Bankruptcy Clause must: (1) apply uniformly to a defined class of debtors; and (2) be geographically uniform." *See In re SCI Direct, LLC*, No. 17-61735, 2020 WL 5929612, at *10 (Bankr. N.D. Ohio Sept. 22, 2020) (citing *Ry. Labor Execs.' Ass'n v. Gibbons*, 455 U.S. 457, 473, 102 S.Ct. 1169, 71 L.Ed.2d 335 (1982)). The Bankruptcy Clause, however, "is not a straitjacket that forbids Congress to distinguish among classes of debtors." *See Gibbons*, 455 U.S. at 469, 102 S.Ct. 1169. In fact, as the Supreme Court has emphasized, "[a] bankruptcy law may be uniform and yet may recognize the laws of the State in certain particulars, although such recognition may lead to different results in different States." *Id.* (internal quotation marks omitted). In the proper circumstances, Congress may "take into account differences that exist between different parts of the country, and ... fashion legislation to resolve geographically isolated problems." *Id.*; *see also Reg'l R.R. Reorganization Cases*, 419 U.S. 102, 159-61, 95 S.Ct. 335, 42 L.Ed.2d 320 (1974) (recognizing that Act of Congress applicable only to rail carriers in certain regions and to carriers reorganizing within certain time period was uniform under the Bankruptcy Clause, in that it was designed to solve specific regional problem).

Several bankruptcy courts have recently addressed similar constitutional challenges to the 2017 Amendment, and most of those courts have ruled that the Amendment does not present a constitutional uniformity problem.[9] As explained below, the Fifth Circuit's *Buffets* decision correctly resolved the uniformity issue concerning the 2017 Amendment's quarterly fee increase and its application to debtors in the Trustee and Administrator districts. *See Buffets*, 979 F.3d 366.

The *Buffets* debtors filed their bankruptcy proceedings in the Western District of Texas in 2016. Those proceedings were pending in 2018 when the increased quar-

9. At least ten bankruptcy courts have addressed the uniformity question that we assess today, and six of those courts have ruled in favor of constitutionality. *See In re John Q. Hammons Fall 2006, LLC*, 618 B.R. 519, 524-26 (Bankr. D. Kan. 2020) (reviewing uniformity question that we assess with respect to 2017 Amendment and ruling — as we do today — in favor of constitutionality); *In re MF Glob. Holdings Ltd.*, 615 B.R. 415, 446-48 (Bankr. S.D.N.Y. 2020) (same); *Point.360 v. Office of the U.S. Trustee*, No. 2:19-ap-01442 (Bankr. C.D. Cal. Mar. 31, 2021) (same); *In re Mosaic Mgmt. Grp., Inc.*, 614 B.R. 615, 623-25 (Bankr. S.D. Fla. 2020) (same); *In re Clayton Gen., Inc.*, No. 15-64266, 2020 Bankr. LEXIS 842 at *27 (Bankr. N.D. Ga. Mar. 30, 2020) (same); *In re Exide Techs.*, 611 B.R. 21, 36-38 (Bankr. D. Del. 2020) (same).

On the other hand, four bankruptcy courts have addressed the same uniformity question that we assess and ruled — as did the Bankruptcy Court in eastern Virginia — that the challenged 2017 Amendment is unconstitutional. *See In re Circuit City Stores, Inc.*, 606 B.R. 260, 269-70 (Bankr. E.D. Va. 2019) (addressing uniformity question and ruling that challenged 2017 Amendment is unconstitutional); *In re Life Partners Holdings, Inc.*, 606 B.R. 277, 286-88 (Bankr. N.D. Tex. 2019) (same); *In re Buffets, LLC*, 597 B.R. 588, 594-95 (Bankr. W.D. Tex. 2019) (same), *rev'd*, 979 F.3d 366 (5th Cir. 2020); *USA Sales, Inc. v. Office of the U.S. Trustee*, 2021 WL 1226369, at *17-18 (C.D. Cal. Apr. 1, 2021) (same).

terly fees required by the 2017 Amendment went into effect. After the *Buffets* debtors declined to pay the increased fees and challenged the constitutionality of the 2017 Amendment on uniformity grounds, the bankruptcy court agreed with the debtors and ruled that the Amendment was not uniform and thus unconstitutional. The U.S. Trustee in Texas appealed, and — as in these appeals — the uniformity issue was certified to the court of appeals.

After concluding that the uniformity requirement of the Bankruptcy Clause is likely applicable to the 2017 Amendment, the Fifth Circuit decided that there is "no uniformity problem" with the Amendment. *See Buffets*, 979 F.3d at 377. That decision was made after a careful assessment of the applicable authorities, and the court of appeals recognized that "the uniformity requirement forbids only arbitrary regional differences in the provisions of the Bankruptcy Code." *Id.* at 378 (internal quotation marks omitted). As the court explained, however, the uniformity requirement does not deny Congress the power to enact legislation that resolves regionally isolated problems. *Id.* According to the Fifth Circuit, when Congress determined that it needed to remedy a shortfall in funding for the Trustee districts, it was entitled to "solve the evil to be remedied with a fee increase in just the underfunded districts." *Id.* (internal quotation marks omitted). Thus, the court of appeals explained, "[i]t is reasonable for Congress to have those who benefit from the Trustee program fill the hole in its finances." *Id.* at 380.

[9] As emphasized by the Fifth Circuit, the Bankruptcy Clause forbids only "arbitrary" geographic differences. And the Supreme Court has never held that a statute contravened the Bankruptcy Clause because of arbitrary geographic distinctions. For example, in the railroad setting, the Court allowed Congress to establish a special court and enact statutes to benefit bankrupt rail carriers in the northeast and midwest, as those were the only railroads facing the problem. *See Reg'l R.R. Reorganization Cases*, 419 U.S. at 159-61, 95 S.Ct. 335.

Just as it had successfully addressed the failure of certain railroads, Congress was confronted here with a U.S. Trustee problem. The 2017 Amendment drew a program-specific distinction that only indirectly has a geographic impact. *See Buffets*, 979 F.3d at 378. Although the Amendment may render it more expensive for some debtors in Virginia — as opposed to North Carolina or Alabama — to go through Chapter 11 proceedings, the 2017 Amendment does not draw an arbitrary distinction based on the residence of the debtors or creditors. Instead, the distinction is simply a byproduct of Virginia's use of the Trustee program. By increasing quarterly fees for large Chapter 11 bankruptcies in Trustee districts, Congress solved the shortfall in the program's funding. The Administrator districts, which are funded by the judiciary's general budget, did not face a similar financial issue. Because only those debtors in Trustee districts use the U.S. Trustees, Congress reasonably solved the shortfall problem with fee increases in the underfunded districts. *Id.*

As recognized by the Fifth Circuit, the Ninth Circuit had observed in 1995 that the establishment of separate Trustee and Administrator districts was an "irrational and arbitrary" distinction for which Congress had given "no justification." *See St. Angelo*, 38 F.3d at 1532. The 2017 Amendment, however, does not suffer from any such shortcoming. Congress has provided a solid fiscal justification for its challenged action: to ensure that the U.S. Trustee program is sufficiently funded by its debtors rather than by the taxpayers. Because the 2017 Amendment does not contravene the uniformity mandate of either the Uniformity Clause or the Bankruptcy Clause, we are constrained to reverse the bankruptcy court and resolve appeal No. 19-2240 in favor of the U.S. Trustee.[10]

B.

Turning to the cross-appeal pursued by the Circuit City Trustee, we must decide whether the 2017 Amendment impermissibly applies to bankruptcy cases that were pending when the Amendment took effect. As explained heretofore, the bankruptcy court in Virginia characterized the 2017 Amendment as substantively prospective, and thus not in violation of any anti-retroactivity constitutional principles. On appeal, the Circuit City Trustee contends that, regardless of the statutory language, applying the new quarterly fees to pending bankruptcy cases is unconstitutionally retroactive. The Circuit City Trustee thus contends that the "exponential statutory increase" in quarterly fees could not have been anticipated when Circuit City's bankruptcy reorganization plan was confirmed. *See* Br. of Appellee 6.

[10–12] Applying a statute to events occurring before it was enacted gives rise to Fifth Amendment due process concerns. *See Landgraf v. USI Film Prods.*, 511 U.S. 244, 266, 114 S.Ct. 1483, 128 L.Ed.2d 229 (1994). Indeed, such a retroactive application may deprive a party of adequate notice and undermine "settled expectations." *Id.* at 265, 114 S.Ct. 1483. In assessing the retroactive impact of legislation, the courts have utilized a two-step analysis. *Id.* at 280, 114 S.Ct. 1483. First, applying ordinary tools of statutory construction, we ask whether Congress "has expressly prescribed the statute's proper reach." *Id.*; *see also Fernandez-Vargas v. Gonzales*, 548 U.S. 30, 37, 126 S.Ct. 2422, 165 L.Ed.2d 323 (2006). And, if Congress did so, "this is the end of the analysis." *See Appiah v. INS*, 202 F.3d 704, 708 (4th Cir. 2000). Only if that effort fails do the courts proceed to the second step. At step two, a reviewing court must determine whether applying the new provision results in an impermissible retroactive consequence by "affecting substantive rights, liabilities, or duties on the basis of conduct arising before its enactment." *See Fernandez-Vargas*, 548 U.S. at 37, 126 S.Ct. 2422 (quoting *Landgraf*, 511 U.S. at 278, 114 S.Ct. 1483). The question for the cross-appeal is thus whether the 2017 Amendment, by its terms, applies to bankruptcy cases that were pending prior to January 1, 2018. If Congress was not clear, we must then decide whether an application of the

10. The U.S. Trustee also contends on appeal that the combined application of § 1930(a)(6)(B) and 1930(a)(7) of Title 28 ensure that any quarterly fee increases would apply equally to all judicial districts. *See* Br. of Appellant 29-32. As such, the Trustee maintains, any discrepancy in impact would be merely a byproduct of implementation efforts, rather than unlawful congressional action. *Id.* Of possible relevance to this proposition, Congress amended § 1930(a)(7) of Title 28 and replaced the word "may" with the word "shall." Subsection (a)(7) now reads: "In districts that are not part of a United States trustee region … the Judicial Conference of the United States shall require the debtor in a case under chapter 11 of title 11 to pay fees equal to those imposed by paragraph (6) of this subsection."

The U.S. Trustee promptly submitted to our panel a post-argument Local Rule 28(j) letter, pointing out this amendment but positing that it is merely a clarifying amendment that further confirms that Congress never gave the Judicial Conference discretion to charge unequal fees. The Liquidating Trustee failed to respond to the U.S. Trustee's Rule 28(j) letter and has not contested the proposition it espouses. Because we rule that the 2017 Amendment is constitutional, we need not further address this additional argument of the U.S. Trustee.

Amendment to those pending bankruptcy cases will lead to impermissibly retroactive consequences.

[13] As the text of the 2017 Amendment indicates, Congress intended for the increased quarterly fees to apply to all Chapter 11 cases. The bankruptcy fees provision mandates that quarterly fees be paid "in each case" and "for each quarter . . . until the case is converted or dismissed," without limitation based on when the case was filed. *See* 28 U.S.C. § 1930(a)(6)(A). In the 2017 Amendment, Congress directed that "[t]he amendments made by this section" — i.e., the increase in quarterly fees for the larger Chapter 11 cases — "shall apply to quarterly fees payable under section 1930(a)(6) . . . for disbursements made in any calendar quarter that begins on or after the date of enactment." *See* Bankruptcy Judgeship Act of 2017, Pub. L. No. 115-72, § 1004, 131 Stat. 1224, 1232 (2017). The Amendment thus makes clear that Congress intended for the increase to apply to all Chapter 11 quarterly fees due in January 2018 or thereafter, without regard to the case's filing date.

Notwithstanding the statutory provision, the Circuit City Trustee contends that Congress never intended for the 2017 Amendment to apply to bankruptcy cases that were pending prior to January 1, 2018. The Circuit City Trustee relies on a 1996 amendment of the same statute and argues that Congress was "crystal clear" in 1996 that the amendment was intended to apply to current cases. *See* Br. of Appellee 22-23. That contention reflects a critical misunderstanding of the 1996 amendment. It was only after several courts reached divergent conclusions about whether Congress intended for the 1996 amendment to apply to ongoing bankruptcy cases that Congress enacted "clarifying legislation," making it explicit that pending cases were covered. *Cf. Brown v. Thompson*, 374 F.3d 253, 259 & n.2 (4th Cir. 2004). Unlike the 1996 amendment, the 2017 Amendment plainly applies to all disbursements made after its effective date.

[14, 15] Even if its terms were somehow ambiguous, however, the 2017 Amendment would have no "retroactive effect" because — consistent with Supreme Court precedent — it does not "impair rights a party possessed when he acted, increase a party's liability for past conduct, or impose new duties with respect to transactions already completed." *See Landgraf*, 511 U.S. at 280, 114 S.Ct. 1483. Although there is a presumption against the retroactive application of statutes, that presumption only applies if there is a possibility that a statute "attaches new legal consequences to events completed before its enactment." *Id.* at 270, 114 S.Ct. 1483. The 2017 Amendment plainly applies only to *future* disbursements, which are triggered by a debtor's conduct occurring after the law's effective date. *See F.D.I.C. v. Faulkner*, 991 F.2d 262, 266 (1993) ("A statute's application is usually deemed prospective when it implicates conduct occurring on or after the statute's effective date." (citations omitted)).

Of importance here, the Fifth Circuit's *Buffets* decision correctly resolved the retroactivity challenge to the 2017 Amendment. *See* 979 F.3d at 374-76. The court of appeals applied the Amendment only to disbursements made after its effective date. *Id.* at 374. After evaluating the congressional history for applying fee increases to disbursements made after an effective date, the court concluded that Congress had always made fee increases so applicable. *Id.* Its decision compared the increased quarterly fees to property taxes that increase after the purchase of a home. And the Fifth Circuit ruled that the challenged fee increase is not impermissibly retroactive because it does not impair rights that debtors possessed when they filed for bankruptcy protection, nor does it increase liability for conduct that had already occurred. *Id.* at 375-76. Instead, this quarterly fee increase merely upsets debtors' "expectations as to amounts owed based on future distributions." *Id.* at 375.

In these circumstances, Congress clearly intended for the 2017 Amendment to apply to all disbursements made after its effective date, and it intended for the Amendment to be prospective. It does not increase a debtor's "liability for past conduct, or impose new duties with respect to transactions already completed." *See Landgraf*, 511 U.S. at 280, 114 S.Ct. 1483. Although the Circuit City Trustee correctly posits that the Amendment increases the quarterly fees that large Chapter 11 debtors will pay, such debtors were reasonably expected to pay fees pursuant to some formula. Accordingly, we are also constrained to reject the Circuit City Trustee's challenge to the Bankruptcy Opinion's retroactivity ruling and resolve appeal No. 19-2255 in favor of the U.S. Trustee.

IV.

Pursuant to the foregoing, we resolve appeal No. 19-2240 by reversing the bankruptcy court's ruling that the 2017 Amendment is unconstitutionally nonuniform. In appeal No. 19-2255, we affirm the bankruptcy court's decision that the 2017 Amendment is not unconstitutionally retroactive. Finally, we remand for such other and further proceedings as may be appropriate.

AFFIRMED IN PART, REVERSED IN PART, AND REMANDED

QUATTLEBAUM, Circuit Judge, concurring in part and dissenting in part:

Make no mistake about it. We have two types of bankruptcy courts in the United States. Forty-eight states operate as part of the United States Trustee Program under which Unites States Trustees aid the courts in the administration and management of bankruptcy cases. But two states—Alabama and North Carolina—operate under a different system. They use Bankruptcy Administrators rather than United States Trustees. And the differences extend beyond titles. Some Chapter 11 debtors in districts that employ the United States Trustees pay materially more in quarterly fees than similarly situated debtors in districts that employ Bankruptcy Administrators. Those fee differences, in turn, trickle down and reduce the amounts unsecured creditors receive. Therefore, many unsecured creditors in the forty-eight states operating under the United States Trustee Program are receiving less of the amounts owed to them than similarly situated unsecured creditors in Alabama and North Carolina.

The Constitution prohibits this lack of uniformity. Article I, Section 8, Clause 4 of the Constitution, known as the Bankruptcy Clause, grants Congress the power to establish "uniform Laws on the subject of Bankruptcies throughout the United States." Because I believe a faithful application of the Constitution's Bankruptcy Clause renders the statutory scheme permitting these different quarterly fees unconstitutional, I respectfully dissent from the portion of Section III-A of the majority's opinion that finds to the contrary. I concur as to the remainder of the majority's well-reasoned opinion.

I.

To understand how we arrived at the point where we have two types of bankruptcy courts, I begin with some background. "Before 1978, bankruptcy judges were responsible for the administration of individual bankruptcy cases, including such tasks as appointing trustees to cases and monitoring individual cases." U.S. Gov't Accountability Off., GAO-GGD-92-133, Bankruptcy Administration: Justification Lacking for Continuing Two Parallel Programs 3 (1992) [hereinafter GAO Report]. "This responsibility placed administrative, supervisory, and clerical functions on judges in addition to their judicial duties." *Id.* at 3–4.

In an attempt to lessen these functions, in 1978, Congress "launched a trustee pilot program within the Department of Justice." *Matter of Buffets, L.L.C.*, 979 F.3d 366, 370 (5th Cir. 2020) (citing Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549, 2662–65 (1978)). The program successfully reduced the administrative duties of bankruptcy judges and increased oversight of the bankruptcy system. Thus, in 1986, Congress permanently created the United States Trustee Program. The Trustee Program is overseen by the Department of Justice's Executive Office for United States Trustees ("EOUST"), which "provide[s] legal, administrative, and management support to the individual [United States Trustee] districts." GAO Report at 4.

But the Trustee Program only operates in forty-eight states, as "[t]he six districts in Alabama and North Carolina fall under the Bankruptcy Administrator program, which the Judicial Conference oversees." *Buffets*, 979 F.3d at 370. Bankruptcy Administrator districts do not benefit from "[t]he centralized support and oversight that the EOUST and its regional offices provide . . . ." GAO Report at 4. Instead, "[e]ach of the six [Bankruptcy Administrator] districts is independent, operating as a separate entity." *Id.* The Bankruptcy Administrator program "in each district is headed by a Bankruptcy Administrator who is selected by the U.S. Court of Appeals for a term of 5 years." *Id.* at 4–5. "It was originally thought that the exclusion of Alabama and North Carolina would last only a few years, but a later law enshrined their special status." *Buffets*, 979 F.3d at 370 n.1 (citing Federal Courts Improvement Act of 2000, Pub. L. No. 106-518, § 501, 114 Stat. 2410, 2421–22 (2000)). As the Acting United States Trustee ("U.S. Trustee") conceded at oral argument, Alabama and North Carolina's refusal to participate in the Trustee Program is not based on any unique attributes of those states. They simply prefer to use Bankruptcy Administrators rather than Trustees. The two systems are, therefore, candidly and unapologetically nonuniform. And the quarterly fees that Chapter 11 debtors pay in the Trustee Program and the Bankruptcy Administrator system are also non-uniform.

The way in which the two systems impose quarterly fees relates to the ways the two systems are funded. The Trustee Program is funded primarily by fees from debtors. *Id.* at 371. Debtors in Chapter 11 cases pay fees based on quarterly "disbursements" that are made until their cases are "converted or dismissed."[1] 28 U.S.C. § 1930(a)(6). Initially, Chapter 11 debtors in Bankruptcy Administrator districts were not required to pay these substantial quarterly fees. *Buffets*, 979 F.3d at 371. Instead, the Bankruptcy Administrator system was funded by the judiciary's general budget. *Id.* at 371. That meant that, in Bankruptcy Administrator dis-

1. Logistically, the Trustee Program is funded by congressional appropriations; however, the appropriation is offset by fees paid into the United States Trustee System Fund. *See* 28 U.S.C. § 589a(b) (directing that various fees should be deposited into the United States Trustee System Fund to offset the congressional appropriation).

tricts, funding from United States taxpayers was not offset by Chapter 11 quarterly fees. *See id.*

In 1994, the United States Court of Appeals for the Ninth Circuit, facing arguments much like those presented to us, ruled that the lack of quarterly fees in Bankruptcy Administrator districts violated the United States Constitution's Bankruptcy Clause, which "empowers Congress to enact 'uniform Laws on the subject of Bankruptcies throughout the United States.' " *See St. Angelo v. Victoria Farms, Inc.*, 38 F.3d 1525, 1529 (9th Cir. 1994) (quoting U.S. Const. art. I, § 8, cl. 4). The Court noted that "bankruptcy law[s] may have different effects in various states due to dissimilarities in state law as long as the federal law itself treats creditors and debtors alike." *Id.* at 1531. Because Chapter 11 debtors were only required to pay quarterly fees in districts participating in the Trustee Program, unsecured creditors in those districts received less money from debtors than they would have if the cases were filed in Alabama or North Carolina. *See id.* at 1531–32. Absent a justification for treating these debtors and creditors differently based solely on their geographic location, the Court ruled that the quarterly fee statute did "not apply uniformly to a defined class of debtors." *Id.* at 1532.

After the *St. Angelo* decision, Congress enacted 28 U.S.C. § 1930(a)(7) which empowered "the Judicial Conference to set fees in [Bankruptcy] Administrator districts that were 'equal to those imposed' in Trustee districts." *Buffets*, 979 F.3d at 371. Critically, however, the amended quarterly fee statute was permissive as to Bankruptcy Administrator districts. It did not *require* equivalent fees. It merely allowed them. *See* 28 U.S.C. § 1930(a)(7) (2018) ("In districts that are not part of a United States trustee region . . . the Judicial Conference of the United States *may require* the debtor in a [Chapter 11 case] to pay fees equal to those imposed [in Trustee Program districts] . . . ." (emphasis added)).[2] If the Judicial Conference elected to impose quarterly fees, those funds were required to be deposited into a fund to offset appropriations from the federal judiciary's general budget. *See Buffets*, 979 F.3d at 371 (citing 28 U.S.C. § 1931).

"The Judicial Conference soon exercised the authority Congress gave it, charging quarterly fees in Administrator districts in the amounts specified in 28 U.S.C. § 1930 . . . ." *Id.* (internal quotation marks omitted). This seemingly—at least in practice—eliminated the specific uniformity problem. That changed a few years ago, however, when bankruptcy filings declined and revenue from quarterly fees decreased. *Id.* With reduced fees, the Trustee Program was unable to make ends meet. *Id.* Thus, in response to its budgetary shortfall, Congress amended 28 U.S.C. § 1930(a)(6) to increase the quarterly fees in Chapter 11 cases. *Id.* Specifically, beginning January 1, 2018, Congress temporarily increased the quarterly fees for the largest Chapter 11 debtors, requiring debtors with quarterly disbursements "equal or exceed[ing] $1,000,000" to pay "the lesser of 1 percent of such disbursements or $250,000." 28 U.S.C. § 1930(a)(6)(B) (2018). This increase in quarterly fees applies "[d]uring each of fiscal years 2018 through 2022, if the balance in the United States Trustee System Fund as of September 30 of the most

2. As noted below, Congress recently amended the language of 28 U.S.C. § 1930(a)(7) to require Bankruptcy Administrator districts to impose equivalent fees. Therefore, because this case involves a challenge to the imposition of quarterly fees prior to the recent amendment, all citations to § 1930(a)(7) refer to the version of the statute in effect prior to the amendment unless otherwise specified.

recent full fiscal year is less than $200,000,000 . . . ." *Id.*

Important here, "[m]any courts in Trustee districts applied the new fees to any quarterly disbursements that postdated the effective date of the 2017 Amendment, even if the bankruptcy case had been pending before the fee increase." *Buffets*, 979 F.3d at 372. This was a dramatic increase for large debtors. Prior to the amendment, debtors whose quarterly disbursements exceeded $30,000,000 were required to pay a $30,000 fee. 28 U.S.C. § 1930(a)(6) (2012). After the amendment, however, those debtors were required to pay a $250,000 fee—an increase of more than 800%. *See* 28 U.S.C. § 1930(a)(6)(B) (2018).

The Bankruptcy Administrator districts did not immediately follow suit and increase their fees. *Buffets*, 979 F.3d at 372. "The Judicial Conference waited until September 2018 to adopt the increased fee schedule." *Id.* But the nine-month delay was not the only difference under the two systems. In Bankruptcy Administrator districts, the significantly increased quarterly fees applied only in cases "filed on or after October 1, 2018." *Id.* (internal quotation marks omitted). This led to vastly disparate fees paid by similarly situated debtors in different districts.

II.

With that background in mind, I turn now to the facts here. In 2008, Circuit City Stores, Inc. and its affiliates ("Circuit City") filed for Chapter 11 bankruptcy protection in the Eastern District of Virginia, which participates in the United States Trustee Program. In September 2010, the bankruptcy court confirmed Circuit City's proposed liquidation plan (the "Liquidating Plan"). "The Liquidating Plan provided for the formation of the Liquidating Trust, overseen by the Liquidating Trustee, to collect, administer, distribute, and liquidate all of [Circuit City's] remaining assets." J.A. 365 (footnote omitted). The Liquidating Plan further required the Liquidating Trustee to "pay quarterly fees to the U.S. Trustee until the Chapter 11 Cases are closed or converted and/or the entry of final decrees." J.A. 110.

Circuit City's bankruptcy cases were pending as of January 1, 2018, when the increased quarterly fee schedule took effect. It was, therefore, required to pay the increased fees. And the increased fees were far from nominal. "In the seven years between entry of the order confirming the Liquidating Plan and the effective date of section 1930(a)(6)(B), the Liquidating Trust paid approximately $833,000 in quarterly fees." J.A. 371 (footnote omitted). "In the first three quarters of 2018 alone, the Liquidating Trust paid approximately $632,000." J.A. 371. Without the increased quarterly fees, Circuit City would have paid $56,400—a difference of approximately $575,600.[3]

Recognizing the potential uniformity issues, the Liquidating Trustee moved to determine the extent of its liability for post-confirmation quarterly fees. The Liquidating Trust raised three arguments: (1) the amended quarterly fee statute was impermissibly applied to cases pending prior to its enactment; (2) the amended quarterly fee statute was non-uniform in violation of the Bankruptcy Clause of the United States Constitution; and (3) the amended quarterly fee statute was non-uniform in

3. The quarterly fee figures offered by the United States Trustee appear to differ from the amounts referenced by the Liquidating Trustee and the bankruptcy court. Regardless of the specific amount, it is undisputed that the Liquidating Trustee paid exponentially higher quarterly fees in 2018 than it would have in a Bankruptcy Administrator district.

violation of the uniformity requirement in the Taxing and Spending Clause of the United States Constitution.[4] The bankruptcy court rejected the Liquidating Trustee's retroactivity argument. However, it found that § 1930(a)(6)(B) violated both the Bankruptcy Clause and the uniformity provision of the Taxing and Spending Clause. I agree with the majority's decision on retroactivity and the uniformity provision of the Taxing and Spending Clause. But I would affirm the bankruptcy court's holding that § 1930(a)(6)(B) violates the Bankruptcy Clause.

Simply put, the imposition of quarterly fees in the two bankruptcy systems is not uniform. Many Chapter 11 debtors in Trustee Program districts pay more than similarly situated debtors in Bankruptcy Administrator districts. As a consequence, similarly situated creditors receive less in Trustee Program districts than in Bankruptcy Administrator districts. How then does the U.S. Trustee justify this obvious lack of uniformity? He offers three reasons that I address in turn.

A.

First, the U.S. Trustee argues that the Constitution's uniformity requirement only applies to substantive bankruptcy laws. To illustrate his point, the U.S. Trustee refers to 28 U.S.C. § 158(b)(1), which authorizes each circuit court to determine whether to establish a bankruptcy appellate panel, as a non-substantive bankruptcy law that is not uniformly implemented. Moreover, the U.S. Trustee argues that important aspects of bankruptcy practice—such as prescribing fees that an attorney or private trustee may charge and the waiver of certain fees for debtors or creditors—vary at the district level. He contends that those provisions are not substantive and, as a result, do not violate Article I, Section 8, Clause 4 of the Constitution. And he then argues that § 1930(a)(6)(B) likewise is not a substantive bankruptcy law and, thus, not constitutionally infirm.

However, there are several problems with this argument. Initially, the U.S. Trustee offers no precedent in support of his substantive versus non-substantive distinction. In fact, as the Fifth Circuit recognized, every bankruptcy court that has addressed this argument has rejected it. *See Buffets*, 979 F.3d at 377. This is hardly surprising since the Supreme Court has "defined 'bankruptcy' as the 'subject of the relations between an insolvent or nonpaying or fraudulent debtor and his creditors, extending to his and their relief.' " *Ry. Labor Execs. Ass'n v. Gibbons*, 455 U.S. 457, 466, 102 S.Ct. 1169, 71 L.Ed.2d 335 (1982) (quoting *Wright v. Union Central Life Ins. Co.*, 304 U.S. 502, 513–14, 58 S.Ct. 1025, 82 L.Ed. 1490 (1938)). The differences in § 1930(a)(6) and (a)(7) fit squarely within this definition.

What's more, there is a world of difference between the provisions cited by the U.S. Trustee and those at issue here. Of course, certain bankruptcy practices will vary at the local level. Bankruptcy courts must have the flexibility to operate in the most appropriate and efficient manner possible given their locality and staffing. But unlike various local rules or the existence of bankruptcy appellate panels, the disparate application of § 1930(a)(6)(B) regularly leads to similarly situated debtors paying *more* in fees and *less* to creditors in Trustee Program districts than they would in Bankruptcy Administrator

4. "The Congress shall have Power To lay and collect Taxes, Duties, Imposts, and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States." U.S. Const. art. I, § 8, cl. 1.

districts. The bankruptcy court below provided a succinct example: "Had the Debtors filed their chapter 11 bankruptcy petitions a mere 140 miles south in Raleigh, North Carolina, the Debtors would be paying substantially lower quarterly fees than they are paying now." J.A. 376 (footnote omitted). Certainly, statutes that alter the amounts similarly situated creditors receive based on geography are sufficiently substantive to implicate the Bankruptcy Clause.

B.

The U.S. Trustee next argues that § 1930(a)(6)(B) is, in any event, uniform. He insists that § 1930(a)(7) "mandates that quarterly fees in bankruptcy-administrator districts be 'equal to those imposed by [section 1930(a)(6)].' " Appellant's Br. at 28 (quoting 28 § 1930(a)(7)). Not so. Section 1930(a)(7) states that, in Bankruptcy Administrator districts, "the Judicial Conference of the United States *may require* the debtor in a [Chapter 11 case] to pay fees equal to those imposed by [§ 1930(a)(6)]." 28 U.S.C. § 1930(a)(7) (2018) (emphasis added). If the operative version of § 1930(a)(7) used the word "shall" rather than "may," this would be an entirely different case.

Illustrating this point, on January 12, 2021, during the pendency of this appeal, President Donald J. Trump signed the Bankruptcy Administration Improvement Act of 2020, Pub. L. 116-325, 134 Stat. 5085 (2021). The Act fixed the uniformity problem by striking the word "may" from § 1930(a)(7) and inserting the word "shall." Pub. L. 116-325, 134 Stat. at 5088. The Act further noted that its purpose was to "confirm the longstanding intention of Congress that quarterly fee requirements remain consistent across all Federal judicial districts." *Id.* at 5086. The U.S. Trustee submitted a Rule 28(j) letter alerting the Court to this legislative change and arguing that the Act merely clarified, rather than changed § 1930(a)(7). I disagree. As is evident from the nine-month delay in implementing the increased quarterly fees, the unambiguous language of § 1930(a)(7) prior to the Act vested the Judicial Conference with discretion to assess increased quarterly fees. The Act constitutes a commendable congressional effort to remedy an unconstitutional statute. While that likely ameliorates the uniformity issue going forward, it does not eliminate the problem in the as-applied challenge before us.

That is so because the Act does not address the other critical difference between § 1930(a)(6) and (a)(7). Remember, in Bankruptcy Administrator districts, the increased quarterly fees only applied to cases filed after October 1, 2018. But in Trustee Program districts, the increased quarterly fees not only applied to disbursements in all cases filed after January 1, 2018, but also to all cases *pending* as of January 1, 2018. Therefore, because the increased quarterly fees in Trustee Program districts capture cases like this one—that was pending as of January 1, 2018—and the language of § 1930(a)(7) prior to enactment of the Act was discretionary as to Bankruptcy Administrator districts, the U.S. Trustee's argument that § 1930(a)(6)(B) and (a)(7) are actually uniform is at odds with reality.

C.

Finally, the U.S. Trustee claims that the differences in the Trustee Program and the Bankruptcy Administrator system are not geographically based. Instead, they are based on the unique budgetary challenges confronting Trustee Program districts. All Trustee Program districts, according to the U.S. Trustee, are treated uniformly, and, therefore, we should only inquire whether the increased fees apply with the same force and effect in the Trustee Program districts.

But this argument misses the forest for the trees. Justifying the differences here on the fact that the Trustee Program districts face the budgetary problems—the trees—ignores the fact that those districts only face the budgetary problems because Congress treated them differently in the first place—the forest. And Congress did that purely based on geography.

To be fair, statutes accounting for geographic differences are not automatically a problem. *See Blanchette v. Conn. Gen. Ins. Corps.*, 419 U.S. 102, 159, 95 S.Ct. 335, 42 L.Ed.2d 320 (1974) ("The uniformity provision does not deny Congress power to take into account differences that exist between different parts of the country, and to fashion legislation to resolve *geographically isolated* problems." (emphasis added)). But they are a problem if not aimed at addressing issues that are geographical in nature. Here, the quarterly fee statute does not "account [for] differences that exist between different parts of the country . . . ." *See id.* at 159, 95 S.Ct. 335. It is not a congressional attempt "to resolve geographically isolated problems." *See id.* Indeed, the difference in bankruptcy systems is arbitrary and financially damages unsecured creditors in every state other than Alabama and North Carolina.

In fact, a September 1992 report by the United States Government Accountability Office found no justification for having both the Bankruptcy Administrator and Trustee Programs. GAO Report at 16 ("We could not find any justification for continuing two separate programs."). Consistent with that, when faced with the question at oral argument whether there was anything geographically distinct about Alabama or North Carolina that justified a different approach in those states, the U.S. Trustee, to his credit, conceded there was not. While the uniformity provision of the Bankruptcy Clause "was not intended to hobble Congress by forcing it into nationwide enactments to deal with conditions calling for remedy only in certain regions," *Blanchette*, 419 U.S. at 159, 95 S.Ct. 335 (internal quotation marks omitted), it is a necessary safeguard to prevent laws from arbitrarily damaging creditors and debtors as a result of regionalism. Accordingly, while the constitutionality of the two types of bankruptcy systems is not before the court, I would nonetheless hold that the amended quarterly fee statute, as applied to the Liquidating Trustee, violates the Bankruptcy Clause.

III.

Words have meaning, and the words of the Bankruptcy Clause are clear. I do not reach my conclusion lightly, as I recognize that, "[i]n considering any constitutional attack on a federal statute, a court presumes that Congress has complied with the Constitution." *United States v. Comstock*, 627 F.3d 513, 518 (4th Cir. 2010). However, no matter how you slice it, uniform means not different. That was true when the Constitution was drafted, and it is still true today. Thus, for the reasons stated above, I would find that the amended quarterly fee statute is unconstitutionally non-uniform.

DEFINITION OF A "PERSONAL INJURY TORT CLAIM" UNDER 28 U.S.C. § 157(B)(5)

BY: MICHAEL W. HILE
JACOBSON HILE KIGHT LLC
The Elliott House
208 East 9th Street
Indianapolis, IN 46202
mhile@jhklegal.com

Seminar Materials for
The Sigmund J. Beck Advanced Bankruptcy Roundtable 2022
August 19-20, 2022
West Baden Springs Hotel/ French Lick Resort Casino
West Baden Springs, Indiana 47432

28 U.S.C § 157(b)(5) provides that "[t]he district court shall order that personal injury tort and wrongful death claims shall be tried in the district court in which the bankruptcy case is pending, or in the district court in the district in which the claim arose, as determined by the district court in which the bankruptcy case is pending." Importantly, this provision does not deprive the bankruptcy court of jurisdiction to hear personal injury claims. *See, e.g., Stern v. Marshall*, 564 U.S. 462, 479 (2011) (Section 157(b)(5) is not jurisdictional); *Adelson v. Smith (In re Smith)*, 389 B.R. 902, 908–13 (Bankr. D. Nev. 2008) (same). It does, however, allocate jurisdiction between the district court and the bankruptcy court. As a result. "the district court will almost always hear personal injury tort cases, especially if a timely request to do so is made." *Smith*, 389 B.R. at 913. Action (or in some cases inaction) by the tort claimant may lead to the claimant being deemed to have consented to a resolution of the claim by the Bankruptcy Code and/or waiver of withdrawal of the reference or waiver of abstention in such cases. *Id*. ("[S]ince the right to have such cases heard in the district court is not jurisdictional, it is also not inviolable; parties may waive the right by consent or by action. Id.). "[Adelson's] complaint conceded that it raised core claims, and it specifically asked this court . . . to hear and determine the existence and amount of his libel claim. He never moved for withdrawal of the reference, and he never made any request, in this court or in the district court, for an order directing that his case be heard before an Article III district judge. Such actions are indicative of, and consistent only with, consent to have this court hear such matters. And this court so finds." Id. at 915.

Neither the Bankruptcy Code nor Title 28 of the United States Code defines the term "personal injury tort.". Consequently, the courts have construed this term using traditional statutory construction methods and have developed three alternate approaches for determining whether a claim is a "personal injury tort" for the purposes of 28 U.S.C § 157(b)(5). *See Stern*, 564 U.S. at 479, n. 4 (The Supreme Court noted, but did not decide, the three-way divide over the "scope of the phrase 'personal injury tort'").

In *In re Gawker Media LLC*, 571 B.R. 612 (Bankr. S.D.N.Y. 2017), the Bankruptcy Judge summarized these three approaches as follows:

> Lower courts in the Second Circuit and elsewhere have adopted different approaches to determine whether a particular claim constitutes a "personal injury tort" claim. [*In re Residential Capital, LLC*, 536 B.R. 566, 571–75 (Bankr. S.D.N.Y. 2015)] (collecting cases). The **"narrow view"** requires a trauma or bodily injury or psychiatric impairment beyond mere shame or humiliation to meet the definition of "personal injury tort." *Id.* at 571–72 (citations omitted); *accord Perino v. Cohen (In re Cohen)*, 107 B.R. 453, 455 (S.D.N.Y. 1989). The **broad view** interprets "personal injury tort" to "embrace[ ] a broad category of private or civil wrongs or injuries for which a court provides a remedy in the form of an action for damages, and include[ ] damage to an individual's person and any invasion of personal rights, such as libel, slander and mental suffering." *Residential Capital*, 536 B.R. at 572 (quoting *Boyer v. Balanoff* (*In re Boyer*), 93 B.R. 313, 317–18 (Bankr. N.D.N.Y. 1988) and collecting cases). Finally, under the **intermediate, "hybrid" approach**, a bankruptcy court may adjudicate claims bearing the "earmarks of a financial, business or property tort claim, or a contract claim" even where those claims might appear to be "personal injury torts" under the broad view. *Id.* (quoting *Stranz v. Ice Cream Liquidation, Inc. (In re Ice Cream Liquidation, Inc.)*, 281 B.R. 154, 161 (Bankr. D. Conn. 2002) and citing, *inter alia*, *Adelson v. Smith (In re Smith)*, 389 B.R. 902, 908–13 (Bankr. D. Nev. 2008)).

Gawker, 571 B.R. at 620 (emphasis added). *See also Smith*, 389 B.R. at 907-08 (discussing the three approaches); *Stranz v. Ice Cream Liquidation, Inc. (In re Ice Cream Liquidation, Inc.)*, 281 B.R. 154, 161 (Bankr. D. Conn. 2002) (same). *See also Byrnes v. Byrnes (In re Byrnes)*, 638 B.R. 821 (Bankr. D.N.M. 2022) (One of the most recent bankruptcy cases (decided March 11, 2022, a copy of which is attached) to analyze the scope of "personal injury tort" and conclude that the narrow approach was correct. The case summarizes the holdings and decisions of what appears to be every other court to have ruled on the issue.).

In *Byrnes,* the New Mexico Bankruptcy Court adopted the narrow approach and determined that the defamation and intentional infliction of emotional distress ("IIED") claims were not personal injury torts under that approach, but likely would be under either of the other two approaches. *Byrnes*, 638 B.R. at 830. To support the adoption of the narrow approach, the Bankruptcy Judge stated nine reasons:

1. The *nosicitur a sociis* analysis is persuasive. "Because "personal injury tort" is next to "wrongful death," the terms should be construed together as dealing with similar types of injuries. *Id*. at 829.
2. The "legislative History shows that Congress meant 'personal injury tort' to refer to torts similar to 'claims arising from automobile accidents,' i.e., a 'narrow range of claims.'" *Id.* (internal citations omitted).
3. The history respecting the personal injury attorney lobbying efforts after Johns-Manville and set forth in the Legislative History of the 1984 bankruptcy amendments leads to conclusion that 28 U.S.C § 157(b)(5) personal injury torts were the "traditional, plain-meaning types." *Id.*
4. There is no constitutional problem with bankruptcy courts hearing tort claims, so a broad interpretation is not required by constitutional considerations. *Id.*
5. Congress could not have intended to burden district courts with the trial of bankruptcy-related claims. *Id.*
6. "Black's Law Dictionary's *first* definition of personal injury tort is 'any harm caused to a person, such as a broken bone, a cut, or a bruise; bodily injury.' . . . The *second* definition was the one relied upon [by cases adopting the broad and/or hybrid method]. Thus, Black's supports the narrow interpretation as much as or more than the broad one." *Id.*
7. The broad approach essentially reads "personal injury" out of 28 U.S.C § 157(b)(5) and

equates the term personal injury tort with all torts. *Id.*

8. The fact that 11 U.S.C § 522(d)(11) refers to "personal bodily injury," a seemingly narrower term that Congress could have used in 28 U.S.C. § 157(b)(5) if a narrower scope was intended, does not control. The presumption that Congress's use of a narrower term in another part of the Bankruptcy Code indicates that Congress knew how to describe a narrower term but instead chose a broader term, does not outweigh the other factors supporting a narrow view. Moreover, such terms were adopted six years apart and are in different titles of the United States Code and do not and are not presumed to have to be construed to give similar meaning especially when common legal parlance (Black's Law Dictionary) equates the two terms. *Id* (see Black's Law Dictionary discussion above).
9. The hybrid approach lacks support in the words of the relevant statutes, any canon of construction or the legislative history, and is an unworkable judicially crafted compromise between two alternate constructions. It cannot be what Congress intended. *Id.*

Note that the Bankruptcy Court issued this opinion while a motion to withdraw the reference was pending with the District Court. The Bankruptcy Court appeared to be signaling to the District Court that this domestic dispute litigation wrapped up as a non-dischargeability litigation was not a case where the District Court should want to tread (i.e., withdraw the reference). The Bankruptcy Court concluded, "[b]ased on the record in this case, Defendant is judgment proof. Thus, it appears Plaintiff is pursuing the claims for noneconomic reasons." *Id*. at 824. The Bankruptcy Court also attached a table to its opinion outlining the history of the case and the plaintiff former-husband's litigiousness: 2 appeals of rulings in state court litigation; 6

appeals of bankruptcy court decisions; 1 appeal of a district court decision; a motion to disqualify the Bankruptcy Judge; a motion to vacate the order of reference to the magistrate judge; and a petition for Writ of Mandamus to the Tenth Circuit Court of Appeals. *Id*. The Court also noted that Mr. Byrnes, the plaintiff/claimant, is a lawyer on inactive status with the bar of New Mexico and can afford litigation while his former wife cannot. Apparently, the District Court and its Magistrate took the hints from the Bankruptcy Judge as the District Court adopted the Magistrate Judge's recommendation to deny the motion to withdraw the reference of the bankruptcy adversary proceeding respecting the non-dischargeability of Mr. Byrnes's defamation and IIED claims. *Byrnes v. Byrnes (In re Byrnes)*, 2022 U.S. Dist. LEXIS 69803 (D.N.M. 2022).

Also attached hereto is a copy of *Smith*, *Adelson v. Smith (In re Smith)*, 389 B.R. 902 (Bankr. D. Nev. 2008), authored by Judge Markell. In *Smith*, Sheldon Adelson sued a member of the press for libel and a determination that his claim was nondischargeable. Judge Markell concluded that "without deciding whether statutory tort claims are covered, this court is convinced that the Ninth Circuit would adopt nothing less than the middle ground [the hybrid method], and it would therefore hold that the libel claims at issue here [bad press] are personal injury tort claims within the meaning of 28 U.S.C. § 157(b)(5)."

Judge Markell was an early adopter of the argument that 28 U.S.C. § 157(b)(5) is not jurisdictional, but rather an allocation of jurisdiction "conferred upon federal courts in an effort to answer the question as to whether a bankruptcy court may enter a binding judgment, or whether it must make proposed findings of fact and conclusions of law for the district's court's use." *Smith*, 389 B.R. at 912. Three years later, the Supreme Court also found this to be the case in *Stern. Stern,* 564 U.S. at 479. As discussed above, Judge Markell found that by action (or the inaction of not timely seeking withdrawal of the reference or district court trial), Sheldon

Adelson had waived his right to have his "personal injury tort" claims tried in the district court and had consented to the bankruptcy judge's entry of final orders on such claims.

The Seventh Circuit Court of Appeals has not yet visited the issue of the construction of "personal injury torts" under 28 U.S.C. § 157(b)(5). The Bankruptcy Court for the Northern District of Illinois, however, has determined that the broad method should be used to construe the term "personal injury tort" under 28 U.S.C. § 157(b)(5). *Leathem v. Von Volkmar (In re Von Volkmar)*, 217 B.R. 561, 566 (Bankr. N.D. Ill. 1998) ("Certainly Congress could have used the term 'personal bodily injury' if it wished to specifically limit personal injury tort claims. . . . In addition, it is arguable that the 'traditional, plain meaning' sense of the term distinguishes between personal injuries, including both bodily and psychiatric harm, as opposed to property damage . . . [and] this court concludes that the better view is the term 'personal injury tort' is not limited to physical bodily harm."

If 28 U.S.C. § 157(b)(5) is not jurisdictional, but solely allocates between the bankruptcy court and the district court the ability to enter a final judgment, and parties may consent to the bankruptcy court's entry of final orders—why is the term personal injury tort and the method to identify them under increasing focus today? Because "personal injury tort claims that are related to a bankruptcy case may be removed from state and federal courts across the nation and consolidated in the bankruptcy court/district court where the bankruptcy case is pending under 28 U.S.C. § 157(b)(5). In mass tort cases, this aggregation is extremely useful for the Debtor and other joint tortfeasors (and their insurers) to attempt global resolution of all claims against shared and non-shared assets.

This is exactly what Johnson & Johnson is seeking to do respecting litigation against it and a its talc supplier, Imerys. Imerys (and related entities) commenced chapter 11 cases in

Delaware; Johnson & Johnson is not a debtor in that case. Johnson & Johnson sought removal and transfer to the bankruptcy court of all the cases where it was a party along with Imerys. Notably, courts generally have swatted down these efforts. *See, e.g., Holman v. Johnson & Johnson*, 600 B.R. 6 (Bankr. N.D. Ill. 2019); *Pritchard v. Johnson & Johnson*, 2019 Bankr. LEXIS 2091 (Bankr. S.D. Fla. 2019) (summarizing similar matters across the country). *See also* Ralph Brubaker, *Mandatory Aggregation of Mass Tort Litigation in Bankruptcy*, 131 YALE L.J. 960 (2022) (arguing for a more liberal related to jurisdiction standard to permit tort claim litigation against non-debtors to be aggregated with claims against debtors in order to secure subject matter jurisdiction over all claims (and parties) in order to promote consensual global settlements in lieu of mandatory third-party releases facing growing challenges and potential legislative prohibition).

Thus, depending on how broad the scope of "related to" jurisdiction is defined in that Circuit, the greater the scope of matters that may be removed under 28 U.S.C. § 1452. Likewise, the broader the method adopted to determine "personal injury tort claims," the greater the number and variety of tort claims that many be aggregated by the District Court under 28 U.S.C. § 157(b)(5). A cynical observer would note that Johnson & Johnson's aggressive strategy bought time and trial extensions in litigation against it while it instituted its Texas two-step. This may have been its goal from the beginning. In any event it appears that Johnson & Johnson learned a lesson after its failed attempt at removal and aggregation. In the chapter 11 case of LTL Management, LLC (its reverse merger subsidiary) in the New Jersey bankruptcy court, Johnson & Johnson sought and obtained the protections of the automatic stay and an injunction of litigation against it. *See LTL Mgmt., LLC v. Those Parties Listed on the Appendix A to Complaint (In re LTL Mgmt., LLC)*, 638 B.R. 291 (Bankr. D.N.J. 2022).

User Name: Michael Hile

Date and Time: Monday, August 1, 2022 10:45:00 PM EDT

Job Number: 176455278

Document (1)

1. Byrnes v. Byrnes (In re Byrnes), 638 B.R. 821

Client/Matter: -None-

Search Terms: Byrnes v. Byrnes (In re Byrnes), 638 B.R. 821

Search Type: Natural Language

Narrowed by:

Content Type	Narrowed by
Cases	-None-

Neutral
As of: August 2, 2022 2:45 AM Z

Byrnes v. Byrnes (In re Byrnes)

United States Bankruptcy Court for the District of New Mexico

March 11, 2022, Decided; March 11, 2022, Filed

No. 20-12086-t7, Adv. No. 20-1070-t

Reporter
638 B.R. 821 *; 2022 Bankr. LEXIS 645 **

In re: SYLVIA MARIE BYRNES, Debtor.BARRY J. BYRNES, Plaintiff, v. SYLVIA MARIE BYRNES, Defendant.

Prior History: Byrnes v. Byrnes (In re Byrnes), 2021 Bankr. LEXIS 1394, 2021 WL 2071061 (Bankr. D.N.M., May 21, 2021)

Core Terms

personal injury tort, defamation, district court, bankruptcy court, intentional infliction of emotional distress, gravamen, narrow interpretation, Withdrawal, cases, state court, defamation claim, cause of action, tort claim, bodily injury, domestic, courts, libel, words, alleged defamatory statement, legislative history, emotional distress, personal injury, humiliation, hybrid, trauma, emotional distress claim, defamation action, plaintiff's claim, narrow range, malicious

Case Summary

Overview

HOLDINGS: [1]-In pro se plaintiff's adversary proceeding against defendant Chapter 7 debtor, for purposes of plaintiff's pending motion to withdraw the bankruptcy court reference for trial of his defamation and intentional infliction of emotional distress (IIED) claims, the court adopted the narrow interpretation of "personal injury tort" in 28 U.S.C.S. § 157(b)(5), so the defamation claim could not be tried in the district court; [2]-Because the gravamen of plaintiff's IIED claim was defamation, the court ruled it would also try the IIED claim since even if it was viable, it was the "tail wagging the dog," so should remain in the bankruptcy court for trial, subject to a different conclusion by the district court on the reference withdrawal motion; [3]-Attempting to keep the parties' expenses to a minimum, the court exercised discretion not to remand the claims to state court.

Outcome

The court recommended to the district court that reference not be withdrawn for either of plaintiff's claims; rulings entered and bench trial scheduled with sufficient intervening time for the district court to rule on defendant's reference withdrawal motion.

LexisNexis® Headnotes

Bankruptcy Law > Procedural Matters > Jurisdiction > Core Proceedings

Torts > Procedural Matters > Commencement & Prosecution > Subject Matter Jurisdiction

HN1[] Jurisdiction, Core Proceedings

Although 28 U.S.C.S. § 157(b)(5) does not deprive the bankruptcy court of jurisdiction to hear personal injury claims, and § 157(b)(5) is not jurisdictional, it allocates jurisdiction between the district court and the bankruptcy court. As a result, the district court will almost always hear personal injury tort cases, especially if a timely request to do so it made.

Bankruptcy Law > Procedural Matters > Jurisdiction > Core Proceedings

Torts > Procedural Matters > Commencement & Prosecution > Subject Matter Jurisdiction

HN2[] Jurisdiction, Core Proceedings

The narrow view as to whether a particular claim constitutes a "personal injury tort" claim under 28 U.S.C.S. § 157(b)(5) requires a trauma or bodily injury or psychiatric impairment beyond mere shame or humiliation to meet the definition of personal injury tort.

Bankruptcy Law > Procedural Matters > Jurisdiction > Core Proceedings

Governments > Legislation > Interpretation

Torts > Procedural Matters > Commencement & Prosecution > Subject Matter Jurisdiction

HN3[] Jurisdiction, Core Proceedings

Noscitur a sociis is, put simply, the principle that a word is known by the company it keeps. The U.S. Supreme Court has relied on the noscitur a sociis canon to avoid ascribing to one word a meaning so broad that it is inconsistent with its accompanying words, thus giving unintended breadth to the Acts of Congress. As to whether a particular claim constitutes a "personal injury tort" claim under 28 U.S.C.S. § 157(b)(5), the relevant statutory provisions couple "personal injury torts" and "wrongful death." "Wrongful death" refers to a death caused by a tortious injury. The term "personal injury tort" should be construed in a manner meaningfully similar to wrongful death, and require a physical trauma.

Governments > Legislation > Interpretation

HN4[] Legislation, Interpretation

The U.S. Supreme Court has repeatedly held that absent a clearly expressed legislative intention to the contrary, statutory language must ordinarily be regarded as conclusive.

Bankruptcy Law > Procedural Matters > Jurisdiction > Core Proceedings

Governments > Legislation > Interpretation

Torts > Procedural Matters > Commencement & Prosecution > Subject Matter Jurisdiction

HN5[] Jurisdiction, Core Proceedings

The United States Bankruptcy Court for the District of New Mexico concludes that "personal injury tort" as used in 28 U.S.C.S. § 157(b)(5) should be interpreted narrowly. Noscitur a sociis analysis is persuasive. Because "personal injury tort" is next to "wrongful death," the terms should be construed together as dealing with similar types of injuries. The legislative history shows that Congress meant "personal injury tort" to refer to torts similar to claims arising from automobile accidents, i.e., a narrow range of claims.

Bankruptcy Law > Procedural Matters > Jurisdiction > Core Proceedings

Torts > Procedural Matters > Commencement & Prosecution > Subject Matter Jurisdiction

HN6[] Jurisdiction, Core Proceedings

There is no constitutional problem with bankruptcy courts hearing tort claims, so a broad interpretation of "personal injury tort" in 28 U.S.C.S. § 157(b)(5) is not required to satisfy Northern Pipeline v. Marathon Pipeline. A narrow interpretation of "personal injury tort" avoids unduly burdening the District Court with trial of bankruptcy-related claims, which burden Congress could not have intended.

Bankruptcy Law > Procedural Matters > Jurisdiction > Core Proceedings

Torts > ... > Invasion of Privacy > False Light > Elements

HN7[] Jurisdiction, Core Proceedings

Under the narrow interpretation of "personal injury tort" in 28 U.S.C.S. § 157(b)(5) , defamation claims are not personal injury torts. Torts such as defamation, false light and injurious falsehood do not require proof of trauma, bodily injury or severe psychiatric impairment. A defamation claim is not a personal injury tort; libel is not a personal injury tort.

Torts > ... > Defamation > Remedies > Damages

Torts > Intentional Torts > Defamation > Slander

Torts > Intentional Torts > Defamation > Libel

Torts > Intentional Torts > Intentional Infliction of Emotional Distress > Remedies

Torts > Intentional Torts > Defamation > Procedural Matters

HN8[] Remedies, Damages

A number of courts have ruled that alleged defamatory statements cannot be the basis of an intentional infliction of emotional distress claim. Although the gravamen of a defamation action is injury to reputation, libel or slander also visits upon a plaintiff humiliation, mortification and emotional distress. In circumstances where a plaintiff states a case of libel or slander, such personal distress is a matter which may be taken into account in determining the amount of damages to which the plaintiff is entitled, but it does not give rise to an independent cause of action on the theory of a separate tort.

Torts > Intentional Torts > Intentional Infliction of Emotional Distress > Elements

HN9[] Intentional Infliction of Emotional Distress, Elements

An independent action for intentional infliction of emotional distress does not lie where the gravamen of the complaint sounds in defamation.

Torts > Intentional Torts > Intentional Infliction of Emotional Distress > Defenses

Torts > Intentional Torts > Intentional Infliction of Emotional Distress > Elements

HN10[] Intentional Infliction of Emotional Distress, Defenses

New Mexico law does not allow litigants to evade the requirements for proving defamation by pleading an Intentional infliction of emotional distress claim on the same facts.

Torts > Intentional Torts > Intentional Infliction of Emotional Distress > Elements

Torts > Intentional Torts > Intentional Infliction of Emotional Distress > Remedies

HN11[] Intentional Infliction of Emotional Distress, Elements

When deciding whether an Intentional infliction of emotional distress claim is a personal injury tort, the Court must determine if the alleged emotional distress is central to the cause of action or is merely an element of damages.

Torts > Intentional Torts > Intentional Infliction of Emotional Distress > Defenses

HN12[] Intentional Infliction of Emotional Distress, Defenses

If the intentional infliction of emotional distress claim is the gravamen of the claim, *28 U.S.C.S. § 157(b)(5)* does not permit the bankruptcy court to try the claim absent consent.

Torts > ... > Defamation > Remedies > Damages

Torts > Intentional Torts > Intentional Infliction of Emotional Distress > Remedies

HN13[] Remedies, Damages

Emotional distress damages are available in defamation cases.

Bankruptcy Law > Procedural Matters > Jurisdiction > Core Proceedings

Governments > Courts > Authority to Adjudicate

HN14[] Jurisdiction, Core Proceedings

The bankruptcy court has a duty to hear all cases in which its subject matter jurisdiction is properly invoked.

Bankruptcy Law > Procedural Matters > Adversary Proceedings > Causes of Action

Bankruptcy Law > Procedural Matters > Jurisdiction > Core Proceedings

Bankruptcy Law > Procedural Matters > Jurisdiction > Noncore Proceedings

HN15[] Adversary Proceedings, Causes of Action

If claims in an adversary proceeding are "core" because they were brought as part of a nondischargeability proceeding, then the bankruptcy court will enter a final judgment. If the claims are not core, then the court will enter proposed findings of fact and conclusions of law for review by the District court. *28 U.S.C.S. § 157(c)(1)*.

Bankruptcy Law > Procedural Matters > Jurisdiction > Removal to District Court

Civil Procedure > ... > Removal > Postremoval Remands > Appellate Review

Civil Procedure > ... > Removal > Specific Cases Removed > Bankruptcy Related Claims

HN16[] Jurisdiction, Removal to District Court

As an alternative to trying the claims, the bankruptcy court and the district court have the right to remand the claims to state court on any equitable ground. *28 U.S.C.S. § 1452(b)*. Congress has placed broad restriction on the power of federal appellate courts to review district court orders remanding removed cases to state court.

Bankruptcy Law > Procedural Matters > Jurisdiction > Core Proceedings

Civil Procedure > Judicial Officers > Judges > Discretionary Powers

HN17[] Jurisdiction, Core Proceedings

The District Court has discretion to withdraw the reference for one or both of the tort claims. *28 U.S.C.S. § 157(d)*.

Counsel: [1]** For Sylvia Marie Byrnes, fdba Happy Trails Ranch & Bed and Breakfast, Inc., Debtor (20-12086-t7): R Trey Arvizu, III, R. Trey Arvizu III - Attorney, Las Cruces, NM.

Barry J Byrnes, Plaintiff Non Filing Spouse, Plaintiff (20-01070-t), Pro se.

For Sylvia Byrnes, Defendant Debtor, Defendant (20-01070-t): R Trey Arvizu, III, R. Trey Arvizu III - Attorney, Las Cruces, NM; Mark Lee Pickett, The Pickett Law Firm, Las Cruces, NM.

Judges: Hon. David T. Thuma, United States Bankruptcy Judge.

Opinion by: David T. Thuma

Opinion

[*824] Before the Court are two tort claims that are ready for trial: defamation and intentional infliction of emotional distress ("IIED"). Both claims were removed from state court after Defendant filed this chapter 7 bankruptcy case. Plaintiff has not consented to the Court hearing either claim. The Court earlier ruled that Plaintiff is not entitled to a jury trial of the claims. *In re Byrnes, 2022 Bankr. LEXIS 252, 2022 WL 272646, at *3 (Bankr. D.N.M.)*.

Plaintiff has moved the United States District Court for the District of New Mexico to withdraw the reference for trial of the claims (the "Reference Withdrawal Motion"). The motion is pending. For the reasons set forth below, the Court makes the following rulings related to trial of the claims:

1. The Court adopts the "narrow" interpretation **[**2]** of "personal injury tort" found in *28 U.S.C. § 157(b)(5)*;

2. Under the narrow interpretation, Plaintiff's defamation claim is not a personal injury tort;

3. Plaintiff's IIED claim may be subject to dismissal or summary disposition because it is based entirely on Defendant's alleged defamatory statements;

4. In any event, the Court can try the IIED claim because the gravamen of Plaintiff's claims is defamation; and

5. The Court will not remand the claims, but will try them in Las Cruces.

If the District Court has a different view about the legal issues before the Court and/or how best to proceed, it can supersede the Court's decision(s) when it rules on the Reference Withdrawal Motion.

A. Facts.[1]

Based on the docket in this proceeding and the State Court Action (defined below), the Court finds:

Barry Byrnes, the pro se[2] plaintiff, is Defendant/Debtor's estranged husband. On March 29, 2019, Plaintiff filed a state court action against Defendant and their son in the Third Judicial District Court, State of New Mexico, styled *Barry Byrnes v. Sylvia and Matthew Byrnes*, No. D-307-CV-2019-00916 (the "State Court Action"). The complaint alleged six causes of action. The state court judge dismissed four of the claims, **[**3]** leaving only the defamation and IIED claims. These claims relate to a heated argument between Plaintiff and Defendant in July 2018, which prompted Defendant to call the police and report that Plaintiff had assaulted her.

Defendant filed this chapter 7 bankruptcy case on October 30, 2020. Plaintiff removed the claims to this Court, simultaneously filing additional claims in a separate proceeding. The Court ordered the proceeding consolidated and ordered Plaintiff to file an amended complaint in the consolidated proceeding.

Plaintiff's amended complaint has two counts. In count one, Plaintiff asserts the defamation and IIED claims and asks that **[*825]** any judgment thereon be declared nondischargeable. Count two seeks an order requiring Debtor "to pay and continue to pay her share of contract and/or domestic support obligations" related to their marital residence, and alleging numerous theories under which such obligations are nondischargeable. Defendant answered count one and filed a motion to dismiss count two.

The main bankruptcy case was closed as a "no asset" case on March 11, 2021.

On March 18, 2021, Plaintiff filed the Reference Withdrawal Motion. The motion was assigned no. CV 21-00295 MV/JHR **[**4]** and is pending.

On July 2, 2021, the Court granted Defendant's motion to dismiss count two, leaving only the defamation and IIED claims to be adjudicated.

Slightly paraphrased, Plaintiff alleges the following conduct by Defendant in count one:

> 7. On July 13, 2018, Plaintiff and Defendant had a domestic argument at their residence.
> 8. Defendant called the police after the argument and alleged that she was assaulted during the argument and that she was a victim of domestic abuse.
> 9. Defendant's factual statement to police are malicious and willful and false.
> 14. On July 16, 2018, Defendant filed a petition in state court for an order of protection from domestic abuse.
> 16. Defendant again alleged that she was assaulted during the domestic argument of July 13 and was a victim of domestic violence.
> 17. Defendant's malicious and false factual statements are handwritten and contained in paragraphs 5 and 6 of the petition.
> 27. Defendant's malicious and willful and false statement about the nature of the alleged assault caused Plaintiff to be targeted for the grand jury investigation.
>
> 43. The malicious and false and injurious words Defendant spoke to police about Plaintiff are recorded by the arresting **[**5]** officer in the Magistrate Court misdemeanor complaint.
> 44. Defendant's malicious and false and injurious written words communicated to the state court and the Domestic Violence Special Commissioner are recorded in the petition she filed in the state court for protection from domestic abuse.

The proceeding has progressed through the pretrial stages. Discovery is now complete and the defamation and IIED claims are ready for trial.

To date, Plaintiff has filed the following appeals and motions related to his claims:

[*826]

Go to table1

Based on the record in this case, Defendant is judgment proof. **[**6]** Thus, it appears Plaintiff is pursuing his claims for noneconomic reasons.

B. Trial of "Personal Injury Torts."

[1] The Court takes judicial notice of its docket in this consolidated adversary proceeding, the main bankruptcy case, and the State Court Action (defined below). *See* St. Louis Baptist Temple, Inc. v. Fed. Deposit Ins. Corp., 605 F.2d 1169, 1172 (10th Cir. 1979) (a court may sua sponte take judicial notice of its docket and of facts that are part of public records).

[2] Mr. Byrnes used to be licensed to practice law in New Mexico. He currently is on inactive status.

28 U.S.C. § 157(b)(5) provides in part:

> The district court shall order that personal injury tort and wrongful death claims shall be tried in the district court in which the bankruptcy case is pending . . . .

HN1[] Although this provision does not deprive the bankruptcy court of jurisdiction to hear personal injury claims, *see, e.g.,* Stern v. Marshall, 564 U.S. 462, 479, 131 S. Ct. 2594, 180 L. Ed. 2d 475 (2011) (§ 157(b)(5) is not jurisdictional); and In re Smith, 389 B.R. 902, 913 (Bankr. D. Nev. 2008) (same), it allocates jurisdiction between the district court and the bankruptcy court. As a result, "the district court will almost always hear personal injury tort cases, especially if a timely request to do so it made." Smith, 389 B.R. at 913. The Court must determine whether the defamation and IIED claims are personal injury tort claims.

C. The Court Adopts the Narrow Interpretation of "Personal Injury Tort."

In In re Gawker Media LLC, 571 B.R. 612 (Bankr. S.D.N.Y. 2017), Judge Bernstein stated:

> Lower courts in the Second Circuit and elsewhere have adopted different approaches to determine whether a particular claim constitutes a "personal injury tort" claim. [In re Residential Capital, LLC, 536 B.R. 566, 571-75 (Bankr. S.D.N.Y. 2015)] (collecting cases). HN2[] The "narrow view" requires a trauma or bodily injury or psychiatric impairment beyond mere shame or humiliation to meet the definition of "personal **[**7]** injury tort." *Id. at 571-72* (citations omitted); *accord* Perino v. Cohen (In re Cohen), 107 B.R. 453, 455 (S.D.N.Y. 1989) . . . . The broad view interprets "personal injury tort" to "embrace[ ] a broad category of private or civil wrongs or injuries for which a court provides a remedy in the form of an action for damages, and include[ ] damage to an individual's person and any invasion of personal rights, such as libel, slander and mental suffering." Residential Capital, 536 B.R. at 572 (quoting Boyer v. Balanoff (In re Boyer), 93 B.R. 313, 317-18 (Bankr. N.D.N.Y. 1988) and collecting cases). Finally, under the intermediate, "hybrid" approach, a bankruptcy court may adjudicate claims **[*827]** bearing the "earmarks of a financial, business or property tort claim, or a contract claim" even where those claims might appear to be "personal injury torts" under the broad view. *Id.* (quoting Stranz v. Ice Cream Liquidation, Inc. (In re Ice Cream Liquidation, Inc.), 281 B.R. 154, 161 (Bankr. D. Conn. 2002) and citing, *inter alia,* Adelson v. Smith (In re Smith), 389 B.R. 902, 908-13 (Bankr. D. Nev. 2008)).

571 B.R. at 620. *See also* Smith, 389 B.R. at 907-08 (discussing the three interpretations); In re Ice Cream Liquidation, Inc., 281 B.R. 154, 160-61 (Bankr. D. Conn. 2002) (same).

The United States Supreme Court acknowledged the disagreement on the proper interpretation of "personal injury tort" in Stern, 564 U.S. at 479 n.4, but did not decide it. Neither the Tenth Circuit nor the Tenth Circuit Bankruptcy Appellate Panel has addressed the issue. A Utah district court judge adopted the narrow interpretation. *See* In re C.W. Mining Co., 2012 U.S. Dist. LEXIS 148846, 2012 WL 4882295, at *6 (D. Utah.).

Judge Bernstein concluded that the narrow interpretation is the proper one:

> Turning first to the canons **[**8]** of statutory interpretation, and specifically the canon *noscitur a sociis*, the Court concludes that the narrow interpretation, which requires trauma or bodily injury, or a psychic injury beyond mere shame or humiliation, is the correct interpretation. HN3[] *Noscitur a sociis* is, put simply, the principle that "a word is known by the company it keeps." *Yates v. United States, __ U.S. __, 574 U.S. 528, 135 S. Ct. 1074, 1085, 191 L. Ed. 2d 64 (2015)* . . . The Supreme Court has relied on the *noscitur a sociis* canon "to avoid ascribing to one word a meaning so broad that it is inconsistent with its accompanying words, thus giving 'unintended breadth to the Acts of Congress.'" Gustafson v. Alloyd Co., 513 U.S. 561, 575, 115 S. Ct. 1061, 131 L. Ed. 2d 1 (1995) (quoting Jarecki v. G.D. Searle & Co., 367 U.S. 303, 307, 81 S. Ct. 1579, 6 L. Ed. 2d 859, 1961-2 C.B. 254 (1961)). Here, the relevant statutory provisions couple "personal injury torts" and "wrongful death." "Wrongful death" refers to "[a] death caused by a tortious injury." BRYAN A. GARNER, BLACK'S LAW DICTIONARY 485 (10th ed. 2014) ("BLACK'S"). The term "personal injury tort" should be construed in a manner meaningfully similar to "wrongful death," and require a physical trauma.

Gawker Media, 571 B.R. at 620-21. He also reviewed the legislative history of § 157(b)(5) in detail and concluded that "the exception was intended to be narrow and not derogate from the bankruptcy court's traditional role of resolving claims through the claims resolution process." **[**9]** Id. at 622. Judge Bernstein was critical of the broad interpretation because it "cuts a broad exception that removes all tort claims from the jurisdiction of the bankruptcy court's claims resolution process." Id. at 622. Finally, Judge Bernstein was critical of the hybrid approach, opining that it "finds no support in the words of the relevant statutes, any canon of construction or the legislative history, and is unworkable. . . ." Id. at 623.

Similarly, in Massey Energy Co. v. W. Va. Consumers for Justice, 351 B.R. 348 (E.D. Va. 2006), the district court held that "the personal injury exception under § 157 is limited to a narrow range of claims that involve an actual physical injury. . . . it is the opinion of this Court that Congress intended to limit the claims fitting the exception by introducing the narrow, modifying language 'personal injury.'" Id. at 351.

[*828] Likewise, in In re Cohen, 107 B.R. 453 (S.D.N.Y. 1989), the district court held:

> This is not a claim for a "personal injury tort" in the traditional, plain-meaning sense of those words, such as a slip and fall, or a psychiatric impairment beyond mere shame and humiliation. HN4[] The Supreme Court has repeatedly held that "'[a]bsent a clearly expressed legislative intention to the contrary, [statutory] language must ordinarily be regarded as conclusive.'" Escondido Mut. Water Co. v. LaJolla Indians, 466 U.S. 765, 772, 104 S. Ct. 2105, 2110, 80 L. Ed. 2d 753 (1984), *quoting* North Dakota v. United States, 460 U.S. 300, 312, 103 S. Ct. 1095, 1102, 75 L. Ed. 2d 77 (1983). There is no legislative history **[**10]** that would bring this plaintiff's claim for a tort without trauma within the statutory exception for a personal injury tort. *See, U.S. Code Congr. & Admin. News*, 1984, at 576 *et seq.* On the contrary, the legislative history indicates that Congress intended this exception for a "narrow range" of claims. *Id.*, Statement of Congr. Kastenmeier at 580.

Id. at 455. Judge Stevenson agreed with Cohen in In re Atron Inc. of Mich., 172 B.R. 541 (Bankr. W.D. Mich. 1994):

> We believe, however, that drawing the distinction as did *Interco, Cohen, Vinci*, and *Bertholet* between the "traditional, plain meaning sense" of the words "personal injury" and the emotional distress and humiliation of nontraditional personal injury tort claims yields the logical, preferable result. We are unwilling to adopt the broad exception to bankruptcy court jurisdiction urged by Claimant and thus open the door to a mass exodus of the claims allowance process to the district court . . . .

Id. at 545.

For other cases adopting the "narrow" interpretation, *see* In re C.W. Mining Co., 2012 U.S. Dist. LEXIS 148846, 2012 WL 4882295, at *6 (quoting Massey with approval); Belcher v. Doe, 2008 U.S. Dist. LEXIS 143761, 2008 WL 11450550, at *4 (W.D. Tex.) (adopting the "narrow understanding" of personal injury tort); Hurtado v. Blackmore, 2007 U.S. Dist. LEXIS 108019, 2007 WL 9753286, at *2 (S.D. Tex.) (quoting and following Massey and Cohen); *Lombard v. Greenpoint Savings Bank*, 1997 WL 114619, at *2 (D. Conn.) (citing Cohen for the proposition that the "exception for personal injury torts applies to a narrow range of claims"); In re Finley, Kumble, 194 B.R. 728, 734 (S.D.N.Y. 1995) (a "tort claim 'without **[**11]** trauma or bodily injury is not within statutory exception for a personal injury tort'"); In re Interco, Inc., 135 B.R. 359, 362 (Bankr. E.D. Mo. 1991) (adopting the narrow view); In re Vinci, 108 B.R. 439, 442 (Bankr. S.D.N.Y. 1989) (following Cohen); In re Sheehan Mem'l Hosp., 377 B.R. 63, 68 (Bankr. W.D.N.Y. 2007) (adopted the narrow interpretation); Bertholet v. Harman, 126 B.R. 413, 415 (Bankr. D.N.H. 1991) (citing Cohen and Vinci with approval); In re Davis, 334 B.R. 874, 878 n.2 (Bankr. W.D. Ky. 2005), aff'd in part and reversed in part on other grounds, 347 B.R. 607 (W.D. Ky. 2006) (citing Cohen, the court rules that libel is not a personal injury tort); In re Chateaugay Corp., 111 B.R. 67, 76 (Bankr. S.D.N.Y. 1990) ("the law in this district is that Congress intended this exception for a 'narrow range of claims'").

In contrast, under the "broad" interpretation:

> The term "personal injury tort" embraces a broad category of private or civil wrongs or injuries for which a court provides a remedy in the form of an action for damages, and includes damage to an individual's person and any invasion of personal rights, such as libel, slander and mental suffering, BLACK'S LAW DICTIONARY 707, 1335 (5th ed. 1979).

[*829] In re Boyer, 93 B.R. 313, 317-18 (Bankr. N.D.N.Y. 1988).[3] In addition to the definitional

---

[3] As discussed below, the definition quoted in Boyer is one of

argument, courts adopting the broad interpretation point to § 522(d)(11), which uses the term "personal bodily injury." These courts argue that if Congress had intended to limit § 157(b)(5) to torts resulting in bodily injury, it could have said so. *See, e.g.*, In re Nifong, 2008 Bankr. LEXIS 1608, 2008 WL 2203149, at *3, (Bankr. M.D.N.C.) (narrow view ignores the language of § 522(d)(11)); In re Ice Cream Liquidation, Inc., 281 B.R. 154, 160 (Bankr. D. Conn. 2002) (same).

The "hybrid" interpretation agrees with the "broad" interpretation **[**12]** but fears that

> the "broader" view may place too much reliance on whether the alleged claim would be considered a "personal injury tort" in a nonbankruptcy context. That presents at least some risk that financial, business or property tort claims also could be withdrawn from the bankruptcy system if that "broader" view is blindly followed. . . . Accordingly . . . . in cases where it appears that a claim might be a "personal injury tort claim" under the "broader" view but has earmarks of a financial, business or property tort claim, or a contract claim, the court reserves the right to resolve the "personal injury tort claim" issue by (among other things) a more searching analysis of the complaint.

Ice Cream Liquidation, 281 B.R. at 161; *see also* Smith, 389 B.R. at 908 (same).

HN5[] The Court concludes that "personal injury tort" should be interpreted narrowly. First, Judge Bernstein's *Noscitur a sociis* analysis is persuasive. Because "personal injury tort" is next to "wrongful death," the terms should be construed together as dealing with similar types of injuries.

Second, the legislative history shows that Congress meant "personal injury tort" to refer to torts similar to "claims arising from automobile accidents," i.e., a "narrow range of claims.[4]

Third, **[**13]** consideration of the personal injury attorney lobbying effort after *Johns-Manville* leads to the conclusion that the personal injury torts referred to in § 157(b)(5) were the "traditional, plain-meaning types."

HN6[] Fourth, there is no constitutional problem with bankruptcy courts hearing tort claims, so a broad interpretation of "personal injury tort" is not required to satisfy Northern Pipeline Const. Co. v. Marathon Pipeline Co., 458 U.S. 50, 102 S. Ct. 2858, 73 L. Ed. 2d 598 (1982). *See* In re Dow Corning Corp., 215 B.R. 346, 353-54 (Bankr. E.D. Mich. 1997) (no constitutional dimension to § 157(b)(2)).

Fifth, a narrow interpretation of "personal injury tort" avoids unduly burdening the District Court with trial of bankruptcy-related claims, which burden Congress could not have intended.

Sixth, Black's Law Dictionary's *first* definition of personal injury tort is "any harm caused to a person, such as a broken bone, a cut, or a bruise; bodily injury." Black's Law Dictionary (10th ed.). The *second* definition was the one relied upon by Boyer and Ice Cream Liquidation. Thus, Black's supports the narrow interpretation as much as or more than the broad one.

Seventh, as Judge Bernstein observed, the "broad" interpretation "essentially **[*830]** equates 'personal injury tort' with any tort. . . ." Gawker Media, 571 B.R. at 622. The broad interpretation reads "personal injury" out of § 157(b)(5), contrary to the rule that statutes should be construed so that, "if it can **[**14]** be prevented, no clause, sentence, or word is superfluous, void, or insignificant." *TRW, Inc. v. Andrews, 534 U.S. 19, 31, 122 S. Ct. 441, 151 L. Ed. 2d 339 (2001)*.

Eighth, it is true that 11 U.S.C. § 522(d)(11) refers to "personal bodily injury" while 28 U.S.C. § 157(b)(5) refers to "personal injury." That difference does not outweigh the reasons favoring a narrow interpretation. Further, the sections were adopted six years apart, addressed different issues, and are in different titles of the United States Code.[5] Finally, Black's Law Dictionary (first definition) equates the two terms.

Ninth, the Court finds persuasive Judge Bernstein's opinion that the hybrid approach lacks "support in the words of the relevant statutes, any canon of construction or the legislative history, and is unworkable. . . ." 571 B.R. at 623. The hybrid approach is not an attempt to construe the statute as much as a judicially crafted compromise between two alternative

two definitions in the current version of Black's Law Dictionary. The first definition supports the narrow interpretation of "personal injury tort."

[4] Gawker Media, 571 B.R. at 621-22, quoting legislative history.

[5] *Cf.* Dewsnup v. Timm, 502 U.S. 410, 112 S. Ct. 773, 116 L. Ed. 2d 903 (1992) (identical language ("allowed secured claim") has different meanings in §§ 506(a) and (d).

constructions. The compromise is unsatisfactory. Whatever Congress intended when it used the term "personal injury tort," it wasn't the hybrid interpretation.

D. The Defamation Claim.

HN7[] Under the narrow interpretation, defamation claims are not personal injury torts. In Gawker Media, for example, Judge Bernstein held:

> Having adopted the narrow interpretation, the Court readily concludes that **[**15]** the Claims do not assert "personal injury torts." Torts such as defamation, false light and injurious falsehood do not require proof of trauma, bodily injury or severe psychiatric impairment, and the *Complaint* does not allege that the Claimants suffered these injuries.

571 B.R. at 623. *See also* Massey Energy Co., 351 B.R. at 351 (defamation claim is not a personal injury tort); Hurtado v. Blackmore, 2007 U.S. Dist. LEXIS 108019, 2007 WL 9753286, at *2 (same); In re Davis, 334 B.R. at 878 n.2 (libel is not a personal injury tort). The other cases adopting the narrow interpretation of "personal injury tort," cited above, did not involve defamation claims, but it is highly likely that they would have agreed with Massey Energy and Gawker Media that defamation is not a personal injury tort.[6]

E. The IIED Claim.

1. The IIED claim may be subject to dismissal or other summary disposition. HN8[] A number of courts have ruled that alleged defamatory statements cannot be the basis of an IIED claim. In Grimes v. Carter, 241 Cal. App. 2d 694, 50 Cal. Rptr. 808 (Ct. App. 1966), **[*831]** for example, the court refused to recognize an independent claim for intentional infliction of emotional distress arising from the alleged defamatory statements, holding:

> It is elementary that, although the gravamen of a defamation action is injury to reputation, libel or slander also visits upon a plaintiff humiliation, mortification and emotional distress. In circumstances **[**16]** where a plaintiff states a case of libel or slander, such personal distress is a matter which may be taken into account in determining the amount of damages to which the plaintiff is entitled, but it does not give rise to an independent cause of action on the theory of a separate tort. To accede to the contentions of the plaintiff in this case would be, in the words of Prosser, a step toward "swallowing up and engulfing the whole law of public defamation." If plaintiff should prevail in her argument it is doubtful whether any litigant hereafter would file a slander or libel action, post an undertaking and prepare to meet substantial defenses, if she could, by simply contending that she was predicating her claim solely on emotional distress, avoid the filing of such bond and render unavailable such substantial defenses as for example, justification by truth.

50 Cal. Rptr. at 813. HN9[] Similarly, in Barker v. Huang, 610 A.2d 1341, 1351 (Del. 1992), the Delaware Supreme Court quoted Grimes and stated: "we hold with the great weight of foreign precedent that an independent action for intentional infliction of emotional distress does not lie where, as here, the gravamen of the complaint sounds in defamation."

For other cases in agreement with Grimes and *Barker, see* Dworkin v. Hustler Magazine, Inc., 668 F. Supp. 1408, 1420 (C.D. Cal. 1987) ("Without **[**17]** such a rule, virtually any defective defamation claim ... could be revived by pleading it as one for intentional infliction of emotional distress; thus, circumventing the restrictions . . . on defamation claims"); DeMeo v. Goodall, 640 F. Supp. 1115, 1117 (D.N.H. 1986) (cause of action for intentional infliction of emotional distress may not be maintained concurrently with a defamation action); Wilson v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 111 A.D.2d 807, 490 N.Y.S.2d 553, 555 (App. Div. 1985) ("[I]t would be improper to allow plaintiff to evade the specific prerequisites for a libel action by presenting his cause of action in terms of the generalized tort of intentional infliction of emotional distress"); Flynn v. Higham, 149 Cal. App. 3d 677, 197 Cal. Rptr. 145, 148 (Ct. App. 1984) ("to allow an independent cause of action for the intentional infliction of emotional distress

[6] Courts adopting the "broad" or "hybrid" interpretation of "personal injury tort" come to the opposite conclusion: they have uniformly ruled that defamation claims *are* personal injury torts. *See, e.g.,* In re Smith, 389 B.R. at 908 (under the hybrid interpretation, libel is a personal injury tort); In re Arnold, 407 B.R. 849, 853 (Bankr. M.D.N.C. 2009) (same); In re Von Volkmar, 217 B.R. 561, 566 (Bankr. N.D. Ill. 1998) (same); In re Bailey, 555 B.R. 557, 561 (Bankr. N.D. Miss. 2016) (same); Control Ctr., LLC v. Lauer, 288 B.R. 269, 286 (M.D. Fla. 2002) ("Defamation is a personal injury tort"); In re Roman Catholic Church for Archdiocese of New Orleans, 2021 U.S. Dist. LEXIS 160497, 2021 WL 3772062, at *4 (E.D. La.) (same); In re White, 410 B.R. 195, 203 (Bankr. W.D. Va. 2008) (same). Thus, the key issue is the proper interpretation of "personal injury tort."

based on the same acts which would not support a defamation action, would ... render meaningless any defense of ... privilege"); Draker v. Schreiber, 271 S.W.3d 318, 325 (Tex. App. 2008) ("As the gravamen of Draker's complaint was one of defamation, the trial court did not err in dismissing her claim for intentional infliction of emotional distress"); Rykowsky v. Kickinson Public School Dist. No. 1, 508 N.W. 2d 348, 352 (N.D. 1993) (IIED claim does not lie where the gravamen of the complaint sounds in defamation); Fridovich v. Fridovich, 598 So.2d 65, 70 (Fla.1992) ("the successful invocation of a defamation privilege *will* preclude a cause of action for intentional infliction of emotional distress if the sole basis for the **[**18]** latter cause of action is the defamatory publication"); Hoffmann-La Roche Inc. v. Zeltwanger, 144 S.W.3d 438, 447 (Tex. 2004) ("[w]here the gravamen of a plaintiff's complaint is really another tort, intentional infliction of emotional distress should not be available"); Kirschstein v. Haynes, 1990 OK 8, 788 P.2d 941, 954 (Okla. 1990) (a claim "for intentional infliction of emotional distress ... based on the same factual underpinnings as a defamation claim **[*832]** for which the privilege applies, ... is also barred by the reach of the absolute privilege"); Rubinson v. Rubinson, 474 F. Supp.3d 1270, 1278-79 (S.D. Fla. 2020) (plaintiff cannot transform a defamation action into an IIED claim by characterizing the alleged defamatory statements as "outrageous"); Miller v. Target Corp., 854 Fed. Appx. 567, 569 (5th Cir. 2021) (IIED is not recoverable in the alternative to a defamation claim); Durepo v. Flower City Television Corp., 147 A.D.2d 934, 537 N.Y.S.2d 391, 392 (App. Div. 1989) (IIED cause of action is redundant to the defamation action and should have been dismissed); Basilius v. Honolulu Pub. Co., Ltd., 711 F. Supp. 548, 552 (D. Haw. 1989) (IIED claim stands or falls with the defamation claim; it is parasitic of it); Decker v. Princeton Packet, Inc., 116 N.J. 418, 432, 561 A.2d 1122 (1989) ("it comports with the first amendment protections to deny an emotional-distress claim based on a false publication that engenders no defamation *per se*"); Illaraza v. HOVENSA LLC, 73 F. Supp. 3d 588, 614 (D.V.I. 2014) (under Virgin Islands law, an IIED claim cannot lie where the gravamen of the complaint sounds in defamation).

New Mexico has not ruled directly on the issue, However, in Andrews v. Stallings, 1995- NMCA 015, 119 N.M. 478, 491, 892 P.2d 611 (Ct. App. 1995), the New Mexico Court of Appeals stated:

> In recent years, public figures increasingly **[**19]** have attempted to use the intentional infliction of emotional distress claim "to make an end-run around the obstacles posed by defamation law's harm to reputation element and its constitutional aspects." Arlen W. Langvardt, *Stopping the End-Run by Public Plaintiffs: Falwell and the Refortification of Defamation Law's Constitutional Aspects*, 26 Am. Bus. L.J. 665, 666 (1989) (footnote omitted) [hereinafter *Stopping the End-Run*]. In Hustler Magazine, Inc. v. Falwell, 485 U.S. 46, 108 S.Ct. 876, 99 L.Ed.2d 41 (1988), the Supreme Court "drastically limited, if not eliminated, public officials' and public figures' ability to employ the emotional distress option to evade the obstacles imposed by defamation law." *Stopping the End-Run, supra*, at 668.

119 N.M. at 491. Andrews shows that ***HN10***[] New Mexico law does not allow litigants to evade the requirements for proving defamation by pleading an IIED claim on the same facts.

Here, the IIED claim is based entirely on Defendant's alleged defamatory statements to the police, the state court, and others. Under the "great weight" of the authority cited above, Plaintiff's IIED claim appears unviable.

2. In any event, the gravamen of plaintiff's claims is defamation, so the Court can try them both. ***HN11***[] When deciding whether an IIED claim is a personal injury tort, the Court must determine if the alleged emotional distress is central **[**20]** to the cause of action or is merely an element of damages. In In re Residential Capital, LLC, 536 B.R. 566 (Bankr. S.D.N.Y. 2015), Judge Glenn observed that "[s]ome courts have held, without analysis or explanation, that the bankruptcy court does not have subject matter jurisdiction to adjudicate the emotional distress claim under section 157(b)(5)," Id. at 572-73. After citing a number of cases, Judge Glenn stated:

> Some courts have found it unnecessary to settle on one single approach for determining whether an emotional distress claim involves a personal injury tort, focusing instead on the "gravamen" of the claim. . . . The court's analysis in [In re Thomas, 211 B.R. 838 (Bankr. D.S.D. 1997)] and in other cases points strongly towards analyzing the context and central focus of the claims—if an IIED **[*833]** claim is the tail wagging the dog, section 157(b)(5) should not require dislodging the claim from bankruptcy court resolution of a portion of a claim asserted against a debtor. ***HN12***[] If the IIED claim is the gravamen of the claim, as the South

> Carolina bankruptcy court found in *Thomas*, *section 157(b)(5)* does not permit the bankruptcy court to try the claim absent consent.

536 B.R. at 573. The district court in Utah came to the same conclusion in *In re Lang, 166 B.R. 964 (D. Utah 1994)*, holding:

> Regardless of whether intentional infliction of emotional distress is a true personal injury tort under *§ 157(b)(5)*, Dr. Lang's claims are fundamentally **[**21]** allegations of fraud. Thus, the court finds Dr. Lang's allegation of emotional distress claim too tangential to his lawsuit to support withdrawal of the entire matter solely on the basis of the emotional distress claim. Further, Dr. Lang's claim of emotional distress is intimately connected to his claims of fraud, making it impractical and inefficient to withdraw the emotional distress claim by itself.

166 B.R. at 967. Similarly, in *Bertholet v. Harman* the bankruptcy court held:

> I believe the better rule is that if a mental distress claim does not involve physical injury, then only if the claim is the gravamen of a complaint would *§ 157(b)(5)* be invoked. Otherwise, as stated above, jurisdiction would too easily be lost from this court, and I cannot believe Congress intended that.
>
> In short, the claims in the present case do not rise to the level of "psychiatric impairment" caused by wilful conduct in that regard. The claims are more in the nature of humiliation and other emotional harm which are incidental claims in this action. This does not implicate *§ 157(b)(5)*.

126 B.R. at 416.

The approach taken by these courts is reasonable and will be followed here. The gravamen of Plaintiff's claims is defamation. Defamation is the "context and central focus of the **[**22]** claim," *536 B.R. at 573*. Plaintiff does not allege any wrongful conduct by Defendant other than her allegedly defamatory statements. The Court concludes that even if the IIED claim is viable, it is the "tail wagging the dog," *id.*, and should remain in the bankruptcy court for trial.[7]

F. The Court Will Try the Claims.

Subject to a different conclusion by the District Court on the Reference Withdrawal Motion, this Court will try the torts claims because defamation is not a personal injury tort and is the gravamen of Plaintiffs' claims. The claims can be tried relatively quickly and inexpensively.[8] The Court does not want to shirk its duty to hear cases filed in bankruptcy court, especially contentious cases like this one. *See, e.g.*, *Dear v. Nair, 2021 U.S. Dist. LEXIS 73663, 2021 WL 1517983, at *5, n.1 (D.N.M.)* ("the Court is mindful of its continuing jurisdictional duty to hear claims properly presented before it. . . ."); *Russell v. Bank of America, N.A., 2012 U.S. Dist. LEXIS 67411, 2012 WL 1739721, at *1 (D. Nev.)* (***HN14***[] "This Court has a duty to hear all cases in which its subject matter jurisdiction is properly invoked. . . ."); *In re Hillsborough Holdings Corp., 123 B.R. 1004, 1013 (Bankr. M.D. Fla. 1990)* (alludes to "the court's presumptive **[*834]** duty to hear and resolve matter which are properly before it").

If the claims are "core" because they were brought as part of a nondischargeability proceeding, then the Court will enter a final judgment. **[**23]** ***HN15***[] If the claims are not "core," then the Court will enter proposed findings of fact and conclusions of law for review by the District Court. *See* *28 U.S.C. § 157(c)(1)*. This issue will be determined later.

G. Remand.

HN16[] As an alternative to trying the claims, this Court and the District Court have the right to remand the claims to state court "on any equitable ground." *See* *28 U.S.C. § 1452(b)*. *See also* *CitiMortgage, Inc. v. Davis, 20 F.4th 352, 356-57, 2021 U.S. App. LEXIS 36579 (7th Cir. 2021)* (the bankruptcy court may remand a case under *28 U.S.C. § 1452(b)*); *Things Remembered, Inc. v. Petrarca, 516 U.S. 124, 127, 116 S. Ct. 494, 133 L. Ed. 2d 461 (1995)* ("Congress has placed broad restriction on the power of federal appellate courts to review district court orders remanding removed cases to state court").

There are good reasons to remand the claims, e.g., convenience of the parties, location of witnesses, and the purely state law nature of the claims. The main

[7] ***HN13***[] Emotional distress damages are available in defamation cases. *See* *Castillo v. City of Las Vegas, 2008-NMCA 141, 145 N.M. 205, 212, 195 P.3d 870 (Ct. App. 2008)*, *citing* *Marchiondo v. Brown, 1982- NMSC 076, 98 N.M. 394, 402, 649 P.2d 462 (S. Ct. 1982)*.

[8] The Court proposes to try the claims in Las Cruces, given the age and economic situation of the parties and the location of the parties, witnesses, and counsel.

reason not to remand them is the potential expense of a state court jury trial. Defendant has no income other than social security. She is 79 and lives with the parties' son. Unlike Plaintiff (a former attorney and pro se in this proceeding), Defendant has to pay counsel. The Court has attempted to keep the parties' expenses to a minimum. Because of that, the Court will not remand the claims to state court for trial.

H. Withdrawing the Reference.

HN17[] The District Court has discretion **[**24]** to withdraw the reference for one or both of the tort claims. *28 U.S.C. § 157(d)*. If the District Court disagrees with the Court's legal analysis or proposed method of proceeding as outlined in this opinion, it could withdraw the reference in full or in part to address the areas of disagreement.

Conclusion

The Court recommends to the District Court that the reference not be withdrawn for either claim. The Court will schedule the claims for a bench trial in Las Cruces, with sufficient intervening time, however, for the District Court to rule on the Reference Withdrawal Motion. A separate order will be entered.

/s/ David T. Thuma

Hon. David T. Thuma

United States Bankruptcy Judge

Entered: March 11, 2022

ORDER ON TRIAL OF TORT CLAIMS

THIS MATTER is before the Court on the issue of which court shall try the defamation and Intentional Infliction of Emotional Distress ("IIED") claims in this adversary proceeding. For the reasons given in the opinion entered herewith, the Court ORDERS:

1. The Court adopts the "narrow" interpretation of "personal injury tort" as that term is used in *28 U.S.C. § 157(b)(5)*;

2. The Court concludes that under the narrow interpretation, Plaintiff's defamation claim is not a personal injury tort and may be tried **[**25]** by the Court;

3. The Court concludes that the IIED claim may be subject to dismissal or summary disposition because it is based entirely on Defendant's alleged defamatory statements;

4. In any event, the Court concludes that it can try the IIED claim because the gravamen of Plaintiff's claims is defamation; and

5. The Court concludes that it will not remand the claims, but will try them in Las Cruces.

6. The Court will issue a subsequent order setting final pretrial deadlines, after the United States District Court has had time to review and consider the opinion and this order in no. CV 21-00295 MV/JHR (the "Reference Withdrawal Proceeding").

7. The parties are directed to file copies of the opinion and this order in the Reference Withdrawal Proceeding.

/s/ David T. Thuma

Hon. David T. Thuma

United States Bankruptcy Judge

Table1 (Return to related document text)

Court	Filing	Date	Disposition
1. State court	Notice of appeal	1/27/20	Dismissed
2. State court	Notice of appeal	2/26/20	Dismissed
3. Bankruptcy court	Notice of appeal	2/16/21	Dismissed
4. Bankruptcy court	Notice of appeal	2/16/21	Dismissed
5. Bankruptcy court	Motion to disqualify judge	3/18/21	Denied
6. Bankruptcy court	Notice of appeal	7/12/21	Dismissed
7. Bankruptcy court	Notice of appeal	8/2/21	Dismissed
8. Bankruptcy court	Notice of appeal	2/7/22	Dismissed
9. District court	Notice of appeal	7/12/21	Pending
10. District court	Motion to vacate the order of reference to Magistrate Judge	11/12/21	Pending
11. Tenth Circuit	Petition for Writ of Mandamus	2/18/22	Pending

Table1 (Return to related document text)

End of Document

LexisNexis

User Name: Michael Hile

Date and Time: Monday, August 1, 2022 10:47:00 PM EDT

Job Number: 176455319

Document (1)

1. *In re Smith, 389 B.R. 902*

   Client/Matter: -None-

   Search Terms: 389 B.R. 902

   Search Type: Natural Language

   Narrowed by:

Content Type	**Narrowed by**
Cases	-None-

In re Smith

United States Bankruptcy Court for the District of Nevada

April 22, 2008, Argued; June 24, 2008, Entered on Docket

Case No.: BK-S-07-16504-BAM, Chapter 7, Adv. Proceeding No.: 08-1012-BAM

Reporter
389 B.R. 902 *; 2008 Bankr. LEXIS 2254 **; 50 Bankr. Ct. Dec. 88

In re: JOHN L. SMITH, Debtor. SHELDON G. ADELSON, Plaintiff, vs. JOHN L. SMITH, Defendant.

Subsequent History: Later proceeding at *Adelson v. Smith (In re Smith), 2008 Bankr. LEXIS 4816 (Bankr. D. Nev., July 17, 2008)*

Disposition: The court denied the creditor's motions.

Core Terms

bankruptcy court, district court, personal injury tort, matters, hear, adversary proceedings, nondischargeability, cases, libel, proceedings, factors, noncore, parties, bankruptcy case, favors, waived, libel claim, state court, courts, exclusive jurisdiction, automatic stay, bad faith, lift, liquidate, wrongful death claim, filing proof, withdrawal, personal injury claim, right to a jury trial, claim for relief

Case Summary

Procedural Posture

Plaintiff creditor filed an adversary proceeding against defendant Chapter 7 debtor, claiming that the debtor committed libel. Three months after he filed his adversary proceeding, the creditor filed a motion to stay the adversary proceeding, and he moved for relief from the automatic stay that was imposed under *11 U.S.C.S. § 362* so he could proceed with a libel action he filed against the debtor in state court. The debtor opposed the motions.

Overview

The creditor, a businessman with casino interests, filed a libel action in a California court, alleging that the debtor committed libel when he wrote a book about Las Vegas, Nevada. Five days before the case was scheduled for trial, the debtor declared bankruptcy, and the action in state court was stayed. The creditor filed an adversary proceeding in the bankruptcy court, seeking a judgment that the debtor committed libel and that any judgment rendered against him was nondischargeable. The creditor filed a proof of claim with respect to the damages alleged in his adversary proceeding, but subsequently filed a motion to stay the adversary proceeding and a motion for relief from the automatic stay to allow the state court action to proceed. The court denied the creditor's motions. The creditor had not shown cause for lifting the automatic stay, and he waived his right to a jury trial and to have the case heard by a federal district court. Although the creditor's claim was a "personal injury tort claim" within the meaning of *28 U.S.C.S. § 157(b)(5)*, that section was not jurisdictional and it did not deprive the bankruptcy court of the power to hear the creditor's adversary proceeding.

Outcome

The court denied the creditor's motions.

LexisNexis® Headnotes

Bankruptcy Law > Procedural Matters > Jurisdiction > General Overview

Governments > Courts > Authority to Adjudicate

HN1[] **Procedural Matters, Jurisdiction**

Bankruptcy courts are legislative courts, created by Congress under Article I of the U.S. Constitution to administer the federal Bankruptcy Code, found in Title 11 of the United States Code.

Bankruptcy Law > Procedural Matters > Jurisdiction > Core Proceedings

Bankruptcy Law > Procedural Matters > Jurisdiction > Federal District Courts

HN2[] Jurisdiction, Core Proceedings

In 1984, Congress revised bankruptcy jurisdiction. Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 333. In this overhaul, general bankruptcy jurisdiction was conferred upon Article III district courts, *28 U.S.C.S. § 1334(b)*, with bankruptcy courts being made units of those district courts, *28 U.S.C.S. § 151*. By rule or order, each district court was given the ability to refer all bankruptcy matters to a bankruptcy court. *28 U.S.C.S. § 157(a)*. Those referrals could be withdrawn by a district court in appropriate cases, *28 U.S.C.S. § 157(d)*, or cases and matters thus referred might be stayed if appropriate federalism or comity concerns justified abstention, *28 U.S.C.S. § 1334(c)*. With respect to the referred matters, Congress did not provide that bankruptcy courts could hear and determine--that is, enter final judgments subject only to appeal--all such matters. What Congress did provide was that bankruptcy courts could hear and determine certain matters, and would draft a report and recommendation for the district court on others. *28 U.S.C.S. § 157(b)* initially handles this division of labor. *Section 157(b)(1)* gives bankruptcy courts the power to hear and determine cases under Title 11 of the United States Code, and all "core" matters that arise in or under Title 11. *Section 157(b)(2)* provides a nonexhaustive list of core matters.

Bankruptcy Law > Procedural Matters > Jurisdiction > General Overview

Torts > Procedural Matters > Commencement & Prosecution > Subject Matter Jurisdiction

HN3[] Procedural Matters, Jurisdiction

28 U.S.C.S. § 157(b) deals specifically with the handling of personal injury tort claims within the bankruptcy system.

Bankruptcy Law > Procedural Matters > Jurisdiction > Core Proceedings

Bankruptcy Law > Procedural Matters > Jurisdiction > Federal District Courts

Bankruptcy Law > Procedural Matters > Jurisdiction > Noncore Proceedings

HN4[] Jurisdiction, Core Proceedings

28 U.S.C.S. § 157(b) does not cover all matters within *28 U.S.C.S. § 1334(b)*'s broad jurisdiction. In addition to bankruptcy cases and civil proceedings arising in and under Title 11 of the United States Code, Congress conferred upon the district courts, for referral to the bankruptcy courts, jurisdiction of matters "related to" cases under Title 11. *Section 157(c)* governs the determination of these related matters, and of noncore matters set forth in *§ 157(b)(1)*. It empowers bankruptcy courts to hear such matters, but on the condition that they be submitted to the district court for a final determination, unless the parties otherwise consent. *28 U.S.C.S. § 157(c)(2)*.

Bankruptcy Law > Procedural Matters > Jurisdiction > Noncore Proceedings

Torts > Procedural Matters > Commencement & Prosecution > Subject Matter Jurisdiction

HN5[] Jurisdiction, Noncore Proceedings

There are three different definitions of a "personal injury tort" under *28 U.S.C.S. § 157(b)(5)*. The narrowest construction of "personal injury tort" requires the aggrieved party to plead an actual physical injury to his or her person. By contrast, the most expansive reading includes civil rights claims under federal antidiscrimination laws as personal injury tort claims. These two views were synthesized into a third view by the United States Bankruptcy Court for the District of Connecticut in In re Ice Cream Liquidation, Inc. In making these determinations, the Ice Cream Liquidation court determined that, based on the legislative history, Congress did not intend *28 U.S.C.S. § 157(b)(5)* to include business or financial torts.

Bankruptcy Law > Procedural Matters > Jurisdiction > Noncore Proceedings

Torts > Intentional Torts > Defamation > General Overview

Torts > Procedural Matters > Commencement & Prosecution > Subject Matter Jurisdiction

HN6[] Jurisdiction, Noncore Proceedings

The middle ground for defining the term "personal injury tort" under *28 U.S.C.S. § 157(b)(5)* that was struck by the United States Bankruptcy Court for the District of Connecticut in In re Ice Cream Liquidation includes traditional, nonphysical torts, such as defamation and libel, but does not include civil rights or sexual harassment claims. This middle ground, therefore, encompasses torts involving bodily harm and reputational harm, without including torts that are personal injury torts by statutory designation only. This middle ground is the most appealing because it is closely aligned with what are traditionally thought of as the common law torts, and while it includes emotional and reputational harms, it does not go so far as to allow nonbankruptcy law to define certain torts as personal injury torts. The United States Bankruptcy Court for the District of Nevada is convinced that the United States Court of Appeals for the Ninth Circuit would adopt nothing less than the middle ground.

Bankruptcy Law > Procedural Matters > Jurisdiction > Federal District Courts

Bankruptcy Law > Procedural Matters > Jurisdiction > General Overview

HN7[] Jurisdiction, Federal District Courts

The United States Court of Appeals for the Ninth Circuit first asks whether federal jurisdiction would exist in a federal district court in order to determine whether a bankruptcy court could have jurisdiction derivatively.

Bankruptcy Law > Procedural Matters > Jurisdiction > Federal District Courts

Bankruptcy Law > Procedural Matters > Jurisdiction > Noncore Proceedings

HN8[] Jurisdiction, Federal District Courts

Congress granted federal district courts original but not exclusive jurisdiction over civil proceedings arising under Title 11 of the United States Code, or arising in or related to a case under Title 11. *28 U.S.C.S. § 1334(b)*. "Related to" jurisdiction is very broad, including nearly every matter directly or indirectly related to bankruptcy. But Congress did not intend district courts to hear all civil cases arising under or related to a bankruptcy case. It provided for a way to route such matters to a bankruptcy court. By local rule or order, *28 U.S.C.S. § 157(a)* permits the transfer of all such matters to a bankruptcy court that Congress created for that purpose. The United States District Court for the District of Nevada, consistent with the practice in every other district in the United States, has provided for such an automatic transfer. D. Nev. R. 1001(b)(1).

Bankruptcy Law > Procedural Matters > Jurisdiction > Core Proceedings

Bankruptcy Law > Procedural Matters > Jurisdiction > Noncore Proceedings

HN9[] Jurisdiction, Core Proceedings

The transfer of jurisdiction from a federal district court to a bankruptcy court does not result in the immediate and irrevocable ability of the bankruptcy court to enter a final order in all such matters. Under the statutory scheme that Congress adopted, the bankruptcy court must first determine whether a civil proceeding is core or noncore. *28 U.S.C.S. § 157(b)(3)*. This determination then controls as to whether the bankruptcy judge has the power to enter a binding final judgment regardless of the parties' consent, or, as the statute states it, whether the bankruptcy court has the power to "hear and determine" the matter. *28 U.S.C.S. § 157(c)*. As the United States Court of Appeals for the Ninth Circuit has stated, in core proceedings, the bankruptcy court may hear, determine, and enter final orders and judgments.

Bankruptcy Law > Procedural Matters > Jurisdiction > Federal District Courts

Bankruptcy Law > Procedural Matters > Jurisdiction > General Overview

Bankruptcy Law > Procedural Matters > Jurisdiction > Noncore Proceedings

HN10[] Jurisdiction, Federal District Courts

28 U.S.C.S. § 157 does not give or take away jurisdiction to hear noncore matters; that is, it does not affect a bankruptcy court's power to hear a noncore proceeding. In noncore proceedings, a bankruptcy court is limited to hearing the matter and submitting proposed findings of fact and conclusions of law to the district court. The district court reviews de novo any finding or conclusion objected to and enters a final order and judgment. 28 U.S.C.S. § 157(c)(1). If the parties consent, the district court may expand the bankruptcy court's power to adjudicate noncore proceedings to include the power to issue final orders and judgments. The purpose of this division is that it segregates those proceedings that an Article I legislative court may hear and decide by a final order from those that an Article III court must subject to nondeferential review as nonfinal orders. The analysis thus proceeds by first asking whether there is subject matter jurisdiction, an inquiry under 28 U.S.C.S. § 1334. Once such jurisdiction is established, the inquiry next focuses on which federal court should hear the matter: the district court directly, or the bankruptcy court by referral.

Civil Procedure > ... > Subject Matter Jurisdiction > Jurisdiction Over Actions > General Overview

HN11[] Subject Matter Jurisdiction, Jurisdiction Over Actions

Without proper jurisdiction, a court cannot proceed at all, but can only note the jurisdictional defect and dismiss the suit.

Bankruptcy Law > Procedural Matters > Jurisdiction > Federal District Courts

Torts > Procedural Matters > Commencement & Prosecution > Subject Matter Jurisdiction

Bankruptcy Law > Procedural Matters > Jurisdiction > Noncore Proceedings

HN12[] Jurisdiction, Federal District Courts

See 28 U.S.C.S. § 157(b)(5).

Bankruptcy Law > Procedural Matters > Jurisdiction > Federal District Courts

Governments > Legislation > Interpretation

Torts > Procedural Matters > Commencement & Prosecution > Subject Matter Jurisdiction

HN13[] Jurisdiction, Federal District Courts

28 U.S.C.S. § 157(b)(5), like any other federal statute, is interpreted according to its plain meaning. It is well established that when the statute's language is plain, the sole function of the courts--at least where the disposition required by the text is not absurd--is to enforce it according to its terms. But this plain meaning must take into account the context of the statute, and a court's goal in interpreting a statute is to understand the statute as a symmetrical and coherent regulatory scheme and to fit, if possible, all parts into a harmonious whole. Statutory language cannot be construed in a vacuum. It is a fundamental canon of statutory construction that the words of a statute must be read in their context and with a view to their place in the overall statutory scheme.

Bankruptcy Law > Procedural Matters > Jurisdiction > Federal District Courts

Torts > Procedural Matters > Commencement & Prosecution > Subject Matter Jurisdiction

HN14[] Jurisdiction, Federal District Courts

28 U.S.C.S. § 157(b)(5) is not worded as Congress might normally construct a restrictive jurisdictional statute. It does not say, for example, that personal injury and wrongful death claims shall be heard exclusively by a federal district court, and not by a bankruptcy court, or that notwithstanding § 157(a), jurisdiction of personal injury and wrongful death claims shall not be referred to a bankruptcy court. Rather, § 157(b)(5) refers only to where a matter may be tried (presumably after all pretrial matters have been resolved, and presumably resolved by a court with jurisdiction), and then provides only that the location of such trials shall be ordered by the district court to be in the district court. This wording is a far cry from a grant of exclusive jurisdiction to the district court of all personal injury and wrongful death claims. Rather, it is perfectly consistent with a referral to a bankruptcy court of such matters, with a mandatory withdrawal to the district court should the district court so order, and as may be consistent with the statute. In this manner, the operation of § 157(b)(5) appears to be similar to the procedure for general withdrawal of the reference. 28 U.S.C.S. § 157(d).

Bankruptcy Law > Procedural Matters > Jurisdiction > General Overview

Torts > Procedural Matters > Commencement & Prosecution > Subject Matter Jurisdiction

HN15[] Procedural Matters, Jurisdiction

The United States Court of Appeals for the Ninth Circuit has held that a bankruptcy court may retain pretrial jurisdiction of a matter for which there is a jury trial right. *28 U.S.C.S. § 157(b)(5)* does not deprive bankruptcy courts of administrative jurisdiction over a personal injury tort claim, and a bankruptcy court may entertain a motion for relief from stay to allow a tort claim to proceed in a state forum.

Bankruptcy Law > Procedural Matters > Jurisdiction > Noncore Proceedings

Torts > Procedural Matters > Commencement & Prosecution > Subject Matter Jurisdiction

HN16[] Jurisdiction, Noncore Proceedings

Bankruptcy courts have at least noncore jurisdiction over personal injury tort claims, and they may hear and determine allowance of such claims.

Bankruptcy Law > Procedural Matters > Jurisdiction > Core Proceedings

Torts > Procedural Matters > Commencement & Prosecution > Subject Matter Jurisdiction

HN17[] Jurisdiction, Core Proceedings

28 U.S.C.S. § 157(b) generally, and *§ 157(b)(5)* in particular, do not create or destroy jurisdiction. They simply allocate the jurisdiction already conferred upon federal courts in an effort to answer the question as to whether a bankruptcy court may enter a binding judgment, or whether it must make proposed findings of fact and conclusions of law for the district court's use.

Bankruptcy Law > Procedural Matters > Jurisdiction > Noncore Proceedings

Torts > Procedural Matters > Commencement & Prosecution > Subject Matter Jurisdiction

HN18[] Jurisdiction, Noncore Proceedings

In making distinctions between core and noncore proceedings, *28 U.S.C.S. § 157(b)* expressly mentions personal injury tort claims, and it provides that they are not core matters, creating the inference that they are noncore matters over which a bankruptcy court has jurisdiction.

Bankruptcy Law > Procedural Matters > Jurisdiction > General Overview

Torts > Procedural Matters > Commencement & Prosecution > Subject Matter Jurisdiction

HN19[] Procedural Matters, Jurisdiction

Holding that bankruptcy courts do not have jurisdiction over personal injury tort claims would prevent bankruptcy courts from estimating personal injury claims under *11 U.S.C.S. § 502(c)*, which is contrary to the current state of the law. A conclusion that *28 U.S.C.S. § 157(b)(5)* is jurisdictional would effectively destroy a bankruptcy court's ability to estimate or otherwise treat personal injury claims. This could unacceptably limit the bankruptcy system's ability to effectively resolve bankruptcy cases involving personal injury claims, calling into question the ability to decide megatort claims.

Bankruptcy Law > Procedural Matters > Jurisdiction > Federal District Courts

Torts > Procedural Matters > Commencement & Prosecution > Subject Matter Jurisdiction

Bankruptcy Law > Procedural Matters > Jurisdiction > General Overview

HN20[] Jurisdiction, Federal District Courts

A federal district court will almost always hear personal injury cases, especially if a timely request to do so is made. That is the allocative aspect of *28 U.S.C.S. § 157(b)(5)*. But since the right to have such cases heard in a district court is not jurisdictional, it is also not inviolable; parties may waive the right by consent or by action. As recognized generally in the Ninth Circuit with respect to the core/noncore distinction, and as recognized specifically in In re Leslie Fay Cos., a party may waive the rights attendant to holding a claim classifiable as a personal injury tort claim.

Bankruptcy Law > Procedural Matters > Jurisdiction > Core Proceedings

Bankruptcy Law > Discharge & Dischargeability > Exceptions to Discharge > General Overview

HN21[] Jurisdiction, Core Proceedings

A nondischargeability allegation is a core matter for which a bankruptcy court has exclusive jurisdiction. Intertwined with the nondischargeability determination, however, is the determination of whether there is a debt owed, and if so, its amount. In the Ninth Circuit, this is a determination that can be made by a bankruptcy court without a jury. Because determination of dischargeability is exclusively within the equitable jurisdiction of a bankruptcy court, it must follow that the bankruptcy court may also render a money judgment in an amount certain without the assistance of a jury.

Bankruptcy Law > Procedural Matters > Jurisdiction > Noncore Proceedings

HN22[] Jurisdiction, Noncore Proceedings

The failure to raise an objection that a bankruptcy court is hearing a noncore matter before the court enters judgment constitutes consent to have the bankruptcy court hear the matter.

Bankruptcy Law > Procedural Matters > Jurisdiction > General Overview

HN23[] Procedural Matters, Jurisdiction

The absence of a timely objection to a bankruptcy court's jurisdiction constitutes implied consent to the resolution of the controversy.

Bankruptcy Law > Procedural Matters > Jury Trials

Civil Procedure > Trials > Jury Trials > Jury Demands

HN24[] Procedural Matters, Jury Trials

Fed. R. Bankr. P. 9015 incorporates *Fed. R. Civ. P. 38(b)* and *(d)*, which provide for a waiver of a jury trial right if the person requesting a jury does not serve a written demand no later than 10 days after service of the last pleading directed to the issue.

Bankruptcy Law > Claims > Proof of Claim > Effects & Procedures

HN25[] Proof of Claim, Effects & Procedures

Filing a proof of claim has serious consequences. When a creditor submits to bankruptcy court jurisdiction by filing a proof of claim in order to collect all or a portion of a debt, it assumes certain risks. For example, the creditor loses the right to a jury trial on any counterclaims filed by the debtor or the trustee. In addition, the creditor loses previously-held rights to assert legal claims against the debtor and his estate. Bankruptcy converts the creditor's legal claim into an equitable claim to a pro rata share of the res.

Bankruptcy Law > ... > Bankruptcy > Case Administration > Bankruptcy Court Powers

Civil Procedure > ... > Entry of Judgments > Stays of Judgments > General Overview

HN26[] Case Administration, Bankruptcy Court Powers

The United States Supreme Court's decision in Landis v. North American Co. stands for the proposition that the power to stay proceedings is incidental to the power inherent in every court to control the disposition of the causes on its docket with economy of time and effort for itself, for counsel, and for the litigants. How the exercise of that power can best be done calls for the exercise of judgment, which must weigh competing interests and maintain an even balance. This judgment must be exercised only when the suppliant for a stay makes out a clear case of hardship or inequity in being required to go forward, if there is even a fair possibility that the stay for which he prays will work damage to someone else. Only in rare circumstances will a litigant in one cause be compelled to stand aside while a litigant in another settles the rule of law that define the rights of both.

Bankruptcy Law > ... > Bankruptcy > Case Administration > Bankruptcy Court Powers

Civil Procedure > ... > Entry of Judgments > Stays of Judgments > General Overview

HN27[] Case Administration, Bankruptcy Court Powers

Where it is proposed that a pending proceeding be stayed, the competing interests which will be affected by the granting or refusal to grant a stay must be weighed. Among those competing interests are the possible damage which may result from the granting of a stay, the hardship or inequity which a party may suffer in being required to go forward, and the orderly course of justice measured in terms of the simplifying or complicating of issues, proof, and questions of law which could be expected to result from a stay.

Bankruptcy Law > Procedural Matters > Jurisdiction > Core Proceedings

Bankruptcy Law > Discharge & Dischargeability > Exceptions to Discharge > Malicious & Willful Injury

HN28[] Jurisdiction, Core Proceedings

A bankruptcy court has exclusive jurisdiction of nondischargeability proceedings under *11 U.S.C.S. § 523(a)(6)*.

Bankruptcy Law > ... > Automatic Stay > Relief From Stay > Relief for Cause

HN29[] Relief From Stay, Relief for Cause

The automatic stay imposed by *11 U.S.C.S. § 362(a)* applies to a judicial proceeding to recover a pre-petition claim from a debtor. *11 U.S.C.S. § 362(a)(1)*. However, relief from the automatic stay may be granted "for cause." *11 U.S.C.S. § 362(d)(1)*.

Bankruptcy Law > ... > Automatic Stay > Relief From Stay > Relief for Cause

HN30[] Relief From Stay, Relief for Cause

Although the term "cause" is not defined in the Bankruptcy Code, courts in the Ninth Circuit have granted relief from the stay under *11 U.S.C.S. § 362(d)(1)* when necessary to permit pending litigation to be concluded in another forum if a nonbankruptcy suit involves multiple parties or is ready for trial.

Bankruptcy Law > ... > Automatic Stay > Relief From Stay > Relief for Cause

Evidence > Burdens of Proof > Burden Shifting

HN31[] Relief From Stay, Relief for Cause

The burden of proof on a motion to modify the automatic stay is a shifting one. To obtain relief from the automatic stay, the party seeking relief must first establish a prima facie case that cause exists for relief under *11 U.S.C.S. § 362(d)(1)*. Once a prima facie case has been established, the burden shifts to the debtor to show that relief from the stay is unwarranted. *11 U.S.C.S. § 362(g)(2)*. If the movant fails to meet its initial burden to demonstrate cause, relief from the automatic stay should be denied.

Bankruptcy Law > ... > Automatic Stay > Relief From Stay > General Overview

HN32[] Automatic Stay, Relief From Stay

Courts have identified various factors relevant to determining whether the stay should be lifted to allow a creditor to continue pending litigation in a nonbankruptcy forum. Most courts analyze twelve non-exclusive factors as issues a bankruptcy court should weigh in determining whether to lift the stay. The first six factors are: (1) whether the relief will result in a partial or complete resolution of the issues; (2) the lack of any connection with or interference with the bankruptcy case; (3) whether the foreign proceeding involves the debtor as a fiduciary; (4) whether a specialized tribunal has been established to hear the particular cause of action and whether that tribunal has the expertise to hear such cases; (5) whether the debtor's insurance carrier has assumed full financial responsibility for defending the litigation; and (6) whether the action essentially involves third parties, and the debtor functions only as a bailee or conduit for the goods or proceeds in question.

Bankruptcy Law > ... > Automatic Stay > Relief From Stay > General Overview

HN33[] Automatic Stay, Relief From Stay

Courts have identified various factors relevant to determining whether the stay should be lifted to allow a creditor to continue pending litigation in a nonbankruptcy forum. Most courts analyze twelve non-exclusive factors as issues a bankruptcy court should weigh in determining whether to lift the stay. The last six factors are: (7) whether litigation in another forum would prejudice the interests of other creditors, the creditors' committee, and other interested parties; (8) whether the judgment claim arising from the foreign action is subject to equitable subordination under *11 U.S.C.S. § 510(c)*; (9) whether the movant's success in the foreign proceeding would result in a judicial lien avoidable by the debtor under *11 U.S.C.S. § 522(f)*; (10) the interests of judicial economy and the expeditious and economical determination of litigation for the parties; (11) whether the foreign proceedings have progressed to the point where the parties are prepared for trial; and (12) the impact of the stay on the parties and the "balance of hurt." Not all of the 12 factors are relevant in every case. Nor is a court required to give each of the factors equal weight in making its determination.

Bankruptcy Law > ... > Automatic Stay > Relief From Stay > General Overview

HN34[] Automatic Stay, Relief From Stay

The legislative history of *11 U.S.C.S. § 362(a)* indicates that deference is sometimes appropriate when dealing with pending lawsuits stayed by a bankruptcy filing. It will often be more appropriate to permit proceedings to continue in their place of origin, when no great prejudice to the bankruptcy estate would result, in order to leave the parties to their chosen forum and to relieve the bankruptcy court from many duties that may be handled elsewhere. The United States Court of Appeals for the Ninth Circuit has indicated that bankruptcy courts should consider judicial economy when deciding stay issues.

Bankruptcy Law > Case Administration > Commencement of Case > Abstention

Bankruptcy Law > ... > Automatic Stay > Relief From Stay > Relief for Cause

HN35[] Commencement of Case, Abstention

The U.S. Court of Appeals for the Ninth Circuit has stated that where a bankruptcy court may abstain from deciding issues in favor of an imminent state court trial involving the same issues, cause may exist for lifting the stay as to the state court trial. In Christensen v. Tucson Estates, Inc., the Ninth Circuit adopted a multifactor test. These factors are: (1) the effect or lack thereof on the efficient administration of the estate if a court recommends abstention; (2) the extent to which state law issues predominate over bankruptcy issues; (3) the difficulty or unsettled nature of the applicable law; (4) the presence of a related proceeding commenced in state court or another nonbankruptcy court; (5) the jurisdictional basis, if any, other than *28 U.S.C.S. § 1334*; (6) the degree of relatedness or remoteness of the proceeding to the main bankruptcy case; (7) the substance rather than form of an asserted core proceeding; (8) the feasibility of severing state law claims from core bankruptcy matters to allow judgments to be entered in state court with enforcement left to the bankruptcy court; (9) the burden of the bankruptcy court's docket; (10) the likelihood that the commencement of the proceeding in the bankruptcy court involves forum shopping by one of the parties; (11) the existence of a right to a jury trial; and (12) the presence in the proceeding of nondebtor parties.

Governments > Courts > Judicial Precedent

HN36[] Courts, Judicial Precedent

The United States Bankruptcy Court for the District of Nevada prefers and applies (because, in each case, it must) Ninth Circuit precedent, especially when it is on point.

Bankruptcy Law > Discharge & Dischargeability > General Overview

HN37[] **Bankruptcy Law, Discharge & Dischargeability**

If the bankruptcy discharge is to mean anything, it should mean that a debtor need not go through a long trial out of state in a forum chosen by a creditor only to undergo a second trial on essentially the same issues in the bankruptcy court.

Bankruptcy Law > ... > Commencement of Case > Voluntary Cases > General Overview

HN38[] **Commencement of Case, Voluntary Cases**

The existence of good faith depends on an amalgam of factors and not upon a specific fact, and a bankruptcy court should examine the debtor's financial status, motives, and the local economic environment. If it is obvious that a debtor is attempting unreasonably to deter and harass creditors in their bona fide efforts to realize upon their securities, good faith does not exist. But if it is apparent that the purpose is not to delay or defeat creditors but rather to put an end to long delays, administration expenses to mortgage foreclosures, and to invoke the operation of the bankruptcy law in the spirit indicated by Congress in the legislation, namely, to attempt to effect a speedy efficient reorganization on a feasible basis, good faith cannot be denied. Good faith is lacking only when a debtor's actions are a clear abuse of the bankruptcy process.

Bankruptcy Law > ... > Commencement of Case > Voluntary Cases > General Overview

HN39[] **Commencement of Case, Voluntary Cases**

The test of good faith is whether a debtor is attempting to unreasonably deter and harass creditors or attempting to effect a speedy, efficient reorganization on a feasible basis.

Counsel: [1]** For JOHN L. SMITH, Debtor: RICHARD MCKNIGHT, LAS VEGAS, NV.

For LENARD E. SCHWARTZER, Trustee: JASON A. IMES, SCHWARTZER & MCPHERSON LAW FIRM, LAS VEGAS, NV.

Judges: Hon. Bruce A. Markell, United States Bankruptcy Judge.

Opinion by: Bruce A. Markell

Opinion

[EDITOR'S NOTE: The following court-provided text does not appear at this cite in 389 B.R. 902]

[*none]

ORDER ON MOTION FOR RELIEF FROM THE AUTOMATIC STAY

On March 21, 2008, Sheldon Adelson, a creditor in this case, filed a motion for relief from the automatic stay, in order to pursue a libel suit against the debtor in California state court. (Docket No. 58). On April 22, 2008, the court heard arguments on that motion.

For the reasons stated in the opinion filed concurrently herewith, which opinion shall constitute the court's findings of facts and conclusions of law with respect to this matter in accordance with FED. R. BANKR. P. 7052 (made applicable to this contested matter by FED. R. BANKR. P. 9014), the plaintiff's motion is DENIED in its entirety.

IT IS SO ORDERED

Entered on Docket

June 24, 2008

/s/ Hon. Bruce A. Markell

Hon. Bruce A. Markell

United States Bankruptcy Judge

[*905] OPINION ON MOTIONS TO STAY PROCEEDING AND FOR RELIEF FROM STAY

I. Facts and Introduction

Plaintiff Sheldon Adelson is a philanthropic businessman with **[**2]** casino interests across the globe. Defendant John L. Smith is a newspaper columnist in Las Vegas. Smith wrote a book about Las Vegas that Adelson believes libeled him. Adelson brought suit in California state court seeking damages for that alleged libel. Shortly before the California case was to go to trial before a jury, on October 10, 2007, Smith filed a chapter 7 case in Nevada, partly in response to Adelson's libel lawsuit, but also partly because of significant medical expenses incurred by a family member.

Within five days of the January 14, 2008 deadline to do so, Adelson filed an adversary **[*906]** proceeding in this court. That proceeding requested this court to determine and to liquidate Smith's liability to Adelson because of Smith's alleged libel, and find that any such debt was nondischargeable. Adelson's complaint did not request a jury trial on any portion of his claims. Almost six weeks later, on February 8, 2008, Adelson filed a proof of claim with respect to the damages alleged in his adversary proceeding. On March 25, 2008, the parties attended an initial status conference on the dischargeability adversary proceeding, at which Adelson participated and during which the court **[**3]** scheduled a five-day libel and nondischargeability trial for December 2008.

On March 21, 2008, shortly before the status conference and almost three months after the adversary proceeding was filed, Adelson moved to stay the adversary proceeding, and he concurrently moved for relief from stay to allow the California state case to go to trial. In addition, Adelson alleged that he was entitled to a jury trial on his libel claims, and that because of that right, the matter would be more efficiently tried in California state court. The evidence for the speedy resolution, however, was not definitive or persuasive; a lawyer for Adelson submitted a declaration about a telephone conversation he had with the California court's clerk. That declaration essentially stated that if relief from stay were granted, the earliest the California case would go to trial was January 2009. The declaration also stated that given the age of the case "the judge may set the case to begin trial according to his own calendar and discretion." [1]

At the hearing on the motion for relief from stay and to stay the adversary proceeding, this court, on its own motion, requested post-hearing briefing on whether *Section 157(b)(5)* of title 28 requires this matter to be heard by an Article III United States District Judge. The parties submitted briefs in response to this point.

After considering the briefs and evidence, this court denies Adelson's motions and retains jurisdiction of this adversary proceeding. As to the motion to lift the stay, Adelson has not met his burden of showing cause. The same infirmity dooms his motion to stay the adversary proceeding. As to whether this court or the district court should hear all future matters, this court holds that Adelson's libel claims are "personal injury tort claims" within the meaning of *Section 157(b)(5)* of title 28, but that the provisions of that section are not jurisdictional in the sense that they deprive this court of the power to hear the matter.

Initially, then, this matter is properly before this court. Although Adelson might at some time have been able to rely on *Section 157(b)(5)* to effect a transfer to **[**5]** the district court, he has waived the benefit of that statute by the language of his complaint, his filing of a proof of claim, and his conduct in these proceedings. As a result, this case will proceed to trial in December 2008 as originally scheduled, and Adelson may not continue to prosecute the California action.

II. Jurisdiction and *28 U.S.C. § 157(b)(5)*

The context in which *Section 157(b)(5)* is found requires some explanation of bankruptcy court jurisdiction. ***HN1***[] Bankruptcy courts are legislative courts, created by Congress under Article I of the Constitution to administer the federal Bankruptcy Code, found in title 11 of the United States **[*907]** Code. After Congress revised the bankruptcy laws in 1978, the initial allocation of jurisdiction was found to have constitutional flaws. *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co., 458 U.S. 50, 102 S. Ct. 2858, 73 L. Ed. 2d 598 (1982)*. In response to this opinion, ***HN2***[] in 1984 Congress revised bankruptcy jurisdiction. Bankruptcy Amendments and Federal Judgeship Act of 1984, *Pub.L. 98-353, 98 Stat. 333*.

In this overhaul, general bankruptcy jurisdiction was conferred upon Article III district courts, *28 U.S.C. § 1334(b)*, with bankruptcy courts being made "units" of those district **[**6]** courts, *28 U.S.C. § 151*. By rule or order, each district court was then given the ability to refer all bankruptcy matters to the bankruptcy courts. *28*

[1] This court gives this statement and the declaration that it contains little weight and takes the declaration to mean that no trial could be started in California until after **[**4]** the scheduled date for the commencement of the nondischargeability action.

U.S.C. § 157(a). These referrals could be withdrawn by the district court in appropriate cases, 28 U.S.C. § 157(d), or the cases and matters thus referred might be stayed if appropriate federalism or comity concerns justified abstention, 28 U.S.C. § 1334(c).

With respect to the referred matters, Congress did not, because it could not, provide that bankruptcy courts could hear and determine -- that is, enter final judgments subject only to appeal -- all such matters. That was the basic infirmity uncovered in *Marathon*. What Congress did provide, however, was that bankruptcy courts could hear and determine certain matters, and would draft a report and recommendation for the district court on others. Section 157(b) initially handles this division of labor. Paragraph (1) gives bankruptcy courts the power to hear and determine cases under title 11, and all "core" matters that arise in or arise under title 11. Paragraph (2) provides a nonexhaustive list of core matters. **HN3**[] Paragraph (5) of that subsection deals specifically with the handling of **[**7]** personal injury tort claims within this system.

HN4[] Section 157(b) does not cover all matters within Section 1334(b)'s broad jurisdiction. In addition to bankruptcy cases, and civil proceedings arising in and under title 11, Congress also conferred upon the district courts, for referral to the bankruptcy courts, jurisdiction of matters "related to" cases under title 11. Section 157(c) governs the determination of these related matters, and of noncore matters set forth in Section 157(b)(1). It empowers the bankruptcy court to hear such matters, but on the condition that they be submitted to the district court for a final determination, unless the parties otherwise consent. *See* 28 U.S.C. § 157(c)(2).

Against this background, this opinion will establish that Adelson's claims are within the jurisdiction conferred upon the district courts, were appropriately referred to this court to hear and determine, and are appropriate to remain here for final determination. This demonstration requires an examination of the positive law governing jurisdiction, and an application of that law to the parties' actions -- or failures to act. After a short discussion of some determinative definitional issues regarding **[**8]** what constitutes a "personal injury tort claim," this opinion will resolve these issues.

A. Is Libel a "Personal Injury Tort Claim"?

The initial inquiry is definitional. A detailed discussion of bankruptcy court jurisdiction is unnecessary if a libel claim is not a "personal injury tort claim" within the meaning of 28 U.S.C. § 157(b)(5). In such a case, this court could proceed directly to Adelson's motion to stay the adversary proceeding and his motion to lift the stay. But if libel is a "personal injury tort claim," additional analysis is necessary t **[*908]** o determine what should be done next. The Ninth Circuit has not ruled on this issue, and the parties cite different lines of cases, each of which provide different tests for determining whether libel is a personal injury tort claim.

Generally speaking, **HN5**[] there are three different definitions of a personal injury tort under 28 U.S.C. § 157(b)(5). 1 COLLIER ON BANKRUPTCY P 3.06 (Alan N. Resnick & Henry J. Sommer eds., 15th ed. rev. 2008). The narrowest construction of personal injury tort requires the aggrieved party to plead an actual physical injury to his or her person. Massey Energy Co. v. West Virginia Consumers for Justice, 351 B.R. 348, 351 (E.D. Va. 2006) **[**9]** (citing In re Vinci, 108 B.R. 439 (Bankr. S.D.N.Y. 1989); In re Interco, 135 B.R. 359 (Bankr. E.D. Mo. 1991)). By contrast, the most expansive reading includes civil rights claims under federal antidiscrimination laws as personal injury tort claims. *See* In re Gary Brew Enterprises Ltd., 198 B.R. 616, 618-19 (Bankr. S.D. Cal 1996) (holding that a claim for relief under 42 U.S.C. § 1983 is a personal injury tort claim); In re Nifong, 2008 Bankr. LEXIS 1608, 2008 WL 2203149 (Bankr. M.D.N.C., May 27, 2008) (same).

These two views were synthesized into a third view in In re Ice Cream Liquidation, Inc., 281 B.R. 154, 160-64 (Bankr. D.Conn. 2002). That court balanced the definitions provided in *Massey Energy* and *In re Gary Brew Enterprises* to reach a middle ground in defining personal injury torts. That court rejected limiting the definition of personal injury torts to bodily injuries, because to do so would be to construe the statute more narrowly than it was written. Ice Cream Liquidation, 281 B.R. at 161.

The court similarly disagreed with the "'broader' view" because it was premised on how nonbankruptcy law categorized a tort without necessarily examining the characteristics of that tort, increasing the probability **[**10]** that business or financial torts could be classified as personal injury torts. *See id.* In making these determinations, the Ice Cream Liquidation court determined that, based on the legislative history, Congress did not intend 28 U.S.C. § 157(b)(5) to include business or financial torts. *Id.*

As a result, ***HN6***[] the middle ground struck in *Ice Cream Liquidation* includes traditional, nonphysical torts, such as defamation and libel, but does not include civil rights or sexual harassment claims. *Id.* This middle ground, therefore, encompasses torts involving bodily harm and reputational harm, without including torts that are personal injury torts by statutory designation only. This middle ground is the most appealing because it is closely aligned with what are traditionally thought of as the "common law torts;" and while it includes emotional and reputational harms, it does not go so far as to allow nonbankruptcy law to define certain torts as personal injury torts. Accordingly, without deciding whether statutory tort claims are covered, this court is convinced that the Ninth Circuit would adopt nothing less than the middle ground, and it would therefore hold that the libel claims at issue here **[**11]** are personal injury tort claims within the meaning of *28 U.S.C. § 157(b)(5)*.

B. Effect of Determining That Libel Claims Are "Personal Injury Tort Claims" on This Court's Jurisdiction

The determination that libel is a personal injury tort claim places the analysis squarely within *Section 157(b)*. Under that structure, as outlined above, this court must first determine whether there is subject matter jurisdiction under *28 U.S.C. § 1334(b)*. As the Ninth Circuit has noted, ***HN7***[] "[W]e first ask whether federal jurisdiction would exist in the district court . . . **[*909]** in order to determine whether the bankruptcy court could have jurisdiction derivatively." *Dunmore v. United States, 358 F.3d 1107, 1113 (9th Cir. 2004)* (citing *Fietz v. Great W. Say. (In re Fietz), 852 F.2d 455, 457 (9th Cir. 1988))*.

In this regard, ***HN8***[] Congress granted the district court "original but not exclusive jurisdiction" over civil proceedings "arising under title 11 or arising in or related to a case under title 11." *28 U.S.C. § 1334(b)*. Here, there is jurisdiction to hear Adelson's two claims for relief: his claim for a declaration of nondischargeability under *11 U.S.C. § 523(a)(6)* is a claim that "arises under" title 11, and, among **[**12]** other connections it has to this case, his request to liquidate and assess damages is "related to" that nondischargeability claim. *See Sasson v. Sokoloff (In re Sasson), 424 F.3d 864, 868 (9th Cir. 2005)* ("'[R]elated to' jurisdiction is very broad, 'including nearly every matter directly or indirectly related to the bankruptcy.'") (quoting *Mann v. Alexander Dawson (In re Mann), 907 F.2d 923, 926 n.4 (9th Cir. 1990))*. As a result, *28 U.S.C. § 1334(b)* supplies jurisdiction in the district court to hear all of Adelson's causes of action.

But Congress did not intend district courts to hear all civil cases arising under or related to a bankruptcy case. It provided for a way to route all such matters to the bankruptcy court. By local rule or order, *28 U.S.C. § 157(a)* permits the transfer of all such matters to the bankruptcy courts that Congress created for that purpose. This district, consistent with the practice in every other district in the United States, has provided for such an automatic transfer. *See* D. NEV. R. 1001(b)(1) ("All cases and proceedings within the bankruptcy jurisdiction of the courts are referred to the bankruptcy judges."). [2]

HN9[] This transfer from district court to bankruptcy court does not result in the immediate and irrevocable ability of the bankruptcy court to enter a final order in all such matters. Under the statutory scheme that Congress adopted, the bankruptcy court must first determine whether a civil proceeding is core or noncore. *28 U.S.C. § 157(b)(3)*. This determination then controls as to whether the bankruptcy judge has the power to enter a binding final judgment regardless of the parties' consent; or, as the statute states it, whether the bankruptcy court has the power to "hear and determine" the matter. *28 U.S.C. § 157(c)*. As the Ninth Circuit has stated, "In 'core' proceedings, the bankruptcy court may hear, determine, and enter final orders and judgments." *Dunmore, 358 F.3d at 1114*.

But ***HN10***[] *Section 157* does not give or take away jurisdiction to hear noncore matters; **[**14]** that is, it does not affect the bankruptcy court's power to hear a noncore proceeding. As stated by the Ninth Circuit:

> In contrast, in "non-core" proceedings, the bankruptcy court is limited to hearing the matter and submitting proposed findings of fact and conclusions of law to the district court. The district court reviews de novo any finding or conclusion objected to and enters a final order and judgment. *See 28 U.S.C. § 157(c)(1)*. If the parties consent, the district court may expand the bankruptcy court's power to adjudicate non-core **[*910]** proceedings

[2] Although *FED. R. BANKR. P. 9029(a)(1)* authorizes **[**13]** separate rules for bankruptcy courts apart from the rules applicable in district courts, a majority of Nevada's district judges have not implemented this provision. As a result, the administrative provisions and the special section on bankruptcy matters of the local district court rules provide the applicable rules for this matter.

> to include the power to issue final orders and judgments.

Dunmore, 358 F.3d at 1114.

The purpose of this division is that it "segregates those proceedings that an Article I legislative court may hear and decide by a final order from those that an Article III court must subject to nondeferential review as nonfinal orders." *Id.* The analysis thus proceeds by first asking whether there is subject matter jurisdiction, an inquiry under 28 U.S.C. § 1334. Once such jurisdiction is established, the inquiry next focuses on which federal court should hear the matter: the district court directly, or the bankruptcy court by referral.

Against this background, **[**15]** this case presents the issue of how to integrate Section 157(b)(5) into this jurisdictional scheme, as Adelson's libel claim is, as determined above, a "personal injury tort claim." As Section 157(b)(5) is in Section 157(b), the distinctions drawn above between jurisdiction and procedure should inform this inquiry. As framed by Adelson, this resolution is critical: if Section 157(b)(5) is jurisdictional, its precepts may not be waived, and this court should immediately dismiss that part of the case for which jurisdiction is lacking. *See* Steel Co. v. Citizens for Better Environment, 523 U.S. 83, 94, 118 S. Ct. 1003, 140 L. Ed. 2d 210 (1998) (stating **HN11**[] "without proper jurisdiction, a court cannot proceed at all, but can only note the jurisdictional defect and dismiss the suit"). But if the provisions of Section 157(b)(5) are procedural, its requirements can be waived, either expressly or by conduct, and this court will have to examine Adelson's actions to determine whether Adelson has waived the requirements by consent or by conduct.

As with all statutory inquiry, the analysis starts with the text of the section. Section 157(b)(5) reads:

> **HN12**[] The district court shall order that personal injury tort and wrongful death claims shall **[**16]** be tried in the district court in which the bankruptcy case is pending, or in the district court in the district in which the claim arose, as determined by the district court in which the bankruptcy case arose.

28 U.S.C. § 157(b)(5).

Adelson argues that Section 157(b)(5) creates a jurisdictional bar that prevents the bankruptcy court from hearing any personal injury claim. In support of this proposition, Adelson cites In re Goidel, 150 B.R. 885, 888-89 (Bankr. S.D.N.Y. 1993) (referring to "the general jurisdictional proscription in 28 U.S.C. § 157(b)(5) that personal injury tort . . . claims shall not be tried in the bankruptcy court"). *See also* In re Grabill, 967 F.2d 1152, 1153 (7th Cir. 1992) (stating "Section 157(b)(5) requires that such actions [personal injury claims] be tried in the district court"); Rizzo v. Passialis (In re Passialis), 292 B.R. 346, 352 (Bankr. N.D. Ill. 2003) (stating that "[t]he [bankruptcy] Court lacks subject matter jurisdiction, however, to adjudicate and liquidate the slander claim", but still adjudicating whether the claim was nondischargeable under *§ 523(a)(6)*). Although the statements in Goidel and these other cases are clear, they are unsupported by **[**17]** any logical analysis.

Had that analysis been undertaken, however, it would have shown the lacuna in the court's logic. **HN13**[] Section 157(b)(5), like any other federal statute, is interpreted according to its plain meaning. As the Supreme Court has stated, "It is well established that 'when the statute's language is plain, the sole function of the courts -- at least where the disposition required by the text is not absurd -- is to enforce it according to its terms.'" Lamie v. United States Tr., 540 U.S. 526, 534, 124 S. Ct. 1023, 157 **[*911]** L. Ed. 2d 1024 (2004) (quoting Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A., 530 U.S. 1, 6, 120 S. Ct. 1942, 147 L. Ed. 2d 1 (2000) (in turn quoting United States v. Ron Pair Enters., Inc., 489 U.S. 235, 241, 109 S. Ct. 1026, 103 L. Ed. 2d 290 (1989)). But this plain meaning must take into account the context of the statute we are called upon to interpret. "Our goal in interpreting a statute is to understand the statute 'as a symmetrical and coherent regulatory scheme' and to 'fit, if possible, all parts into a . . . harmonious whole.'" Am. Bankers Ass'n v. Gould, 412 F.3d 1081, 1086 (9th Cir. 2005) (quoting Food & Drug Admin. v. Brown & Williamson Tobacco Corp., 529 U.S. 120, 133, 120 S. Ct. 1291, 146 L. Ed. 2d 121 (2000)). *See also* Davis v. Mich. Dep't of Treasury, 489 U.S. 803, 809, 109 S. Ct. 1500, 103 L. Ed. 2d 891 (1989)("[S]tatutory **[**18]** language cannot be construed in a vacuum. It is a fundamental canon of statutory construction that the words of a statute must be read in their context and with a view to their place in the overall statutory scheme.").

Against this interpretive background, it is significant that **HN14**[] Section 157(b)(5) is not worded as Congress might normally construct a restrictive jurisdictional statute. It does not say, for example, "Personal injury and wrongful death claims shall be heard exclusively by the district court, and not by the bankruptcy court" or

"Notwithstanding Section 157(a), jurisdiction of personal injury and wrongful death claims shall not be referred to the bankruptcy court." *Cf.* 28 U.S.C. § 1334(a) ("[T]he district courts shall have original and exclusive jurisdiction of all cases under title 11"); 28 U.S.C. § 1333 ("The district courts shall have original jurisdiction [of admiralty matters], exclusive of the courts of the States . . . ."); 15 U.S.C. § 78aa ("The district courts of the United States . . . shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability **[**19]** or duty created by this chapter or the rules and regulations thereunder.") (matters related to Securities Exchange Act of 1934). *See generally* 13 CHARLES ALAN WRIGHT, ARTHUR R. MILLER & EDWARD H. COOPER, FEDERAL PRACTICE AND PROCEDURE & PROCEDURE § 3527 (2d ed. 1984 & Supp. 2008). Rather, Section 157(b)(5) refers only to where a matter may be tried (presumably after all pretrial matters have been resolved, and presumably resolved by a court with jurisdiction), [3] and then provides only that the location of such trials "shall [be] order[ed]" by the district court to be in the district court. This wording is a far cry from a grant of exclusive jurisdiction to the district court of all personal injury and wrongful death claims. Rather, it is perfectly consistent with a referral to this court of such matters, with a mandatory withdrawal to the district court should the district court so **[*912]** order, and as may be consistent with the statute. In this manner, the operation of Section 157(b)(5) appears to be similar to the procedure for general withdrawal of the reference. 28 U.S.C. § 157(d).

But in this case there is no general order or local rule withdrawing such matters, and Adelson has not requested the district court to withdraw the reference. *See* FED. R. BANKR. P. 5011; D. NEV. R. 5011; Rohr v. Northwestern Corp. (In re Northwestern Corp.), No. 03-12872 CGC, 04-110 JJF, 2004 U.S. Dist. LEXIS 7702, 2004 WL 1044421 (D. Del., April 29, 2004) **[**21]** (movant established sufficient cause to withdraw the reference from bankruptcy court in light of fact that section 157(b)(5) required personal injury tort claims to be resolved in district court). [4] Without such an order, jurisdiction to hear such matters would remain in the bankruptcy court, where it was referred by operation of the general order of referral, until such time as a timely request to transfer the case was made. *See* In re UAL Corp., 310 B.R. 373, 383 (Bankr. N.D. Ill. 2004) (**HN16**[] bankruptcy court has at least noncore jurisdiction over personal injury tort claims, and it may hear and determine allowance of such claims).

Leslie Fay adopted this analysis. In re Leslie Fay Cos., 212 B.R. 747 (Bankr. S.D.N.Y. 1997). In that case, the bankruptcy court analogized 28 U.S.C. § 157(b)(5) to a noncore proceeding. Id. at 773. As with the core versus noncore distinction, the court found that the requirements of Section 157(b)(5) did not present issues of jurisdiction, but rather issues regarding **[**22]** the allocation of authority to enter final judgments between the bankruptcy court and the district court. *Id.* ("Section 157(b)(5) does not change the result, for the provision only directs the procedure once it is determined that an action is a personal injury tort"); *see also* Mintze v. American Gen. Fin. Servs., Inc. (In re Mintze), 434 F.3d 222, 228-29 (3d Cir. 2006) (finding bankruptcy court had subject matter over noncore matter for purposes of whether arbitration clause could be enforced).

The analogy drawn in Leslie Fay between noncore proceedings and the power of the bankruptcy court to hear a personal injury case is sound. **HN17**[] Section 157(b) generally, and Section 157(b)(5) in particular, do not create or destroy jurisdiction. They simply allocate the jurisdiction already conferred upon federal courts in an effort to answer the question as to whether a bankruptcy court may enter a binding judgment, or whether it must make proposed findings of fact and conclusions of law for the district court's use.

This distinction between conferring jurisdiction and

[3] On a related issue, **HN15**[] the Ninth Circuit has held that a bankruptcy court may retain pretrial jurisdiction **[**20]** of a matter for which there is a jury trial right. Sigma Micro Corp. v. Healthcentral.com (In re Healthcentral.com), 504 F.3d 775, 787 (9th Cir. 2007) (agreeing with those courts that hold that "a Seventh Amendment jury trial right does not mean the bankruptcy court must instantly give up jurisdiction and that the case must be transferred to the district court. . . . Instead, the bankruptcy court is permitted to retain jurisdiction over the action for pre-trial matters."). *See also* In re Pacific Gas & Elec. Co., 279 B.R. 561 (Bankr. N.D. Cal. 2002) (bankruptcy court may determine pretrial matters such as relief from stay and abstention motions); In re New York Medical Group, P.C., 265 B.R. 408, 412 (Bankr. S.D.N.Y. 2001) (Section 157(b)(5) does not deprive bankruptcy court of administrative jurisdiction over personal injury tort claim, and bankruptcy court may entertain motion for relief from stay to allow tort claim to proceed in state forum).

[4] Under D. NEV. R. 5011(b), the time for filing a request to withdraw the reference has passed.

allocating jurisdiction once conferred illuminates the logical conclusion that Adelson fails to reach -- that lack of jurisdiction **[**23]** over personal injury cases generally would mean a lack of jurisdiction for specific matters related to such cases, *see* Steel Co., 523 U.S. at 94, and this proposition is contrary to accepted law and practice. [5] ***HN18***[] In making distinctions between core and noncore proceedings, *Section 157(b)* expressly mentions personal injury tort claims, and it provides that they are not core matters, creating the inference that they are noncore matters over which this court has jurisdiction. **[*913]** *See, e.g.*, *28 U.S.C. § 157(b)(2)(B)* (declaring core matters relating to allowance or disallowance of claims except if they pertain to "the liquidation or estimation of contingent or unliquidated personal injury tort or wrongful death claims against the estate for purposes of distribution . . . ."); *§ 157(b)(2)(O)* (declaring core "other proceedings affecting the liquidation of assets of the estate or the adjustment of the debtor-creditor or the equity security holder relationship, except personal injury tort or wrongful death claims"). [6]

Besides this legal impediment, there is also a practical one. ***HN19***[] Holding that there is no jurisdiction over personal injury tort claims would also prevent the court from estimating personal injury claims under **[**25]** *Section 502(c)*, which is also contrary to the current state of the law. *See* *In re Dow Corning Corp., 211 B.R. 545, 562-64 (Bankr. E.D. Mich. 1997)* (denying motion to estimate claims for noncompliance with *Section 502(c)* but not on jurisdictional grounds); *G-I Holdings, Inc. v. Bennett (In re G-I Holdings, Inc.), 295 B.R. 211, 219-19 (Bankr. D.N.J. 2003)* (withdrawing the reference to the bankruptcy court would be improper because the committee planned to have that court estimate the value of personal injury claims, which is a core proceeding).

In short, a conclusion that *28 U.S.C. § 157(b)(5)* is jurisdictional would effectively destroy the bankruptcy court's ability to estimate or otherwise treat personal injury claims. This could unacceptably limit the bankruptcy system's ability to effectively resolve bankruptcy cases involving personal injury claims, calling into question the ability to decide megatort claims such as those presented in A.H. Robins or Dow Corning. *Leslie Fay* avoids this problem because it recognizes that there is no *jurisdictional* bar to a bankruptcy court's hearing an adversary proceeding grounded in a personal injury case.

To be clear, ***HN20***[] the district court will almost **[**26]** always hear personal injury cases, especially if a timely request to do so is made. That is the allocative aspect of *Section 157(b)(5)*. But since the right to have such cases heard in district court is not jurisdictional, it is also not inviolable; parties may waive the right by consent or by action. As recognized generally in the Ninth Circuit with respect to the core/noncore distinction, and as recognized specifically in *In re Leslie Fay,* a party may waive the rights attendant to holding a claim classifiable as a personal injury tort claim. This opinion now turns to whether Adelson waived that right here.

C. Adelson Waived the Right to Have the District Court Determine His Libel Claims

In assessing whether Adelson waived his right to a determination in another court, the following simple facts are undisputed:

> **[*914]** . Paragraph 4 of Adelson's complaint commencing this adversary proceeding explicitly states, "This is a core proceeding in Defendant's Bankruptcy Case pursuant to *28 U.S.C. § 157(b)(2)(I)*." [7]

[5] Even courts that hold that exclusive jurisdiction is in the district court permit nondischargeability determinations regarding the exact same claim to proceed in bankruptcy court. *See,* ***[**24]*** *e.g.*, *Rizzo v. Passialis (In re Passialis), 292 B.R. 346, 352 (Bankr. N.D. Ill. 2003)*.

[6] The jurisdiction in the bankruptcy court for pretrial estimation is supported by the following statement in the *Congressional Record*:

> The estimation of contingent or unliquidated claims in order to allow or provide for the distribution of an estate would, of course, be a core proceeding. I think it was intended, certainly by the conferees, that the estimation function, and thus the proceeding with the distribution, would not be interfered with by the change that was wrought to deal with the personal injury court [sic] actions and wrongful death actions at the instance of the junior Senator from Ohio in the conference yesterday.

130 CONG. REC. 20,229 (daily ed. June 29, 1984) (rem. of Rep. Kindness). A more exhaustive examination of the legislative history of the amendments, which demonstrate a more equivocal view, is set forth in *In re UAL Corp., 310 B.R. 373, 382-83 & n.9 (Bankr. N.D. Ill. 2004)*.

[7] The rules applicable to this adversary proceeding required

. Paragraph 1 of the Prayer for Relief in Adelson's complaint requests "[t]hat the court determine that Defendant [Smith] is indebted to Plaintiff [Adelson] in the amount of at least $ 15 million **[**27]** plus interest, attorneys' fees and costs that continue to accrue and that Plaintiff [Adelson] is entitled to judgment in that amount plus such other amounts, all as to be proven at trial."

. Paragraph 2 of the Prayer for Relief in Adelson's complaint requests "[t]hat Defendant's [Smith's] debt arose as a result of Defendant's [Smith's] willful and malicious injuries to Plaintiff [Adelson] as alleged herein and that the debt be deemed nondischargeable pursuant to *11 U.S.C. § 523(a)(6)*."

. Adelson's complaint did not request or demand a jury trial, and Adelson did not file any separate demand or request for a jury trial in the adversary proceeding before filing these motions.

. On February 8, 2008, Adelson filed a proof of claim in this case. The amount of the claim was unliquidated, and Adelson referred to both the California state court action and the nondischargeability proceedings as courts in which the claim would need to be liquidated.

These facts establish that Adelson has consented to this court's jurisdiction to liquidate **[**28]** his libel claim without a jury.

Any inquiry should start with the basic proposition that ***HN21***[] the nondischargeability allegation is a core matter for which the bankruptcy court has exclusive jurisdiction. *Sasson v. Sokoloff (In re Sasson), 424 F.3d 864, 869 (9th Cir. 2005)*, *cert. denied*, *547 U.S. 1206, 126 S. Ct. 2890, 165 L. Ed. 2d 917 (2006)*. *See also 11 U.S.C. § 523(c)*; 4 COLLIER ON BANKRUPTCY, supra at P 523.03 ("[T]he bankruptcy court has exclusive jurisdiction of dischargeability determinations under *section 523(a)(2)*, *(4)* and *(6)*."). Intertwined with the nondischargeability determination, however, is the determination of whether there is a debt owed, and if so, its amount. In the Ninth Circuit, this is a determination that can be made by the bankruptcy court without a jury. *In re Sasson, 424 F.3d at 870*. *Sasson* reasons that because determination of dischargeability is "exclusively within the equitable jurisdiction of the bankruptcy court, then it must follow that the bankruptcy court may also render a money judgment in an amount certain without the assistance of a jury." *Sasson, 424 F.3d at 869-70* (quoting *Cowen v. Kennedy (In re Kennedy), 108 F.3d 1015, 1017-18 (9th Cir.1997))*. *See also Hickman v. Hana (In re Hickman), 384 B.R. 832, 838 (B.A.P. 9th Cir. 2008)*. **[**29]** [8]

Sasson thus stands directly for the proposition that this court has the power to determine Smith's liability to Adelson, if **[*915]** any, as well as the amount of any damages. There is nothing to block the extension of this reasoning to tort claims under *Section 157(b)(5)* to the extent that the district court has not, in the words of the statute, "order[ed] that personal injury and wrongful death claims shall be tried in the district court . . . ." Indeed, *Sasson* itself involved a claim under *Section 523(a)(6)*. Presumably, this state of the law explains why Adelson stated in his complaint that this matter is core, and why **[**30]** he specifically asked this court to determine whether Smith libeled him.

Given the above, Adelson's current position is puzzling. His complaint conceded that it raised core claims, and it specifically asked this court, long before the court raised *Section 157(b)(5)* as an issue, to hear and determine the existence and amount of his libel claim. He never moved for withdrawal of the reference, and he never made any request, in this court or in the district court, for an order directing that his case be heard before an Article III district judge. Such actions are indicative of, and consistent only with, consent to have this court hear such matters. And this court so finds.

But even if these actions do not constitute express consent within the meaning of *Section 157(b)(3)* and *(5)*, they certainly constitute implied consent, and implied consent is sufficient in this circuit for such matters. *Mann v. Alexander Dawson (In re Mann), 907 F.2d 923, 926 (9th Cir. 1990)* (***HN22***[] failure to raise objection that bankruptcy court was hearing a noncore matter before bankruptcy court entered judgment constitutes consent to have bankruptcy court hear matter); *Daniels-Head & Assocs. v. William M. Mercer, Inc. (In re Daniels-Head & Assocs.), 819 F.2d 914, 918-19 (9th*

Adelson to state his position regarding whether this matter was core or noncore. *FED. R. BANKR. P. 7008(a)*.

[8] This court is aware that not all circuits adopt as broad a view of a bankruptcy court's powers as does *Sasson*, and that the relief requested here might be appropriate in those jurisdictions. *See Goldschmidt v. Erickson (In re Erickson), 330 B.R. 346, 349-50 (Bankr. D. Conn. 2005)* ("In light of the fact that this court cannot liquidate the discrimination claim, it is readily apparent that the movant is entitled to relief from stay so that she may liquidate the claim."); *In re Nifong, 2008 Bankr. LEXIS 1608, 2008 WL 2203149 (Bankr. M.D.N.C., May 27, 2008)*. Nonetheless, *Sasson* is controlling here.

Cir.1987) **[**31]** (finding that, with respect to type of consent necessary, "consent implied from the parties' actions is sufficient.") (citing DuVoisin v. Foster (In re Southern Indus. Banking Corp.), 809 F.2d 329, 331 (6th Cir.1987) (**HN23**[] "the absence of a timely objection to the bankruptcy court's jurisdiction constitutes implied consent to the resolution of the controversy")); Price v. Lehtinen (In re Lehtinen), 332 B.R. 404, 410 (B.A.P. 9th Cir. 2005) (failure to object to bankruptcy court's hearing of noncore matter until appeal overruled; waiver constituted consent). [9]

Adelson's other actions cement this view. Adelson makes much of the fact that he will lose his jury trial right if this court hears and determines the issues raised in his complaint. That claim is specious. Adelson lost his right to a jury determination when he failed to request a jury within ten days after filing his initial complaint. **HN24**[] FED. R. BANKR. P. 9015 (incorporating FED. R. CIV. P. 38(b) & (d), which provide for a waiver of a jury trial right if the person requesting a jury does not serve "a written demand . . . no later than 10 days after [service of] the last pleading directed to the issue . . . ."). *See also* D. NEV. R. 9015(c) ("A demand for a jury trial must appear immediately following the title of the complaint or answer containing **[*916]** the demand, or in another document as may be permitted by FED. R. CIV. P. 38(b).").

And if there was any doubt about his loss of a right to a jury trial, he reaffirmed that loss when he filed a proof of claim in this case. Langenkamp v. Culp, 498 U.S. 42, 44-45, 111 S. Ct. 330, 112 L. Ed. 2d 343 (1990). As the Ninth Circuit has explained, **[**33]** **HN25**[] filing a proof of claim has serious consequences.

> When a creditor submits to bankruptcy court jurisdiction by filing a proof of claim in order to collect all or a portion of a debt, it assumes certain risks. For example, the creditor loses the right to a jury trial on any counter-claims filed by the debtor or the trustee. *See* Langenkamp, 498 U.S. at 44-45, 111 S.Ct. 330. In addition, the creditor loses previously-held rights to assert "legal claims" against the debtor and his estate; bankruptcy "converts the creditor's legal claim into an equitable claim to a pro rata share of the res." Katchen [v. Landy], 382 U.S. [323], at 336, 86 S. Ct. 467, 15 L. Ed. 2d 391 [(1966)].

Hong Kong and Shanghai Banking Corp., Ltd. v. Simon, 153 F.3d 991, 997 (9th Cir. 1998). [10]

To conclude, this court **[**34]** has subject matter jurisdiction over all claims for relief in Adelson's complaint. It has exclusive jurisdiction over Adelson's core claim for relief for nondischargeability, and Adelson has consented to this court's determination and liquidation of any debt owed to him by Smith. As Adelson has failed to seek or obtain an order under Section 157(b)(5) directing that the matter be tried in the district court, this court has the matter properly before it. Consideration of Adelson's remaining requests are now in order.

III. Motion to Stay Adversary Proceeding

Adelson also moved to stay the prosecution of adversary proceeding. His six-page motion cites two cases, and two cases only. One is a 1936 United States Supreme Court case, Landis v. North American Co., 299 U.S. 248, 57 S. Ct. 163, 81 L. Ed. 153 (1936), and the other is a more recent Ninth Circuit case, Lockyer v. Mirant Corp., 398 F.3d 1098 (9th Cir. 2005), that cites *Landis*. What is striking about this relative lack of authority is what Adelson did *not* do: he did not move to abstain under 28 U.S.C. § 1334(c). [11] As a result, the

---

[9] An argument against consent by action might be made by analogy to the rules regarding referrals to magistrate judges; because consent cannot be lightly inferred in the context of proceedings before magistrate judges, see Nasca v. Peoplesoft, 160 F.3d 578 (9th Cir. 1998), neither should consent be inferred in the context of proceedings before bankruptcy judges. But *In re Daniels-Head* expressly rejected this comparison, holding that there were differences between the Federal Magistrates Act and the Bankruptcy Act with regard to the issue of implied consent. 819 F.2d at 918 ("[T]he Magistrates Act specifically requires the parties' explicit **[**32]** consent to the magistrate's jurisdiction . . . . The 1984 [Bankruptcy] Act, on the other hand, does not, on its face, require explicit consent.").

[10] Adelson's proof of claim purports to reserve his right to jury trial, but he can no more stave off a waiver in that manner than he could accede to this court's jurisdiction only on the condition that he win. As Langenkamp and Simon establish, filing a proof of claim carries with it undeniable waivers and risks, and Adelson and his lawyers should have known of these when they filed Adelson's complaint and his proof of claim.

[11] Part of Adelson's motion for relief from stay cites cases involving abstention, **[**35]** and at one point asks for relief from stay for abstention. But Adelson never asks this court to

standards of the two cases cited control this motion.

Neither *Landis* nor *Lockyer* justify a stay in this case.**HN26**[] *Landis* stands for the proposition that "the power to stay proceedings is incidental to the power inherent in every court to control the disposition of the causes on its docket with economy of time and effort for itself, for counsel, and for litigants." *299 U.S. at [*917] 254*. But the Court went on to state that "[h]ow [the exercise of this power] can best be done calls for the exercise of judgment, which must weigh competing interests and maintain an even balance." *Id. at 254-55*. This judgment must be exercised only when:

> the **[**36]** suppliant for a stay . . . make[s] out a clear case of hardship or inequity in being required to go forward, if there is even a fair possibility that the stay for which he prays will work damage to some one else. Only in rare circumstances will a litigant in one cause be compelled to stand aside while a litigant in another settles the rule of law that define the rights of both.

Id. at 255.

In *Lockyer*, after finding that the automatic stay did not apply to district court litigation outside of the chapter 11 debtor's home court, the court addressed the propriety of a stay under *Landis*. Citing prior authority, the court indicated that:

> **HN27**[] Where it is proposed that a pending proceeding be stayed, the competing interests which will be affected by the granting or refusal to grant a stay must be weighed. Among those competing interests are the possible damage which may result from the granting of a stay, the hardship or inequity which a party may suffer in being required to go forward, and the orderly course of justice measured in terms of the simplifying or complicating of issues, proof, and questions of law which could be expected to result from a stay.

398 F.3d at 1110 (citing *CMAX, Inc. v. Hall, 300 F.2d 265 (9th Cir. 1962))*.

In **[**37]** reversing the district court's grant of a stay, the Ninth Circuit focused on the fact that in past cases invoking *Landis* (and in which a *Landis* stay was denied), the only remedy sought was damages; there was no injunction seeking cessation of continuing harm. *Id. at 1112*. As in this case, the remedial request is backward-looking: a request for damages for alleged past harm. In such cases, the Ninth Circuit adopted the Supreme Court's quotation above, and denied a *Landis* stay when there was a "fair possibility" that the stay would "work damage" to the party being stayed. *Id.*

Here, Smith's discharge can be determined only by this court; as indicated before, **HN28**[] a bankruptcy court has exclusive jurisdiction of nondischargeability proceedings under *Section 523(a)(6)*. *Sasson, 424 F.3d at 869-70*. Moreover, this court can hear and determine the nondischargeability issues before Adelson's California lawsuit could be tried. For these and other reasons, there is more than a "fair possibility" of damage to Smith if this case is delayed while the California lawsuit moves forward. Accordingly, the motion to stay the adversary proceeding is denied.

IV. Motion for Relief From Stay to Pursue State Court [**38] Action

Adelson seeks relief from the stay in order to pursue his California libel action. **HN29**[] The automatic stay imposed by *§ 362(a)* applies to Adelson's California action, as it is a judicial proceeding to recover a prepetition claim from the debtor. *11 U.S.C. § 362(a)(1)*. However, relief from the automatic stay may be granted "for cause." *11 U.S.C. § 362(d)(1)*. Adelson seeks relief on three independent grounds: that cause exists to defer to the California litigation; that cause exists because abstention would be appropriate; and that Smith's lack of good faith in filing his bankruptcy case provides the necessary cause. Each of these will be examined.

A. Cause to Pursue Litigation in Another Forum

HN30[] Although the term "cause" is not defined in the Code, courts in the Ninth **[*918]** Circuit have granted relief from the stay under *§ 362(d)(1)* when necessary to permit pending litigation to be concluded in another forum if the nonbankruptcy suit involves multiple parties or is ready for trial. *See, e.g.*, *Christensen v. Tucson*

---

abstain under *28 U.S.C. § 1334(c)*. All he has done is ask for relief from stay and for a stay of the adversary proceedings. This court has take Adelson's papers at face value, but it notes that even had Adelson properly sought abstention, it would not have been granted given Adelson's delay in bringing the issue to this court, and the later trial date in California state court, both of which contribute to the fact that the California state court proceeding cannot be timely adjudicated as required by *Section 1334(c)(1)*.

Estates, Inc. (In re Tucson Estates, Inc.), 912 F.2d 1162, 1166 (9th Cir. 1990) (stating that "[w]here a bankruptcy court may abstain from deciding issues in favor of an imminent state **[**39]** court trial involving the same issues, cause may exist for lifting the stay as to the state court trial"); Packerland Packing Co. v. Griffith Brokerage Co. (In re Kemble), 776 F.2d 802, 807 (9th Cir. 1985) (affirming an order lifting the stay to permit a creditor to pursue a conversion and fraudulent conveyance action pending in the federal district court following a remand of the case by the appellate court for a retrial on the damages issue). [12]

HN31[] The burden of proof on a motion to modify the automatic stay is a shifting one. Sonnax Indus., Inc. v. Tri Component Prods. Corp. (In re Sonnax Indus., Inc.), 907 F.2d 1280, 1285 (2d Cir. 1990). To obtain relief from the automatic stay, the party seeking relief must first establish a prima **[**40]** facie case that "cause" exists for relief under § 362(d)(1). Mazzeo v. Lenhart (In re Mazzeo), 167 F.3d 139, 142 (2d Cir. 1999); Duvar Apt., Inc. v. Fed. Deposit Ins. Corp. (In re Duvar Apt., Inc.), 205 B.R. 196, 200 (9th Cir. BAP 1996). Once a prima facie case has been established, the burden shifts to the debtor to show that relief from the stay is unwarranted. 11 U.S.C. § 362(g)(2); Sonnax, 907 F.2d at 1285; Duvar Apt., 205 B.R. at 200. If the movant fails to meet its initial burden to demonstrate cause, relief from the automatic stay should be denied. Spencer v. Bogdanovich (In re Bogdanovich), 292 F.3d 104, 110 (2d Cir. 2002); Mazzeo, 167 F.3d at 142; Kim, 71 B.R. at 1015.

1. The *Sonnax/Curtis* Factors

HN32[] Courts have identified various factors relevant to determining whether the stay should be lifted to allow a creditor to continue pending litigation in a nonbankruptcy forum. [13] In particular, most courts analyze twelve nonexclusive factors as issues a bankruptcy court should weigh in determining whether to lift the stay to permit pending litigation to continue in another forum:

1. Whether the relief will result in a partial or complete resolution of the issues;

2. The lack of any connection **[**41]** with or interference with the bankruptcy case;

3. Whether the foreign proceeding involves the debtor as a fiduciary;

4. Whether a specialized tribunal has been established to hear the particular cause of action and whether that tribunal has the expertise to hear such cases;

[*919] 5. Whether the debtor's insurance carrier has assumed full financial responsibility for defending the litigation;

6. Whether the action essentially involves third parties, and the debtor functions only as a bailee or conduit for the goods or proceeds in question;

HN33[] 7. Whether the litigation in another forum would prejudice the interests of other creditors, the creditors' committee and other interested parties;

8. Whether the judgment claim arising from the foreign action is subject to equitable subordination under Section 510(c);

9. Whether movant's success in the foreign proceeding would result in a judicial lien avoidable by the debtor under Section 522(f);

10. The interests of judicial economy and the expeditious and economical determination of litigation for the parties;

11. Whether the foreign proceedings have progressed to the point where the parties are prepared for trial, and

12. The impact of the stay on the parties **[**42]** and the "balance of hurt."

These twelve factors originated in In re Curtis, 40 B.R. 795, 799-800 (Bankr. D. Utah 1984) and were adopted by the Second Circuit Court of Appeals in Sonnax, 907 F.2d at 1285. Other courts have also adopted them. *See, e.g.,* Bogdanovich, 292 F.3d at 110 n. 1; Mazzeo,

---

[12] Section 362(a)'s legislative history supports this conclusion:

> [I]t will often be more appropriate to permit proceedings to continue in their place of origin, when no great prejudice to the bankruptcy estate would result, in order to leave the parties to their chosen forum and to relieve the bankruptcy court from many duties that may be handled elsewhere.

H.R. REP. NO. 595, 95TH CONG., 1ST SESS. 341 (1977); S. REP. NO. 989, 95TH CONG., 2D SESS. 50 (1978).

[13] These factors are closely related to those that a bankruptcy court must consider in deciding whether to exercise permissive abstention under 28 U.S.C. § 1334(c)(1). In re Hakim, 212 B.R. 632, 639 (Bantu. N.D. Cal. 1997). *See also* Tucson Estates, 912 F.2d at 1167. Of course, in this case Adelson has not requested abstention.

167 F.3d at 142-43; Goya Foods, Inc. v. Unanue-Casal (In re Unanue-Casal), 159 B.R. 90, 96 (D.P.R. 1993), *aff'd*, *23 F.3d 395 (1st Cir. 1994)*; Walker v. Wilde (In re Walker), 103 B.R. 281, 284-85 (D. Utah 1989); Busch v. Busch (In re Busch), 294 B.R. 137, 141 n. 4 (10th Cir. BAP 2003); Truebro, Inc. v. Plumberex Specialty Prods., Inc. (In re Plumberex Specialty Prods., Inc.), 311 B.R. 551 (Bankr. C.D. Cal. 2004).

The Second Circuit first applied the *Curtis* factors in *Sonnax,* which has become the leading case at the circuit level. As noted in *Sonnax*, not all of the twelve *Curtis* **[**43]** factors are relevant in every case. *Id. at 1286*; *see* *Mazzeo, 167 F.3d at 143*. Nor is a court required to give each of the *Curtis* factors equal weight in making its determination. *Burger Boys, Inc. v. S. St. Seaport Ltd. Pa. (In re Burger Boys, Inc.), 183 B.R. 682, 688 (S.D.N.Y. 1994)*; *In re N.Y. Med. Group, P.C., 265 B.R. 408, 413 (Bankr. S.D.N.Y. 2001)*.

2. Application of the *Sonnax/Curtis* Factors

Application of the *Sonnax*/*Curtis* factors is relatively easy. Some of the factors do not apply; [14] others only tangentially. [15] **[*920]** The remaining five factors -- numbers 1, 2, 10, 11, and 12 -- in turn encompass a common-sense approach to the allocation of litigation between this court and the California forum.

Factor 1 relates to whether relief in the California forum would result in a complete adjudication. It would not. As has been stated, this court has exclusive jurisdiction over the nondischargeability claim for relief. *Sasson, 424 F.3d at 869-70*. **[**45]** At most, the California court will adjudicate the liability, if any, on the libel claim, but not the nondischargeability of it in bankruptcy. As a result, this forum is the only forum in which there can be complete resolution of all the issues.

Factor 2 relates to the connection or interference with the bankruptcy case. This issue also favors Smith, but in a minor way. Deference to the California state forum would prolong Smith's bankruptcy, but not by a significant amount. The evidence -- such as it is -- indicates that a libel trial can be held in California within several months after this court decides the nondischargeability issues.

This connection also assists with factor 10, the interests of judicial economy. Since this forum is the only court with jurisdiction over all of Adelson's claims for relief, it initially makes sense that resources would be conserved and costs saved if the matter were tried entirely here. This is especially true here given that this court can go to trial before the California court, and because it is clear that Adelson has waived his jury trial rights in this forum. [16]

Factor 11 favors Adelson; the California case was within a week of trial when Smith filed his bankruptcy case. But Adelson dallied in filing his nondischargeability complaint -- waiting several months after Smith filed his bankruptcy case to do so -- and then waited another

---

[14] Smith is not a fiduciary to Adelson or anyone else, and thus factor 3 does not apply. He also has no insurance coverage for the California action; his publisher is apparently not covering his legal defense costs. As a consequence, factor 5 does not apply. Smith clearly is not a bailee or other conduit, eliminating the relevance of factor 6. Any libel judgment would likely not be subject to subordination, and thus factor 8 is inapplicable. Finally, no judgment in the California action could, **[**44]** without further action such as domestication in Nevada, result in a judicial lien Smith could avoid under *Section 522(f)*, thus eliminating factor 9.

[15] The California Superior Court is able constitutionally to try libel cases before a jury, and thus might be argued to be a specialized tribunal with specialized expertise as outlined in factor 4.. But this factor anticipates courts that have special jurisdiction or expertise, such as probate courts and will contests, or, as in Colorado, water courts and water rights. *See* www.courts.state.co.us/supct/supctwaterctindex.htm. Finally, as this is a chapter 7 case, the California litigation would have some minor effect on other interested parties (such as other creditors who have filed nondischargeability cases based on alleged libel), but the interest of such litigants is far more attenuated than the interest of a creditors' committee in an operating chapter 11 case. Factor 7 is thus only minimally relevant.

[16] ***HN34***[] The legislative history of *Section 362(a)* indicates that deference is sometimes appropriate **[**46]** when dealing with pending lawsuits stayed by a bankruptcy filing:

> [I]t will often be more appropriate to permit proceedings to continue in their place of origin, when no great prejudice to the bankruptcy estate would result, in order to leave the parties to their chosen forum and to relieve the bankruptcy court from many duties that may be handled elsewhere.

H.R. REP. No. 595, 95TH CONG., 1ST SESS. 341 (1977); S. REP. No. 989, 95TH CONG., 2D SESS. 50 (1978). In addition, the Ninth Circuit has indicated that bankruptcy courts should consider judicial economy when deciding stay issues. *See* *Piombo Corp. v. Castlerock Prop. (In re Castlerock Prop.), 781 F.2d 159, 163 (9th Cir. 1986)*.

three months before even seeking relief to proceed in California. This delay belies Adelson's stated desire for swift resolution. In addition, due in large part to this delay, the slim and likely unreliable evidence Adelson proffered indicates **[**47]** that early 2009 is the first likely time that the California trial could be reset. *See* note 1, *supra*, and accompanying text. Against this background, the fact that trial was imminent in California when Smith filed his case recedes significantly in relevance. Adelson's sluggish and dawdling response to Smith's bankruptcy filing is now the main cause for a late trial in California; Smith's bankruptcy filing has receded in significance as the reason why Adelson cannot have a quick trial.

Finally, Factor 12 directs the court to examine the impact of the stay on the **[*921]** parties and the "balance of hurt." This factor favors Smith. He is a chapter 7 debtor with significant family medical expenses and a business need to stay in the city in which he works. Adelson is a global casino magnate who wishes a quick resolution of this matter. Both parties would thus seem to benefit from an adjudication by this court; Smith for the lack of expenses and inconvenience that a California trial would cause, and Adelson for the quicker resolution that this court can offer.

On balance, with most factors favoring Smith, this court finds that the *Sonnax*/*Curtis* factors do not indicate that Adelson has established **[**48]** sufficient cause for relief from stay.

B. Cause for Stay Relief and Grounds for Abstention Under 28 U.S.C. § 1334(c)

Although Adelson has not moved for this court to abstain in favor of the California litigation, its motion to lift the automatic stay states that "[c]ause exists to grant stay relief on abstention grounds." [17] ***HN35***[] The Ninth Circuit has recognized this type of cause. *Christensen v. Tucson Estates, Inc. (In re Tucson Estates, Inc.), 912 F.2d 1162, 1166 (9th Cir. 1990)* ("Where a bankruptcy court may abstain from deciding issues in favor of an imminent state court trial involving the same issues, cause may exist for lifting the stay as to the state court trial."). In *Tucson Estates*, the Ninth Circuit adopted a multifactor test. [18] These factors are:

> (1) the effect or lack thereof on the efficient administration of the estate if a Court recommends abstention, (2) the extent to which state law issues predominate over bankruptcy issues, (3) the difficulty or unsettled nature of the applicable law, (4) the presence of a related proceeding commenced in state court or other nonbankruptcy court, (5) the jurisdictional basis, if any, other than *28 U.S.C. § 1334*, (6) the degree of relatedness **[**49]** or remoteness of the proceeding to the main bankruptcy case, (7) the substance rather than form of an asserted "core" proceeding, (8) the feasibility of severing state law claims from core bankruptcy matters to allow judgments to be entered in state court with enforcement left to the bankruptcy court, (9) the burden of [the bankruptcy court's] docket, (10) the likelihood that the commencement of the proceeding in bankruptcy court involves forum shopping by one of the parties, (11) the existence of a right to a jury trial, and (12) the presence in the proceeding of nondebtor parties.

Tucson Estates, 912 F.2d at 1167 (citing *In re Republic Reader's Serv., Inc., 81 B.R. 422, 429 (Bankr. S.D. Tex. 1987)*.

On balance, these factors weigh in favor of Smith. Initially, with respect to the first factor, allowing the California action **[*922]** to proceed will delay Smith's discharge and the administration of his case. The simple fact remains that this court can get to trial quicker than the California court.

The second factor is relatively neutral. Although California law issues will determine whether Smith libeled Adelson, the interpretation of whether such libel,

[17] Normally, a party would simply seek an order requiring this court to abstain from hearing the liquidation portion of the nondischargeability proceeding in favor of a determination in the California action. *See* *28 U.S.C. § 1334(c)(2)*; *FED. R. BANKR. P. 5011(b)* & *(c)*.

[18] After citing *Tucson Estates*, Adelson strangely moves to a Sixth Circuit case, *In re Dow Corning Corp., 113 F.3d 565 (6th Cir. 1997)* as stating the standard for relief from stay when abstention issues exist. ***HN36***[] This court prefers **[**50]** and applies (because, in each case it must) Ninth Circuit precedent, especially when it is on point, as *Tucson Estates* is here. And in any event, abstention under both *§ 1334(c)(2)* and *Dow Corning* requires a "timely" adjudication in another forum. The evidence here is that this court will be able to adjudicate the nondischargeability proceeding before trial can be rescheduled in California state court. This court thus finds that there can be no timely adjudication in the California state court.

if found, is "willful and malicious" is exclusively a matter of federal law, and thus properly before this court. [Sasson, 424 F.3d at 869-70].

The third factor also favors Smith; identification of the elements of the California law of libel is particularly **[**51]** difficult to state, and the law is unsettled. *See, e.g.*, [CAL. CIVIL CODE § 45]; [Khawar v. Globe Int'l, Inc., 19 Cal. 4th 254, 79 Cal. Rptr. 2d 178, 965 P.2d 696 (1998)]; [Smith v. Maldonado, 72 Cal. App. 4th 637, 645, 85 Cal. Rptr. 2d 397, 402 (1st Dist. Ct. App. 1999)]; 5 WITKIN, SUMMARY OF CALIFORNIA LAW, TORTS § 529(2), at p. 782 (10th ed. 2005).

Factor four favors Adelson; the California action is a related proceeding in a nonbankruptcy court. Factor five also favors Adelson; while he claims residence in Malibu, California, nothing in these proceedings has established the state in which he is a citizen (if a California citizen, diversity jurisdiction would be an alternate ground for this court to entertain the lawsuit), and thus the jurisdictional basis is primarily, if not exclusively, [28 U.S.C. § 1334(b)].

The sixth and seventh factors favor Smith. When viewed from the perspective of Smith's discharge, the nondischargeability adversary proceeding is central to this bankruptcy case, and a matter that may be determined only in this court. On the other hand, it is possible that a judgment could be rendered in Adelson's favor, after much time and expense, in a California court that would then be discharged by **[**52]** a finding in this court that Smith did not act willfully or maliciously, as those terms are understood in bankruptcy law.

The eighth factor also favors Smith, as it makes little sense to sever the libel determination from the nondischargeability determination, as indicated above. The fact that this court could give Adelson five trial days within the same year as the filing indicates that the trial of this matter is not a significant burden on this court's docket, indicating that factor nine favors Smith.

The only allegation of forum shopping -- the focus of the tenth factor -- is that Smith filed his case in bad faith, and that allegation is dealt with in Smith's favor in the next section of this opinion. Suffice it to say, however, that this court finds no bad faith in Smith's filing.

As indicated above, Adelson has waived his right to a jury trial, thus favoring Smith again with respect to the eleventh factor. Finally, the twelfth factor, the presence of nondebtor parties, favors Adelson, given that Smith's publisher is a codefendant in the California action. At oral argument, Smith's counsel represented that Smith's publisher is not covering Smith's legal defense costs and is not considered **[**53]** a likely source of funds as a codefendant on any judgment.

This analysis demonstrates that Smith's interest in a prompt resolution of his nondischargeability action in this forum is stronger than Adelson's interest in restarting the California action. The basic fact remains that ***HN37***[] if the bankruptcy discharge is to mean anything, it should mean that a debtor need not go through a long trial out of state in a forum chosen by Adelson only to undergo a second trial on essentially the same issues here. Adelson has not demonstrated cause on abstention-related grounds.

[*923] *C. Cause and Smith's Alleged "Bad Faith" Filing*

Adelson points to the closeness in time between the scheduled start of the California trial and Smith's filing of his bankruptcy case. He contends that such a short period -- five days -- constitutes bad faith, and that such bad faith provides "cause" under [Section 362(d)] to grant relief from stay.

Adelson's argument is unsound. Adelson's initial authorities all relate to bad faith inherent in filing a chapter 11 case for a newly formed entity to which real property had beem recently transferred in an effort to thwart foreclosure of those properties, [Meadowbrook Investors' Group v. Thirtieth Place, Inc. (In re Thirtieth Place, Inc.), 30 B.R. 503 (9th Cir. B.A.P. 1983)]; **[**54]** [In re Yukon Enters., Inc., 39 B.R. 919 (Bankr. C.D. Cal. 1984)]; [Duggan v. Highland First Ave. Corp., 25 B.R. 955 (Bankr. C.D. Cal. 1982)], or cases involving dismissal of a reorganization bankruptcy filed to thwart state procedural rules and delay payment of a debt within the ability of the debtor to pay, [Marsch v. Marsch (In re Marsch), 36 F.3d 825. (9th Cir. 1994)]; [Leavitt v. Soto (In re Leavitt), 209 B.R. 935 (9th Cir. B.A.P. 1997)], *aff'd*, [171 F.3d 1219 (9th Cir. 1999)]. Of course, neither of those fact patterns is present here.

The only Ninth Circuit case cited by Adelson that is even remotely applicable is [Idaho v. Arnold (In re Arnold), 806 F.2d 937 (9th Cir. 1986)]. And that case favors Smith. In *Arnold* the debtors had defaulted on real estate purchase contracts; the nondebtor party on the contract was the State of Idaho. The state sought relief from stay on the basis of the debtors' bad faith filing, noting that the filing avoided a scheduled foreclosure, and that the proceeds of the foreclosure would have been earmarked for public purposes, namely public school endowments. In affirming a denial of stay relief, *Arnold* states:

> **HN38**[] The existence of good faith depends on an amalgam of **[**55]** factors and not upon a specific fact. Matter of Littlecreek Development Co., 779 F.2d at 1072. The bankruptcy court should examine the debtor's financial status, motives, and the local economic environment. *Id.* Said a Ninth Circuit bankruptcy panel:
>
> > If it is obvious that a debtor is attempting unreasonably to deter and harass creditors in their bona fide efforts to realize upon their securities, good faith does not exist. But if it is apparent that the purpose is not to delay or defeat creditors but rather to put an end to long delays, administration expenses . . . to mortgage foreclosures, and to invoke the operation of the [bankruptcy law] in the spirit indicated by Congress in the legislation, namely, to attempt to effect a speedy efficient reorganization, on a feasible basis . . . good faith cannot be denied.
>
> In re Thirtieth Place, Inc., 30 B.R. 503, 505 (Bankr. App. 9th Cir.1983) (quoting In re Loeb Apartments, Inc., 89 F.2d 461, 463 (7th Cir.1937)).
> Good faith is lacking only when the debtor's actions are a clear abuse of the bankruptcy process.

Id. at 939.

Eight years after *Arnold*, the Ninth Circuit reaffirmed the basic principles of that case. **HN39**[] "The test [of good faith] is whether **[**56]** a debtor is attempting to unreasonably deter and harass creditors or attempting to effect a speedy, efficient reorganization on a feasible basis." Marsch v. Marsch (In re Marsch), 36 F.3d 825, 828 (9th Cir. 1994) (per curiam); [19] Plumberex, 311 **[*924]** B.R. at 560. *See also* 3 COLLIER ON BANKRUPTCY, supra, P 362.07[7][a].

Here, there is no clear abuse of the bankruptcy process, and no real evidence of an intent to deter or harass creditors. It is beyond dispute that Smith has financial problems other than those caused by the libel action; he has a family member with significant medical expenses. [20] And Adelson knows this; he **[**57]** publicly offered to establish a $ 200,000 medical and educational fund for Smith and his family, an offer that Smith rejected because, he said, accepting the money would compromise his objectivity in his future columns involving Adelson. [21]

Yet Adelson contends in his moving papers that Smith "has no *need* for the bankruptcy process." (Emphasis in original). This assertion is based on the *ipse dixit* that "Adelson's claim is not subject to discharge." These two statements blink at key facts, facts that Adelson knows yet ignores in order to make prove his **[**58]** theory. Under Marsch and Arnold, the presence of these key facts -- Smith's independent need for bankruptcy relief and the contingent state of the nondischargeability claim -- critically cripple any effort to find bad faith. Adelson's motion for relief from stay on Smith's alleged bad faith filing is denied.

V. Conclusion

Adelson's motions will be denied, and this court will retain jurisdiction of this adversary proceeding. As to the motion to lift the stay, Adelson has not met his burden of showing cause; the same infirmity dooms his motion to stay the adversary proceeding. As to whether this court or the district court should hear all future matters, this court holds that Adelson's libel claims are "personal injury tort claims" within the meaning of Section 157(b)(5) of title 28, but that the provisions of that section are not jurisdictional in that they deprive this court of the power to hear the matter.

---

[19] *Marsch* dealt with dismissal of a chapter 11 case for a lack of good faith. There, the nonbusiness debtor had filed a chapter 11 case for the sole purpose of frustrating the entry of a state court judgment in favor of an ex-spouse, a judgment that the court believed that the debtor could ultimately pay. Even though *Marsch* dealt with dismissal for lack of good faith, many courts have held that the same standard applies to terminating the stay for a lack of good faith. *See, e.g.*, The Fairville Company, L.P. v. Ramkaran (In re Ramkaran), 315 B.R. 361, 365-66 (D. Md. 2004).

[20] Smith listed approximately $ 100,000 in medical bills on his schedules, and about $ 17,500 in common consumer debt. His unpaid legal expenses were listed at approximately $ 95,000. He listed, albeit as disputed, Adelson's libel claim at $ 15 million, the amount Adelson's stated in this adversary proceeding.

[21] Adelson's offer was disclosed in a letter Adelson sent to Smith's newspaper, the *Las Vegas Review Journal*, on October 27, 2007. The court initially excluded this evidence, but given that, at a minimum, it is an admission of a party opponent, FED. R. EVID. 801(d)(2), the court will consider it in connection with Adelson's motions.

As a result, although Adelson might at some time have been able to rely on *Section 157(b)(5)*, he has waived the benefit of that statute by the language of his complaint, his filing a proof of claim, and his conduct in these proceedings. His request to stay the adversary proceeding **[**59]** is not well taken, and he fails to establish cause for relief from stay to proceed in California state court. As a result, this case will proceed to trial in December 2008 as originally scheduled, and Adelson may not continue to prosecute the California action.

This opinion constitutes the court's findings of fact and conclusions of law under *FED. R. BANKR. P. 7052*. Separate orders conforming with *FED. R. BANKR. P. 9021* will **[*925]** be entered in the bankruptcy case and in the adversary proceeding.

Entered on Docket

June 24, 2008

/s/ Hon. Bruce A. Markell

Hon. Bruce A. Markell

United States Bankruptcy Judge

End of Document

Sigmund J. Beck Advanced Bankruptcy Roundtable
West Baden Springs Resort
West Baden Springs, Indiana
August 19-20, 2022

I'd Rather Be Fishing:
Can Rule 2004 Be Used Post-Confirmation to Investigate Litigation Claims?

Edward M. ("Ted") King
Bryan J. Sisto
Frost Brown Todd LLC
Louisville, Kentucky

Materials – *In re Defoor Ctr., LLC*, 634 B.R. 630 (Bankr. M.D. Fla. 2021)
In re Cinderella Clothing Indus., Inc., 93 B.R. 373 (Bankr. E.D. Pa. 1988)
In re Millennium Lab Holdings II, LLC, 562 B.R. 614 (Bankr. D. Del. 2016)

When the term "fishing expedition" is used in litigation, it is usually to reel a party back in from an overzealous, overbroad, or irrelevant discovery request. In bankruptcy, however, Fed. R. Bankr. P. 2004 has been interpreted many times to allow a party to do just that – go fishing for discovery. *In re Lufkin*, 255 B.R. 204, 208 (Bankr. E.D. Tenn. 2000); *In re Szadkowski*, 198 B.R. 140, 141 (Bankr. D. Md. 1996) ("A Rule 2004 examination allows a broad 'fishing expedition' into an entity's affairs for the purpose of obtaining information relevant to the administration of the bankruptcy estate.").

As powerful and broad as Rule 2004 is, however, there can be rough waters for a party that ventures too far out to sea with its Rule 2004 motion. Here, we break down a recent case that examined the limits of Rule 2004 in a post-confirmation case, and then discuss just how far offshore that parties seeking Rule 2004 discovery should be allowed to cast their line.

In re Defoor Centre, LLC

The Debtor owned an event center in Atlanta, Georgia (the "Property"), which had fallen into financial distress near the beginning of the COVID-19 pandemic. The Debtor found a party, GB Square (the "Buyer"), willing to purchase the Property, with financing to be provided by Newtek Business Lending (the "Lender"). The loan was to close on April 15, 2020, but the Lender asked for an extension of the closing date, until May 7, 2020. The day before closing, the Lender informed the Debtor and the Buyer that due to issues relating to the pandemic, it was halting all lending activity.

The Debtor's own mortgage lender sued to foreclose on the Property and was unmoved to grant any reprieve by the Debtor's plight, so the Debtor was left with no choice but to file for bankruptcy. The Debtor filed on June 1, 2022, in the U.S. Bankruptcy Court for the Middle District of Florida (the "Court"). Concurrent with the petition, the Debtor filed a first day sale motion seeking permission to sell the Property to the Buyer. The Lender ultimately never provided funding, so the sale motion was granted only after another lender was located. However, the terms of the new financing were more expensive than the original terms agreed to by the Lender.

The Debtor's plan was confirmed and paid out 100 percent of secured and unsecured claims while paying nothing to the Debtor's equity holders. Under the plan, the Buyer assigned any claims it might have against the Lender to the Debtor. Also, the plan specifically retained jurisdiction over any action the Debtor would bring against the Lender. Seeking to investigate potential claims against the Lender, the Debtor served discovery requests pursuant to Rule 2004 upon the Lender, asking for, among other things, any and all documents relating to the failed lending transaction between Buyer and Lender. The Lender objected, and the Court had to decide whether the Debtor could proceed.

Rule 2004

Rule 2004(a) authorizes any party in interest to move for an order to conduct the examination of any entity. Rule 2004(b) further provides that the scope of this examination may relate to "the acts, conduct, or property or to the liabilities and financial condition of the debtor, or to any matter which may affect the administration of the debtor's estate, or to the debtor's right to a discharge."

Rule 2004 is a "basic discovery device" permitting a "broad investigation into the financial affairs of debtors to ensure the proper administration of the estate[]." *In re Symington*, 209 B.R. 678, 684 (Bankr. D. Md. 1997). The purpose of such an examination is to aid in the discovery of assets, including potential causes of action, and if a third person can be shown to have a relationship with, or knowledge of, the debtor's affairs, the party is subject to an examination pursuant to Rule 2004 of the Federal Rules of Bankruptcy Procedure. *Snyder v. Society Bank*, 181 B.R. 40, 41 (S.D. Tex. 1994), *aff'd* 52 F.3d 1067 (5th Cir. 1995); *Lufkin*, 255 B.R. at 208. *See also*, *Symington*, 209 B.R. at 684 (noting that a Rule 2004 examination is "an investigatory tool, its nature is inquisitory rather than accusatory, although information discovered by its employment may presage litigation").

<u>The First Dispute – Whether the Court Had Jurisdiction to Order Rule 2004 Discovery</u>

The Lender objected to the Rule 2004 requests, arguing in part that the Court did not have subject matter jurisdiction to order Rule 2004 because there was not a close nexus between the Debtor's plan or the bankruptcy case and the Debtor's potential case against the Lender – particularly in light of the post-confirmation posture of the bankruptcy case.

The Court provided a detailed analysis of two cases discussing Rule 2004 in a post-confirmation setting, *In re Cinderella Clothing Indus., Inc.*, 93 B.R. 373 (Bankr. E.D. Pa. 1988), and *In re Millennium Lab Holdings II, LLC,* 562 B.R. 614 (Bankr. D. Del. 2016).

The *Cinderella* court had granted a post-confirmation Rule 2004 motion only in part, allowing a group of creditors to investigate whether a debtor could comply with the terms of the confirmed plan, but denying the motion as to an investigation into whether the debtor failed to make certain disclosures relating to an asset purchase agreement, because the creditors would not have standing to pursue a claim, regardless of what they found.

The *Cinderella* court noted that its post-confirmation authority was "limited to issues which the court… still has the power to entertain." *Cinderella*, 93 B.R. at 376. Those issues "were restricted to the administration of the case post-confirmation." *Id.* So, in the *Cinderella* case, the court determined that it had the power to enforce the terms of a confirmed chapter 11 plan, but it lacked authority to authorize Rule 2004 discovery into a dispute that it would not have the power to hear.

The *Millennium* court took a broader view of post-confirmation use of Rule 2004, holding that because Rule 2004 "arises in" bankruptcy and is not merely "related to" bankruptcy, there were no barriers to the post-confirmation use of Rule 2004, other a than lack of good cause:

> Multiple courts have held that Rule 2004 is a rule of bankruptcy procedure that does not exist independent of a bankruptcy environment. Put another way, Rule 2004 by its nature, and not the particular factual circumstance, could arise only in the context of a bankruptcy case. As such, Rule 2004 arises in title 11 of the Bankruptcy Code, and the Court has subject matter jurisdiction to adjudicate this dispute.

Millennium, 562 B.R. at 622 (internal citations and quotations omitted).

The party objecting to Rule 2004 discovery in the *Millennium* case made a plausible argument that the facts being investigated would lead to a cause of action which the *Millennium* court would not have authority to hear, but the *Millennium* court held that it did not have "prophetic powers" and would allow Rule 2004 discovery to see where the investigation would lead. The *Millennium* court, therefore, granted Rule 2004 discovery for a party seeking to investigate claims that could potentially benefit creditors of the estate. The *Millennium* court, however, denied Rule 2004 discovery to a third-party that was seeking to investigate claims that would only benefit itself, because that party was seeking to gain a strategic advantage in private litigation outside the jurisdiction of the court.

The *Defoor* Court noted that *Cinderella* and *Millennium* appeared to be odds, but proposed three principles that could reconcile their holdings:

1) Bankruptcy courts have jurisdiction over Rule 2004 motions post-confirmation because Rule 2004 discovery "arises in" a case under title 11. And "arising-in" jurisdiction—unlike "related-to" jurisdiction—is not restricted post-confirmation.

2) When considering whether good cause exists for post-confirmation Rule 2004 discovery, bankruptcy courts should take into consideration their limited related-to post-confirmation jurisdiction: if the matter being investigated under Rule 2004 lies outside the bankruptcy court's jurisdiction, then no cause exists for the Rule 2004 discovery; but the mere fact that Rule 2004 discovery may reveal claims that lie outside the court's jurisdiction does not, by itself, preclude Rule 2004 discovery.

3) Rule 2004 discovery should not be permitted when it is being used to gain an advantage in private litigation.

In finding it had jurisdiction over the Debtor's Rule 2004 Motion, the Court acknowledged that the ruling appeared inconsistent with its own ruling in a similar case from only months prior. The issue in the prior case was whether the court had subject-matter jurisdiction over a post-confirmation adversary proceeding concerning a real estate dispute. The Court recognized that like in the *Defoor* case, in the prior case "the Debtor's primary asset was real property; the property was sold before confirmation; the sales proceeds were sufficient to pay allowed claims (other than claims of equity holders); the plan was substantially consummated before the Debtor began pursuing its post-confirmation claims; and the main (if not sole) beneficiaries of the post-confirmation claims were equity holders."

For all these similarities, there were two crucial differences, according to the Court. First, in the *Defoor* case, the plan explicitly retained jurisdiction over the Debtor's claims against the Lender. Second, in the prior case, the Court could actually read the adversary complaint and the alleged claims to determine definitively whether it had post-confirmation jurisdiction over those claims. Like *Millennium,* in the *Defoor* case, the Court stated that it could not predict the future, and so it had jurisdiction over the Rule 2004 motion as long as it could potentially have jurisdiction over any resulting claims, which it could not yet determine.

The Second Dispute – Whether the Debtor Had Good Cause to Seek Rule 2004 Discovery

After its exhaustive several-page analysis agreeing with the Debtor that it had jurisdiction over the Debtor's Rule 2004 motion against the Lender, the Court denied the Rule 2004 motion. The Court found, in a much briefer analysis, that the Debtor did not have good cause to seek the discovery, because the Rule 2004 requests amounted to seeking an impermissible advantage in private litigation.

The Court noted that the Debtor had known about the potential claims against the Lender since before it filed for bankruptcy (the claims were listed on its schedules, the Debtor discussed facts which supported the claim in prior pleadings, and the Debtor included the causes of action against the Lender in its plan). The Court recognized the proposition that "Rule 2004 examinations are meant to obtain preliminary information. Parties then use them to file adversary proceedings and get more details in the discovery process." *In re Scherer*, 2019 WL 10733909, at *1 (Bankr. M.D. Fla. Feb. 7, 2019).

Finally, while acknowledging that a party can go on a "fishing expedition" under Rule 2004, the Court noted that the Federal Rules of Civil Procedures generally prohibit "fishing expeditions." When a party has enough information to put together a complaint, the Court reasoned, it was time for that party to stop fishing and instead be governed by the ordinary rules of discovery.

Discussion Questions:

1. Is there tension between the Court finding (a) that it either might or might not have jurisdiction over an adversary proceeding between the Debtor and the Lender because there were too many unknowns to make that determination, but also finding that (b) there was enough information for the Debtor to stop the "fishing expedition" and proceed to a lawsuit? Could the Court resolve this tension by telling the Debtor "either way, you need to file a lawsuit *somewhere*," or is it an appropriate use of Rule 2004 to determine whether the Court should be the venue for the lawsuit?

2. Do you think that the Court's reliance on the plan's reservation of jurisdiction as a basis for post-confirmation jurisdiction is appropriate?

3. Would the result be any different pre-confirmation, given the holding that Rule 2004 "arises in" bankruptcy and is therefore squarely within the Court's subject-matter jurisdiction? To be consistent with the *Defoor* ruling, would the Court also have to deny the same motion pre-confirmation, because the Debtor had enough information to proceed to litigation? Are there other pre-confirmation considerations that would weigh on the analysis, such as cost to the estate of pursuing litigation?

4. Based on this case, is there a window where Rule 2004 discovery could ever be authorized post-confirmation to investigate a debtor's potential claim when the chapter 11 plan is able to describe the claim sufficiently to retain jurisdiction? What is the point of the Court writing several pages explaining why it had jurisdiction over the Rule 2004 motion because the claims were described in the plan, but the claims being described in the plan meant there was not good cause for pursuing the Rule 2004 motion?

5. What are the strategic implications here if you are a debtor's attorney crafting a plan or a creditor's attorney reviewing a plan? Is it always better for the object of a Rule 2004 motion to be sued rather than to comply with Rule 2004 discovery requests? What are situations where you would advise your client to just participate with Rule 2004 rather than force the opposing party to sue first? When would you recommend the opposite?

6. The Court seems to create a bit of a chicken and egg issue regarding Rule 2004 in the context of investigating potential litigation. A party needs a good basis to use Rule 2004, but if its basis is too developed, it no longer has good cause to use Rule 2004. Does this opinion overcomplicate what should be a relatively straightforward issue? What questions do you have left about using Rule 2004 post-confirmation… or at any time?

AAR Rules). So, for example, assuming that "[t]he long-standing and universal practice within the rail industry is to return empty cars to their owner without attempting to impose any freight charge" (which is the SLC's main extrinsic evidence contention), that does not mean that AAR Car Service Rule 2 itself prohibits the imposition of tariffs or other charges. For example, such tariffs or other charges for the transportation of empty cars may be invalid or unreasonable by reason of rate setting statutes such as 49 U.S.C. §§ 10701, 10702 and 10704. Possibly, as the SLC also suggested in the Opposition and at oral argument, a tariff or other charge cannot be imposed for the movement of empty cars unless the owner has "request[ed]" return of the empty cars under 49 U.S.C. §§ 11101(a) and (b).[9] Or, maybe there is some other reason for the alleged industry course of dealing (like an informal "protocol"). The Court simply does not know. But, just because "a long-standing and universal practice within the rail industry" not to charge for the movement of empty cars exists, that does not mean AAR Car Service Rule 2 is ambiguous.

Accordingly, as a matter of Colorado contract law, the Court rejects the SLC's invitation for the Court to determine that AAR Car Service Rule 2 is ambiguous.

VII. Conclusion.

In an effort to narrow the issues for trial, the Trustee has requested partial summary judgment on a very narrow question: Does AAR Car Service Rule 2 preclude the Trustee from imposing a tariff or charge for the return of empty SLC-owned freight cars? The Trustee has met his summary judgment burden. For the reasons set forth above, the Court concurs with the Trustee that AAR Car Service Rule 2 does not preclude the Trustee from imposing a tariff or charge for the return of empty SLC-owned freight cars. Thus, the Court grants the Summary Judgment Motion and enters partial summary judgment on that discrete issue regarding AAR Car Service Rule 2.

IN RE: DEFOOR CENTRE, LLC, Debtor.

Case No. 8:20-bk-04273-MGW

United States Bankruptcy Court,
M.D. Florida,
Tampa Division.

Signed December 07, 2021

Background: Chapter 11 debtor sought post-confirmation Rule 2004 discovery from creditor. Creditor objected.

Holdings: The Bankruptcy Court, Michael G. Williamson, J., held that:

(1) Bankruptcy Court had jurisdiction to rule on request for post-confirmation Rule 2004 discovery, and

(2) debtor was not entitled to post-confirmation Rule 2004 discovery to investigate potential claims that debtor already identified in its schedules and articulated facts giving rise to.

Request for Rule 2004 discovery denied.

9. 49 U.S.C. §§ 11101 states: "(a) A rail carrier providing transportation or service subject to the jurisdiction of the Board ... shall provide the transportation or service on reasonable request .... (b) A rail carrier shall also provide to any person, on request, the carrier's rates and other service terms." In one of its many alternative arguments, the SLC suggests that the Trustee cannot impose the Tariff because it is not really a "tariff" at all and since charges can only be assessed "on request." Opp'n at 10-11.

1. Bankruptcy ⚷3047(1), 3570

When considering whether to allow postconfirmation Rule 2004 discovery, bankruptcy courts should take into consideration their limited "related to" postconfirmation jurisdiction; if matter being investigated under Rule 2004 is one that lies outside bankruptcy court's jurisdiction, then no cause exists for Rule 2004 discovery. 28 U.S.C.A. §§ 157, 1334; Fed. R. Bankr. P. 2004.

2. Bankruptcy ⚷3040.1

Rule 2004 examination is meant to provide debtor with the preliminary information needed to file a complaint. Fed. R. Bankr. P. 2004.

3. Bankruptcy ⚷3570

Bankruptcy courts have jurisdiction over Rule 2004 motions post-confirmation because Rule 2004 discovery "arises in" case under title 11. 28 U.S.C.A. §§ 157, 1334; Fed. R. Bankr. P. 2004.

4. Bankruptcy ⚷3570

"Arising-in" jurisdiction, unlike "related-to" jurisdiction, is not restricted post-confirmation. 28 U.S.C.A. §§ 157, 1334.

5. Bankruptcy ⚷3047(1), 3570

Mere fact that post-confirmation Rule 2004 discovery may reveal claims that lie outside bankruptcy court's jurisdiction does not, by itself, preclude Rule 2004 discovery. 28 U.S.C.A. §§ 157, 1334; Fed. R. Bankr. P. 2004.

6. Bankruptcy ⚷3047(1)

Post-confirmation Rule 2004 discovery should not be permitted when it is being used to gain advantage in private litigation. Fed. R. Bankr. P. 2004.

7. Bankruptcy ⚷3570

Bankruptcy Court had jurisdiction to rule on Chapter 11 debtor's request for post-confirmation Rule 2004 discovery from creditor; plan specifically referenced the potential causes of action against creditor. 28 U.S.C.A. §§ 157, 1334; Fed. R. Bankr. P. 2004.

8. Bankruptcy ⚷3040.1

For bankruptcy court to grant Rule 2004 discovery, it must make finding of "good cause." Fed. R. Bankr. P. 2004.

9. Bankruptcy ⚷3041

As party seeking discovery under Rule 2004, debtor bears burden of proving that "good cause" exists for discovery it seeks. Fed. R. Bankr. P. 2004.

10. Bankruptcy ⚷3041

Debtor can prove "good cause" for Rule 2004 discovery by showing that either discovery is needed to establish claim or that denial of discovery would cause undue hardship or injustice. Fed. R. Bankr. P. 2004.

11. Bankruptcy ⚷3047(1)

Chapter 11 debtor was not entitled to post-confirmation Rule 2004 discovery from creditor to investigate potential claims, which debtor had already identified in its schedules and articulated the facts giving rise to those potential claims in its case management summary, and debtor had included the potential causes of action in its plan; debtor had the preliminary information needed to file an adversary complaint against creditor and therefore Rule 2004 discovery appeared to be an attempt by debtor to gain a strategic advantage in private litigation, and because debtor would have ample opportunity to conduct discovery once it filed an adversary complaint, it would not suffer a hardship or be prejudiced by denial of Rule 2004 discovery. Fed. R. Bankr. P. 2004.

12. Bankruptcy ⚷3040.1

Under "pending proceeding" rule, once adversary proceeding or contested matter is commenced, discovery should be pursued under the Federal Rules of Civil Procedure, as incorporated in Bankruptcy Rules, and not Rule 2004. Fed. R. Civ. P. 1 et seq.; Fed. R. Bankr. P. 2004.

Mark F. Robens, Esq., Stichter, Riedel, Blain & Postler, P.A., Tampa, Counsel for Newtek Business Lending, LLC.

David S. Jennis, Esq., Mary A. Joyner, Esq., Brandon, Counsel for Debtor.

MEMORANDUM OPINION ON POST-CONFIRMATION RULE 2004 DISCOVERY

Michael G. Williamson, United States Bankruptcy Judge

After confirming its chapter 11 plan, the Debtor sought Rule 2004 discovery from Newtek Business Lending. The Debtor wanted to use the Rule 2004 discovery to investigate potential causes of action against Newtek that would fund a distribution to the Debtor's equity holders. The potential causes of action were listed in the Debtor's schedules; described in some detail in the Debtor's case management summary; and provided for in the Debtor's confirmed plan. Newtek objected to the Rule 2004 discovery because, in its view, the causes of action the Debtor sought to investigate were outside this Court's limited post-confirmation "related-to" jurisdiction.

[1] When considering whether to allow post-confirmation Rule 2004 discovery, bankruptcy courts should take into consideration their limited "related-to" post-confirmation jurisdiction: if the matter being investigated under Rule 2004 is one that lies outside the bankruptcy court's jurisdiction, then no cause exists for the Rule 2004 discovery. But here, the Court cannot tell whether the Debtor's potential causes of action lie outside this Court's jurisdiction because those causes of action haven't been filed yet.

[2] Even so, the Court will deny the Debtor's request for Rule 2004 discovery. A Rule 2004 examination is meant to provide the Debtor with the preliminary information needed to file a complaint. Here, the Debtor already has that information. To allow the Debtor to use Rule 2004 when it already has the preliminary information needed to file its potential causes of action would give the Debtor an undue strategic advantage in what amounts to private litigation.

I. Background.[1]

The Debtor used to own an event center in Atlanta, Georgia, known as the Defoor Center.[2] Prepetition, the Debtor contracted to sell the Defoor Center to GB Square, LLC.[3] According to the Debtor, Newtek Business Lending, an approved SBA lender, agreed to fund the purchase.[4]

As the Debtor tells the story, Newtek agreed to close the loan by April 15, 2020. Then, as the Debtor and GB Square

1. The background for this Memorandum Opinion largely comes from the Debtor's motion to compel Rule 2004 discovery (Doc. No. 120), case management summary (Doc. No. 8), and Subchapter V plan (Doc. No. 54), as well as argument by Debtor's counsel at the August 17, 2021 hearing on the Debtor's motion to compel Rule 2004 discovery. The Court assumes Newtek disputes the Debtor's allegations of wrongdoing. In setting forth the background of this dispute, the Court is not making any findings regarding Newtek's alleged wrongdoing.

2. Doc. No. 8, ¶¶ 2 & 7.

3. *Id.* at ¶ 10.

4. *Id.* at ¶ 12.

neared the closing date, Newtek asked to extend the closing to May 7, 2020.[5] But, on May 6, 2020, Newtek's president apparently advised the Debtor and GB Square that, even though the loan had been fully approved by Newtek and the SBA, Newtek was pausing all lending until further notice.[6]

In the meantime, the Debtor's mortgage lender had sued to foreclose its mortgage on the Defoor Center.[7] The Debtor had managed to (literally and figuratively) buy more time from its lender so that it could close the sale with GB Square.[8] But the lender ultimately gave the Debtor a drop-dead date of May 21, 2020—just two weeks after Newtek advised GB Square it was pausing all lending until further notice.[9] With no funding from Newtek in place to close the sale, the Debtor filed for chapter 11 bankruptcy.[10]

The same day it filed this case, the Debtor filed a motion seeking approval of the sale of the Defoor Center to GB Square.[11] In its sale motion, the Debtor indicated that GB Square had been in constant contact with Newtek and that Newtek had assured GB Square that financing for the sale would be forthcoming.[12] Although the Court approved the sale motion, Newtek did not provide the funding. Instead, to close the sale, GB Square had to obtain alternate financing,[13] which was more expensive than GB Square anticipated.

Both the Debtor and GB Square believe they have causes of action against Newtek based on Newtek's alleged failure to fund the loan. GB Square assigned whatever causes of action it may have against Newtek, if any, to the Debtor. Under the Debtor's Subchapter V plan, the proceeds from any litigation against Newtek would be used to fund the distribution to Class 4 equity claims.[14] The Debtor's plan specifically provided that the Court retained jurisdiction over any potential claims against Newtek.[15]

After the Debtor confirmed its plan, it served a Rule 2004 subpoena on Newtek.[16] Rule 2004, of course, permits a debtor-in-possession to examine non-debtors regarding (among other things) the debtor's property, financial condition, and matters affecting the administration of the debtor's estate. The Rule 2004 subpoena demanded that Newtek produce fourteen categories of documents, including all communications with the Debtor, GB Square, and the SBA; all documents relating to any transactions with GB Square; all wire transfers, canceled checks, or other documents relating to any loans to GB Square; all internal documents on how Newtek advises customers about Paycheck

5. *Id.* at ¶¶ 13 & 14.

6. *Id.* at ¶¶ 15 – 17.

7. *Id.* at ¶ 23.

8. *Id.* at ¶¶ 23 & 24.

9. *Id.* ¶¶ 16, 23 & 24.

10. *Id.* at ¶ 24.

11. Doc. No. 3.

12. *Id.* at ¶ 3.

13. Doc. No. 40-1.

14. Doc. No. 54, Art. 6. Other creditors were to be paid from the proceeds from the sale of the Defoor Center. *Id.*

15. Doc. No. 54, § 13.2.3. The plan reserves jurisdiction to determine all "Causes of Action." *Id.* "Causes of Action" is expressly defined to include any claims against Newtek. *Id.* at § 1.2.15 ("The Causes of Action include but are not limited to those against Newtek Business Lending and/or the U.S. Small Business Administration.").

16. Doc. No. 119.

Protection Program (PPP) loans; and all internal documents on how Newtek processes, approves, and funds PPP loans.[17]

When Newtek failed to produce documents responsive to the subpoena, the Debtor moved to compel production.[18] Newtek has objected. Newtek primarily argues that this Court's "related-to" jurisdiction is limited post-confirmation to matters having a "close nexus" to—i.e., matters relating to the interpretation, consummation, execution, or administration of—the Debtor's Subchapter V plan or this bankruptcy case.[19] Because, in Newtek's view, the Debtor has failed to demonstrate how the claims it seeks to investigate have a close nexus to the Debtor's plan or this bankruptcy case, Newtek says the Court should not compel Rule 2004 discovery.[20]

II. Conclusions of Law.

More than thirty years ago, in *In re Cinderella Clothing Industries, Inc.*, the court considered its authority to order a Rule 2004 examination post-confirmation.[21] There, a group of creditors compromised their administrative claims so the debtor could confirm a plan.[22] The plan provided for the sale of the debtor's assets to an entity called Since 1914, Inc., which was wholly owned by Jolene, Inc.[23] After confirmation, the creditors discovered that Jolene, Inc. allegedly transferred its interest in Since 1914, Inc. to a group of individuals headed by the debtor's president.[24] Because the creditors would not have compromised their administrative claims (or voted for confirmation) had they known the debtor's assets were being sold to a group headed by the debtor's president, they sought to examine various individuals under Rule 2004 in an effort to have the case dismissed or converted (or to have the plan modified).[25]

In deciding whether it had the power to order the Rule 2004 examinations, the court explained that the decision to allow a Rule 2004 examination after confirmation must be considered in the context of a bankruptcy court's limited post-confirmation jurisdiction.[26] Thus, while the broad language of Rule 2004 plainly permits use of Rule 2004 post-confirmation, the court reasoned that a Rule 2004 examination "must be limited to issues which the court, at that time, still has the power to entertain."[27]

Those issues, in the court's view, were "restricted to the administration of the case post-confirmation."[28] The critical issue, then, was whether the proposed Rule 2004 examinations would produce "any information germane to the administration of the case," such as a motion to dismiss or

17. *Id.*

18. Doc. No. 120.

19. Doc. No. 131, ¶ 8 (citing *Jeffrey L. Miller Invs., Inc. v. Premier Realty Advisors, LLC (In re Jeffrey L. Miller Invs., Inc.),* 624 B.R. 913 (Bankr. M.D. Fla. 2021)).

20. *Id.* at ¶¶ 8 – 13.

21. 93 B.R. 373, 376 – 78 (Bankr. E.D. Pa. 1988) ("The first issue concerns the power of a bankruptcy court to order Rule 2004 examinations of the debtor's principals and non-debtor parties post-confirmation.")

22. *Id.* at 374 – 75.

23. *Id.* at 374 – 75.

24. *Id.*

25. *Id.* at 378.

26. *Id.* at 377.

27. *Id.*

28. *Id.*

convert the case, a motion to modify the plan, or a motion seeking to revoke the confirmation order.[29] The court concluded that, by and large, they would not.

While the facts the creditors sought to discover—i.e., that the debtor failed to adequately disclose the nature of the asset purchase agreement before confirmation—could have been grounds for revoking the confirmation order, the creditors missed the 180-deadline for seeking revocation.[30] What's more, the creditors could not use the Rule 2004 discovery to seek modification of the plan because they lacked standing to do so.[31]

The creditors did, however, have the right to compel compliance with the plan (or have the case dismissed or converted) based on Since 1914, Inc.'s failure to make payments under the asset purchase agreement and, in turn, the debtor's failure to make its plan payments.[32] But the Rule 2004 examinations did not seek discovery regarding whether payments had been made under the asset purchase agreement or the plan.[33] In fact, the debtor conceded the payments had not been made. So the court declined to permit the Rule 2004 examinations as proposed, though it did allow the creditors to conduct limited Rule 2004 examinations regarding enforcement of the asset purchase agreement and the debtor's ability to comply with the confirmed plan.[34]

More recently, the court in *Millennium Lab Holdings II, LLC* took a different approach to post-confirmation Rule 2004 discovery.[35] In that case, the debtor's confirmed plan established two trusts: a "Corporate Trust" and a "Lender Trust."[36] The "Corporate Trust" held the debtor's retained causes of action, while the "Lender Trust" held causes of action contributed by certain lenders.[37] The trustee of the two trusts was responsible for investigating potential claims against third parties relating to the debtor's financial collapse.[38] As part of his investigation, the trustee sought to examine the third parties under Rule 2004.[39] The third parties objected to the Rule 2004 discovery, arguing the court lacked subject-matter jurisdiction to order Rule 2004 examinations.[40]

The court overruled the third parties' subject-matter jurisdiction objection. Although the court acknowledged that its post-confirmation "related-to" jurisdiction was limited to matters having a close nexus to the debtor's plan or bankruptcy case,[41] the court explained that Rule 2004 examinations fall within the court's "arising in title 11" jurisdiction, which is not limited post-confirmation.[42] That should have ended the court's inquiry.

The creditors, however, argued that the court should look through the Rule 2004 motion to the causes of action the trustee may bring based on the information learned during the Rule 2004 examina-

29. *Id.* at 377 – 78.

30. *Id.* at 375, 378.

31. *Id.* at 378.

32. *Id.* at 379.

33. *Id.*

34. *Id.*

35. 562 B.R. 614 (Bankr. D. Del. 2016).

36. *Id.* at 619.

37. *Id.*

38. *Id.*

39. *Id.* at 619 – 620.

40. *Id.* at 620.

41. *Id.* at 621 – 22.

42. *Id.* at 622 – 23.

tions.[43] According to the creditors, the causes of action the trustee hoped to discover lacked the requisite "close nexus" for "related to" jurisdiction. Therefore, the creditors argued, the court lacked subject-matter jurisdiction to order Rule 2004 discovery.

The court rejected that approach because there was no way to determine which causes of action the trustee may discover:

> [T]he Objectors argue that the Court, in conducting its post-confirmation jurisdictional analysis, should not look at the Rule 2004 Motion itself, but rather should look through the Motion to the underlying causes of actions that the Trustee may bring based on information gathered from his investigations. The Objectors contend that because the causes of action that will follow an investigation are non-core and do not have the requisite "close nexus" to the bankruptcy proceeding, the Court does not have jurisdiction to adjudicate this Rule 2004 Motion. *Such a contention endows the Court with prophetic powers it does not, and cannot, have. As numerous courts have recognized when presented with a Rule 2004 motion, "there is no way to determine where the investigations will lead, what claims may be revealed, and what issues are core and non-core."*[44]

Having concluded it had jurisdiction to order Rule 2004 discovery, the court went on to consider whether the trustee established "good cause" for the requested Rule 2004 examinations.

As for the Rule 2004 examinations on the Corporate Trust's behalf, the trustee argued the facts as he knew them created a strong suspicion of wrongdoing but that the documents and information he had access to were not enough to determine the scope of the trustee's viable claims, which would benefit all claimants in Class 2 of the debtor's confirmed plan.[45] The court concluded that was sufficient to establish cause for a Rule 2004 examination on the Corporate Trust's behalf.[46]

The Rule 2004 examinations on the Lender Trust's behalf, though, were a different story. Although that trust was established under the plan, it consisted of claims belonging to certain lenders—not the debtor. And only those lenders—not all Class 2 claimants—would benefit from any recovery. So the court viewed the Rule 2004 examination on the Lender Trust's behalf as an impermissible attempt to gain a strategic advantage in what amounted to private litigation:

> In this case, the Trustee is entitled to Rule 2004 examinations on behalf of the Corporate Trust, as such an examination is a "legitimate post-confirmation inquiry" to ascertain potential causes of action, which success would benefit the Debtors' creditor body. Any request for information regarding potential causes of action belonging to the Lenders' Trust, however, is denied, as Rule 2004 was not intended to provide private litigants [i.e. the Consenting Lenders] with "a strategic advantage in fishing for potential private litigation." The fact that the Lender Trust was created by the Plan does not infuse the Lender Trust with bankruptcy tools that would not otherwise be available to third party creditors pursuing claims against non-

43. *Id.* at 623.

44. *Id.* (emphasis added) (citations omitted).

45. *Id.* at 627 – 28.

46. *Id.*

debtor entities.[47]

At first glance, the approaches taken by the *Cinderella Clothing* and *Millennium Lab Holdings* courts appear at odds. In fact, the *Millennium Lab Holdings* court noted that it disagreed with the *Cinderella Clothing* court with respect to part of its analysis.[48] But this Court believes that *Cinderella Clothing* and *Millennium Lab Holdings* can be read together and that three principles can be gleaned from doing so.

[3–6] First, bankruptcy courts have jurisdiction over Rule 2004 motions post-confirmation because Rule 2004 discovery "arises in" a case under title 11. And "arising-in" jurisdiction—unlike "related-to" jurisdiction—is not restricted post-confirmation. Second, when considering whether "good cause" exists for post-confirmation Rule 2004 discovery, bankruptcy courts should take into consideration their limited "related-to" post-confirmation jurisdiction: if the matter that is being investigated under Rule 2004 is one that lies outside the bankruptcy court's jurisdiction, then no cause exists for the Rule 2004 discovery; but the mere fact that Rule 2004 discovery *may* reveal claims that lie outside the court's jurisdiction does not, by itself, preclude Rule 2004 discovery. Third, Rule 2004 discovery should not be permitted when it is being used to gain an advantage in private litigation.

[7] How do those principles apply here? For starters, this Court has jurisdiction to order Rule 2004 discovery post-confirmation. In considering whether to do so, the Court is not convinced, at this point, that the claims the Debtor seeks to investigate lie, as Newtek argues, outside this Court's limited post-confirmation related-to jurisdiction.

To be sure, the Court is sympathetic to Newtek's argument. After all, eight months ago, in *In re Jeffrey L. Miller Investments, Inc.*, this Court dismissed an adversary proceeding for lack of subject-matter jurisdiction on facts similar to those here.[49]

In *Jeffrey L. Miller Investments*, the debtor sued Premier Realty Advisors (and its principals) for allegedly fraudulently inducing the debtor to enter into a real estate sales contract. The debtor filed its adversary complaint two months after confirming its chapter 11 plan. By the time the debtor had filed its complaint, its plan had been fully consummated: the debtor's real property (its primary asset) had been sold at an auction; all the debtor's allowed claims had been paid in full from the sales proceeds; and the surplus sales proceeds had been distributed to the Debtor's principal.[50]

In ruling on a motion to dismiss, this Court noted that its post-confirmation "related-to" jurisdiction was limited to matters having a close nexus to the chapter 11 plan or the bankruptcy case—i.e., matters affecting the interpretation, consummation, execution, or administration of the confirmed plan.[51] Because the debtor's plan had already been fully consummated, and any recovery was only for the benefit of the debtor's principal, this Court concluded there was no close nexus to the chapter 11

47. *Id.* at 629.

48. *Id.* at 624.

49. *Jeffrey L. Miller Invs., Inc. v. Premier Realty Advisors, LLC (In re Jeffrey L. Miller Invs., Inc.),* 624 B.R. 913, 916 – 917 (Bankr. M.D. Fla. 2021).

50. *Id.* Indeed, all that had happened *before* the debtor in that case had confirmed its plan.

51. *Id.*

plan or the bankruptcy case; therefore, the Court concluded it lacked subject-matter jurisdiction over the debtor's claims.[52]

Here, like in *Jeffrey L. Miller Investments*, the Debtor's primary asset was real property;[53] the property was sold before confirmation;[54] the sales proceeds were sufficient to pay allowed claims (other than claims of equity holders);[55] the plan was substantially consummated before the Debtor began pursuing its post-confirmation claims;[56] and the main (if not sole) beneficiaries of the post-confirmation claims were equity holders.[57] But there are two key differences between this case and *Jeffrey L. Miller Investments*.

First, unlike in *Jeffrey L. Miller Investments*, the plan in this case specifically referenced the potential causes of action against Newtek.[58] At least one court has suggested that the requisite "close nexus" may exist if the plan specifically enumerated a cause of action over which the bankruptcy court had jurisdiction.[59] Second, and more important, the procedural posture in *Jeffrey L. Miller Investments* was different: there, unlike here, the debtor had alleged its post-confirmation claims in a complaint, which allowed the Court to determine whether there was a close nexus to the debtor's plan or bankruptcy case.

Like the *Millennium Lab Holdings* court, this Court is not endowed with prophetic powers that allow it to pre-judge subject-matter jurisdiction over yet-to-be-filed causes of action. At this stage, the Court cannot definitively say that the causes of action the Debtor is pursuing lie outside this Court's subject-matter jurisdiction. So lack of subject-matter jurisdiction is not grounds for denying Rule 2004 discovery. Even so, the Court will deny Rule 2004 discovery for another reason.

[8–10] For the Court to grant Rule 2004 discovery, it must make a finding of "good cause."[60] As the party seeking discovery under Rule 2004, the Debtor bears the burden of proving that "good cause" exists for the discovery it seeks.[61] The Debtor can prove good cause by showing that either the Rule 2004 discovery is needed to establish a claim or that denial of the Rule 2004 discovery would cause undue hardship or injustice.[62] The Debtor has failed to make that showing here.

52. *Id.* at 920.

53. Doc. No. 1.

54. Doc. No. 1; Doc. No. 43.

55. Doc. No. 73, ¶ 10.

56. Doc. No. 103.

57. Doc. No. 54, Art. 6.

58. Doc. No. 54, § 1.2.15.

59. *BWI Liquidating Corp. v. City of Rialto (In re BWI Liquidating Corp.)*, 437 B.R. 160, 165 (Bankr. D. Del. 2010) ("A 'close nexus' may be found where the plan specifically enumerates the cause of action.").

60. *In re Gaime*, 2018 WL 7199806, at *2 (Bankr. M.D. Fla. Dec. 18, 2018) ("In granting a request for Rule 2004 examination, the court must make a finding of 'good cause.' ").

61. *Id.*; *see also In re Wilcher*, 56 B.R. 428, 434 (Bankr. N.D. Ill. 1985) ("Although a Rule 2004 examination may be ordered *ex parte*, once a motion to quash a subpoena is made, the examiner bears the burden of proving that good cause exists for taking the requested discovery."); *In re Serignese*, 2019 WL 2366424, at *2 (Bankr. S.D.N.Y. June 3, 2019) ("The Movants bear the burden of showing good cause for the [Rule 2004] examination they are seeking.").

62. *In re Gaime*, 2018 WL 7199806, at *2 ("This burden can be satisfied by demonstrating either that the Rule 2004 discovery is needed to establish a claim, or that the denial of the discovery would cause undue hardship or injustice.").

[11] For starters, the Debtor is not a newcomer to the scene.[63] Rather, the Debtor was one party to the transaction that gives rise to the alleged claims against Newtek.[64] The Debtor was able to identify the potential cause of action against Newtek on its schedules;[65] it articulated the facts giving rise to its potential claims (whether direct or by way of assignment) in its Case Management Summary;[66] and it included the potential causes of action in its plan.[67]

Given that, it is apparent the Debtor has the preliminary information needed to bring whatever claims it may have against Newtek. That preliminary information is all Rule 2004 is intended to provide:

> Rule 2004 examinations are meant to obtain preliminary information. Parties then use that information to file adversary proceedings and get more details in the discovery process.[68]

Because the Debtor will have ample opportunity to conduct discovery once it files an adversary complaint, it will not suffer a hardship or be prejudiced by the denial of Rule 2004 discovery.

[12] To the contrary, allowing the Debtor to conduct Rule 2004 discovery would give the Debtor an unfair strategic advantage. Unlike Rule 26 of the Federal Rules of Civil Procedure, which generally prohibits "fishing expeditions,"[69] Rule 2004 "is often described as being in the nature of a fishing expedition."[70] Had the Debtor already filed its alleged claims against Newtek, the "pending proceeding" rule would bar the Debtor from circumventing the Federal Rules' prohibition on "fishing expeditions."[71]

63. *In Good Hope Refineries, Inc.*, 9 B.R. 421, 422 (Bankr. D. Mass. 1981) (explaining that an examination under then Bankruptcy Rule 205(a), a precursor to Rule 2004, was ''intended to give the Trustee, a newcomer into the Debtor's affairs, all available information as to the Debtor's commercial existence''); *Schlossberg v. Madeoy (In re Madeoy)*, 2015 WL 4879960, at *7 (Bankr. D. Md. July 30, 2015) (explaining that as a newcomer to the debtor's transactions, ''the investigative tools provided to the Trustee [under Rule 2004] are crucial to enable him, as for all trustees, to obtain an understanding of the assets and transactions of the estate and to determine whether factual support exists to bring claims'').

64. Doc. No. 8, ¶¶ 10 – 23. The Debtor also took assignment of whatever potential claims may belong to GB Square, the other party to the transaction.

65. Doc. No. 1, Schedule A/B.

66. Doc. No. 8, ¶¶ 10 – 23.

67. Doc. No. 54, § 1.2.15.

68. *In re Scherer*, 2019 WL 10733909, at *1 (Bankr. M.D. Fla. Feb. 7, 2019).

69. *In re The Charles F. Hamblen Post 37 Am. Legion Dep't of Fla., Inc.*, 2019 WL 10733641, at *2 (Bankr. M.D. Fla. June 26, 2019) (''Although the scope of discovery is broad, 'the discovery rules do not permit the [parties] to go on a fishing expedition.' ''); *Sec. Inv. Protection Corp. v. Bernard L. Madoff Inv. Secs. LLC*, 496 B.R. 713, 724 (Bankr. S.D.N.Y. 2013) (explaining that ''many courts have 'routinely decline[d] to authorize fishing expeditions' '').

70. *In re Vox II, LLC*, 2008 WL 596697, at *2 (Bankr. D. Md. Mar. 4, 2008) (''Discovery under Rule 2004 is far broader than discovery under the Federal Rules of Civil Procedure and is often described as being in the nature of a fishing expedition.'').

71. *In re Gaime*, 2018 WL 7199806, at *3 (Bankr. M.D. Fla. Dec. 18, 2018). ''Under this [pending proceeding] rule, 'once an adversary proceeding or contested matter is commenced, discovery should be pursued under the Federal Rules of Civil Procedure and not Rule 2004.' '' *Id.* (quoting *In re Glitnir banki hf.*, 2011 WL 3652764, at *4 (Bankr. S.D.N.Y. Aug. 19, 2011)).

Although the Debtor has not yet filed an adversary proceeding, it has the preliminary information to do so. The Debtor should not be allowed to delay the filing of an adversary proceeding so that it can avoid the "pending proceeding" rule and gain a tactical advantage by "going fishing" under Rule 2004, thereby discovering information it could not in the adversary proceeding.

This is particularly true here because the Debtor's claims are tantamount to private litigation: the Debtor is pursuing a claim it took assignment of from a non-debtor (along with whatever direct claims it may have) against a stranger to the bankruptcy proceeding for the benefit of equity. Indeed, the Rule 2004 discovery here is very much like the Rule 2004 discovery that the *Millennium Lab Holdings* court prohibited.

Recall, in *Millennium Lab Holdings*, the trustee under the debtor's confirmed plan sought to investigate claims held by the Lender Trust (which held claims belonging to some of the debtor's lenders). Even though the Lender Trust was created by the plan, the *Millennium Lab Holdings* court concluded that the discovery sought did not fall within Rule 2004 because "Rule 2004 was not intended to provide private litigants [i.e. the Consenting Lenders] with 'a strategic advantage in fishing for potential private litigation.' "[72]

III. Conclusion

More than thirty years ago, in discussing the scope of Bankruptcy Rule 205, which is the precursor to Rule 2004, the bankruptcy court in *In re Good Hope Refineries, Inc.* explained that discovery under Rule 205 (now Rule 2004) was not intended to provide a party a strategic advantage in private litigation:

> Rule 205 is intended to provide the Trustee, generally new to the case, with a very broad discovery device to aid in an efficient and expeditious ingathering of all of the pertinent facts necessary in the effective administration of the estates.
>
> *It is not intended to give the rehabilitated debtor post confirmation a strategic advantage in fishing for potential private litigation.* Our basic concept of fair play expressed in the constitutional legalese of equal protection and due process should require all litigants to use the same discovery and procedural rules when not directly engaged in those activities that call for the bankruptcy umbrella, namely, that collection of activities characterized as the administration of the estate.[73]

Because the Rule 2004 discovery here appears to be an attempt by the Debtor to gain a strategic advantage in private litigation, as opposed to an attempt to discover the preliminary information needed to file an adversary complaint against Newtek, the Court will enter a separate order denying the Debtor's request for Rule 2004 discovery.

ORDERED.

72. 562 B.R. 614, 629 (Bankr. D. Del. 2016).

73. *In Good Hope Refineries, Inc.*, 9 B.R. 421, 423 (Bankr. D. Mass. 1981) (emphasis added).

In re CINDERELLA CLOTHING INDUSTRIES, INC., Debtor.

Bankruptcy No. 83–04477F.

United States Bankruptcy Court, E.D. Pennsylvania.

Nov. 21, 1988.

Creditors filed application to take examination following confirmation of Chapter 11 plan. The Bankruptcy Court, Bruce I. Fox, J., held that: (1) Bankruptcy Court has authority, in narrow context, to use Rule 2004 examinations postconfirmation; examination, though, must be limited to issues which court at that time still has power to entertain, that is, it is restricted to administration of case postconfirmation; (2) creditors were not entitled to postconfirmation examination to extent creditors sought to inquire as to whether there was knowing failure to adequately disclose full nature of asset purchase agreement prior to confirmation; but (3) creditors were entitled to Rule 2004 examination of principals of Chapter 11 debtor and company purchasing debtor's assets pursuant to confirmed Chapter 11 plan, in which company one of debtor's principals had ownership interest, to determine whether debtor has acted consistently with terms of plan, so that creditors could obtain information relevant to decision of whether to give up on plan or whether plan could be salvaged.

Application granted in part.

1. Bankruptcy ⚷3569

Even if Chapter 11 debtor and its principal acted fraudulently, Bankruptcy Code's 180–day limitation period precluded bankruptcy court from setting aside order of confirmation. Bankr.Code, 11 U.S.C.A. § 1144.

2. Bankruptcy ⚷3570

Whether emanating from general powers of court to enforce decrees or from specific Bankruptcy Code provisions, there exists residual, albeit limited, court authority over confirmed Chapter 11 case. Bankr. Code, 11 U.S.C.A. §§ 105(a), 1112, 1127, 1142, 1144.

3. Bankruptcy ⚷3042

Bankruptcy court has authority, in narrow context, to use Rule 2004 examinations postconfirmation; examination, though, must be limited to issues which court at that time still has power to entertain, that is, it is restricted to administration of case postconfirmation. Rules Bankr.Proc.Rules 2004, 2004(b), 11 U.S.C.A.

4. Bankruptcy ⚷3042

Critical question in determining whether to permit Rule 2004 examination postconfirmation in Chapter 11 case is whether examination will produce any information germane to continued administration of case. Rules Bankr.Proc.Rules 2004, 2004(b), 11 U.S.C.A.

5. Bankruptcy ⚷3042

Creditors were not entitled to postconfirmation Rule 2004 examination to extent creditors sought to inquire as to whether there was knowing failure to adequately disclose full nature of asset purchase agreement prior to confirmation, where any modification of confirmed plan would be time barred. Bankr.Code, 11 U.S.C.A. § 1144; Rules Bankr.Proc.Rule 2004, 11 U.S.C.A.

6. Bankruptcy ⚷3569

Postconfirmation modification of Chapter 11 plan is limited to requests by either plan proponent or debtor. Bankr.Code, 11 U.S.C.A. § 1127(b).

7. Bankruptcy ⚷3047(1)

Information regarding nature of sale of stock in purchaser of Chapter 11 debtor's assets by debtor's principal and when sale was contemplated would not advance creditors' position in seeking to have case dismissed or converted for a material default under confirmed plan or inability to effectuate substantial consummation of plan, and thus, creditors were not entitled to Rule 2004 examination regarding such information. Bankr.Code, 11 U.S.C.A. § 1112(b)(7, 8); Rules Bankr.Proc.Rule 2004, 11 U.S.C.A.

8. Bankruptcy ⚷3047(1)

Creditors were entitled to Rule 2004 examination of principals of Chapter 11 debtor and company purchasing debtor's assets pursuant to confirmed Chapter 11 plan, in which company one of debtor's principals had ownership interest, to determine whether debtor has acted consistently with terms of plan, so that creditors could obtain information relevant to decision of whether to give up on plan or to attempt to salvage plan; no action had been undertaken by debtor to enforce its rights under asset purchase agreement even though company purchasing assets had not tendered payments due under agreement. Bankr.Code, 11 U.S.C.A. § 1142; Rules Bankr.Proc.Rule 2004, 11 U.S.C.A.

Peter D. Wolfson, Myerson & Kuhn, New York City and Philadelphia, Pa., for applicants, Intern. Ladies' Garment Workers' Union and ILGWU Nat. Retirement Fund.

Michael L. Temin, Wolf, Block, Schorr and Solis-Cohen, Philadelphia, Pa., for objectors, Gerald J. McConomy, and James M. Matour.

Myron A. Bloom, Adelman Lavine Gold & Levin, Philadelphia, Pa., for objector, Frank G. Santillo.

Erwin L. Pincus, Pincus, Bressler, Hahn, Reich & Weinberg, P.C., Philadelphia, Pa., for objector, Erwin L. Pincus.

Thomas Zielinski, William Howard, Cozen & O'Connor, Philadelphia, Pa., for George N. Collie, objector, and Harry J. Conn.

MEMORANDUM OPINION

BRUCE I. FOX, Bankruptcy Judge:

The International Ladies' Garment Workers Union and the ILGWU National Retirement Fund, joined orally by another creditor, have filed an application to take examinations pursuant to Bankr.Rule 2004 of the following individuals: Gerald J. McConomy, Esquire; James M. Matour, Esquire; Erwin L. Pincus, Esquire; Frank G. Santillo; Harry J. Conn; and George M. Collie. All but Mr. Conn have filed objections to the application. This narrow dispute concerns the appropriateness of conducting 2004 examinations post-confirmation.

I.

On November 16, 1983, Cinderella Clothing Industries, Inc., a manufacturer of girls' clothing, filed a voluntary petition in bankruptcy under chapter 11. By July 19, 1984 the creditors' committee had filed a plan of reorganization followed by the debtor's own plan on October 9, 1984. Amendments and objections ensued for a period of years culminating in the confirmation of the debtor's second amended plan of reorganization on April 23, 1987.

The plan has been offered in evidence in this contested matter (Exhibit M-2), *see generally, In re Aughenbaugh*, 125 F.2d 887 (3d Cir.1942), and contains the following relevant terms: funding for the plan was to be provided, in large measure, by the sale of certain assets to Since 1914, Inc., a Utah corporation, which was a wholly owned subsidiary of Jolene, Inc., for the sum of $740,000.00 payable in installments with final payment due within 30 months.[1]

The applicants allege that the Union was the collective bargaining agent for the debtor's unionized employees and the Fund was a multiemployer pension plan, *see* 29 U.S.C. §§ 1301 *et seq.*, to which the debtor was obligated to contribute. The applicants further allege that the Union and the Fund held large administrative claims that

1. The amended disclosure statement, Exhibit M-3, at Article II ¶ 2.2.1 states that Since 1914, Inc.'s obligations under the purchase agreement were secured by a purchase money security interest in favor of the debtor. The purchase agreement attached to the confirmed plan, though, does not contain this provision.

had to be voluntarily compromised pursuant to 11 U.S.C. § 1129(a)(9) if a plan of reorganization were to be confirmed. In fact, those claims were substantially compromised as part of the negotiations leading up to the confirmation of the debtor's second amended plan.

The instant dispute arises from the applicants' belief that between the time of confirmation and the effective date of the plan, Jolene, Inc. sold approximately 90% of the stock of Since 1914, Inc. to a group of individuals headed by Frank Santillo, the president of the debtor. They further allege that this sale to the debtor's principal was contemplated at the time the disclosure statement was prepared and at the time the confirmation hearing was held, but that this planned transaction was not disclosed to creditors. Had the applicants known that the buyer, Since 1914, Inc., was to be controlled by those who controlled the debtor, they assert that they would not have compromised their claims, or voted in favor of confirmation. In addition, the applicants contend (without contradiction) that Since 1914, Inc. has failed to tender all payments agreed upon in the asset purchase agreement. As a result, they request an order permitting 2004 examinations of the debtor's principals, of counsel to the debtor, and of counsel to Since 1914, Inc. Further, the applicants contend in their application, at ¶¶ 14, 15:

> The Fund and the Union believe that serious questions exist concerning the adequacy of disclosure concerning the foregoing and, moreover, whether fraud was perpetrated upon them, other creditors and this Court in connection with the confirmation and/or implementation of the Debtor's Plan.
>
> In order to assess (1) whether there was information that should have been disclosed which was not disclosed; (2) whether there was any fraud committed; (3) whether there is liability on the part of any or all of the officers and directors of the Debtor, Jolene, Inc., the Insider Group, including without limitation, Santillo, or any other person, it is necessary to flush out the underlying facts and circumstances. For this purpose, examinations pursuant to Bankruptcy Rule 2004 are required....

Although the disclosure statement made no reference to any sale of Since 1914, Inc. stock to Mr. Santillo, it did contain this disclaimer:

> *Default under 1914 Purchase Agreement.* Because 1914 is required to pay for the assets it is to purchase under the 1914 Production Agreement in installments over time, there is no absolute assurance that all payments will be timely made. 1914, although a subsidiary of Jolene, Inc., has no assets and operations other than those associated with or to be acquired under the 1914 Production Agreement and the 1914 Purchase Agreement. Consequently, 1914's ability to make the payments due under the 1914 Purchase Agreement is dependent upon the production of goods under Cinderella's trademarks and upon proceeds of 1914's licensing of same to third parties....

Exhibit M-3, VII, A, at 10. The disclosure statement noted that Mr. Santillo was to be an employee of Since 1914, Inc. but did not mention any prospective ownership interest. (Exhibit M-3, X, at 11).

II.

[1] According to the objectors (who deny that the sale of stock of Since 1914, Inc. was contemplated prior to confirmation), the initial hurdle for the applicants to overcome is the statute of limitations bar found in 11 U.S.C. § 1144:

> On request of a party in interest at any time before 180 days after the date of the entry of the order of confirmation, and after notice and a hearing, the court may revoke such order if and only if such order was procured by fraud. An order under this section revoking an order of confirmation shall—
>
> (1) contain such provisions as are necessary to protect any entity acquiring rights in good faith reliance on the order of confirmation; and
>
> (2) revoke the discharge of the debtor.

There is no dispute that the instant application was filed long past the 180 day limitations period established by section 1144, and hence must be disallowed. *See, e.g., Matter of Newport Harbor Associates*, 589 F.2d 20 (1st Cir.1978) (six-month limitation period of former 11 U.S.C. § 386, the Bankruptcy Act predecessor to current § 1144, was strictly construed). Any doubt that the requirement of fraud, raised within the applicable limitations period, represents the sole basis for revoking confirmation has been resolved by the 1984 amendment to § 1144 (P.L. No. 98–353, § 515), which added the phrase "if and only if." *Compare In re Isidor Klein, Inc.*, 22 F.2d 906 (2d Cir.1927) (fraud is the only ground upon which confirmation may be revoked) *with* 9 *Collier on Bankruptcy*, ¶ 11.01, at 644 (14th ed. 1978) (a standard akin to Fed.R.Civ.P. 60 may be applied). Thus, the applicants concede that even if their worst fears about the debtor and its principal were realized, pursuant to 11 U.S.C. § 1144 it is now too late to set aside the order of confirmation entered in April 1987. (Applicants' memorandum, at 10). That being so, the question becomes whether this court retains the discretion to order 2004 examinations and, if so, whether that discretion should be exercised.

A.

The first issue concerns the power of a bankruptcy court to order 2004 examinations of the debtor's principals and non-debtor parties post-confirmation. Since at least 1944, courts have recognized the competing interests between retaining jurisdiction after confirmation until entry of the final decree (*see* Bankr.R. 3020), and ending the "tutelage" status of reorganization, a period "which may limit and hamper [the corporation's] activities and throw doubt upon its responsibility." *North American Car Corp. v. Peerless Weighing & Vending Mach. Corp.*, 143 F.2d 938, 940 (2d Cir.1944).

Courts have balanced these two concerns in various ways, *see Matter of Coral Air, Inc.*, 40 B.R. 979 (D.V.I.1984) (jurisdiction retained); *In re Paradise Valley Country Club*, 26 B.R. 990 (Bankr.D.Colo.1983), *aff'd*, 31 B.R. 613 (D.Colo.1983) (concurrent jurisdiction with state court); *In re J.T. Gerken Trucking, Inc.*, 10 B.R. 203 (Bankr.N.D.Ohio 1981) (jurisdiction denied), and differ on the significance of a reservation of jurisdiction clause in either the order of confirmation or the plan itself. *Compare In re Tri–L Corp.*, 65 B.R. 774, 778 (Bankr.D.Utah 1986) (reservation clause in plan or order does not extend jurisdiction beyond that permitted by statute) *and In re J.T. Gerken Trucking, Inc.* (no jurisdiction retained over enforcement of an assumed executory contract) *with Matter of Hudson Feather & Down Products, Inc.*, 36 B.R. 466 (E.D.N.Y.1984) (plan's retention of jurisdiction permits resolution of adversary proceeding, the proceeds of which will not go to creditors).[2] However, it has long been recognized, without dispute, that the bankruptcy court's jurisdiction continues post-confirmation:

> to protect its [confirmation] decree, to prevent interference with the execution of the plan and to aid otherwise in its operation.

In re Dilbert's Quality Supermarkets, Inc., 368 F.2d 922, 924 (2d Cir.1966). *Accord, e.g., In re Pittsburgh Terminal Coal Corp.*, 183 F.2d 520 (3d Cir.1950), *cert. denied*, 340 U.S. 904, 71 S.Ct. 280, 95 L.Ed. 654 (1950); *In re New York, N.H. & H.R. Co.*, 169 F.2d 337 (2nd Cir.1948), *cert. denied*, 335 U.S. 867, 69 S.Ct. 138, 93 L.Ed. 412 (1948); *In re Lombard–Wall, Inc.*, 44 B.R. 928, 935 (Bankr.S.D.N.Y.1984), *aff'd*

2. The plan itself had a lengthy retention of jurisdiction provision, Article XI, which stated in part:

> The Bankruptcy Court shall retain jurisdiction over this proceeding until the Plan has been fully consummated, including, but not limited to, the following matters:
>
> . . . . .
>
> F. To adjudicate all claims or controversies arising out of any purchases, sales or contracts made or undertaken by the debtor during the pendency of these proceedings;
>
> . . . . .
>
> I. To make such orders as are necessary or appropriate to carry out the provisions of the Plan.

in relevant part, 48 B.R. 986 (S.D.N.Y. 1985).

[2] Whether emanating from the general power of courts to enforce their decrees, *see generally* 11 U.S.C. § 105(a); *In re Timbers of Inwood Forest Assocs., Ltd.,* 808 F.2d 363, 373–74 (5th Cir.1987) (*en banc*), *aff'd sub nom United Sav. Assoc. v. Timbers of Inwood Forest Assocs., Ltd.,* — U.S. —, 108 S.Ct. 626, 98 L.Ed.2d 740 (1988); *In re Chinichian,* 784 F.2d 1440, 1442–43 (9th Cir.1986), or from specific bankruptcy code sections such as 11 U.S.C. § 1112 (allowing for conversion or dismissal after confirmation), § 1127 (allowing for plan modification after confirmation), § 1142 (allowing for plan enforcement post-confirmation), and § 1144 (allowing for revocation of confirmation), there exists a residue, albeit limited, of court authority over a confirmed chapter 11 case. *See, e.g., Goodman v. Phillip R. Curtis Enterprises, Inc.,* 809 F.2d 228 (4th Cir.1987) (jurisdiction retained under § 1127); *In re Harlow Properties, Inc.,* 56 B.R. 794 (B.A.P. 9th Cir.1985) (creditors may obtain specific performance against debtor pursuant to § 1142).

B.

[3] The utilization of Bankr.Rule 2004 post-confirmation must be considered in the context of this limited court jurisdiction. The primary purpose of a 2004 examination "is to permit the trustee to quickly ascertain the extent and location of the estate's assets." *Matter of Wilcher,* 56 B.R. 428, 433 (Bankr.N.D.Ill.1985). As the Supreme Court noted in discussing former § 21(a) of the Bankruptcy Act, from which former Bank.Rule 205 and current Rule 2004 are, in part, derived: [3]

> The object of the examination of the bankrupts and other witnesses to show the condition of the estate is to enable the court to discover its extent and whereabouts, and to come into possession of it, that the rights of creditors may be preserved.

Cameron v. United States, 231 U.S. 710, 717, 34 S.Ct. 244, 246, 58 L.Ed. 448 (1914). *Accord In re GHR Energy Corp.,* 35 B.R. 534 (Bankr.D.Mass.1983).

The current permitted scope of the 2004 examination, set forth in Rule 2004(b),[4] supports both this view as well as the notion that a 2004 examination is generally a pre-confirmation discovery tool. Nonetheless, the broad language of Rule 2004(b), referring to "any matter which may affect the administration of the debtor's estate," the "source of any money or property acquired or to be acquired by the debtor for purposes of consummating a plan," and "any other matter relevant to the case" allows, in a narrow context, the use of Rule 2004 post-confirmation. The examination, though, must be limited to issues which the court, at that time, still has the power to entertain. That is, it is restricted to the administration of the case post-confirmation. The binding effect of confirmation upon debtors and creditors alike under 11 U.S.C. § 1141 (*see, e.g., In re Ruti–Sweetwater, Inc.,* 836 F.2d 1263 (10th Cir.1988); *Republic Supply Co. v. Shoaf,* 815 F.2d 1046 (5th Cir.1987); *Matter of Gregory,* 705 F.2d 1118 (9th Cir.1983)) makes the primary purpose of a 2004 examination inapplicable. Yet, the use of such a discovery tool to obtain information relevant to the continued administration of the case post-confirmation, such as a possible motion under §§ 1112, 1127, 1142 or 1144,

3. *See, e.g., In re Silverman,* 36 B.R. 254, 257 n. 5 (Bankr.S.D.N.Y.1984); 12 *Collier on Bankruptcy* ¶ 205.02, at 2–79 (14th ed. 1978).

4. Rule 2004(b) states:
(b) Scope of Examination. The examination of an entity under this rule or of the debtor under § 343 of the Code may relate only to the acts, conduct, or property or to the liabilities and financial condition of the debtor, or to any matter which may affect the administration of the debtor's estate, or to the debtor's right to a discharge. In an individual's debt adjustment case under chapter 13 or a reorganization case under chapter 11 of the Code, other than for the reorganization of a railroad, the examination may also relate to the operation of any business and the desirability of its continuance, the source of any money or property acquired or to be acquired by the debtor for purposes of consummating a plan and the consideration given or offered therefor, and any other matter relevant to the case or to the formulation of a plan.

is supportable, if so limited. *See In re Gronski,* 86 B.R. 428 (Bankr.E.D.Pa.1988) (post-confirmation 2004 examination of the debtor had been ordered to determine whether the debtor had achieved a significant post-confirmation income increase justifying plan modification under 11 U.S.C. § 1329(a)).

The decision of *In re Good Hope Refineries, Inc.,* 9 B.R. 421 (Bankr.D.Mass.1981) is not to the contrary. Although the court quashed a subpoena issued in connection with the debtor's desire to examine a third party under Rule 2004 post-confirmation, it did so largely because it viewed the subject of the dispute as outside the appropriate scope of the court's concern. In that respect, this decision comports with others that have denied the requested examination because any information obtained would not affect the administration of the bankruptcy case. *E.g., In re Continental Forge Co.,* 73 B.R. 1005, 1007 (Bankr.W.D. Pa.1987):

> The examination of a witness as to matters having no relationship to the debtor's affairs or no effect on the administration of his estate is improper.

Accord Matter of Wilcher (*res judicata* barred matters sought to be discovered); *In re Silverman* (same). *See also In re GHR Energy Corp.,* 35 B.R. at 534 (examination of third parties limited to "those having knowledge of a debtor's acts, conduct or financial affairs so far as this relates to a debtor's proceeding in bankruptcy").

III.

[4] Whether a 2004 examination of the individuals listed in the instant matter will produce any information germane to the continued administration of this case becomes the critical question. The Union and the Fund suggest, in their memorandum, at 3, that:

> Applicants seek to examine the Respondents, all of whom either played a role in the transactions at issue or who may have information with respect thereto, in order to learn exactly what transactions occurred, what agreements were entered into, when they occurred, and who was involved. Upon learning more about the the underlying facts so that a well informed decision can be made, Applicants intend to seek appropriate relief from the Bankruptcy Court, such as an order converting or dismissing the case, modifying the Plan, enforcing the Plan and Purchase Agreement, or seeking new management.

[5] To a very large extent, the information sought by the applicants is connected to whether there was a knowing failure to adequately disclose the full nature of the asset purchase agreement prior to confirmation. While I acknowledge the seriousness of the accusations, along with the objectors' heated denials, that matter is now time-barred in this court. Whether it may be raised in a non-bankruptcy forum I need not decide. *See Matter of Newport Harbor Associates,* 589 F.2d at 24. It is easy to conclude, however, that whatever counsel to Since 1914, Inc. or debtor's counsel knew, and when they knew it, cannot be uncovered by a post-confirmation 2004 examination requested beyond the limitations period of § 1144.

[6] Similarly, applicants' suggestion that they might utilize the information to be obtained by the examination in filing a motion to modify the debtor's chapter 11 plan ignores the plain meaning of § 1127(b). Unlike § 1329(a), which now allows unsecured creditors to seek modifications of a chapter 13 plan post-confirmation, *see In re Gronski,* § 1127(b) is limited by its terms to only a plan proponent or the debtor requesting modification. Here, the debtor was the plan proponent, and thus creditors are precluded from seeking a plan modification.[5] In these circumstances, a 2004 examination is improper.

5. *Goodman v. Phillip R. Curtis Enterprises, Inc.,* cited by applicants, involved a confirmed plan proposed by creditors, and so is inapposite. If the applicants believe that a sale of 90% of the Since 1914, Inc. stock represents an unauthorized plan modification by the debtor they are free to raise that point through some contested matter. The facts germane to that issue are known and would not necessitate a 2004 examination.

[7] Certainly, the applicants have standing to seek compliance with the terms of the confirmed plan or to have the case dismissed or converted to chapter 7 pursuant to § 11 U.S.C. § 1112(b)(7), (8). *Matter of Coral Air, Inc.* Insofar as a motion to dismiss or convert is concerned, I agree with the objectors that the broad examination request made by the applicants is inappropriate. The debtor acknowledges that Since 1914, Inc. has not tendered the payments due under the purchase agreement and the debtor in turn has not tendered its requisite plan payments to creditors. Information regarding the nature of the stock sale to Mr. Santillo and when the sale was contemplated will not advance the creditors' position under § 1112. Thus, an examination on these points is not required.

[8] The final point argued by the Union and the Fund has the most merit.[6] Whether a debtor has acted in conformity with the "terms, provisions, interest, and purpose" of the confirmed plan is a legitimate post-confirmation inquiry. *In re Pittsburgh Terminal Coal Corp.*, 183 F.2d at 523. To the extent the debtor, by actions of its principals, has sought to evade the terms of the plan, such actions may be challenged by creditors. *Id.; Matter of Coral Air, Inc.* The applicants are correct in noting both that no action has been undertaken by the debtor to enforce its rights under the asset purchase agreement and that 11 U.S.C. § 1142 gives the court the power to enforce debtor compliance with plan terms, *see In re Harlow Properties, Inc.*, and to prevent third parties from interfering with the consummation of the plan. *See In re Pittsburgh Terminal Coal Corp.*

Before the applicants give up on this plan, they have the right to decide whether it can be salvaged and should have the opportunity to obtain relevant information from knowledgeable employees of the debtor and the buyer. *Cf. In re Diversified Capital Corp.*, 89 B.R. 826 (Bankr.C.D.Cal. 1988) (failure of debtor to move to set aside a transfer justified appointment of creditors' committee post-confirmation); *In re Northampton Corp.*, 37 B.R. 110, 115 (Bankr.E.D.Pa.1984), *aff'd*, 59 B.R. 963 (E.D.Pa.1984) (limiting discovery regarding a motion to dismiss). As third parties as well as the debtor can be examined under Rule 2004, *see Chereton v. United States*, 286 F.2d 409 (6th Cir.1961), *cert. denied*, 366 U.S. 924, 81 S.Ct. 1351, 6 L.Ed.2d 384 (1961); *In re Continental Forge Co.*, I will grant the application insofar as it seeks to examine principals of the debtor and Since 1914, Inc. and is limited in scope to the enforcement of the asset purchase agreement and the debtor's ability to comply with the terms of the confirmed plan.

An appropriate order shall be entered.

6. The applicants also suggest, relying upon *In re F & S Central Manufacturing Corp.*, CV 87-1065, unpublished memorandum (E.D.N.Y. March 30, 1988) (Raggi, J.), that creditors may have a post-confirmation claim against Jolene, Inc. despite the disclaimer found in the disclosure statement, quoted above. Even if such a claim exists, and assuming that this court would have jurisdiction to hear it, a 2004 examination would be inappropriate. *See In re GHR Energy Corp.; In re Good Hope Refineries, Inc.* The discovery process in adversary proceedings should be utilized.

In re PINTO TRUCKING SERVICE, INC., Debtor.

William SCHAPS, Trustee for Pinto Trucking Service, Inc., Plaintiff,

v.

JUST ENOUGH CORPORATION, Defendant.

Bankruptcy No. 85-04753S.
Adv. No. 87-0829S.

United States Bankruptcy Court,
E.D. Pennsylvania.

Nov. 21, 1988.

Trustee for Chapter 7 business debtor sought to set aside transfer of debtor's displace the presumption against extraterritorial application." *Kiobel v. Royal Dutch Petroleum Co.*, — U.S. —, 133 S.Ct. 1659, 1669, 185 L.Ed.2d 671 (2013). In this case, they did not.

[13] The focus of Bankruptcy Code § 547 is the initial transfer, and that transfer occurred in Israel. The Transfer was not domestic, and hence, cannot be avoided. Furthermore, because the Transfer cannot be avoided, Goldfarb's claim is not subject to disallowance under 11 U.S.C. § 502(d). *Maxwell II*, 93 F.3d at 1054.

The Clerk of the Court is respectfully directed to enter judgment in favor of the defendant dismissing the action.

IN RE: MILLENNIUM LAB HOLDINGS II, LLC, et. al., Debtors.[1]

Case No. 15–12284 (LSS) (Jointly Administered)

United States Bankruptcy Court, D. Delaware.

Signed December 2, 2016

Background: Trustee of creditor and lender trusts established under debtors' confirmed Chapter 11 plan moved for leave to take Rule 2004 examination of third parties with knowledge of circumstances surrounding debtors' financial collapse.

Holdings: The Bankruptcy Court, Laurie Selber Silverstein, J., held that:

(1) motion was one over which bankruptcy court could exercise "arising in" jurisdiction;

(2) debtors' confirmed Chapter 11 plan did not have to specifically reserve jurisdiction in order for bankruptcy court to exercise post-confirmation "arising in" jurisdiction over motion;

(3) trustee was entitled to conduct Rule 2004 examination of third parties with knowledge of circumstances of debtors' financial collapse, in order to decide whether there were causes of action to be brought on behalf of creditor trust, but not to determine whether there were claims to be brought on behalf of lender trust;

(4) as matter of apparent first impression, trustee's dual role, as trustee of both creditor and lender trust, and fact that information discovered by examination conducted on behalf of creditor trust might be used to benefit lender trust, was not sufficient reason to deny examination; and

(5) arbitration clause in Chapter 11 debtors' prepetition engagement letter with accounting firm did not apply to motion for Rule 2004 examination, which was not "dispute or claim."

Motion granted in part and denied in part.

1. Bankruptcy 🔑2063

Bankruptcy court had authority to determine whether it had subject matter jurisdiction over motion.

2. Bankruptcy 🔑2043(1)

Proceeding is one over which bankruptcy court can exercise "arising under" jurisdiction if the Bankruptcy Code creates the cause of action or provides the sub-

1. The Debtors were: Millennium Lab Holdings II, LLC; Millennium Health, LLC; and RxAnte, LLC.

stantive right invoked. 28 U.S.C.A. § 1334(b).

See publication Words and Phrases for other judicial constructions and definitions.

3. Bankruptcy ⚷2043(1)

Proceeding is one over which bankruptcy court can exercise “arising in” jurisdiction if the proceeding, by its nature and not the particular factual circumstance, could arise only in context of bankruptcy case. 28 U.S.C.A. § 1334(b).

See publication Words and Phrases for other judicial constructions and definitions.

4. Bankruptcy ⚷2043(3)

Preconfirmation, a proceeding is one over which bankruptcy court can exercise “related to” jurisdiction if outcome of proceeding could conceivably have any effect on estate being administered in bankruptcy. 28 U.S.C.A. § 1334(b).

See publication Words and Phrases for other judicial constructions and definitions.

5. Bankruptcy ⚷2043(3)

Post-confirmation, a bankruptcy court's “related to” jurisdiction shrinks and extends to a matter only if there is close nexus to the bankruptcy plan or proceeding sufficient to uphold bankruptcy court jurisdiction over the matter. 28 U.S.C.A. § 1334(b).

6. Bankruptcy ⚷3570

Post-confirmation, a bankruptcy court has “related to” jurisdiction to construe and enforce provisions of confirmed Chapter 11 plan, and over matters affecting the interpretation, implementation, consummation, execution or administration of confirmed plan. 28 U.S.C.A. § 1334(b).

7. Bankruptcy ⚷3570

Motion by trustee of trusts established under debtors' confirmed Chapter 11 plan, to take Rule 2004 examination of third parties with knowledge of circumstances of debtors' financial collapse to investigate whether there were causes of action to be brought on behalf of trusts, was motion that could not exist independent of bankruptcy environment, and over which bankruptcy court could exercise “arising in” jurisdiction, despite fact that motion was filed post-confirmation. 28 U.S.C.A. § 1334(b); Fed. R. Bankr. P. 2004.

See publication Words and Phrases for other judicial constructions and definitions.

8. Bankruptcy ⚷2043(3), 3203(1)

While bankruptcy court's “related to” jurisdiction shrinks post-confirmation, there is no comparable constriction on court's post-confirmation “arising in” jurisdiction. 28 U.S.C.A. § 1334(b).

9. Bankruptcy ⚷3041

In deciding whether it could exercise subject matter jurisdiction over motion by trustee of trusts established under debtors' confirmed Chapter 11 plan, to take Rule 2004 examination of third parties with knowledge of circumstances surrounding debtors' financial collapse to investigate whether there were causes of action to be brought on behalf of trusts, it was inappropriate for court, not being endowed with prophetic powers, to speculate over possible causes of action that might be pursued after investigation was complete and whether it would have subject matter jurisdiction over such possible, future causes of action. 28 U.S.C.A. § 1334(b); Fed. R. Bankr. P. 2004.

10. Bankruptcy ⚷2047

Debtors' confirmed Chapter 11 plan did not have to specifically reserve jurisdiction in order for bankruptcy court to exercise post-confirmation “arising in” jurisdiction over motion filed by trustee of trusts established under confirmed plan, for leave to take Rule 2004 examination of third parties with knowledge of circumstances surrounding debtors' financial collapse in order to investigate whether there were causes of action to be brought on behalf of trusts; when matter implicated court's "arising in" jurisdiction, it had intimate connection to bankruptcy proceedings and there was less of a risk of unending jurisdiction in absence of language in plan specifically reserving jurisdiction. 28 U.S.C.A. § 1334(b); Fed. R. Bankr. P. 2004.

11. Bankruptcy ⟹3040.1

Purpose of Rule 2004 examination is to discover nature and extent of bankruptcy estate in order to distribute debtor's assets for benefit of its creditors. Fed. R. Bankr. P. 2004.

12. Bankruptcy ⟹3047(1)

Legitimate goals of Rule 2004 examination include discovering assets, examining transactions, and determining whether wrongdoing has occurred, and potential examinees include third parties that possess knowledge of debtor's acts, conduct, liabilities or financial condition which relate to administration of bankruptcy estate. Fed. R. Bankr. P. 2004.

13. Bankruptcy ⟹3040.1, 3041

A Rule 2004 examination is not a deposition; it serves different purpose and is governed by different procedural rules. Fed. R. Bankr. P. 2004.

14. Bankruptcy ⟹3047(1)

Unlike traditional discovery, which narrowly focuses on issues germane to the dispute, scope of Rule 2004 examination is broad and unfettered. Fed. R. Bankr. P. 2004.

15. Bankruptcy ⟹3040.1

Rule 2004 examination is generally not available once adversary proceeding or contested matter has been commenced; at that point, discovery is made pursuant to the Federal Rules of Bankruptcy Procedure. Fed. R. Bankr. P. 2004.

16. Bankruptcy ⟹3040.1

Parties do not have an absolute right to conduct Rule 2004 examinations, the granting of which is dependent on discretion of court. Fed. R. Bankr. P. 2004.

17. Bankruptcy ⟹3041

In deciding whether to grant motion to conduct Rule 2004 examination, court must balance competing interests of parties and weigh the relevance and necessity of the information sought by examination. Fed. R. Bankr. P. 2004.

18. Bankruptcy ⟹3040.1

Rule 2004 examination is not available to creditors seeking to use examination to deal with their special problems. Fed. R. Bankr. P. 2004.

19. Bankruptcy ⟹3047(1), 3570

Trustee of creditor and lender trusts established under debtors' confirmed Chapter 11 plan, one of which trusts held debtors' retained claims, and the other of which held claims contributed by consenting lenders, was entitled to conduct Rule 2004 examination of third parties with knowledge of circumstances of debtors' financial collapse, in order to decide whether there were causes of action to be brought on behalf of creditor trust, but not to determine whether there were claims to be brought on behalf of lender trust, whose assets would inure solely to benefit of contributing lenders; investigation into existence of consenting lenders' claims against non-debtor parties did not fall within scope or purpose of Rule 2004 as it was not investigation into property or financial condition of debtors and would not further recovery and distribution of debtors' assets or otherwise assist with estate administration. Fed. R. Bankr. P. 2004.

20. Bankruptcy ⚷3041

Party seeking to conduct Rule 2004 examination bears burden of showing "good cause" for the examination which it seeks. Fed. R. Bankr. P. 2004.

21. Bankruptcy ⚷3040.1

Generally, "good cause" is shown for Rule 2004 examination if the examination is necessary to establish the claim of the party seeking the examination, or if denial of such request would cause the examiner undue hardship or injustice. Fed. R. Bankr. P. 2004.

22. Bankruptcy ⚷3040.1

Rule 2004 was not intended to provide private litigants with strategic advantage in fishing for potential private litigation. Fed. R. Bankr. P. 2004.

23. Bankruptcy ⚷3040.1, 3570

Mere fact that same individual was trustee of both creditor and lender trusts established under debtors' confirmed Chapter 11 plan, and that information which he learned when taking Rule 2004 examination on behalf of creditor trust, to determine whether debtors had causes of action against third parties which creditor trust could pursue as holder of all of debtors' retained causes of action, might also be utilized for benefit of lender trust not entitled to conduct Rule 2004 examination was not sufficient reason to deny Rule 2004 examination which was legitimately sought on behalf of creditor trust. Fed. R. Bankr. P. 2004.

24. Alternative Dispute Resolution ⚷454

Bankruptcy ⚷3047(1)

Arbitration clause in Chapter 11 debtors' prepetition engagement letter with accounting firm, which required that "[a]ny dispute or claim between the parties" had to be submitted first to non-binding mediation and, if mediation was unsuccessful, to binding arbitration, did not apply to Rule 2004 examination that was sought of members of firm; motion for Rule 2004 examination was not "dispute or claim."

25. Bankruptcy ⚷3040.1

Rule 2004 examination is investigatory tool used prior to dispute. Fed. R. Bankr. P. 2004.

Ryan M. Bartley, Pauline K. Morgan, Young Conaway Stargatt & Taylor, LLP, Anthony W. Clark, Jason M. Liberi, Skadden Arps Slate Meagher & Flom LLP, Wilmington, DE, Andrew Breidenbach, John M. DiMatteo, Holwell Shuster & Goldberg LLP, Raquelle L. Kaye, Skadden Arps Slate Meagher & Flom LLP, New York, NY, Matthew N. Kriegel, Felicia Gerber Perlman, Skadden, Arps, Slate, Meagher & Flom LLP, Chicago, IL, for Debtors.

Re: D.I.: 312, 313, 325, 326, 327, 328, 330, 339, 358, 359, 360, 361, 362, 367

MEMORANDUM

LAURIE SELBER SILVERSTEIN, UNITED STATES BANKRUPTCY JUDGE

This matter is before the Court on the motion (the "Rule 2004 Motion" or "Motion")[2] of Marc S. Kirschner, as trustee of two trusts created pursuant to the Debt-

2. *Motion of the Plan Trustee for Authority to Take Targeted Discovery, Pursuant to the Debtors' Confirmed Plan or Reorganization, Confirmation Order, Bankruptcy Code Section 105(a)*

ors' plan of reorganization, seeking authority under Federal Rule of Bankruptcy Procedure 2004 ("Rule 2004") to take discovery from certain third parties (the "Third Parties") [3] regarding the cause of the Debtors' financial collapse. The Third Parties each object [4] to the Rule 2004 Motion. The Court has considered the Rule 2004 Motion, each Objection, the argument of counsel at a hearing held on May 4, 2016 and the supplemental submissions made post-hearing. After due deliberation, the Court **FINDS and CONCLUDES** as follows:

Background [5]

The Debtors are in the business of providing laboratory-based diagnostic testing. In April 2014, the Debtors borrowed approximately $1.8 billion [6] pursuant to a certain senior secured term loan agreement (the "2014 Credit Agreement"), the proceeds of which were primarily used to pay off certain existing debt and provide a special dividend to equity holders, as well as to provide for working capital.

On November 10, 2015, the Debtors filed petitions for chapter 11 relief together

and Bankruptcy Rule 2004 (the "Rule 2004 Motion") [D.I. 312].

3. The Trustee requests document production from: (a) JPMorgan Chase Bank, N.A; (b) J.P. Morgan Securities LLC; (c) Citibank Global Markets Inc.; (d) BMO Capital Markets Corp.; (e) Bank of Montreal; (f) SunTrust Bank; (g) Simpson Thacher & Bartlett LLP; and (h) KPMG LLP.

4. *See Objection of JPMorgan Chase Bank, N.A., J.P. Morgan Securities LLC, and Simpson Thacher & Bartlett LLP to the Motion of the Plan Trustee for Authority to Take Discovery Under Rule 2004* (the "JP Morgan Objection") [D.I. 325]; *Objection of SunTrust Bank to the Motion of the Plan Trustee for Authority to Take Discovery Under Bankruptcy Rule 2004* (the "SunTrust Objection") [D.I. 326]; *Objection of Citigroup Global Markets Inc. to the Motion of the Plan Trustee for Authority to Take Discovery Under Rule 2004* (the "Citigroup Objection") [D.I. 327]; *Objection to Motion of the Plan Trustee for Authority to Take Targeted Discovery, Pursuant to the Debtors' Confirmed Plan of Reorganization, Confirmation Order, Bankruptcy Code Sections 105(a) and Bankruptcy Rule 2004* (the "BMO Objection") [D.I. 328]; *KPMG LLP's Objections to the Plan Trusts' Motion to take Targeted Discovery, Pursuant to the Debtor's [sic] Confirmed Plan of Reorganization, Confirmation Order, Bankruptcy Code Section 105(a) and Bankruptcy Rule 2004* (the "KPMG Objection") [D.I. 330]; *Supplemental Objection of JPMorgan Chase Bank, N.A., J.P. Morgan Securities LLC, and Simpson Thacher & Bartlett LLP to the Motion of the Plan Trustee for Authority to Take Discovery Under Rule 2004 (the* "JP Morgan Supplemental Objection") [D.I. No. 358]; *Joinder of Citigroup Global Markets Inc. to the "Supplemental Objection of JPMorgan Chase Bank, N.A., J.P. Morgan Securities LLC, and Simpson Thacher & Bartlett LLP to the Motion of the Plan Trustee for Authority to Take Discovery Under Rule 2004"* (the "Citigroup Supplemental Objection") [D.I. 359]; *KPMG LLP's Supplemental Objections to the Plan Trusts ' Motion to Take Targeted Discovery* (the "KPMG Supplemental Objection") [D.I. 360]; *Supplemental Objection of SunTrust Bank to the Motion of the Litigation Trustee for Authority to Take Discovery Under Bankruptcy Rule 2004* (the "SunTrust Supplemental Objection") [D.I. 361]; *Joinder of the BMO Entities in the Supplemental Objection Filed by JPMorgan Chase Bank, N.A. to Plan Trustee for Authority to Take Targeted Discovery, Pursuant to the Debtors' Confirmed Plan or Reorganization, Confirmation Order, Bankruptcy Code Section 105(a) and Bankruptcy Rule 2004* (the "BMO Supplemental Objection") [D.I. 362] (each, an "Objection," and collectively, the "Objections").

5. The Court is writing for the parties. A detailed background of the Debtors, their business, the Plan and the bankruptcy case is found in *In re Millennium Lab Holdings II, LLC*, 543 B.R. 703 (Bankr. D. Del. 2016), which supplements the background discussion herein.

6. The 2014 Credit Agreement permitted borrowings up to $1,825,000,000. *See* Trustee Ex. 2. The Trustee states that the amount of indebtedness incurred pursuant to the 2014 Credit Agreement was $1.8 billion. *See* Rule 2004 Motion at ¶ 2.

with their *Prepackaged Joint Chapter 11 Plan of Reorganization of Millennium Lab Holdings II, LLC* (as later amended, the "Plan").[7] The Plan contained a settlement (embodied in a prepetition restructuring support agreement) that resolved disputes between the Debtors, certain prepetition lenders under the 2014 Credit Agreement and the Debtors' equity holders, Millennium Lab Holdings, Inc. ("MLH") and TA Millennium, Inc. ("TA"). Under the settlement, MLH and TA contributed $325 million to the Debtors and received releases from the Debtors and third parties; the claims under the 2014 Credit Agreement were converted into a new term loan in the amount of $600 million; the prepetition lenders received 100% of the equity of the reorganized Millennium; two trusts were created to pursue additional recoveries against "Excluded Parties"; [8] and all other creditors received a 100% recovery.[9]

On December 14, 2015, an order confirming the Plan was entered. As anticipated, the Plan provided for the creation of the two trusts: the Millennium Corporate Claim Trust (the "Corporate Trust") and the Millennium Lender Claim Trust (the "Lender Trust," and collectively with the Corporate Trust, the "Trusts"). The Corporate Trust holds the Debtors' retained claims, and the Lender Trust holds claims contributed by the Consenting Lenders.[10] All holders of claims arising under or relating to the 2014 Credit Agreement are the beneficiaries of the Corporate Trust,[11] while the Consenting Lenders are the beneficiaries of the Lender Trust.[12] The Plan provided funding for both Trusts.[13]

On December 21, 2015, Mr. Kirschner (the "Trustee") was appointed as the trustee of both Trusts. On April 6, 2016, the Trustee filed the Rule 2004 Motion seeking authority to examine the Third Parties on behalf of both the Corporate Trust and the Lender Trust. The Trustee seeks to investigate claims the Trusts may have against the Third Parties related to the Debtors' financial collapse. In particular, the Trustee is seeking to investigate (i) the banks that served as arrangers and/or administrative agents under the 2014 Credit Agreement (i.e. J.P. Morgan Chase Bank, N.A.; J.P. Morgan Securities LLC; Citibank Global Markets Inc.; BMO Capital Markets Corp.; Bank of Montreal [14]; and

7. *Amended Prepackaged Joint Chapter 11 Plan of Reorganization of Millennium Lab Holdings II, LLC* [D.I. No. 182].

8. Under the Plan, the term "Excluded Parties" means any party not expressly identified as one of the Released Parties, or as a Related Party of such Released Party, including but not limited to (a) Bank of Montreal, (b) BMO Capital Markets, (c) Citibank Global Markets Inc., (d) Citibank, N.A., (e) J.P. Morgan Securities LLC, (f) JPMorgan Chase Bank, N.A., in its individual corporate capacity and in its capacity as Prior Administrative Agent, (g) KPMG LLP, (h) Skadden, Arps, Slate, Meagher & Flom LLP (including its partners and other attorneys), (i) Suntrust Bank, and (j) any affiliates or Related Parties of the foregoing parties listed in (a) through (i). Although not specifically listed in this definition, Simpson Thacher & Bartlett LLP falls within the definition of Excluded Parties.

9. *In re Millennium Lab Holdings II, LLC*, 543 B.R. at 706; *see also* Plan Confirmation Court Decision Tr. 12:4–5, Dec. 11, 2015 [D.I. 206].

10. Capitalized terms not defined herein are ascribed the meaning provided to them in the Plan.

11. *See* Plan, Article V(F)(iii).

12. *See* Plan, Article V(G)(iii).

13. *See* Plan, Article V(F)(i), (ii); Plan, Article V(G)(i), (ii).

14. The Trustee appears to refer to Bank of Montreal as an administrative agent or arranger. However, it is not evident to the Court that Bank of Montreal served in either of these roles with respect to the 2014 Credit Agreement.

SunTrust Bank) (ii) Simpson Thacher & Bartlett LLP, the law firm that represented J.P. Morgan Chase Bank, N.A. (the administrative agent under the 2014 Credit Agreement) and J.P. Morgan Securities LLC (the joint lead arranger and joint bookrunner under the 2014 Credit Agreement) in connection with the 2014 Credit Agreement; and (iii) KPMG, the Debtors' historical accounting firm (collectively, the "Objectors").

On April 22, 2016, the Objectors filed their Objections to the Rule 2004 Motion. The Objectors generally assert that: (i) the Court lacks subject matter jurisdiction over the post-confirmation Rule 2004 Motion and (ii) the information requested in the Rule 2004 Motion either falls outside of the scope of Rule 2004 or is overly broad. Separately, KPMG argues that any discovery disputes between KPMG and the Debtors are governed by the arbitration clause contained in the prepetition engagement agreement between KPMG and the Debtors dated July 10, 2015 (the "KPMG Engagement Agreement").[15] On April 29, 2014, the Trustee filed an omnibus reply.[16]

On May 4, 2016, the Court held an evidentiary hearing on the Rule 2004 Motion.[17] The Trustee's declaration in support of the Rule 2004 Motion was admitted without objection and the Trustee provided additional live testimony. The Trustee testified that he believes that: (i) substantial harm was caused to the Debtors as a result of the 2014 Credit Agreement; (ii) an investigation regarding the circumstances surrounding the origination and papering of the 2014 Credit Agreement is appropriate; and (iii) the Third Parties possess information regarding these circumstances and regarding the possible attendant damages. Nevertheless, the Trustee further testified that "[t]he relief requested in the [2004] Motion is truly in the nature of an initial investigation. No decision has been made to initiate litigation against any party." [18]

Following the hearing, the parties provided limited supplemental briefing.[19]

Discussion

I. Subject Matter Jurisdiction

[1] The Court has authority to determine whether it has subject matter jurisdiction over this Motion.[20]

Bankruptcy courts derive subject matter jurisdiction from federal statute, rather than Article III of the constitution.[21]

15. *See* KPMG Objection at ¶¶ 22–23 [D.I. 330].

16. *Plan Trustee's Omnibus Reply to Objections to the Motion of the Plan Trustee for Authority to Take Targeted Discovery, Pursuant to the Debtors' Confirmed Plan of Reorganization, Confirmation Order, Bankruptcy Code Sections 105(a) and Bankruptcy Rule 2004* (the "Trustee's Omnibus Reply") [D.I. 339].

17. *See* Rule 2004 Mot. Hr'g Tr., May 4, 2016 [D.I. 353].

18. *Declaration of Marc S. Kirschner in Support of the Trustee's Motion to Take Targeted Discovery Pursuant to Bankruptcy Rule 2004* at ¶ 9 ("Kirschner Declaration") [D.I. 313].

19. *See* JP Morgan Supplemental Objection; Citigroup Supplemental Objection; KPMG Supplemental Objection; SunTrust Supplemental Objection; BMO Supplemental Objection; *Plan Trustee's Omnibus Supplemental Reply to Supplemental Objections of the Motion of the Plan Trustee for Authority to Take Targeted Discovery, Pursuant to the Debtors' Confirmed Plan of Reorganization, Confirmation Order, Bankruptcy Code Sections 105(a) and Bankruptcy Rule 2004* [D.I. 367].

20. *See, e.g., In re BWI Liquidating Corp.*, 437 B.R. 160, 163 (Bankr. D. Del. 2010) (citation omitted) (holding that a federal court has authority to determine whether it has subject matter jurisdiction over a dispute).

21. *See, e.g., In re Resorts Int'l, Inc.*, 372 F.3d 154, 161 (3d Cir. 2004) (citations omitted).

Nevertheless, "[t]he bankruptcy court's jurisdictional mandate is quite broad." [22] Pursuant to 28 U.S.C. §§ 1334 and 157, bankruptcy courts have subject matter jurisdiction over four types of matters, pending referral from the district court: "(1) cases under title 11, (2) proceeding arising under title 11, (3) proceedings arising in a case under tide 11, and (4) proceedings related to a case under tide 11." [23]

Cases falling under the first three categories are typically referred to as core proceedings, whereas proceedings "related to" a case under title 11 are designated as non-core proceedings.[24] Regardless of whether a proceeding is designated core or non-core, the bankruptcy court has subject matter jurisdiction over the matter.

"Cases under title 11" refers to the bankruptcy petition itself.[25]

[2] A proceeding 'arises under' title 11 if "the Bankruptcy Code creates the cause of action or provides the substantive right invoked." [26] Examples of proceedings "arising under" title 11 include causes of action to recover fraudulent conveyances, avoidance actions brought under section 544(b), actions to recover postpetition transfers under section 549, actions against general partners under section 723, controversies regarding whether to appoint or elect a trustee under chapter 11, motions to obtain financing with priority over existing liens, and sales free and clear of liens.[27]

[3] A proceeding 'arises in' title 11 if the proceeding "by its nature, and not the particular factual circumstance, could arise only in the context of a bankruptcy case." [28] Examples of proceedings "arising in" title 11 includes " 'administrative matters' such as allowance and disallowance of claims, orders in respect to obtaining credit, determining the dischargeability of debts, discharges, confirmation of plans, [and] orders permitting the assumption or rejection of contracts." [29]

[4–6] Whether a proceeding 'relates to' a bankruptcy case varies depending on whether the proceeding is commenced pre or post confirmation. Pre-confirmation, a proceeding 'relates to' a bankruptcy case if "the outcome of that proceeding could conceivably have any effect on the estate being administered in bankruptcy." [30] Examples of "related to" jurisdiction pre-confirmation typically include "causes of action owned by the debtor that became property of a title 11 estate under section 541 (as distinguished from postpetition causes of action, i.e., those that come into

22. *In re McMahon Books, Inc.*, 173 B.R. 868, 873 (Bankr. D. Del. 1994).

23. 28 U.S.C. §§ 1334 and 157; *see also In re Resorts Int'l, Inc.*, 372 F.3d at 162.

24. *See In re Resorts Int'l, Inc.*, 372 F.3d at 162 (citation omitted).

25. *See In re New Century TRS Holdings, Inc.*, 505 B.R. 431, 440 (Bankr. D. Del.), *appeal dismissed sub nom., In re New Century TRS Holdings Inc.*, 526 B.R. 562 (D. Del. 2014), *aff'd sub nom., In re New Century TRS Holdings, Inc.*, 619 Fed.Appx. 46 (3d Cir. 2015) (citation omitted).

26. *Id.* at 441 (citations omitted); *see also* 1 COLLIER ON BANKRUPTCY ¶ 3.01[3](e)(i) (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2016).

27. *See* 1 COLLIER ON BANKRUPTCY ¶ 3.01[3](e)(i) (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2016).

28. *In re New Century TRS Holdings, Inc.*, 505 B.R. at 441 (citation omitted).

29. *Stoe v. Flaherty*, 436 F.3d 209, 218 (3d Cir. 2006), *as amended* (Mar. 17, 2006) (citation omitted).

30. *Id.* at 164 (citing *Pacor, Inc. v. Higgins*, 743 F.2d 984, 994 (3d Cir. 1984)).

existence during the pendency of the bankruptcy case)" and (2) "suits between third parties that in the absence of bankruptcy, could have been brought in a district court or a state court." [31] Post-confirmation, a bankruptcy court's "related to" jurisdiction shrinks, and therefore, as first outlined by the Third Circuit in *In re Resorts International*, a proceeding 'relates to' a bankruptcy case post-confirmation only if "there is a close nexus to the bankruptcy plan or proceeding sufficient to uphold bankruptcy court jurisdiction over the matter." [32] "Related to" jurisdiction post-confirmation includes proceedings to construe and enforce provisions of a plan, and matters affecting the interpretation, implementation, consummation, execution or administration of a confirmed plan.[33]

Both the Trustee, in his initial submission, and therefore the Objectors, in their Objections, argue that the Rule 2004 Motion should be analyzed in the context of the "related to" jurisdictional analysis laid out in *Resorts.* The Objectors argue that the Rule 2004 Motion does not have the mandated close nexus to the bankruptcy plan or proceeding, and thus the Court does not have bankruptcy court jurisdiction over the matter. The Court disagrees.[34]

[7] The "related to" analysis proposed by the Objectors is unsuitable for a Rule 2004 motion. Multiple courts have held that Rule 2004 is a rule of *bankruptcy* procedure that does not exist "independent of a bankruptcy environment." [35] Put another way, Rule 2004 "by its nature, and not the particular factual circumstance, could arise only in the context of a bankruptcy case." [36] As such, Rule 2004 "arises in" title 11 of the Bankruptcy Code, and the Court has subject matter jurisdiction to adjudicate this dispute.[37]

[8] The fact that this Rule 2004 Motion was filed post-confirmation does not alter this conclusion. Four years after *Resorts,* the Third Circuit in *Seven Fields* explored post-confirmation jurisdiction in the context of "arising in" jurisdiction. In *Seven Fields,* the court held that once the bankruptcy court determines that it has "arising in" jurisdiction over a matter, the analysis is complete.[38] The court explained:

> After considering the parties' arguments, we will affirm the order of the district court and thus, in effect, the order of the bankruptcy court as we conclude that the bankruptcy court had core jurisdiction in this case. The bank-

31. 1 COLLIER ON BANKRUPTCY ¶ 3.01 [3](e)(ii) (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2016).

32. *In re Resorts Int'l, Inc.,* 372 F.3d at 166–67.

33. *Id.* at 167, 168–69.

34. *See, e.g.,* JP Morgan Objection at ¶¶ 9–16; KPMG Objection at ¶¶ 8–14; JP Morgan Supplemental Objection ¶¶ 6–8; KPMG Supplemental Objection at ¶¶ 6–16.

35. *In re Refco, Inc.,* No. 06 Civ. 1888 (GEL), 2006 WL 1379616, at *2 (S.D.N.Y. May 16, 2006) (emphasis in original) (citation omitted); *see also In re Recoton Corp.,* No. 04 Civ. 2466 (DLC), 2004 WL 1497570, at *4 (S.D.N.Y. July 1, 2004) (citation omitted) (Rule 2004 is "an action that has as its foundation the creation, recognition, or adjudication of rights which would not exist independent of a bankruptcy environment.").

36. *In re New Century TRS Holdings, Inc.,* 505 B.R. at 441.

37. A determination that the Court has "arising under" rather than "arising in" jurisdiction would not alter the conclusion that the Court has subject matter jurisdiction over the Motion.

38. *See In re Seven Fields Dev. Corp.,* 505 F.3d 237, 260 (3d Cir. 2007).

ruptcy and district courts were not required to address the "close nexus" test because the test was not applicable in this "arising in" proceeding. As we discussed in *Resorts,* the "close nexus" standard only applies for the purposes of determining whether a federal court has jurisdiction over a non-core "related to" proceeding in the post-confirmation context. Appellants seem to believe that any time a party files a case post-confirmation, the "close nexus" test is triggered. This is plainly not the case. While courts may choose to rely on "related to" jurisdiction because it is the broadest category of federal bankruptcy jurisdiction when examining their own jurisdiction, it certainly is not incumbent upon them to do so, because, as occurred here, a party may argue and a court may decide that a proceeding falls within one of the narrower categories of jurisdiction, such as "arising in" jurisdiction, in which case "related to" jurisdiction and the corresponding "close nexus" test are not implicated.[39]

The court in *Seven Fields* further explained that in contrast to cases based on "related to" jurisdiction, "cases that 'aris[e] in' the bankruptcy case must satisfy a stringent standard in which the matter must have an intimate connection with the bankruptcy proceedings, and *thus the stage at which the complaint is filed is not determinative.*" [40] Accordingly, unlike with "related to" jurisdiction, there is no comparable constriction on the Court's "arising in" jurisdiction post-confirmation, and the Court has subject matter jurisdiction over the Rule 2004 Motion.

[9] Notwithstanding this straightforward analysis, the Objectors argue that the Court, in conducting its post-confirmation jurisdictional analysis, should not look at the Rule 2004 Motion itself, but rather should look through the Motion to the underlying causes of actions that the Trustee *may* bring based on information gathered from his investigations. The Objectors contend that because the causes of action that will follow an investigation are non-core and do not have the requisite "close nexus" to the bankruptcy proceeding, the Court does not have jurisdiction to adjudicate this Rule 2004 Motion.[41] Such a contention endows the Court with prophetic powers it does not, and cannot, have. As numerous courts have recognized when presented with a Rule 2004 motion, "there is no way to determine where the investigations will lead, what claims may be revealed, and what issues are core and non-core." [42]

The Court is not persuaded that the cases cited by the Objectors dictate a dif-

39. *Id.* (citations omitted).

40. *Id.* at 265 n.26 (alteration in original) (emphasis added).

41. *See, e.g.,* JP Morgan Objection at ¶¶ 9–16; KPMG Objection at ¶¶ 8–14; JP Morgan Supplemental Objection at ¶¶ 6–8; KPMG Supplemental Objection ¶¶ 4–5. While this argument was premised on "related to" jurisdiction, I will consider it nonetheless.

42. *In re Friedman's, Inc.,* 356 B.R. 779, 784 (Bankr. S.D. Ga. 2005); *see also In re Refco, Inc.,* 2006 WL 1379616, at *2 (citation omitted) (finding that while the claims that the committee may later bring may be non-core, "the investigation into the possible existence of those yet-to-be-determined claims [via a Rule 2004 examination] is purely a bankruptcy matter"); *In re Table Talk, Inc.,* 51 B.R. 143, 146 (Bankr. D. Mass. 1985) (emphasis in original) (stating, in the mandatory withdrawal context, that even assuming *arguendo* that an antitrust suit, "when and if it is filed, would be subject to mandatory withdrawal" because it was non-core "it does not logically follow that a Rule 2004 examination would, at this time, be precluded by a future contingency."); *cf. In re SemCrude L.P.,* No 11–1174 (SLR), 2012 WL 5554819, at *3 (D. Del. Nov. 15, 2012) (affirming the bankruptcy court's decision to look at the motion before it—a motion to enjoin—and not the subject matter of the underlying litigation pending in a different outcome. First, almost all of the cases cited by the Objectors were decided prior to *Resorts* and *Seven Fields*, and thus do not perform the mandated analysis in the Third Circuit.

Second, while some of the decisions offered by the Objectors are couched in a jurisdictional framework, a careful reading demonstrates that their analyses truly turns on whether the requested examinations comport with the scope of Rule 2004, rather than whether the court has jurisdiction over the motions. So, for example, in *In re Express One International, Inc.*, the court evaluated whether the party requesting the Rule 2004 examinations had demonstrated good cause for the 2004 examinations, not whether the court had jurisdiction to decide the Rule 2004 motion.[43] And in *In re Good Hope Refineries, Inc.*, the court specifically held that it had jurisdiction over a post-confirmation request for a Rule 205 (now 2004) examination, but denied the requested relief because the examination did not fall within the scope of the rule.[44]

Finally, in *In re Cinderella Clothing Industries*, the bankruptcy court did look through the Rule 2004 request to the potential causes of action that would stem from an investigation in order to determine whether the court should grant the Rule 2004 motion.[45] In that case, certain creditors sought to take investigations in order to bolster an effort to dismiss or convert the bankruptcy case, or modify a confirmed plan. Because dismissal, conversion or modification of the plan were time barred and/or because the movants would not have standing to seek that relief, the court denied the requested Rule 2004 examination (while permitting other examinations on specific topics).[46] The court further stated that whether a cause of action existed in another forum was not relevant. To the extent that this is a universal statement, the Court respectfully disagrees and notes that the case cited in support of that proposition was in a different legal context.[47]

None of these cases convince the Court that in order to determine whether it has

ferent court when conducting its jurisdictional analysis); *In re Asia Glob. Crossing, Ltd.*, 322 B.R. 247, 254–55 (Bankr. S.D.N.Y. 2005) (citing Hon. Barry Russell, BANKRUPTCY EVIDENCE MANUAL § 501.3, at 826 (2004 ed.)) (explaining that "[e]ven if the Trustee ultimately intends to pursue state law claims, federal law nonetheless controls the privilege" as an examination under Rule 2004 is "aimed at discovering evidence upon which future causes of action may be based and is therefore governed by bankruptcy law rather than state substantive law.").

43. *See In re Express One Intern., Inc.*, 217 B.R. 215, 217 (Bankr. E.D. Tex. 1998).

44. *See In re Good Hope Refineries, Inc.*, 9 B.R. 421, 422–23 (Bankr. D. Mass 1981) (emphasis added) ("I am satisfied that this Court can properly exercise jurisdiction over actions brought by a Debtor after a Plan has been confirmed by the Court, even if such actions are against a post-filing creditor, with no claim against the estate . . . I now turn to the issue of whether or not, under the facts of this case, the Court *should* exercise its jurisdiction.").

45. *See In re Cinderella Clothing Indus., Inc.*, 93 B.R. 373, 378–79 (Bankr. E.D. Pa. 1998).

46. *See Id.* The court did permit a Rule 2004 examination to the extent it was "limited in scope to the enforcement of the asset purchase agreement and the debtor's ability to comply with the terms of the confirmed plan." *Id.* at 379.

47. Similarly, in *In re Barnes*, the court found that because it would not have jurisdiction over the breach of contract claim that was the subject of the Rule 2004 examination, the Rule 2004 examination would be inappropriate. *See In re Barnes*, 365 B.R. 1, 4–6 (Bankr. D.D.C. 2007). But, *Barnes* was not a post-confirmation chapter 11 case, rather, it was an individual chapter 7 case that had not yet been closed by the chapter 7 trustee. The subject matter jurisdiction, the Court must speculate over possible causes of action that may be pursued after the investigation is complete. When evaluating jurisdiction, the Court will look at the motion in front of it—the Rule 2004 Motion—and not at a future lawsuit that the Trustee may file.

[10] The Objectors' final challenge to subject matter jurisdiction also fails. Certain of the Objectors argue that the Plan does not contain the requisite reservation of jurisdiction language to provide the Court with jurisdiction over the Motion.[48] The cases cited by these Objectors are inapposite as they analyze plan provisions in the post-confirmation "related to" jurisdictional context.[49] In the context of post-confirmation "related to" jurisdiction, courts have held that a plan needs to contain a specific retention of jurisdiction provision because such language helps ensure that "bankruptcy court jurisdiction would not raise the specter of 'unending jurisdiction'" post-confirmation.[50] But, when the court's jurisdiction 'arises in' title 11, the cause of action has an "intimate connection to the bankruptcy proceedings" and therefore there is less of a risk of "unending jurisdiction." [51]

In re Insilco is instructive.[52] In that case, Judge Carey found post-confirmation jurisdiction over core claims without analyzing the reservation of rights language in the relevant plan, but denied post-confirmation jurisdiction over non-core claims where the plan did not contain the requisite reservation of rights.[53] Here too, the Court need not determine whether the Plan contains the requisite reservation of rights language to determine its subject matter jurisdiction over the Rule 2004 Motion. The Court's subject matter jurisdiction over the Rule 2004 Motion stems from the fact that it is a proceeding that 'arises in' title 11 of the Bankruptcy Code (i.e. it is a core proceeding).[54]

Having dealt with all of the objections to the Court's jurisdiction, the Court concludes that it has subject matter jurisdiction over the Rule 2004 Motion.

II. Scope of the Trustee's Rule 2004 Motion

Rule 2004 provides that "[o]n motion of any party in interest, the court may order

Barnes court specifically stated that the requested examination did not relate to the administration of the bankruptcy estate or the rights, liabilities or obligations of the debtor. *Id.* at 3.

48. *See, e.g.,* KPMG Objection at ¶ 13 n.3; KPMG Supplemental Objection at ¶¶ 6–16.

49. *See, e.g., In re BWI Liquidating Corp.,* 437 B.R. at 166 (concluding that "a Plan must specifically describe a cause of action in order to retain 'related to' jurisdiction."); *see also In re AstroPower Liquidating Trust,* 335 B.R. 309, 325 (Bankr. D. Del. 2005) (citation omitted) ("The Court concludes that where, as here, the Plan specifically describes an action over which the Court had 'related to' jurisdiction pre-confirmation and expressly provides for the retention of such jurisdiction to liquidate that claim for the benefit of the estate's creditors, there is a sufficiently close nexus with the bankruptcy proceeding to support jurisdiction post-confirmation.").

50. *In re BWI Liquidating Corp.,* 437 B.R. at 165 (citation omitted); *see also In re AstroPower Liquidating Trust,* 335 B.R. at 325 (citation omitted).

51. *In re Seven Fields Dev. Corp.,* 505 F.3d at 265 n.26.

52. *See In re Insilco Techs., Inc.,* 330 B.R. 512 (Bankr. D. Del. 2005), *aff'd,* 394 B.R. 747 (D. Del. 2008).

53. *See Id.* at 519–26.

54. The Court takes no position on the need to review a plan for retention of jurisdiction language with respect to matters "related to" the bankruptcy case.

the examination of any entity." [55]

[11, 12] Rule 2004 further provides that:

> [t]he examination of an entity under this rule or of the debtor under § 343 of the Code may relate only to the acts, conduct, or property or to the liabilities and financial condition of the debtor, or to any matter which may affect the administration of the debtor's estate, or to the debtor's right to a discharge. In ... a reorganization case under chapter 11 of the Code ... the examination may also relate to the operation of any business and the desirability of its continuance, the source of any money or property acquired or to be acquired by the debtor for purposes of consummating a plan and the consideration given or offered therefor, and any other matter relevant to the case or to the formulation of a plan.[56]

The purpose of a Rule 2004 examination is to "discover the nature and extent of the bankruptcy estate" in order to distribute debtor's assets for the benefit of its creditors.[57] "Legitimate goals of Rule 2004 examinations include 'discovering assets, examining transactions, and determining whether wrongdoing has occurred.' " [58] Potential examinees include "third parties that possess knowledge of the debtor's acts, conduct, liabilities or financial condition which relate to the administration of the bankruptcy estate." [59]

[13–15] A Rule 2004 examination is not a deposition; it serves a different purpose and is governed by different procedural rules.[60] "Unlike traditional discovery, which narrowly focuses on the issues germane to the dispute," the scope of Rule 2004 is broad and unfettered, and has been likened to a "fishing expedition" and "an inquisition." [61] Indeed, a Rule 2004 examination is generally not available once an adversary proceeding or contested matter has been commenced; at that point, discovery is made pursuant to the Federal Rules of Bankruptcy Procedure.[62]

[16–18] Nevertheless, parties do not have an absolute right to Rule 2004 examinations—the granting of a Rule 2004 examination is dependent on the discretion of the court.[63] The rule requires a balancing of "the competing interests of the parties, weighing the relevance of and necessity of the information sought by examination." [64] Further, Rule 2004 is not available to cred-

55. Fed. R. Bankr. P. 2004(a).

56. Fed. R. Bankr. P. 2004(b).

57. *In re Washington Mut., Inc.*, 408 B.R. 45, 50 (Bankr. D. Del. 2009) (citation omitted); *see also In re Recoton Corp.*, 307 B.R. 751, 755 (Bankr.S.D.N.Y.2004) (citation omitted).

58. *In re Washington Mut., Inc.*, 408 B.R. at 50 (quoting *In re Enron Corp.*, 281 B.R. 836, 840 (Bankr. S.D.N.Y. 2002)).

59. *In re E.W. Resort Dev. V, L.P., L.L.L.P.*, No. 10–10452 (BLS), 2014 WL 4537500, at *7 (Bankr. D. Del. Sept. 12, 2014) (citations omitted).

60. *See Simon v. FIA Card Services*, 732 F.3d 259, 268 (3d Cir. 2013) (citing *In re J & R Trucking, Inc.*, 431 B.R. 818, 821 (Bankr. N.D. Ind. 2010)).

61. *In re J & R Trucking, Inc.*, 431 B.R. at 821; *In re Good Hope Refineries, Inc.*, 9 B.R. at 422 (citations omitted) (discussing Rule 205, the predecessor to Rule 2004); *In re Washington Mut., Inc.*, 408 B.R. at 50 (citation omitted).

62. *See In re Bennett Funding Grp., Inc.*, 203 B.R. 24, 28 (Bankr. N.D.N.Y. 1996) (citations omitted).

63. *See* Fed. R. Bankr. P. 2004(a) (emphasis added) ("On motion of any party in interest, the court *may* order the examination..."); *see also In re Enron Corp.*, 281 B.R. at 840.

64. *In re Drexel Burnham Lambert Grp., Inc.*, 123 B.R. 702, 712 (Bankr. S.D.N.Y. 1991).

itors seeking "to use this section to deal with their special problems." [65]

The Rule 2004 Motion on behalf of the Corporate Trust

[19] The Trustee seeks to conduct an investigation on behalf of the Corporate Trust in order to explore prepetition causes of action the Debtors may have against the Third Parties. In particular, the Trustee states that he seeks document production bearing upon the Debtors' financial collapse and chapter 11 filing. He argues that the facts as he knows them to date create "a strong suspicion of wrongdoing" in connection with the 2014 Credit Agreement, which caused creditors substantial harm.[66] Proceeds from the claims (if any) the Trustee subsequently chooses to bring on behalf of the Corporate Trust based on the results of his Rule 2004 investigation will be distributed to all creditors holding claims in Class 2.[67] Thus, the Trustee's Rule 2004 Motion with respect to the Corporate Trust fits squarely within the purpose of Rule 2004, as he seeks to examine third parties for the purpose of "discovering assets, examining transactions, and determining whether wrongdoing has occurred" on behalf of the Debtors' estate.[68]

The Objectors argue that the Trustee has failed to demonstrate the requisite good cause to warrant the requested Rule 2004 examinations,[69] or that, at the very least, the discovery requests promulgated by the Trustee are overly burdensome and should be narrowed.[70]

[20, 21] The party seeking to conduct a 2004 examination has the burden of showing good cause for the examination which it seeks.[71] "Generally, good cause is shown if the [Rule 2004] examination is necessary to establish the claim of the party seeking the examination, or if denial of such request would cause the examiner undue hardship or injustice." [72] The Trustee has testified that the examinations are necessary to "enable the Plan Trusts to determine the scope of viable claims that may exist on behalf of the Plan trusts against potential third parties that may be culpable for causing such harm to the Debtors." [73] The fact that the Trustee already has access to certain documents and information of the Debtors does not detract from the Trustee's testimony that the documents already in his purview are not sufficient to determine the scope of the

65. *In re J & R Trucking, Inc.*, 431 B.R. 818, 821 (Bankr. N.D. Ind. 2010) (quoting Norton Bankruptcy Rules, 2009–10 ed., Rule 2004 ed. comment (c), at 136–37).

66. Rule 2004 Motion at ¶ 2.

67. Claimants in Class 2 are holders of claims arising under or relating to the 2014 Credit Agreement. *See* Plan, Article III(C)(ii). Under the Plan, general unsecured claims are paid in full in case. *See* Plan, Article III(C).

68. *In re Washington Mut., Inc.*, 408 B.R. at 50 (citation omitted).

69. *See, e.g.*, JP Morgan Objection at ¶¶ 21–22; KPMG Objection at ¶¶ 15–21; SunTrust Objection at ¶ 2; BMO Objection at ¶¶ 36–41.

70. *See, e.g.*, JP Morgan Objection at ¶¶ 23–31; KPMG Objection at ¶¶ 18–21; Citigroup Objection pp. 1–2; SunTrust Objection at ¶ 3; BMO Objection at ¶¶ 26–35, 42–51.

71. *See In re Eagle–Picher Indus., Inc.*, 169 B.R. 130, 134 (Bankr. S.D. Ohio 1994), *as amended* No. 1–91–10100, 1994 WL 731628 (Bankr. S.D. Ohio Aug. 2, 1994); *see also In re Metiom, Inc.*, 318 B.R. 263, 268 (S.D.N.Y. 2004) (citation omitted); *In re Countrywide Home Loans, Inc.*, 384 B.R. 373, 393 (Bankr. W.D. Pa. 2008).

72. *In re Metiom, Inc.*, 318 B.R. at 268 (alteration in original) (citation omitted).

73. Kirschner Declaration at ¶ 8.

Trustee's viable claims.[74] As such, the Trustee has demonstrated good cause warranting granting of the Trustee's Rule 2004 Motion on behalf of the Corporate Trust.

The Court will defer on ruling on the breadth of the specific requests until the parties meet and confer to see whether the parties can resolve their differences. The Trustee is encouraged to avoid duplicative requests, both with respect to documents already in the Trustee's possession and in terms of targeting document requests to the most relevant Third Party(ies).[75] Any disputes that cannot be consensually resolved will be addressed pursuant to applicable rules.

The Rule 2004 Motion on behalf of the Lender Trust

The Trustee's request to use Rule 2004 to investigate claims held by the Lender Trust is not within the scope or purpose of Rule 2004. Although the Lender Trust was established pursuant to the Plan, it is not comprised of debtor claims. Rather, the Consenting Lenders voluntarily contributed their claims to the Lender Trust (presumably to more effectively prosecute the claims), and those Consenting Lenders, not all claimants in Class 2, will be the beneficiaries of any recovery from that trust.[76]

An investigation into the existence of the Consenting Lenders' claims against non-debtor Third Parties does not fall within the scope or purpose of Rule 2004 as it is not an investigation into the "property or to the liabilities and financial condition of the debtor," [77] and will not further the recovery and distribution of the Debtors' assets or otherwise assist with the administration of this case. The Court is persuaded by the well-reasoned decision in *J & R Trucking,* in which the court concludes:

> As for movants' desire to identify third parties [in addition to the debtor] who may also be liable to them, that, quite simply is neither this court's concern nor the purpose of Rule 2004. No matter how artfully one tries to disguise the requested examinations, by dressing them up in the robes of bankruptcy administration, their real purpose is to identify another entity movants might be able to collect from, and whether those efforts would have any impact on the bankruptcy estate is of no real concern to them. Movants understandably want to [sic] their money, but that does not justify turning a tool that has been developed to efficiently administer bankruptcy estates into a private collection device for creditors. Movants have other tools and other fora which they can use to investigate their rights against third parties and to collect the amounts they are owed. They should use them and not Rule 2004." [78]

74. *See Id.*

75. *See, e.g.,* JP Morgan Objection at ¶¶ 25–29; KPMG Objection at ¶¶ 19–20; BMO Objection at ¶¶ 28–37, 39–51; *but see* Trustee's Omnibus Reply at ¶¶ 34–37; 42–44; 48–54.

76. *See* Plan, Article V(G)(iii). The Court recognizes that in this case the two sets of beneficiaries are largely the same.

77. Fed. R. Bankr. P. 2004(b).

78. *In re J & R Trucking, Inc.,* 431 B.R. at 822–23 (citation omitted); *see also In re Hilsen,* No. 87–11261 (JMP), 2008 WL 2945996, at *4 (Bankr. S.D.N.Y. July 25, 2008) ("Rule 2004 may be used to discover information about estate property, but it is not a proper means to inquire with respect to non-estate property."); *In re Good Hope Refineries, Inc.,* 9 B.R. at 423 (Rule 205 "is not intended to give the rehabilitated debtor post confirmation a strategic advantage in fishing for potential private litigation.")

[22] In this case, the Trustee is entitled to Rule 2004 examinations on behalf of the Corporate Trust, as such an examination is a "legitimate post-confirmation inquiry" to ascertain potential causes of action, which success would benefit the Debtors' creditor body.[79] Any request for information regarding potential causes of action belonging to the Lenders' Trust, however, is denied, as Rule 2004 was not intended to provide private litigants [i.e. the Consenting Lenders] with "a strategic advantage in fishing for potential private litigation." [80] The fact that the Lender Trust was created by the Plan does not infuse the Lender Trust with bankruptcy tools that would not otherwise be available to third party creditors pursuing claims against non-debtor entities.

Does the Trustee's role as trustees for both the Corporate Trust and the Lender Trust compel a different result?

[23] The Court recognizes that, as of now, the same individual serves as trustee for both Trusts. The Court further recognizes that, as currently stylized, the document requests proposed by the Trustee are propounded on behalf of both the Corporate Trust and the Lender Trust. Thus, even as the Court denies the Trustee's request for Rule 2004 examinations with respect to the Lender Trust, the granting of the Trustee's request for Rule 2004 examinations with respect to the Corporate Trust effectively provides the Trustee with the information sought in both of his capacities. While Objectors did not raise this concern in exactly this context, the Court has considered this issue.

Research did not reveal a reported case directly on point. But, multiple courts have held that the possible use of information obtained through a Rule 2004 examination in collateral litigation pending in a different forum is not sufficient reason to deny an examination if it is not sought for the purpose of circumventing the federal rules of civil or bankruptcy procedure.[81] For example, the court in *In re Washington Mutual* granted the requested Rule 2004 examination of a party involved in a pending proceeding, finding that the examination was warranted as it sought to discover evidence unrelated to the pending proceeding.[82] The court further found that where there was no pending proceeding involving the proposed examinee, but the possibility of such a future proceeding exists, the Rule 2004 examination was also warranted.[83] In both situations, the court found that there was no concern that the movant was seeking to circumvent the Federal Rules of Civil Procedure, and an "aggressive application of the 'pending proceeding' rule may prevent legitimate Rule 2004 examinations . . ., thereby interfering with the trustee's fiduciary duty to maximize

79. *In re Express One Intern., Inc.*, 217 B.R. at 217.

80. *In re Good Hope Refineries*, 9 B.R. at 423.

81. *See In re Table Talk, Inc.*, 51 B.R. at 145 (alteration in original) (citation omitted) ("It is, however, 'clear that pending litigation . . . against the person sought to be examined and the possible use of 205 [now 2004] testimony in that collateral litigation is not sufficient reason for denying examination.' "); *see also In re Mittco, Inc.*, 44 B.R. 35, 37 (Bankr. E.D. Wis. 1984) (citation omitted) (same); *In re Mantolesky*, 14 B.R. 973, 979 (Bankr. D. Mass. 1981) (citations omitted) (same); *In re Buick*, 174 B.R. 299, 305 (Bankr. D. Colo. 1994) (permitting a creditor to take a Rule 2004 examination after the trustee had already filed an adversary proceeding); *In re Washington Mut., Inc.*, 408 B.R. at 51–53.

82. *See In re Washington Mut., Inc.*, 408 B.R. at 52.

83. *See Id.* at 53.

estate assets."[84] Accordingly, in the first instance, the potential use of information obtained through the Corporate Trust's Rule 2004 examination *by another party* (the Lender Trust) *in a proceeding that has yet to be commenced* (and may not ever be commenced) cannot dictate denial of the Trustee's Rule 2004 Motion.

III. Arbitration Clause in the KPMG Engagement Agreement

[24] Finally, KPMG argues that, as the prepetition Engagement Agreement between the Debtors and KPMG contains an arbitration clause, the Trustee's request to obtain information from KPMG should be governed by certain arbitration discovery rules, rather than by Rule 2004.[85] The Trustee does not dispute the validity of the arbitration clause; rather the Trustee argues that the scope of the arbitration clause does not include the examinations and information sought pursuant to Rule 2004.

The Supreme Court has repeatedly stated that the Federal Arbitration Act requires courts to "rigorously enforce agreements to arbitrate."[86] Nevertheless, the court must first determine whether the arbitration clause is applicable to the issue at hand.[87]

[25] The arbitration clause in the KPMG Engagement Agreement provides that "[a]ny dispute or claim between the parties shall be submitted first to nonbinding mediation and if mediation is not successful within 90 days after the issuance of one of the parties of a request for mediation then to binding arbitration."[88] However, a Rule 2004 examination is not a "dispute or claim"; it is an investigatory tool used prior to a dispute.[89] As discussed *supra*, the initiation of an adversary proceeding or a contested matter generally precludes the use of Rule 2004.[90] Therefore, by its plain language, the arbitration clause in the Engagement Letter does not apply to this Rule 2004 Motion.

New Century TRS Holdings, Inc., decided by Judge Carey, is illustrative.[91] In *New Century*, KPMG sought to use an arbitration clause in its engagement letter to prevent the transfer of documents from a court-appointed examiner to a liquidating trustee. The court found that the arbitration clause did not govern the issue, as at "the time this relief was sought, no evidence was presented that any claim had been asserted or that any particular proceeding had been commenced against KPMG."[92] The court further noted that "[t]o the contrary, the relief requested in the motions do not prevent KPMG from asserting any right to arbitration (and attendant rights) if a proceeding is commenced."[93] Here too, the Rule 2004 Motion does not seek information related to any particular claim or proceeding; rather,

84. *Id.* at 50 (citation omitted).

85. *See* KPMG Objection at ¶¶ 22–23.

86. *Shearson/American Exp., Inc. v. McMahon*, 482 U.S. 220, 226, 107 S.Ct. 2332, 96 L.Ed.2d 185 (1987) (citations omitted).

87. *See In re New Century TRS Holdings, Inc.*, 407 B.R. 558, 570 (Bankr. D. Del. 2009) ("before I can consider whether an arbitration clause is enforceable, I must determine whether the particular clause is applicable to the motions before me.").

88. KPMG Objection Ex. 1 at p. 5.

89. *See, e.g., In re J & R Trucking, Inc.*, 431 B.R. at 821 (citation omitted).

90. *See Id.*

91. *See In re New Century TRS Holdings, Inc.*, 407 B.R. 558 (Bankr. D. Del. 2009).

92. *Id.* at 571.

93. *Id.*

the Rule 2004 Motion seeks information regarding prospective claims that the Trustee *may* bring in the future, whether against KPMG or another party. If and when the Trustee brings any claims, KPMG can then assert any right to arbitration it may have.

Similarly compelling is the decision in *In re Friedman's*.[94] In that case, the debtor's accounting firm moved for a protective order, arguing that the arbitration provision in its engagement letter prevented the debtor from compelling discovery via Rule 2004.[95] The court denied the motion, finding that although arbitration clauses are generally favored, the arbitration clause did not govern the matter. In reaching this conclusion, the court explained that:

> [the debtor] has not identified a specific cause of action that is the source of its request for Rule 2004 examination . . . Although the investigations may reveal that there is a claim directly against E & Y [the accounting firm] that can be asserted by the estate, that determination has not yet been made and has not been submitted to mediation or arbitration. Accordingly, the arbitration clause and dispute resolution procedures simply have not been triggered because there is no identifiable, discrete dispute between the parties that could be argued to control the scope of discovery.[96]

The court further explained that a finding that the arbitration clause prevented a Rule 2004 investigation "would defeat a fundamental purpose of Rule 2004, which is to grant debtors . . . a broad power to determine what causes of action they may possess." [97]

The rationale in *In re Daisytek, Inc.*, cited by KPMG, is unpersuasive in this instance.[98] In *Daisytek*, the court vacated a bankruptcy court order allowing a post-confirmation creditors' trust to take a Rule 2004 examination of the debtor's pre-bankruptcy accountants, finding that the bankruptcy court needed to look at the "underlying nature of the proceedings that could flow from the information obtained through the Rule 2004 examination" in order to determine whether the motion needed to be submitted to arbitration.[99] As discussed in section I *supra*, the Court will not speculate as to what causes of action the Trustee may unearth through the Rule 2004 investigations, and therefore the reasoning in *Daisytek* is not compelling.[100]

The Court finds that the arbitration clause in the KPMG Engagement Agreement does not apply to this Rule 2004 Motion.

Conclusion

The Court has subject matter jurisdiction to adjudicate this post-confirmation Rule 2004 Motion. The Trustee has demonstrated good cause with respect to the

94. *See In re Friedman's, Inc.*, 356 B.R. 779 (Bankr. S.D. Ga. 2005).

95. *See Id.* at 782.

96. *Id.* at 783–84.

97. *Id.* at 784.

98. *See In re Daisytek, Inc.*, 323 B.R. 180 (N.D. Tex. 2005)

99. *Id.* at 187.

100. KPMG's argument with respect to arbitration highlights the dangers of speculating as to causes of action that the Trustee might bring in the future. Until a complaint is filed against KPMG, the Court cannot determine whether arbitration is required as to all counts of the complaint, several counts of the complaint, or none of the complaint. *See e.g. Hays and Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 885 F.2d 1149, 1155 (3d Cir. 1989) (discussing arbitration in the context of debtor-derived claims as opposed to causes of action created under the Bankruptcy Code for the benefit of creditors of the estate).

Rule 2004 examinations of the Third Parties requested on behalf of the Corporate Trust, and thus this Rule 2004 Motion is granted with respect to the Corporate Trust. For the reasons discussed above, the Rule 2004 Motion is denied with respect to the Lender Trust. An order will issue.

IN RE: PATRIOT COAL CORPORATION, et al., Debtors.

Eugene Davis, solely in his capacity as Liquidating Trustee for the PCC Liquidating Trust, Plaintiff,

v.

West Virginia State Tax Department, Defendant.

15–32450–KLP
Adv. Pro. No. 16–03109–KLP

United States Bankruptcy Court,
E.D. Virginia,
Richmond Division.

Signed 11/22/2016

Background: Trustee of liquidating trust established under debtors' confirmed Chapter 11 plans brought adversary proceeding to compel turnover of tax refunds to which debtors were allegedly entitled from state, and state taxing authority moved to dismiss based, inter alia, on its Eleventh Amendment immunity.

Holding: The Bankruptcy Court, Keith L. Phillips, J., held that allegations in trustee's complaint against state taxing authority, regarding bankruptcy court's ability to determine the estate's right to the tax refunds pursuant to bankruptcy statute allowing it to determine amount or legality of any tax, did not sufficiently set forth an undisputed right on part of estate to these tax refunds, and did not state proper claim for turnover, as to which the States would have waived their sovereign immunity.

Motion granted.

1. Bankruptcy 🔑2049, 2050

While a proceeding for turnover of estate property is "core proceeding," that bankruptcy court may decide, an unliquidated, disputed state law cause of action to bring funds into bankruptcy estate is a non-core, related to proceeding, and is not proceeding over which bankruptcy court can exercise "core" jurisdiction as turnover proceeding. 28 U.S.C.A. § 157(b)(2)(E).

2. Federal Courts 🔑2371

As general rule, a state's Eleventh Amendment immunity prevents federal courts, including bankruptcy courts, from entering money judgments against state. U.S. Const. Amend. 11.

3. Federal Courts 🔑2375(1)

State's Eleventh Amendment immunity may be waived. U.S. Const. Amend. 11.

4. Federal Courts 🔑2371

Eleventh Amendment protections apply only to judicial proceedings constituting a "suit" against the state. U.S. Const. Amend. 11.

5. Federal Courts 🔑2371

In deciding whether a proceeding constitutes a "suit" against the state, of kind barred by the Eleventh Amendment, court should consider, from a procedural standpoint, the degree of coercion exercised by federal court in compelling the state to attend and whether the resolution, or the remedy, would require jurisdiction over the state, and from a substantive standpoint, whether the proceeding involves

CARS, CARS, CARS

City of Chicago, Illinois v Fulton

141 S.Ct. 585 (U.S. 2021)

And Addendum

In re Cordova
635 B.R. 321 (Bkrtcy.N.D.Ill., 2021)

Judge Robyn L. Moberly
U.S. Bankruptcy Court
Southern District of Indiana

Just when you think certain law is settled, it changes. *City of Chicago, Illinois v. Fulton,* 141 S.Ct. 585 (U.S. 2021), is just such a case. The case started with cars being towed and impounded in Chicago for unpaid parking tickets and moving violations, which generate a significant amount of revenue for the city. Outstanding debt for Chicago traffic tickets surpassed $1.8 billion last year. The City issues around three million tickets a year, and revenue from those tickets in 2016 exceeded a quarter of a billion dollars and constituted seven percent of the City's operating budget. Melissa Sanchez & Sandhya Kambhampati, Driven into Debt: How Chicago Ticket Debt Sends Black Motorists into Bankruptcy, ProPublica Ill. (Feb. 27, 2018), https://features.propublica.org/driven-into-debt/chicago-ticket-debt-bankruptcy. *Matter of Mance*, 31 F.4th 1014, 1016 (C.A.7 (Ill.), 2022).

Since debtors couldn't get to their jobs or otherwise live in the city without their cars, it became wide practice in Chicago for debtors to file Chapter 13 bankruptcies, obtain the automatic stay and quickly get their cars returned by the city's towing companies. The city decided they'd fight this loss of income and quit returning the cars upon notice of the automatic stay and debtor's request for the return of their vehicles after the filing of a bankruptcy. Several cases sprung from this new policy of refusing to return the cars to the owners and the bankruptcy judges in Chicago decided they'd all rule and write decisions on the *Motions to*

Enforce the Stay filed by the debtors' attorneys. Several of the cases were consolidated and went to the Seventh Circuit Court of Appeals.[1]

There was no dispute but that the debtors each had an equitable interest in their cars and, thus, the vehicles were estate property under 11 USC §541. Noting that section 362(a)(3) had been amended in 1984 from 'to obtain possession' to 'obtain possession … *or to exercise control'*, (emphasis added) the bankruptcy court surmised that this additional language was intended to broaden the concept of possession to include property not in the physical possession of the debtor at the time of filing.

According to the Seventh Circuit at that time, the turnover section, 11 U.S.C. §542 (a), required a creditor in possession of estate property to deliver the property of the estate to the trustee. Citing *Thompson v. General Motors Acceptance Corp., LLC*, 566 F.3d 699 (C.A.7 (Ill.),2009), the Seventh Circuit stated that § 542(a) "indicates that turnover of a seized asset is compulsory." Observing that § 542(a) works in conjunction with §362(a), the Code then substitutes 'adequate protection' for possession as one of the lien creditor's rights in the bankruptcy case. Since possession is "incident" to the automatic stay, the creditor must return the estate property to the trustee/debtor and at that point the Court may condition the right of the debtor to retain the property on debtor paying adequate protection. Citing *Whiting Pools,* 462 U.S. at 204, 103 S.Ct. 2309, the Court stated that a "creditor with a secured interest in property included in the estate must look to §363 for protection*,* rather than to the nonbankruptcy remedy of possession." So, we all continued to require creditors in possession of estate assets to immediately turn

[1] The United States Bankruptcy Court for the Northern District of Illinois, Jacqueline P. Cox, J., 584 B.R. 252, Deborah Lee Thorne, J., 588 B.R. 811, Carol A. Doyle, J., 590 B.R. 467, and Jack B. Schmetterer, J., 2018 WL 2570109, and city appealed. Consolidating cases for purposes of appeal, the Court of Appeals for the Seventh Circuit, Flaum, Circuit Judge, 926 F.3d 916, affirmed. Certiorari was granted.

them over to the debtor upon filing of the bankruptcy petition and entry of the automatic stay.

The appeal to the Seventh Circuit involved 4 cases, in one of which, *Howard,* the underlying bankruptcy petition had been dismissed and he did not participate in the briefing on appeal. The city had already disposed of his vehicle. The Circuit Court noted that the dismissal of the underlying case does not moot issues that are related to an alleged violation of the automatic stay. *Denby-Peterson v. Nu2u Auto World*, 595 B.R. 184, 188 (D.N.J. 2018). A court "must have the power to compensate victims of violations of the automatic stay and punish the violators, even after the conclusion of the underlying bankruptcy case." *In re Johnson*, 575 F.3d 1079, 1083 (10th Cir. 2009) (citing *In re Davis,* 177 B.R. 907, 911–12 (B.A.P. 9th Cir. 1995)).

The Seventh Circuit's approach was much the same as the approach taken by the Chicago bankruptcy judge. Section 362(a)(3) of the Bankruptcy Code provides that a Chapter 13 bankruptcy petition "operates as a stay, applicable to all entities, of ... any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate." 11 U.S.C. § 362(a)(3). There is no debate the debtor has an equitable interest in his vehicle, and "as such, it is property of his bankruptcy estate." *Thompson v. General Motors Acceptance Corp.,* 566 F.3d 699 (7th Cir. 2009). (*citing United States v. Whiting Pools, Inc.,* 462 U.S. 198, 203, 103 S.Ct. 2309, 76 L.Ed.2d). "Holding onto an asset, refusing to return it, and otherwise prohibiting a debtor's beneficial use of an asset all fit within th[e] definition, as well as within the commonsense meaning of the word." *Thompson,* 566 F.3d at 702.

Moreover, Congress in the1984 amendment to § 362(a)(3) prohibited conduct that "exercise[d] control" over estate assets. We determined this addition suggested congressional intent to make the stay more inclusive by including conduct of "creditors who seized an asset pre-petition." See *In re Javens*, 107 F.3d 359, 368 (6th

Cir. 1997) ("The fact that 'to obtain possession' was amended to 'obtain possession ... or to exercise control' hints [ ] that this kind of 'control' might be a broadening of the concept of possession ... It could also have been intended to make clear that [§ 362](a)(3) applied to property of the estate that was not in the possession of the debtor." *In re Del Mission Ltd.*, 98 F.3d 1147, 1151 (9th Cir. 1996) (The 1984 amendment "broaden[ed] the scope of § 362(a)(3) to proscribe the mere knowing retention of estate property.").

Since a creditor has the burden of requesting protection of its interest in the asset under § 363 "if a creditor is allowed to retain possession, then this burden is rendered meaningless—a creditor has no incentive to seek protection of an asset of which it already has possession." *Thompson*, 566 F.3d at 704. For § 363 to have meaning then, the asset must be returned to the estate prior to the creditor seeking protection of its interest. Id.; cf. *In re Sharon*, 234 B.R. 676, 684 (B.A.P. 6th Cir. 1999). This position brought the Seventh Circuit in line with the majority rule, held by the Second, Eighth, and Ninth Circuits. *See Weber*, 719 F.3d 72; *Del Mission* 98 F.3d 1147; *In re Knaus*, 889 F.2d 773 (8th Cir. 1989). Although the Tenth Circuit adopted the City's view, see *In re Cowen*, 849 F.3d 943 (10th Cir. 2017), that position was still the minority rule. The fact is the City wanted to maintain possession of the vehicles not because it wants the vehicles but to put pressure on the debtors to pay their tickets. That is precisely what the stay is intended to prevent. *In re Fulton*, 926 F.3d 916, 925–26 (C.A.7 (Ill.), 2019).

The City's continued possession of a debtor's vehicle is one way to perfect its lien. The City can also perfect its lien by filing notice of its interest in the vehicle, such as with the Secretary of State or the Recorder of Deeds. And the Chapter 13 plan, itself, provides a public record of secured liens. See 11 U.S.C. § 1325(a)(5) (regarding the rights of secured creditors related to confirmation of the plan). Thus, the City does not need to retain possession of the vehicle to maintain perfection of its lien.

The City's possessory lien is not destroyed by its involuntary loss of possession due to forced compliance with the Bankruptcy Code's automatic stay. Since the City did not indicate any intent to abandon or release its lien, its possessory lien survives its loss of possession to the bankruptcy estate. See *In re Estate of Miller,* 197 Ill.App.3d 67, 144 Ill.Dec. 890, 556 N.E.2d 568, 572 (1990) ("The law respecting common law retaining liens is that the involuntary relinquishment of retained property pursuant to a court order does not result in the loss of the lien."); Restatement (First) of Security § 80 cmt. c (1941) ("The lien is a legal interest dependent upon possession. Where the lienor voluntarily gives up the possession, his lien, at least so far as it is a legal interest, is gone. The lienor ... does not lose his legal interest if he is deprived without his consent of his possession.").

The City also cited to § 362(b)(4) to except it from the stay. That section provides that a Chapter 13 bankruptcy petition does not operate as a § 362(a) automatic stay:

> of the commencement or continuation of an action or proceeding by a governmental unit ... to enforce such governmental unit's or organization's police and regulatory power, including the enforcement of a judgment other than a money judgment, obtained in an action or proceeding by the governmental unit to enforce such governmental unit's ... police or regulatory power.

"This exception has been narrowly construed to apply to the enforcement of state laws affecting health, welfare, morals and safety, but not to 'regulatory laws that directly conflict with the control of the res or property by the bankruptcy court.'" *In re Cash Currency Exch., Inc.,* 762 F.2d 542, 555 (7th Cir. 1985) (quoting *In re Missouri*, 647 F.2d 768, 776 (8th Cir. 1981)).

Courts apply two tests to determine whether a state's actions fall within the scope of § 362(b)(4)—the pecuniary purpose test and the public policy test. The pecuniary purpose test requires the court to "look to what specific acts the government wishes to carry out and determine if such execution would result in an economic advantage over third parties in relation to the debtor's estate." *In re*

Emerald Casino, Inc., No. 03-cv-05457, 2003 WL 23147946, at *8 (N.D. Ill. Dec. 24, 2003)). "[I]f the focus of the police power is directed at the debtor's financial obligations rather than the [government's] health and safety concerns, the automatic stay is applicable." *In re Ellis*, 66 B.R. 821, 825 (N.D. Ill. 1986). Although the City argued otherwise, the Court found that by retaining the car until its fines were all paid, the City is "attempting to satisfy a debt outside the bankruptcy process," which would give it an advantage over other parties interested in the debtors' estates. *Emerald Casino*, 2003 WL 23147946.

Then came the Supreme Court's decision in the appeal of the Seventh Circuit's decision in Fulton, *City of Chicago, Illinois v. Fulton*, 141 S.Ct. 585 (U.S., 2021). In a nutshell, the Court held that the automatic stay (the "more natural reading" of § 362(a)(3)) is that it endeavors to maintain the status quo at the time of the filing of the bankruptcy petition. It prohibits affirmative acts to collect a debt or disturb the status quo of the bankruptcy estate but imposes no obligation on a creditor to immediately return the property to the debtor. The Court determined that a requirement to return property in the creditor's possession merely in response to the filing of a petition for bankruptcy runs afoul of §542, "Turnover of property to the estate". This section provides, with just a few exceptions, that an entity in possession of property of the bankruptcy estate "shall deliver to the trustee, and account for" that property.

The Court focused on three terms used in § 362(a)(3) to arrive at the intended meaning of the section: "stay," "act," and "exercise control". These are words of passive, not affirmative, behavior. A "stay" typically acts to suspend judicial alteration of the status quo; an "act" is something performed; and to "exercise control" generally means to put in practice or to carry out an action. The key words in § 362(a)(3) all direct the reader to conclude the section prohibits affirmative actions to collect a debt or alter the status quo. While there is ambiguity in these terms, §542 directs the reader to the Court's conclusion. §542 states:

> "[A]n entity, other than a custodian, in possession, custody, or control, during the case, of property that the trustee may use, sell, or lease under section 363 of this title, or that the debtor may exempt under section 522 of this title, shall deliver to the trustee, and account for, such property or the value of such property, unless such property is of inconsequential value or benefit to the estate."

One of the serious problems created by enforcing immediate return of estate property held at the time of filing is that it renders §542 superfluous. Since §542 is the guiding principle in turnover actions, any other interpretation would make §362 the driving force in turnover proceedings. To construe §362 as the primary turnover section would eliminate the exceptions to turnover established by §542: property which may be exempted by the debtor, property that the trustee may use, sell or lease, and property of inconsequential value or benefit to the estate.

Prior to the 1984 amendment, there is no argument that §362 was not a turnover section. If Congress had intended §362 to take such a primary turnover position when it grafted "or to exercise control" onto §362, Congress would have indicated it was making such a dramatic change in the rights and responsibilities of creditors. Therefore, the Court determined that mere retention of estate property after the filing of a bankruptcy petition does not violate § 362(a)(3) of the Bankruptcy Code.

Justice Sotomayor wrote a concurring opinion emphasizing that the City of Chicago's decision to hold debtors' cars does not comport with the fresh start intended by the Code. She also noted the range of issues not addressed in this decision. The debtor has recourse in this situation. For one, he can use §542 to obtain possession of the vehicle but must be prepared to show the vehicle is insured and must pay adequate protection as a substitute for the security of possession. The obvious problem with §542(a) is the delay occasioned by an adversary proceeding. Justice Sotomayor invites courts to create workarounds to shorten the time it takes to conclude a turnover action. *In re Fulton*, 926 F.3d 916, 924 (C.A.7 (Ill.), 2019).

As an epilogue to the last *Fulton* decision, the City appealed later decisions of the bankruptcy court and district court which had found that the impoundment liens held by the City were judicial, not statutory. The issue presented in the appeal was whether the City's possessory lien on a vehicle that it impounds due to unpaid tickets should be deemed a "judicial lien" or a "statutory lien" under the Bankruptcy Code. If the lien is judicial, all parties agreed, it is avoidable in bankruptcy under 11 U.S.C. § 522(f). If the lien is instead deemed statutory, it is not avoidable under the same provision. *Matter of Mance*, 31 F.4th 1014, 1016 (C.A.7 (Ill.), 2022). The *Mance* decision is interesting because it delves deeply into the statutory construction of each type of lien in the Bankruptcy Code. The Seventh Circuit found that the City's impoundment liens were judicial and therefore, avoidable under section 522(f). It's a decision well worth reading if confronted with categorizing a lien as statutory or judicial.

Discussion Post-Fulton

Cordova v City of Chicago

On December 6, 2021, Judge Barnes issued a Memorandum decision denying, in part, and granting, in part, a *Motion to Dismiss* ("motion") filed by the City of Chicago ("City") against its citizen, Emelida Cordova. Unrelated to this discussion, the case involves a claim for certification of a class of similarly situated Chicago citizens. The case alleges the City violated the automatic stay and turnover provisions of the Bankruptcy Code, specifically section 362 (a)(4),(6), and (7) and section 542(a). The City's motion argued that *Fulton* ruled that violation of the automatic stay under section 362(a)(3) requires an affirmative act, and merely holding the impounded vehicle was insufficient. Therefore, under this reasoning, the entirety of section 362 also requires such an affirmative act.

The facts of the underlying dispute are not contested. The plaintiff's car was impounded and she filed a chapter 13 bankruptcy to get possession of her car back. The City's policy required a debtor to pay an upfront payment of $1,000 and to treat the City's claim as fully secured in the Chapter 13 Plan. The policy did not take into account the value of the vehicle or the diminution of value due to the passage of time. At the time the lawsuit was filed by the Plaintiff, the Seventh Circuit had held that merely holding the impounded vehicle was a violation of the stay. Months after the filing, the Supreme Court decision in *Fulton* was handed down. As a result, the Plaintiff amended her Complaint to allege the refusal to return the impounded vehicle violated sections 362(a)(4),(6), and (7) as well as section 542(a).

Section 362 (a)(4) and (6)

The relevant parts of section 362 are as follows:

> [A] petition filed under section 301, 302, or 303 of this title ... operates as a stay, applicable to all entities, of—
> *336 ...
> (4) any act to create, perfect, or enforce any lien against property of the estate;
> ...
> (6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title;
> (7) the setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor;
> ....
> 11 U.S.C. §§ 362(a)(4), (6) & (7).

The Court found that *Fulton* is limited by its own terms to section 362(a)(3) and therefore retention of the vehicle could still be a stay violation. Further, the City may have committed other actions in violation of the automatic stay since the pleading stage doesn't require a thorough explanation of the underlying facts and theories. Further, the City's interpretation leaves debtors with virtually no immediate remedy and other creditors with no remedy at all.

Justice Sotomayor emphasized in her *Fulton* concurrence that the Court was not deciding whether and when the other sections of 362(a) may require a creditor to return a debtor's property. The City's argument relies on the words "act" and "stay", which are just 2 of the 3 terms that assisted the Court's determination that 362(a)(3) requires an affirmative act to justify a violation of the automatic stay. Judge Barnes noted that *Fulton* interpreted the combination of "act", "stay" and "to exercise control over" in conjunction with one another to find that there was no stay violation. The phrase "to exercise control over" is unique to 362(a)(3).

Justice Sotomayor cited to the case of *In re Kuehn,* 563 F.3d 289 (C.A.7 (Wis.),2009) as an example of a violation of 362 (a)(6). In *Kuehn*, the university refused to provide to a student-debtor their college transcript until a debt was paid to the university. The Seventh Circuit found this refusal was for the purpose of collecting a debt. The student had a contractual right to the transcript, was willing to pay to produce the transcript and the transcript had no intrinsic value. *Kuehn* found this to be a violation of 362(a)(6) prohibition on an act to collect prepetition debt. Judge Barnes cited to a case of Judge Thorne's *In re Peake*, 588 B.R. 811, 820 (Bankr. N.D. 2018) where Judge Thorne points out that the municipal code allows other lienholders to obtain release of the vehicles by merely paying the towing cost, not the judgment amount, suggesting that the purpose of the City's refusal to return the vehicle to the debtor was to collect a debt.

Essentially, the Court refused to adopt a very expansive view of *Fulton* on the procedural step of a motion to dismiss. The Court refused to dismiss the counts of the Complaint alleging violations of 362(a)(4) and (6).

Section 362(a)(7)

Offsetting a debt owed to the debtor against a debt owed by the debtor is preserved under section 553(a), but it is nonetheless stayed under 362(a)(7). The plaintiff's Complaint alleged that the City effected a setoff but the caselaw requires the element of permanency to the setoff. *Citizens Bank of Maryland v. Strumpf*, 516 U.S. 16 (U.S.Md.,1995). The Court ruled that an administrative hold on an account by the bank until the bank could obtain stay relief was not a setoff. To affect a setoff, there must be three steps: a decision to effectuate a setoff, some action accomplishing the setoff and a recording of the setoff. The plaintiff's mere allegation that a setoff had occurred was insufficient and the underlying facts that were pleaded in the Complaint foreclosed the possibility of proving a setoff had occurred.

Section 542(a)

The City argued that it had no duty to turnover property of the estate until there was an order in the adversary proceeding to compel turnover. The City further stated that it was entitled to adequate protection and its bargaining with debtor was merely an attempt to secure adequate protection.

The Court noted that the City had an express statutory obligation to return estate property under section 542(a). Essentially, the City states that it has no duty to return the property until it is ordered to do so. However the Court found the self-executing nature of 542(a) to be fundamental, citing 5 COLLIERS ON BANKRUPTCY ¶542.02: "By its express terms, 542(a) is self-executing, and does not require that the trustee take any action or commence a proceeding or obtain a court order to compel the turnover."

The Court ruled that the section 542(a) claim survived the dismissal motion.

Punitive Damages

Unrelated to the automatic stay discussions, the Court also addressed the plaintiff's prayer for punitive damages. "[n]otwithstanding an assertion of sovereign immunity, sovereign immunity is abrogated as to a governmental unit to the extent set forth in ... Sections ... 362 ... [and] ... 542 ...." 11 U.S.C. § 106(a)(1). Section 106 goes on to clarify that "[t]he court may issue against a governmental unit an order, process or judgment ... including an order or judgment awarding a money recovery, but not including an award of punitive damages ...." 11 U.S.C. § 106(a)(3). *Cordova, infra at* 347. The Court wrote in depth on the nuances of section 106(a)(1) and found that this prayer for relief must be dismissed. A reading of the full case expands this discussion meaningfully.

The Court ruled that the Complaint stated plausible claims for violation of sections 362(a)(4) and (6), section 542(a) and dismissed 362(a)(7) and the prayer for punitive damages.

Sigmund J. Beck Advanced Bankruptcy Roundtable
West Baden Springs Resort, West Baden Springs, Indiana
August 19-20, 2022

Melissa M. Root
JENNER & BLOCK LLP
Chicago, Illinois

Administrative Claims in Post-Confirmation Pre-Effective Date Purgatory
***Ellis v. Westinghouse Elec. Co. LLC*, 11 F. 4th 221 (3rd Cir. 2021)**

Westinghouse Electric Company confirmed its plan of reorganization on March 28, 2018, in the United States Bankruptcy Court for the Southern District of New York. A condition precedent to the Plan's effective date was the closing of an investment transaction, and because of necessary regulatory approvals, the effective date did not occur until August 1, 2018. The Plan set an administrative claims bar date that was thirty days after the Plan's effective date. The Plan further provided that holders of administrative claims that did not file a claim by the administrative bar date "shall be forever barred, estopped, and enjoined" from asserting those claims against the debtor. The Plan also contained language discharging all claims as of the effective date.

On May 31, 2018, two months after the Plan was confirmed, but two months before the Plan went effective, Westinghouse terminated Timothy Ellis' employment. In July 2018, Ellis filed a charge with the EEOC, and in October 2018, Ellis filed suit against Westinghouse in the United States District Court for the Western District of Pennsylvania. Westinghouse moved for summary judgment, arguing that Ellis' discrimination claim was an administrative claim, and that as a consequence of Ellis' failure to file an administrative claim before the administrative claim bar date, the claim was discharged by the Plan and confirmation order.

<u>The District Court Decision</u>

The District Court denied Westinghouse's motion for summary judgment. It concluded that section 503 did not authorize the use of a bar date to discharge post-confirmation administrative expense claims, and that section 1141 prohibited the discharge of post-confirmation claims. Specifically, with respect to section 503, the District Court was persuaded by *dicta* in *Sanchez v. Nw. Airlines, Inc.*, 659 F.3d 671 (8th 2011), that section 503 permits administrative priority for "*Reading*-like" tort claims (see below) but does not render them dischargeable if not asserted by the administrative bar date. And with respect to section 1141, the district court reasoned that a post-confirmation claim that had "nothing to do with the implementation or accomplishment of any provision of the Plan" and "did not arise from or relate to the laws regarding the bankrupt's financial condition" could not be discharged by section 1141 (citing to the Supreme Court's decision in *Hollywell Corp. v. Smith*, in which the Court explained: "[e]ven if § 1141(a) binds creditors of the corporate and individual debtors with respect to claims that arose before confirmation, we do not see how it can bind the United States or any other creditor with respect to postconfirmation claims."503 U.S. 47, 58 (1992), and distinguishing the Third Circuit's decision in *In re Arctic Glacier Int'l, Inc.,* 901 F.3d 162, 166 (3d Cir. 2018)).

The District Court certified the question to the Third Circuit for immediate interlocutory appeal.

The Third Circuit Decision

The Third Circuit, in an opinion authored by Judge Ambro, reversed the District Court and held that the plan discharged Ellis' administrative claim.

The Third Circuit found that Ellis' claim was an administrative claim subject to section 503. Citing to *Reading Company v. Brown*, 391 U.S. 471 (1968), the court explained that Ellis' employment benefitted Westinghouse's estate, and that the age discrimination claim, which arose out of that employment, was a cost "ordinarily incident to operation of a business." The district court had similarly found that Ellis' claim was an administrative claim, but it attempted to distinguish *Reading*-type claims from other administrative claims, noting in *dictum* that "*Reading* defines administrative expense claims for the purpose of priority status under section 503, which differ from purposes of dischargeability." The Third Circuit rejected this argument—"[a] claim is either an administrative expense claim or it is not; it cannot be a chameleon." The court explained that section 503 permits bankruptcy courts to set and enforce bar dates for administrative expense claims, and for good reason, given that section 1129(a)(9)(A) requires administrative claims to be paid in full.

Reaching the threshold issue, the Third Circuit focused on the fact that, post-confirmation but pre-effective date, the estate still exists. It is not the pre-bankruptcy debtor, nor is it the reorganized debtor. Thus, the "Bankruptcy Code ties the viability of administrative expense claims (and, by extension, the coverage of a bar date for those claims) to the existence of the estate, not confirmation of the plan." The fact that section 503 does not mention the word "discharge" was not persuasive to the court—"[i]n practice, the specter of discharge is integral to a bar date. Without it, bar dates have no teeth." The Third Circuit viewed section 503 and section 1141 as working in "tandem": "section 503 gives bankruptcy courts the power to set bar dates" and "1141(d) allows the plan and confirmation order generally to govern the discharge of claims."

Finally, the Third Circuit rejected the argument that because section 1141(d)(1)(A) provides that confirmation of a plan discharges the debtor from any debt *that arose before the date of such confirmation*, that it created a categorical rule that only pre-confirmation claims may be discharged. Noting that section 1141 contains the proviso, "[e]xcept as otherwise provided in this subsection, in the plan, or in the order confirming the plan," the Third Circuit reasoned that section 1141 creates a default rule for discharging pre-confirmation debts, meaning it applies only when the plan and confirmation order are "silent on the issue." Because the Plan in Westinghouse provided for the discharge of administrative claims not timely filed by the administrative claims bar date, the Plan "overrides" the default rule.

<u>Discussion Questions</u>:

1. Section 1129(a)(9)(A) requires a plan to pay administrative claims in full. What happens if post-confirmation/pre-effective date, an unexpected administrative claim is filed that the debtor does not have sufficient funds to pay?

2. Ellis argued that discharging his claim went beyond giving the Debtor a "fresh start" and instead created a windfall. What do you think?

3. Holders of post-confirmation administrative claims do not vote on the plan. Does that matter? Is that fair?

4. Does this open the door for gamesmanship? Is there a scenario where it would be advantageous for a debtor to have a lengthy period between confirmation and the effective date?

<u>Appendix</u>

1. *Ellis v. Westinghouse Elec. Co. LLC*, 11 F. 4th 221 (3d Cir. 2021)

2. *Ellis v. Westinghouse Elec. Co. LLC*, 2020 WL 4499931 (W.D. Penn. Aug 5, 2020)

11 F.4th 221
United States Court of Appeals, Third Circuit.

Timothy ELLIS
v.
WESTINGHOUSE ELECTRIC CO., LLC, Appellant

No. 20-2867
|
Argued on April 6, 2021
|
(Opinion filed: August 30, 2021)

Synopsis
Background: Employee, whose age discrimination claim against Chapter 11 debtor, his former employer, arose after confirmation of debtor's plan of reorganization but before the plan went into effect, did not assert claim in the New York bankruptcy court in which debtor's bankruptcy case had been commenced but, instead, filed suit against debtor in federal court in Pennsylvania. Following a stay pending employee's exhaustion of state administrative remedies, debtor moved for summary judgment, arguing that claim was not timely filed by the administrative claims bar date. The United States District Court for the Western District of Pennsylvania, Mark R. Hornak, Chief Judge, 2020 WL 4499931, denied debtor's motion, granted summary judgment in favor of employee, and certified questions for immediate interlocutory appeal.

Holdings: The Court of Appeals, Ambro, Circuit Judge, held that:

[1] postpetition employment discrimination claims against a debtor-employer are "actual and necessary" administrative expenses, and

[2] addressing an issue of apparent first impression for a federal appellate court, the Bankruptcy Code authorizes bankruptcy courts to set and enforce bar dates for administrative expense claims, including claims arising after confirmation of a Chapter 11 plan but before its effective date, so if holders of post-confirmation, pre-effective date administrative expense claims choose to bypass the bankruptcy process and do not timely file such claims by the bar date, the claims face discharge like pre-confirmation claims.

Reversed.

West Headnotes (45)

[1] **Bankruptcy** Time for Filing

In bankruptcy, the "bar date" is a deadline set by the bankruptcy court for creditors to file claims against, or request payment from, the debtor. Fed. R. Bankr. P. 3003(c)(3).

1 Cases that cite this headnote

[2] **Bankruptcy** Time for Filing

Claims filed by creditors after the bar date without an acceptable excuse are usually "discharged" in bankruptcy, meaning the creditor cannot pursue the claim further and the debtor is released from the liability.

[3] **Bankruptcy** Effect as discharge

Chapter 11 plan of reorganization typically discharges claims occurring before the plan is "confirmed," that is, approved, by the bankruptcy court.

[4] **Bankruptcy** Creation of estate; time
Bankruptcy Legal or equitable interests in general

Filing a bankruptcy petition has immediate consequences; it creates an estate that, with some exceptions, comprises all legal or equitable interests of debtors in property as of commencement of case. 11 U.S.C.A. § 541(a)(1).

[5] **Bankruptcy** Claims allowable; what constitutes "claim."

Bankruptcy Code defines the term "claim" broadly to include the right to payment as well as the right to an equitable remedy for breach of performance if such breach gives rise to a right to payment. 11 U.S.C.A. § 101(5).

[6] **Bankruptcy** Administrative expenses in general

Bankruptcy Provisions for satisfaction of claims; relation to recovery in liquidation

Postpetition actual, necessary costs and expenses of preserving the estate are treated as administrative expense claims entitled to priority under the Bankruptcy Code's distribution scheme and paid in full under a Chapter 11 plan unless the claimant agrees to other treatment. 11 U.S.C.A. §§ 503(b)(1)(A), 507(a)(2), 1129(a)(9)(A).

[7] **Bankruptcy** Construction, execution, and performance

Although Chapter 11 plans usually become effective shortly after confirmation, there may be delay of months or longer in cases where, for example, debtor must wait for regulators to approve plan or investors to finalize financing.

[8] **Federal Courts** Interlocutory, Collateral, and Supplementary Proceedings and Questions; Pendent Appellate Jurisdiction

On an interlocutory appeal, the Court of Appeals' scope of review is generally constrained to the questions certified for review by the district court, though the appellate court may consider any grounds justifying reversal.

[9] **Federal Courts** Summary judgment

On review of a district court's summary judgment decision, the Court of Appeals' standard of review is plenary, meaning the appellate court reviews anew the district court's decision, applying the same standard it must apply.

1 Cases that cite this headnote

[10] **Federal Civil Procedure** Absence of genuine issue of fact in general

Federal Civil Procedure Right to judgment as matter of law

To prevail on its motion for summary judgment, the moving party must show that there is no genuine dispute as to any material fact and it is entitled to judgment as a matter of law. Fed. R. Civ. P. 56(a).

[11] **Bankruptcy** Protection Against Discrimination or Collection Efforts in General; "Fresh Start."

Principal purpose of the Bankruptcy Code is to grant a fresh start to the honest but unfortunate debtor.

[12] **Bankruptcy** Protection Against Discrimination or Collection Efforts in General; "Fresh Start."

Debtor's interest in a fresh start is not absolute, as the Bankruptcy Code tries to strike the delicate balance between the competing interests of creditors pursuing their claims and debtors in obtaining a fresh start and finality.

[13] **Bankruptcy** Administrative expenses in general

For a claim to qualify as an administrative expense, the claimant must typically show there was a postpetition transaction between the claimant and the estate, and the expenses yielded a benefit to the estate. 11 U.S.C.A. § 503(b)(1)(A).

[14] **Bankruptcy** Reorganization cases

Postpetition employment discrimination claims against a Chapter 11 debtor-employer are “actual and necessary” administrative expenses; such claims arise out of employees' employment, which benefits the bankruptcy estate, and treating them as administrative expenses furthers the policy goal of the administrative expense section of the Bankruptcy Code, namely, providing incentives for employees to continue working for a bankrupt company. 11 U.S.C.A. § 503(b)(1)(A).

[15] **Bankruptcy** Administrative expenses in general

In determining whether a claim qualifies as an administrative expense, courts must look at the utility of the underlying exercise, rather than focus on what went wrong. 11 U.S.C.A. § 503(b)(1)(A).

[16] **Bankruptcy** Administrative expenses in general

Administrative expense claims may not be categorized differently for the purposes of priority and discharge; a claim is either an administrative expense claim or it is not, and it cannot be a chameleon. 11 U.S.C.A. §§ 503, 503(b)(1)(A).

[17] **Bankruptcy** Necessity of Filing; Effect of Failure

Claims not filed and addressed in bankruptcy cannot be asserted later against reorganized debtor.

[18] **Bankruptcy** Time for Filing

For prepetition claims, bankruptcy courts have the power to set bar dates before which proofs of claim against the debtor's estate must be filed. Fed. R. Bankr. P. 3003(c)(3).

[19] **Bankruptcy** Time for Filing

Claims not filed by bar date are typically discharged, meaning claimant cannot recover from debtor or reorganized debtor. Fed. R. Bankr. P. 3003(c)(3).

[20] **Bankruptcy** Time for Filing

Claims bar date is binding on a creditor even if it does not participate in the bankruptcy.

1 Cases that cite this headnote

[21] **Bankruptcy** Extension of Time; Excuse for Delay

To avoid unnecessarily harsh results, claimant can still file claim after bar date if he shows excusable neglect. Fed. R. Bankr. P. 3003(c)(3), 9006(b)(1).

[22] **Constitutional Law** Bankruptcy

Any discharge of debt in bankruptcy must satisfy due process requirements. U.S. Const. Amend. 5.

[23] **Bankruptcy** Time for Filing

Bankruptcy Code authorizes bankruptcy courts to set and enforce bar dates for administrative expense claims. 11 U.S.C.A. §§ 503, 503(a); Fed. R. Bankr. P. 3003(c)(3).

[24] **Bankruptcy** Time for Filing

Although, to be technical, a claimant files a "request for payment" rather than a "proof of claim" for an administrative expense claim, much of the logic and case law about general bar dates for prepetition claims apply with equal force to administrative expense claims. 11 U.S.C.A. § 503(a).

[25] **Bankruptcy** Time for Filing

Bankruptcy Construction, execution, and performance

Chapter 11 debtor can choose not to set an administrative expense claim bar date; if no bar date is set, and depending on the terms of the plan, the claim could be filed any time against the debtor or the reorganized debtor, limited only by the relevant statute of limitations. 11 U.S.C.A. § 503(a).

[26] **Bankruptcy** Administrative claims; request for payment

A governmental unit is not required to file a request for payment of an administrative tax expense. 11 U.S.C.A. § 503(b)(1)(D).

1 Cases that cite this headnote

[27] **Bankruptcy** Administrative claims; request for payment

Administrative expense section of the Bankruptcy Code provides both a carrot and a stick for creditors promptly to request payment of administrative expenses: file claims on time and, if valid, they will receive priority treatment in the bankruptcy and get paid in full under the plan, but file the claims late and they will face discharge. 11 U.S.C.A. § 503(a).

[28] **Bankruptcy** Provisions for satisfaction of claims; relation to recovery in liquidation

Chapter 11 plan must pay administrative expense claims in full. 11 U.S.C.A. § 1129(a)(9)(A).

[29] **Bankruptcy** Time for Filing

Bankruptcy court may set multiple administrative claims bar dates to help debtor implement workable plan. Fed. R. Bankr. P. 3003(c)(3).

[30] **Bankruptcy** Loss to or diminution of estate and unlikelihood of rehabilitation

Inability to pay administrative expenses is called "administrative insolvency," typically resulting in conversion of the Chapter 11 case to Chapter 7 liquidation. 11 U.S.C.A. § 503.

[31] **Bankruptcy** Time for Filing
Bankruptcy Effect as discharge

Bankruptcy courts' authorization to set and enforce administrative expense claim bar dates includes claims arising after confirmation of a Chapter 11 plan but before its effective date, so if holders of post-confirmation, pre-effective date administrative expense claims choose to bypass the bankruptcy process and do not timely file claims by the bar date, the claims face discharge like pre-confirmation claims; nothing in Bankruptcy Code says that only pre-confirmation claims must be "timely filed," Code instead ties viability of administrative expense claims and, by extension, coverage of bar date for those claims, to existence of the estate, not plan confirmation, categorical carveout from bar date for all post-confirmation claims would needlessly tie hands of courts to use bar date as reorganization tool, and Code provision stating that plan confirmation discharges pre-confirmation debts is default rule applicable only when plan and confirmation order are silent on issue. 11 U.S.C.A. §§ 503, 1141(d)(1); Fed. R. Bankr. P. 3003(c)(3).

2 Cases that cite this headnote

[32] **Statutes** Absent terms; silence; omissions

Courts generally refrain from adding words to a statute.

[33] **Bankruptcy** Administrative expenses in general

Because administrative expenses preserve the bankruptcy "estate," what matters is that the claim accrues against the estate before it ceases to exist. 11 U.S.C.A. § 503(b)(1)(A).

1 Cases that cite this headnote

[34] **Bankruptcy** Construction, execution, and performance

While typically the bankruptcy estate ends when a Chapter 11 plan is confirmed, the plan can extend the life of the estate to a later date such as the effective date. 11 U.S.C.A. § 1141(b).

2 Cases that cite this headnote

[35] **Bankruptcy** Necessity of Filing; Effect of Failure

Bankruptcy Extension of Time; Excuse for Delay

Failing to file a claim by the bar date does not automatically discharge it, as a bankruptcy court can still accept a late filing "for cause" or refuse to discharge a claim based on due-process concerns. U.S. Const. Amend. 5; 11 U.S.C.A. § 503.

[36] **Bankruptcy** Effect as discharge

Section of the Bankruptcy Code stating that confirmation of a Chapter 11 plan discharges pre-confirmation debts is not a categorical rule but, instead, is a default rule that applies only when the plan and confirmation order are silent on the issue. 11 U.S.C.A. § 1141(d)(1).

1 Cases that cite this headnote

[37] **Bankruptcy** Effect

Section of the Bankruptcy Code governing effect of confirmation of Chapter 11 plans generally preserves broad flexibility for a plan and confirmation order to override default rules. 11 U.S.C.A. § 1141.

[38] **Bankruptcy** Effect

While confirmation of a Chapter 11 plan generally vests property of the estate in the debtor, the Bankruptcy Code allows the plan and confirmation order to delay vesting. 11 U.S.C.A. § 1141(b).

[39] **Bankruptcy** Effect

Property dealt with by a Chapter 11 plan or the confirmation order is generally free and clear of all claims after confirmation. 11 U.S.C.A. § 1141(c).

[40] **Bankruptcy** Administrative claims; request for payment

Constitutional Law Bankruptcy

Any discharge of a late-filed administrative expense claim must comport with due process, so a claim is only subject to discharge if a creditor received adequate notice of the bankruptcy and had a fair opportunity to press his claim. U.S. Const. Amend. 5; 11 U.S.C.A. § 503(a).

1 Cases that cite this headnote

[41] **Bankruptcy** Lack or insufficiency of notice

A key element of adequate notice, in context of determining whether a claimant received adequate notice of a claims bar date, is information about the types of claims subject to the bar date. Fed. R. Bankr. P. 3003(c)(3).

[42] **Bankruptcy** Sufficiency of Filing

Burden to comply with a claims bar date is low; a creditor does not even have to know the amount or validity of the claim, for he can easily file a "protective" claim putting the debtor on notice without conceding any issues.

[43] **Bankruptcy** Eligibility to vote; impairment

Administrative expense claims are usually considered unimpaired and not entitled to vote on a Chapter 11 plan. 11 U.S.C.A. § 1126(f).

[44] **Bankruptcy** Administrative expenses in general

Administrative expense claims can only be against the bankruptcy "estate." 11 U.S.C.A. § 503.

[45] **Bankruptcy** Time for Filing

Bankruptcy Code gives bankruptcy courts discretion to set and enforce bar dates by which creditors must file administrative expense claims. 11 U.S.C.A. § 503.

***226** Appeal from the United States District Court for the Western District of Pennsylvania (D.C. Civil Action No. 2-18-cv-01442), District Judge: Honorable Mark R. Hornak

Attorneys and Law Firms

Robert B. Niles-Weed (Argued), Weil Gotshal & Manges, 767 Fifth Avenue, New York, NY 10153 Zachary Tripp, Weil Gotshal & Manges, 2001 M Street, N.W., Suite 600, Washington, DC 20036, Shelly R. Pagac, Eric G. Soller, Pietragallo Gordon Alfano Bosick & Raspanti, 301 Grant Street, One Oxford Centre, 38th Floor, Pittsburgh, PA 15219, Counsel for Appellant

Joel S. Sansone (Argued), Massimo Terzigni, Elizabeth A. Tuttle, Law Offices of Joel Sansone, 603 Stanwix Street, Two Gateway Center, Suite 1290, Pittsburgh, PA 15222, Counsel for Appellee

Before: AMBRO, GREENAWAY, JR., and BIBAS, Circuit Judges

OPINION OF THE COURT

AMBRO, Circuit Judge

[1] **[2]** **[3]** Dates matter in bankruptcy. For creditors, none is more important than the "bar date," a deadline set by the bankruptcy court for them to file claims against, or request payment from, the debtor. Claims filed after the bar date without an acceptable excuse are usually discharged (meaning the creditor cannot pursue the claim further and the debtor is released from the liability). The bar date interacts with the Chapter 11 plan of reorganization, which typically discharges claims occurring before the plan is confirmed (*i.e.*, approved) by the bankruptcy court.

But what if the claim arose after a plan was confirmed and before it goes into effect? To our knowledge, no federal appellate court has directly addressed this issue. We hold that sections 503 and 1141 of the Bankruptcy Code authorize bankruptcy courts to set and enforce bar dates for administrative expense claims, including claims arising after confirmation of a plan but before its effective date. The holder of a post-confirmation administrative expense claim cannot choose to bypass the bankruptcy process, so if the claim is not timely filed by the bar date, it faces discharge like a pre-confirmation claim. Thus, we reverse the District Court's decision that a claim for employment discrimination that arose after plan confirmation and was not filed by the applicable bar date could not be discharged.

I. BACKGROUND

A. The Westinghouse Chapter 11 Case

Westinghouse Electric Company LLC (together with its debtor-affiliates, "Westinghouse" or the "Debtors") operates a global nuclear power business. In March 2017, following costly delays with several nuclear power projects, Westinghouse filed for Chapter 11 bankruptcy in the Southern District of New York (the "New York Bankruptcy Court" or "Bankruptcy Court"). *In re Westinghouse Elec. Co. LLC*, No. 17-10751-MEW, ECF No. 1 (Bankr. S.D.N.Y. Mar. 29, 2017). Through the bankruptcy process, Westinghouse hoped to receive "judicial confirmation of a reorganization plan that [would] enable[ ] ***227** [it] to restructure its pre-bankruptcy debts, pay its creditors, and return to active operation as a viable enterprise, free from judicial control and creditor scrutiny." *In re Great Am. Pyramid Joint Venture*, 144 B.R. 780, 788 (Bankr. W.D. Tenn. 1992).

[4] **[5]** **[6]** Filing a bankruptcy petition has immediate consequences. It " 'creates an estate' that, with some exceptions, comprises 'all legal or equitable interests of the [Debtors] in property as of the commencement of the case.' " *City of Chicago v. Fulton*, ––– U.S. ––––, 141 S. Ct. 585, 589, 208 L.Ed.2d 384 (2021) (quoting 11 U.S.C. § 541(a)(1)). The petition also affects the classification and treatment of claims under the Bankruptcy Code. Holders of prepetition claims[1] not secured by collateral typically recover only a fraction of the claim amount. On the other hand, postpetition "actual, necessary costs and expenses of preserving the estate" are treated as administrative expense claims entitled to priority under the Bankruptcy Code's distribution scheme and paid in full under a Chapter 11 plan unless the claimant agrees to other treatment. *See* 11 U.S.C. §§ 503(b)(1)(A), 507(a)(2), 1129(a)(9)(A); *In re Energy Future Holdings Corp.*, 990 F.3d 728, 741 (3d Cir. 2021) (hereinafter "*EFH Admin Expense Decision*").

In June 2017, the New York Bankruptcy Court set a "General Bar Date" for September 1, 2017—the deadline by which creditors had to file proofs of claims for most prepetition claims. As is typical in bankruptcy cases, the bar date for postpetition administrative expense claims is later than the general prepetition claims bar date because the estate continues to incur expenses throughout the bankruptcy. Westinghouse's Chapter 11 plan of reorganization (the "Westinghouse Plan" or simply the "Plan") contemplated a bar date for administrative expense claims of "the first Business Day that is 30 days following the [Plan's effective date]." App. at 260, Plan § 1.3. The Plan further provided, with its usual overlapping verbs, that "Holders of Administrative Expense Claims that ... do not file and serve [a request for payment] by the Administrative Expense Claims Bar Date shall be forever barred, estopped, and enjoined from asserting such [ ] Claims against the Debtors, ... or their property, and such [ ] Claims shall be deemed compromised, settled, and released as of the Effective Date." App. at 275, Plan § 2.1. The Plan also contained customary language discharging all claims as of the Effective Date. App. at 301–02, Plan §§ 11.1, 11.3.

Westinghouse then proceeded with negotiating and confirming the Plan. In February 2018, it informed creditors of various deadlines for filing objections to and voting on the Plan. Following a hearing, the Bankruptcy Court confirmed the Plan on March 28, 2018 (the "Confirmation Date"), concluding that it satisfied all the requirements for confirmation in 11 U.S.C. § 1129.

[7] Although plans usually become effective shortly after confirmation, there can be a delay of months or longer in cases where, for example, the debtor must wait for regulators to approve the plan or investors to finalize financing. *See, e.g.*, *In re Venoco LLC*, 998 F.3d 94, 107 n.14 (3d Cir. 2021); *In re Worldcom, Inc.*, 401 B.R. 637, 640 (Bankr. S.D.N.Y. 2009). The effectiveness of the confirmed Westinghouse Plan ***228** was delayed pending the closing of an investment transaction, which in turn required approval from government agencies such as the Department of Energy. As a result, it did not become effective until August 1, 2018 (the "Effective Date").

That day, all the property of the Debtors' estates (subject to a few exceptions) vested in the reorganized Westinghouse, which began a fresh corporate life. *See* App. at 281, Plan § 5.1. *See generally* *In re Montgomery Ward, LLC*, 634 F.3d 732, 737 (3d Cir. 2011) (noting there are three entities in a successful Chapter 11, "the pre-bankruptcy debtor, the estate, and the post-bankruptcy business" (quoting Elizabeth Warren, *A Theory of Absolute Priority*, 1991 Ann. Surv. Am. L. 9, 12 (1992)). When Westinghouse gave notice of the Effective Date, it also told creditors that, under the confirmed Plan, August 31, 2018 is the deadline for filing administrative expense claims (the "Administrative Claims Bar Date"). App. at 558. The notice emphasized that those who do not file a claim by then will see their claims "discharged as of the Effective Date." *Id.* All this was blessed by the New York Bankruptcy Court. App. at 250–51, Confirmation Order ¶ 47.

B. Ellis and the Pennsylvania District Court Case

Timothy Ellis worked for Westinghouse from 2010 until 2018, most recently as Vice President, Global Projects Management Operations. *See* *Ellis v. Westinghouse Elec. Co.*, No. 2:18-cv-01442, 2020 WL 4499931, at *3 (W.D. Pa. Aug. 5, 2020) (hereinafter "Dist. Ct. Op."). On May 31, 2018, about two months after the New York Bankruptcy Court confirmed the Plan, Westinghouse terminated Ellis's employment, explaining that his department was being restructured. However, Ellis, 67 years old at the time, believed he was unlawfully fired due to his age. He immediately hired counsel, who represented him by filing a charge with the federal Equal Employment Opportunity Commission (the "EEOC") in July 2018. The parties agree that Ellis's employment discrimination claim "arose" when he was terminated, so it is a claim after confirmation of the Plan but before its Effective Date.

During its bankruptcy case, Westinghouse served Ellis with three notices: the first about the General Bar Date, the second about the Plan objection and voting deadlines, and the third about the Effective Date and the Administrative Claims Bar Date. Ellis acknowledges receiving the first two notices but does not admit receiving the third. *See* Dist. Ct. Op. at *3–4. He never took any action in the New York Bankruptcy Court to assert his employment discrimination claim.

Instead, in October 2018, Ellis filed suit in the Western District of Pennsylvania District Court against (the now reorganized) Westinghouse. It was initially stayed pending Ellis's exhaustion of state administrative remedies. After the case resumed in July 2019, Westinghouse filed a motion for summary judgment, arguing that Ellis's claim, as an administrative expense claim not timely filed by the Administrative Claims Bar Date, was discharged by the Plan and the order confirming it.

The District Court denied Westinghouse's motion and granted summary judgment in favor of Ellis as to the bankruptcy discharge issue. It first concluded that Ellis received proper notice of the Administrative Claims Bar Date, in part because the Debtors' claims and noticing agent affirmed that all three notices were sent to Ellis and none were returned as undeliverable. Dist. Ct. Op. at *7. However, the Court ultimately decided that Ellis's claim was not discharged in the bankruptcy, concluding that ***229** § 503 of the Bankruptcy Code does not authorize the use of a bar date to discharge postconfirmation administrative expense claims. *Id*. at *13. It further held that § 1141(d) of the Bankruptcy Code prohibits the discharge of post-confirmation claims. *Id.* at *19.

Recognizing the novel and complex legal questions involved, the District Court certified the following questions to our Court for immediate interlocutory appeal:

> Where a plaintiff's claim under the Age Discrimination in Employment Act (and parallel provisions of state law) arises after the confirmation of an approved bankruptcy plan of reorganization, but prior to the effective date of the plan and the vesting of the bankruptcy estate as set forth and defined in such plan by order of the bankruptcy court: (1) is the plaintiff's claim barred by the provisions of 11 U.S.C. § 503 if the plaintiff did not file such employment discrimination claim as a claim for an administrative expense prior to the postconfirmation administrative claim bar date under the plan; and/or (2) is such employment discrimination claim discharged by the provisions of 11 U.S.C. § 1141, and/or under the principles of *res judicata*, if such claim was not filed in the bankruptcy court prior to the postconfirmation effective and discharge dates set out in the plan?

Dist. Ct. Op. at *19. We agreed to hear the appeal.

II. JURISDICTION AND STANDARD OF REVIEW

The District Court had jurisdiction pursuant to 28 U.S.C. §§ 1331 and 1343, as Ellis asserts a claim under the federal Age Discrimination in Employment Act ("ADEA"), 29 U.S.C. § 621 *et seq*.[2] The District Court also had jurisdiction to decide whether Ellis's claim was discharged in the New York Bankruptcy Court case. *See In re Apex Oil Co.*, 406 F.3d 538, 543 (8th Cir. 2005) (holding that a non-bankruptcy court "is fully competent to determine whether the [bankruptcy] plan and the injunction" barred certain claims); *see also Whitehouse v. LaRoche*, 277 F.3d 568, 576 (1st Cir. 2002) (explaining that bankruptcy and non-bankruptcy courts have concurrent jurisdiction over whether a claim was discharged by bankruptcy).[3]

[8] **[9]** **[10]** We have jurisdiction over this interlocutory appeal under 28 U.S.C. § 1292(b). Our scope of review "is generally constrained to the questions certified for review by the district court, [though] we may consider any grounds justifying reversal." *Morris v. Hoffa*, 361 F.3d 177, 196 (3d Cir. 2004) (emphasis and quotation omitted). Our standard of review is plenary, meaning we review anew the District Court's summary judgment decisions, applying the same standard it must apply. *See Rivas v. City of Passaic*, 365 F.3d 181, 193 (3d Cir. 2004). To prevail, Westinghouse as the moving party must show "that there is no genuine dispute as to any material fact and [it] is entitled to judgment ***230** as a matter of law." Fed. R. Civ. P. 56(a).

III. ANALYSIS

[11] **[12]** "The principal purpose of the Bankruptcy Code is to grant a fresh start to the honest but unfortunate debtor." *Marrama v. Citizens Bank of Mass.*, 549 U.S. 365, 367, 127 S.Ct. 1105, 166 L.Ed.2d 956 (2007) (internal quotation marks and citation omitted); *see also N.L.R.B. v. Bildisco & Bildisco*, 465 U.S. 513, 527, 104 S.Ct. 1188, 79 L.Ed.2d 482 (1984) ("[T]he policy of Chapter 11 is to permit successful rehabilitation of debtors."). However, the debtor's interest in a fresh start is not absolute, as the Bankruptcy Code tries to strike the "delicate balance between the competing interests of creditors pursuing their claims and debtors in obtaining a fresh start and finality." *In re Bugarenko*, 373 B.R. 394, 400 (Bankr. E.D. Pa. 2007). This case puts in play these two competing interests.

Against this backdrop, we conclude as follows. First, Ellis's employment discrimination claim is an "actual and necessary" administrative expense claim under § 503(b)(1)(A). Second, § 503 authorizes bankruptcy courts to set and enforce bar dates for administrative expense claims. Third, that provision permits the discharge of postconfirmation administrative expense claims not timely filed by the bar date. Fourth, § 1141(d)(1)'s language regarding the discharge of pre-confirmation claims is a default rule that can be overridden by the plan and confirmation order. Finally, various policy and practical concerns about the discharge of post-confirmation claims are overstated and ignore the creditor-friendly protections still in place.

A. A Postpetition Employment Discrimination Claim Is an Administrative Expense Claim.

[13] **[14]** For the Administrative Claims Bar Date to be invoked, Ellis's claim must be an "Administrative Expense

Claim" as defined by the Plan. The Plan's definition references § 503(b) of the Bankruptcy Code, which provides in relevant part that, "[a]fter notice and a hearing, there shall be allowed administrative expenses, ... including the actual, necessary costs and expenses of preserving the estate." App. at 260, Plan § 1.2; 11 U.S.C. § 503(b). To qualify, the claimant must typically show there was a "[postpetition] transaction between the claimant and the estate" and the "expenses yielded a benefit to the estate." *See EFH Admin Expense Decision*, 990 F.3d at 741 (internal quotation marks omitted) (quoting *In re Women First Healthcare, Inc.*, 332 B.R. 115, 121 (Bankr. D. Del. 2005)). On first glance, employment discrimination claims do not fit neatly into this definition.

However, we agree with the District Court's suggestion that, per the Supreme Court's decision in *Reading Company v. Brown*, 391 U.S. 471, 88 S.Ct. 1759, 20 L.Ed.2d 751 (1968), postpetition employment discrimination claims are "actual and necessary" administrative expenses. In *Reading*, a bankruptcy receiver's negligence allegedly caused a fire that resulted in damage to a non-debtor third party, who then asserted an administrative expense claim against the estate. *Id.* at 473–74, 88 S.Ct. 1759. The Court held that, under the predecessor to the Bankruptcy Code, the claim was for the "actual and necessary costs" of preserving the estate. *Id.* at 475, 484–85, 88 S.Ct. 1759.

Like the tort claim in *Reading*, an employment discrimination claim is a "cost[ ] ordinarily incident to operation of a business." *Id.* at 483, 88 S.Ct. 1759. Further, a federal employment law violation is often considered a statutory tort. *See* ***231** *Price Waterhouse v. Hopkins*, 490 U.S. 228, 264, 109 S.Ct. 1775, 104 L.Ed.2d 268 (1989) (O'Connor, J., concurring) (referring to Title VII of the Civil Rights Act of 1964 as creating a "statutory employment 'tort' "). Indeed, at least two circuits have applied the *Reading* exception to employment discrimination claims. *See Sanchez v. Northwest Airlines, Inc.*, 659 F.3d 671, 679 (8th Cir. 2011) (explaining that employment discrimination claims are administrative expenses because they come "out of the regular employment relationship between the debtor and its employee");[4] *In re Zilog*, 450 F.3d 996, 999 n.1 (9th Cir. 2006) ("Thus, under *Reading* and its progeny, [employment] discrimination claims that arise post-petition but pre-confirmation can be filed as administrative expenses against the debtor's estate.").[5]

[15] We recognize this result appears counterintuitive, as Westinghouse does not need to violate employment laws to operate. To be sure, we do not mean to imply that employment discrimination is merely a cost of doing business. But that "is the wrong prism to use in looking at the situation." *Sanchez*, 659 F.3d at 679. "Rather than focus on what went wrong, we must look at the utility of the underlying exercise." *Id.* The employment discrimination claim arose out of Ellis's employment, which without dispute benefitted the Westinghouse estate. Treating such claims as administrative expenses furthers the policy goal of § 503(b)(1)(A)—providing incentives for employees to continue working for a bankrupt company. *Pa. Dep't of Env't Res. v. Tri-State Clinical Lab'ys, Inc.*, 178 F.3d 685, 690 (3d Cir. 1999). Without the assurance that any valid employment discrimination claim would be paid in full, workers may leave based on fear that their rights will not be fully protected.

[16] We part, however, from the District Court's suggestion that certain administrative expense claims may be categorized differently for the purposes of priority and discharge. *See* Dist. Ct. Op. at *12; *see also Sanchez*, 659 F.3d at 678 (stating in a *dictum* that "*Reading* defines administrative expenses for the purposes of priority status under § 503, which differ from purposes of dischargeability."). Under this view, a *Reading*-type administrative expense claim that is entitled to priority could still be outside the reach of a bar date. But this position finds no textual support in the Bankruptcy Code. A claim is either an administrative expense claim or it is not; it cannot be a chameleon. And as explained below, the importance of the bar date is even greater when the debtor's administrative solvency is at stake. As a practical matter, the District Court's position that the claim is entitled to administrative priority, ***232** but not subject to discharge, is untenable, as that would allow creditors to cherry-pick whether they want to recover from the estate or the reorganized debtor. Ellis's claim is thus an administrative expense claim under § 503 and subject to the Administrative Claims Bar Date.

B. Section 503 Allows Bankruptcy Courts to Set and Enforce Bar Dates for Administrative Expense Claims.

[17] At a high level, bar dates ensure that the promise of a fresh start is not illusory, as claims not filed and addressed in the bankruptcy cannot be asserted later against the reorganized debtor. "[I]t not only allows the trustee or debtor-in-possession to estimate the debtor's potential liabilities, it is also essential in formulating a viable reorganization plan. Without a final claims deadline, participants in the reorganization process would be hindered by undue caution in their negotiations and in voting on the plan." *In re Energy Future Holdings Corp.*, 619 B.R. 99, 118 n.109 (Bankr. D.

Del. 2020) (quoting *In re Trump Taj Mahal Assocs.*, 156 B.R. 928, 938 (Bankr. D.N.J. 1993)).

[18] For prepetition claims, bankruptcy courts have the power to set bar dates "before which proofs of claim against the debtor's estate must be filed." *See In re Energy Future Holdings Corp.*, 949 F.3d 806, 811 (3d Cir. 2020) (hereinafter "*EFH Bar Date Decision*"); *see also* Fed. R. Bankr. P. 3003(c)(3). In practice, they often set multiple bar dates to address the specific needs of the case. *See In re Lehman Bros. Holdings, Inc.*, 433 B.R. 113, 118–19 (Bankr. S.D.N.Y. 2010) (discussing "custom-made features" in the Bar Date Order and different bar dates based on claim types).

[19] **[20]** **[21]** **[22]** Claims not filed by the bar date are typically discharged, meaning the claimant cannot recover from the debtor or the reorganized debtor. *See EFH Bar Date Decision*, 949 F.3d at 811. The bar date is binding on a creditor even if he does not participate in the bankruptcy. *See Tenn. Student Assistance Corp. v. Hood*, 541 U.S. 440, 447, 124 S.Ct. 1905, 158 L.Ed.2d 764 (2004) ("If a creditor chooses not to submit a proof of claim, once the debts are discharged, the creditor will be unable to collect ...."). To avoid unnecessarily harsh results, a claimant can still file a claim after the bar date if he shows "excusable neglect." *EFH Bar Date Decision*, 949 F.3d at 814; *see also* Fed. R. Bankr. P. 9006(b)(1). Any discharge must also satisfy due process requirements. *See Chemetron Corp. v. Jones*, 72 F.3d 341, 346 (3d Cir. 1995) ("*Chemetron I*") (holding that "[i]nadequate notice is a defect which precludes discharge of a claim in bankruptcy").

[23] **[24]** **[25]** **[26]** The bankruptcy court's power to set and enforce bar dates extends to postpetition administrative expense claims. Section 503(a) provides that "[a]n entity may timely file a request for payment of an administrative expense, or may tardily file such request if permitted by the court for cause."[6] This language "provides courts with the statutory authority to set and enforce administrative claim bar dates." 4 Collier on Bankruptcy ¶ 503.02[2] (16th ed. ***233** 2021);[7] *see In re Eagle-Picher Indus., Inc.*, 447 F.3d 461, 465 (6th Cir. 2006) (explaining that the Bankruptcy Code "permit[s] the parties to establish a bar date by which time all administrative expenses must be asserted against the debtor or face discharge"); *Sanchez*, 659 F.3d at 677 (noting that an administrative expense claim bar date "force[s] creditors to comply with [it] or face a discharge").[8]

[27] **[28]** **[29]** **[30]** Section 503 thus provides both a carrot and a stick for creditors promptly to request payment of administrative expenses. File claims on time and, if valid, they will receive priority treatment in the bankruptcy and get paid in full under the plan. File the claims late and they will face discharge. The harsh result is justified because, like general claim bar dates for prepetition claims, bar dates for administrative expense claims help the debtors know their liabilities and implement a viable plan to obtain a fresh start. Because the plan must pay administrative expense claims in full under 11 U.S.C. § 1129(a)(9)(A), unexpected administrative expenses can jeopardize the entire restructuring or become a significant burden to the reorganized debtor.[9] Inability to pay administrative expenses is called "administrative insolvency," typically resulting in conversion of the Chapter 11 case to Chapter 7 liquidation. *See* 7 Collier, *supra* ¶ 1100.07[2] n.10; *see, e.g.*, *In re Constellation Enters. LLC*, 587 B.R. 275, 279 (D. Del. 2018). Putting all this together, bankruptcy courts have flexibility under § 503 to set and enforce bar dates for administrative expense claims that are subject to discharge if not timely filed.

C. Section 503 Authorizes the Discharge of Post-Confirmation Administrative Expense Claims.

[31] So far we know that, were Ellis fired on March 27, 2018, (*i.e.*, the day before the Confirmation Date), his claim would be subject to discharge if not filed by a reasonable bar date (*e.g.*, 30 days after the Confirmation Date). We next consider whether an administrative expense claim that arose between the plan's confirmation and effective date is also bound by the bar date and subject to discharge.

[32] We begin with the text of the Bankruptcy Code. *See Merit Mgmt. Grp., LP v. FTI Consulting, Inc.*, ––– U.S. ––––, 138 S. Ct. 883, 893, 200 L.Ed.2d 183 (2018). Nothing in § 503(a) says that only pre-confirmation claims must be "timely filed." Ellis is essentially asking us to hold that a bankruptcy court can never set a bar date that applies to post-confirmation administrative ***234** expense claims. Section 503 recognizes no such limitation, and we generally refrain from adding words to a statute. *See Hanover Bank v. C.I.R.*, 369 U.S. 672, 687, 82 S.Ct. 1080, 8 L.Ed.2d 187 (1962) (explaining that courts cannot "add to or alter the words employed to effect a purpose which does not appear on the face of the statute").

[33] **[34]** In fact, when considering the broader "statutory structure," *see Merit Mgmt.*, 138 S. Ct. at 894, the only temporal limit is with the existence of the estate, not the date of plan confirmation. Because administrative expenses preserve the bankruptcy "estate," what matters is that the claim accrues against the estate before it ceases to exist. *See* 11 U.S.C. § 503(b)(1)(A). While typically the estate ends when the plan is confirmed, the plan can extend the life of the estate to a later date such as the effective date. *See Venoco*, 998 F.3d at 107 n.14; *Hillis Motors, Inc. v. Haw. Auto. Dealers' Ass'n*, 997 F.2d 581, 588–89 (9th Cir. 1993) (holding that where the plan "unambiguously provides for the continuation of the estate post-confirmation," there can be allowed postconfirmation administrative expense claims); *see also* 11 U.S.C. § 1141(b). Here the Plan provided that the estate's property did not vest in the reorganized debtors until the Effective Date (August 1, 2018). App. at 281, Plan, § 5.1. The Westinghouse estate therefore continued to exist until that date, and any post-confirmation expenses qualify as administrative expense claims. App. at 260, Plan § 1.2 (defining "Administrative Expense Claim" to include expenses "incurred on or after the Petition Date and *through the Effective Date*") (emphasis added).

The Bankruptcy Code thus ties the viability of administrative expense claims (and, by extension, the coverage of a bar date for those claims) to the existence of the estate, not confirmation of the plan. Permitting the bankruptcy court to manage all claims against the estate is a logical result. Where the gap between the confirmation date and effective date is significant, concerns about undisclosed liabilities are heightened, and the bar date becomes even more important. A categorical carveout from the bar date for all post-confirmation claims would needlessly tie the hands of bankruptcy courts to use the bar date as a reorganization tool. *See* 4 Collier, *supra* ¶503.02[2] (explaining that § 503 allows "courts [to] exercise their discretion in setting bar dates according to the circumstances of each case").

[35] The District Court questioned whether authority for discharging an administrative expense claim can even be based on § 503, as it does not mention the word "discharge," which is discussed in § 1141. *See* Dist. Ct. Op. at *13. In practice, the specter of discharge is integral to a bar date. Without it, bar dates would have no teeth. *See* 4 Collier, *supra* ¶ 503.02[2] ("[T]he effect of not permitting the 'filing' of a tardy request (except for cause) is that such expenses will not be approved for payment from the estate."); *see also Eagle-Picher*, 447 F.3d at 465 (explaining the bar date is a deadline "by which all administrative expenses must be asserted against the debtor or face discharge").[10] We believe the better view is that §§ 503 and 1141 work in tandem. Section 503 gives bankruptcy courts the ***235** power to set and enforce bar dates. And, as discussed below, § 1141(d) allows the plan and confirmation order generally to govern the discharge of claims (with a few exceptions).

D. Section 1141(d)(1) Does Not Prohibit the Discharge of Post-Confirmation Claims.

[36] Ellis argues, and the District Court agreed, that § 1141 of the Bankruptcy Code bars the discharge of valid postconfirmation claims in this case. *See* Dist. Ct. Op. at *18–19. The relevant provision provides:

> *Except as otherwise provided in this subsection, in the plan, or in the order confirming the plan*, the confirmation of a plan—
>
> (A) discharges the debtor from any debt that *arose before the date of such confirmation*, and any debt of a kind specified in section 502(g), 502(h), or 502(i) of this title ... ; and
>
> (B) terminates all rights and interests of equity security holders and general partners provided for by the plan.

11 U.S.C. § 1141(d)(1) (emphasis added).

We disagree with the Court that this provision is a categorical rule. Our reading is that § 1141(d)(1) creates a default rule for discharging pre-confirmation debts, meaning it applies only when the plan and confirmation order are silent on the issue. Here the Plan provided for the discharge of postconfirmation claims not timely filed by the Administrative Claims Bar Date. This overrides the default rule in § 1141(d)(1).

Our holding tracks the text of the statute. Placement of the "[e]xcept as otherwise provided" proviso at the beginning of subsection (d)(1) means the carveout applies to everything that follows. Tellingly, Congress did not place the proviso *after* a specific phrase in the subsection to invoke the "rule of the last antecedent." *See Barnhart v. Thomas*, 540 U.S. 20, 26, 124 S.Ct. 376, 157 L.Ed.2d 333 (2003) (explaining this principle of statutory interpretation under which "a limiting clause or phrase ... should ordinarily be read as modifying only the noun or phrase that it immediately follows").

[37] **[38]** **[39]** Our reading is also consistent with the structure of § 1141. Elsewhere, the section preserves broad flexibility for a plan and confirmation order to override default rules. As already previewed, § 1141(b) states the default rule that confirmation vests property of the estate in the debtor but allows the plan and confirmation order to delay vesting. *See Hillis Motors*, 997 F.2d at 588–89. An identical carveout is in § 1141(c), which "states the general rule that property dealt with by the plan or the confirmation order is free and clear of all claims" after confirmation. *See* 8 Collier, *supra* ¶ 1141.04. Further, Congress knew when not to include any carveout language, as is the case with various exceptions to discharge that bind the parties no matter what the plan or confirmation order says. *See, e.g.*, 11 U.S.C. § 1141(d)(6); *see also Jennings v. Rodriguez*, ––– U.S. ––––, 138 S. Ct. 830, 844, 200 L.Ed.2d 122 (2018) (reasoning that express exceptions imply there are no other exceptions).

The District Court relied on the Ninth Circuit's *dictum* that § 1141(d)(1) might prohibit the discharge of postconfirmation claims. *See Zilog*, 450 F.3d at 1001 n.5 ("We are uncertain whether post-confirmation debts can in fact be discharged in bankruptcy."). The Court suggested that the " '[e]xcept as otherwise provided' clause ... can be read in either of two ways." *Id.* (alteration in original). First, the words might modify "any debt." Second, they might modify " 'before the date ***236** of such confirmation' ... [, so] even postconfirmation debts could be discharged if that were provided for in the reorganization plan." *Id.* The Court did not take a position but remarked it finds "the first alternative more plausible." *Id.* For the reasons laid out above, we do not follow this either-or choice and read the carveout phrase to apply to everything that follows in that subsection; a plan, or the order confirming it, can trump the discharge rule provided by subsection (d)(1). For our case, that means the confirmed Westinghouse Plan governs which post-confirmation claims are subject to discharge.

We are also unpersuaded by the reliance of the District Court on *Holywell Corp. v. Smith*, 503 U.S. 47, 112 S.Ct. 1021, 117 L.Ed.2d 196 (1992), which held that a Chapter 11 plan did not discharge tax liability assessed after the plan became effective. *Id.* at 51, 58–59, 112 S.Ct. 1021. The Court remarked that "[e]ven if § 1141(a) binds creditors of the corporate and individual debtors with respect to claims that arose before confirmation, *we do not see how it can bind the United States or any other creditor with respect to postconfirmation claims*." *Id.* at 58, 112 S.Ct. 1021 (emphasis added). But *Holywell* is of little value for our analysis, as it dealt with claims against a post-bankruptcy liquidating trustee after the plan took effect and had nothing to do with a bar date for administrative expenses. *Id.* at 51, 112 S.Ct. 1021. Moreover, it was discussing § 1141(a), and made no mention of the discharge provision in § 1141(d). In any event, and as the District Court acknowledged, we have already clarified that *Holywell* does not mean bankruptcy plans can never bar post-confirmation liability. *In re Arctic Glacier Int'l, Inc.*, 901 F.3d 162, 167 (3d Cir. 2018).

We also understand the import of our *Arctic Glacier* decision differently than the District Court. That case was about the *res judicata* effect of a confirmed plan's release provisions on investors who purchased shares after confirmation. *Id.* at 165. It never tried to address the entire scope of when post-confirmation liability can be discharged. *Id.* at 167. The issue here is narrower—whether a creditor is bound by an administrative claim bar date approved by the Bankruptcy Court. The analysis is not the same, for the point of a bar date is to bind creditors who did not participate in the bankruptcy. *See Hood*, 541 U.S. at 447, 124 S.Ct. 1905 ("A bankruptcy court is able to provide the debtor a fresh start ... despite the lack of participation of all of his creditors.").

To be clear, our holding today is limited to the enforceability of a bar date for administrative expense claims and does not otherwise interfere with Ellis's rights to challenge a confirmed plan. For example, Ellis could have objected after confirmation if the Plan's treatment of his claims were controversial (for example, by delaying payment later than is reasonable or making payments in a form other than cash, rather than paying valid claims in full in cash on the Effective Date). And, as he did in the District Court, Ellis could contest the adequacy of the notice he received and whether discharge of his claim violated due process, which are arguments routinely reviewed by courts post-confirmation. *See Jones v. Chemetron Corp.*, 212 F.3d 199, 209–10 (3d Cir. 2000) ("*Chemetron II*") (holding that the claim of a tort claimant who was not born as of the claims bar date was not discharged by the confirmation order); *Zilog*, 450 F.3d at 1001 n.5 ("[E]ven if the bankruptcy court had the power to discharge postconfirmation claims, the court abused its discretion in discharging the ... claims here."); *In re Pavlovich*, 952 F.2d 114, 119 (5th Cir. 1992) (allowing a bank to challenge the debtor's post-confirmation actions).

***237** The upshot is that holders of post-confirmation, pre-effective date administrative expense claims are bound by a bar date like other holders of claims against the estate, and thus they cannot choose to bypass the bankruptcy process altogether. Ellis may not litigate his underlying employment discrimination claim without filing a request for payment in the New York Bankruptcy Court. And because he never filed such a request for payment, we reverse the District Court's denial of Westinghouse's motion for summary judgment.

E. Policy and Practical Concerns About Discharging Post-Confirmation Claims Are Overstated.

Our holding today is supported by the Bankruptcy Code and furthers its principal purpose of granting the debtor a fresh start. *See Marrama*, 549 U.S. at 367, 127 S.Ct. 1105. As noted, bar dates are essential for a debtor to know and manage its liabilities. In the few cases where a bankruptcy plan does not become effective for some time after confirmation, the debtor still needs comfort that holders of post-confirmation, pre-effective date administrative expense claims will not come out of the woods later to assert them against the reorganized debtor. Without this assurance, payments to other creditors may need to be delayed for fears that higher priority claims could be lurking. In fact, barring the discharge of post-confirmation claims would exacerbate this problem: creditors would likely take a "wait-and-see" approach, as many would rather press their claims against a reorganized debtor with no judicial supervision. This could saddle the reorganized debtor with significant and unexpected liabilities, hence hobbling from the start its prospects for a successful, long-term reorganization.

[40] **[41]** Still, some may be concerned that our holding favors the debtor at the expense of creditors' rights. Those concerns fail to appreciate fully the creditor protections that still exist. First, any discharge of a late-filed administrative expense claim must comport with due process, so a claim is only subject to discharge if a creditor received adequate notice of the bankruptcy and had a fair opportunity to press his claim. *See Chemetron I*, 72 F.3d at 346 ("Due process requires notice that is reasonably calculated to reach all interested parties, reasonably conveys all the required information, and permits a reasonable time for a response." (internal citation and quotation marks omitted)). And to refresh, the bankruptcy court can still accept late filings "for cause." 11 U.S.C. § 503(a). We therefore do not share the concern that discharge of post-confirmation debts could occur "without any notice of the discharge." *See In re Holly's Inc.*, 172 B.R. 545, 561 (Bankr. W.D. Mich. 1994).[11]

[42] Second, the burden to comply with a bar date is low. Other Westinghouse creditors with post-confirmation administrative claims were able to file timely requests for payment. Westinghouse's Op. Br. at 14 (noting claims for charges of equipment rental and maintenance and services of software company after plan confirmation). A creditor does not even ***238** have to know the amount or validity of the claim, for he can easily file a "protective" claim putting the debtor on notice without conceding any issues. *See DPWN Holdings (USA), Inc. v. United Air Lines, Inc.*, 246 F. Supp. 3d 680, 691 (E.D.N.Y. 2017). Thus, contrary to the District Court's view, complying with the bar date does not compress the statute of limitations available to Ellis outside of bankruptcy or deprive the EEOC of enough time to investigate his allegations. *See* Dist. Ct. Op. at *14.

[43] Third, although holders of post-confirmation administrative expense claims had no opportunity to vote on or object to the plan before confirmation, their interests are well protected because the Bankruptcy Code requires any plan to pay valid administrative expense claims in full. *See* 11 U.S.C. § 1129(a)(9)(A). Indeed, administrative expense claims are usually considered unimpaired and not entitled to vote on the plan. *See* 11 U.S.C. § 1126(f); *In re Combustion Eng'g, Inc.*, 391 F.3d 190, 220–21 (3d Cir. 2004). And as explained earlier, a post-confirmation administrative expense claimant still has various options to challenge the treatment of his claim after plan confirmation.

[44] Fourth, contrary to the District Court's suggestion, our holding does have limiting principles. *See* Dist. Ct. Op. at *14. To reiterate, administrative expense claims can only be against the bankruptcy "estate." So in this case the Administrative Claims Bar Date could not discharge claims arising after the Effective Date, when the estate's property was vested in the reorganized debtors. The Court speculated that the discharge timeframe could be pushed "for months or even years to a distant" effective date. *Id.* But that ignores the reality that a debtor usually wants to emerge from bankruptcy as soon as possible. Putting aside the intangible reputational and goodwill costs, the sheer size of professional expenses in a bankruptcy often overwhelms petition-date expectations. *See* Arturo Bris, Alan Schwartz & Ivo Welch, *Who Should Pay for Bankruptcy Costs?*, 34 J. Legal Stud. 295, 296 n.1 (2005).

Finally, Ellis's argument that filing a claim compromises his right to a jury trial is not novel, as the issue exists for pre-confirmation claims as well. Ellis's Br. at 20; *see Langenkamp v. Culp*, 498 U.S. 42, 44–45, 111 S.Ct. 330, 112 L.Ed.2d 343 (1990) (per curiam) (holding "there is no Seventh Amendment right to a jury trial" in the claims-allowance process). Without wading into the morass on this complex topic, we note that the consequences of filing a claim are not as straightforward as Ellis suggests. *See* 1 Collier, *supra* ¶ 3.08; *see also* 28 U.S.C. § 157(e); *In re Highcrest Mgmt. Co.*, 30 B.R. 776, 778–79 (Bankr. S.D.N.Y. 1983) (lifting the automatic stay to permit a jury trial to proceed in the district court).

* * * * *

[45] Each bankruptcy is unique. While a reorganization plan typically becomes effective immediately after it is confirmed, in some cases there can be a significant delay. The Bankruptcy Code recognizes this complexity. Section 503 gives bankruptcy courts discretion to set and enforce bar dates by which creditors must file administrative expense claims. And while § 1141(d) states a default rule that confirmation of a plan discharges pre-confirmation debts, it preserves flexibility for the plan and confirmation order to say otherwise.

Here, Ellis's post-confirmation, pre-effective-date, employment discrimination claim was an administrative expense claim subject to a bar date. Because he never filed a request for payment in the New York Bankruptcy Court, the claim was discharged in the bankruptcy unless he can ***239** convince that Court to accept a late filing.[12] The result may be severe, but that is a price for a debtor's fresh start. Creditors still have significant protections, though choosing to avoid the bankruptcy process is typically not an option. We thus reverse the District Court's decision.

All Citations

11 F.4th 221, 70 Bankr.Ct.Dec. 156

Footnotes

1 The Bankruptcy Code defines the term "claim" broadly to include the "right to payment" as well as the "right to an equitable remedy for breach of performance if such breach gives rise to a right to payment." 11 U.S.C. § 101(5); *see In re Rodriguez*, 629 F.3d 136, 138–39 (3d Cir. 2010).

2 To the extent Ellis is still pursuing a state law claim under the Pennsylvania Human Relations Act, the District Court had supplemental jurisdiction over it. *See* 28 U.S.C. § 1367(a).

3 A week after filing its summary judgment motion, Westinghouse also filed a parallel motion with the New York Bankruptcy Court seeking to enjoin Ellis from prosecuting his claim. After he argued in the Pennsylvania District Court that the New York Bankruptcy Court motion was duplicative, Westinghouse agreed to continue that motion indefinitely. *See* Dist. Ct. Op. at *2. The District Court noted that, assuming the Bankruptcy Court maintained jurisdiction, Westinghouse could have withdrawn its motion for summary judgment and proceeded only in the latter Court. *Id.* at n.2.

4 In *Sanchez*, an employee with a postpetition, but *pre*-confirmation, discrimination claim argued it was not discharged by the bar date. 659 F.3d at 674–75. The Eighth Circuit ultimately sided with the employee, concluding his claim survived under the specific terms of the plan, which exempted from discharge any administrative expenses "incurred in the ordinary course of business." *Id.* at 678; *see also In re Eagle-Picher Indus., Inc.*, 447 F.3d 461, 467 (6th Cir. 2006) (same). Ellis does not raise a similar argument, so it is forfeited. In any event, the argument would likely be unworkable here, as the language in the Westinghouse Plan and notices differ from those cases. *See Sanchez*, 659 F.3d at 676 (providing in the relevant notice that claims do not need to be filed for "[l]iabilities incurred in the ordinary course of business").

5 The Ninth Circuit in *Zilog* held that a postpetition (and arguably post-confirmation) employment discrimination claim cannot be discharged "without first allowing for the presentation of such claims." 450 F.3d at 1001. That is not the case for Ellis, who received notice of the filing deadline a month before the Administrative Claims Bar Date.

6 To be technical, a claimant files a "request for payment" rather than a "proof of claim" for an administrative expense claim. 4 Collier on Bankruptcy ¶ 503.02[1] (16th ed. 2021). Still, much of the logic and case law about general bar dates for prepetition claims apply with equal force to administrative expense claims. *See id.* ¶ 503.02[2] (explaining that courts have often relied on the "excusable neglect" standard to determine "whether to allow a tardily filed request for payment of an administrative expense").

7 A debtor can choose not to set an administrative expense claim bar date. If no bar date is set, and depending on the terms of the plan, the claim could be filed any time against the debtor or the reorganized debtor, "limited only by the relevant statute of limitations." *In re Worldcom, Inc.*, 401 B.R. 637, 647 n.13 (Bankr. S.D.N.Y. 2009).

8 One exception is that a governmental unit is not required to file a request for payment of an administrative tax expense. 11 U.S.C. § 503(b)(1)(D); 4 Collier, *supra* ¶ 503.02[3].

9 In a lengthy case, the bankruptcy court may set multiple administrative claims bar dates to help the debtor implement a workable plan. *See In re Chicago Newspaper Liquidation Corp.*, 490 B.R. 487, 491 n.4 (Bankr. D. Del. 2013). Even here, where the Administrative Claims Bar Date was after the Effective Date, the bar date encourages claimants to file claims promptly and gives the reorganized Westinghouse comfort that it does not face significant unknown liabilities. *See In re CM Wind Down TopCo Inc.*, No. 17-13381-SCC Docket No. 1105, Hr'g Tr. 12:13–18 (Bankr. S.D.N.Y. Dec. 13, 2018) (Chapman, J.) (explaining that the bar date applies to postconfirmation administrative expense claims because "sometimes [companies] want absolute certainty that on day [31] of the reorganized debtor's life ... they know what they're dealing with").

10 The District Court suggests that the "face discharge" language means the authority for discharge does not stem from § 503. Dist. Ct. Op. at *13. We disagree. The more logical reading, and the way we use the phrase in this opinion, is that failing to file a claim by the bar date does not automatically discharge it, as a bankruptcy court can still accept a late filing "for cause" or refuse to discharge a claim based on due-process concerns.

11 The District Court held that Ellis received adequate notice of the Administrative Expense Claim Bar Date and did not certify that part of its ruling for us to consider on appeal, so we do not reach the issue and take no position on it. *See* Dist. Ct. Op. at *8–9. Still, we reiterate that a key element of adequate notice is information about the types of claims subject to a bar date. As most claimants and attorneys will be unfamiliar with the Supreme Court's holding in *Reading*, all parties would benefit if notices of administrative expense claim bar dates make clear that tort and other litigation claims may be subject to that cutoff.

12 Our decision does not prevent Ellis from filing a claim in the Bankruptcy Court and asking it to accept the late filing "for cause." 11 U.S.C. § 503(a).

End of Document

KeyCite Red Flag - Severe Negative Treatment
Reversed by Ellis v. Westinghouse Electric Co., LLC, 3rd Cir.(Pa.), August 30, 2021

2020 WL 4499931
United States District Court, W.D. Pennsylvania.

Timothy ELLIS, Plaintiff,
v.
WESTINGHOUSE ELECTRIC COMPANY, LLC, Defendant.

2:18-cv-01442
|
Signed 08/05/2020

Attorneys and Law Firms

Joel S. Sansone, Elizabeth Tuttle, Massimo A. Terzigni, Law Offices of Joel Sansone, Pittsburgh, PA, for Plaintiff.

Eric G. Soller, Shelly R. Pagac, Pietragallo Gordon Alfano Bosick & Raspanti, LLP, Pittsburgh, PA, for Defendant.

OPINION

Mark R. Hornak, Chief United States District Judge

***1** The matter before the Court presents a Gordian Knot of bankruptcy law entangled with an employment discrimination claim, spanning different courts in two jurisdictions, and the tension between those legal frameworks and tribunals. Boiled down, the Court must resolve the Defendant Westinghouse Electric Company's ("WEC" or "the Defendant") Motion for Summary Judgment, which argues that Timothy Ellis' ("the Plaintiff") age discrimination claims asserted in this Court were discharged by the Defendant's Chapter 11 bankruptcy proceeding in the Southern District of New York. (ECF No. 31.) For the reasons that follow, the Court will deny the Defendant's Motion.[1]

I. PROCEDURAL POSTURE

Beginning with the Defendant's bankruptcy proceedings, WEC filed its Chapter 11 bankruptcy petition in March of 2017 in the United States Bankruptcy Court for the Southern District of New York ("the bankruptcy court"). *In re Westinghouse Electric Co., LLC*, No. 17-10751-MEW (Bankr. S.D.N.Y. filed Mar. 29, 2017), ECF No. 1 [hereinafter "*WEC Bankr.*"]. In June of that year, the bankruptcy court entered an order establishing a deadline for filing proofs of claims against WEC. *Id.*, ECF No. 788. About two weeks later, WEC filed an affidavit of service with the bankruptcy court affirming that notice of the proofs-of-claim deadline was sent to, among others, potential creditors to include the Plaintiff. *Id.*, ECF No. 881, Ex. F, at 166. Then in February 2018, the bankruptcy court entered notice of the hearing on confirmation for the bankruptcy reorganization plan ("the Plan") with procedures on how to file objections to the Plan. *Id.*, ECF No. 2644. Notice of the same was served on potential creditors, including the Plaintiff. *Id.*, ECF No. 2802, Ex. J, at 164. The Plan was confirmed on March 28, 2018, when the bankruptcy court entered its Findings of Fact, Conclusions of Law, and Order Confirming Modified Second Amended Joint Plan of Reorganization ("Confirmation Order"). *Id.*, ECF No. 2988. The Confirmation Order and the Plan appended to it set several conditions precedent for the Plan's Effective Date. *Id.*, ECF No. 2988-1, at 41–42. After those conditions were met several months later, a period of time which is of critical importance in the matter before this Court, notice of the occurrence of the Effective Date was filed on August 1, 2018. *Id.*, ECF No. 3705. As before, this notice was also served on potential creditors, including the Plaintiff. *Id.*, ECF No. 3724, Ex. D, at 269.

***2** With respect to the matter here, the Plaintiff filed his Complaint on October 26, 2018. (ECF No. 1.) In January 2019, the Parties agreed to stay the case pending exhaustion of administrative remedies for the Plaintiff's supplemental state law discrimination claim. (ECF No. 8.) The case was not reopened until July 25, 2019. (ECF No. 15.) The Defendant filed its Answer and the Court held an initial case management conference in September 2019, which stalled almost immediately when the Defendant for the first time raised during that conference the bankruptcy issue now before the Court. (ECF Nos. 18, 24.) The instant Motion for Summary Judgment was filed a short time later in November 2019. (ECF No. 31.)

A week after the Motion was filed, the Defendant filed Notice on the docket alerting the Court that it had also filed a parallel motion in the bankruptcy court in New York, seeking to enjoin the Plaintiff from prosecuting his claim against WEC in this Court. (ECF No. 35.) This resulted in an emergency motion by the Plaintiff asking this Court to stay the "duplicative" bankruptcy motion in the New York bankruptcy court. (ECF No. 36.) After this Court held a hearing on the issue, the Defendant voluntarily continued the proceeding in the bankruptcy court until January 22, 2020. (ECF No. 40.) Accordingly, the Court dismissed the Plaintiff's emergency motion without prejudice as moot and set a briefing schedule to address the Defendant's Motion for Summary Judgment. (ECF No. 41.) Upon receiving a Response, Reply, and Sur-Reply, the Court heard oral argument on January 15, 2020. (ECF No. 54.) During argument, the Court advised the Defendant that it would not acquiesce to the deadline the Defendant had effectively set for the Court to decide the matter in light of the short fuse resulting from the parallel proceedings in S.D.N.Y. The Court stated its intention to enjoin those proceedings if necessary to provide this Court a reasonable amount of time to address the Motion here.[2] The Defendant thereafter filed a Notice that the proceedings in the New York bankruptcy court were voluntarily continued indefinitely. (ECF No. 56.) Finally, after supplemental briefing on certain discrete issues, this matter became ripe for disposition. (ECF Nos. 57–60.)

II. LEGAL STANDARD

Summary judgment will be granted when there are no genuine issues of material fact in dispute and the movant is entitled to judgment as a matter of law. Fed. R. Civ. P. 56(a). To withstand a summary judgment motion, an issue of fact in dispute must be both genuine and material, i.e., one upon which a reasonable factfinder could base a verdict for the non-moving party and one which is essential to establishing the claim. *Anderson v. Liberty Lobby Inc.*, 477 U.S. 242, 248 (1986). When considering a summary judgment motion, the Court may not weigh the evidence or make credibility determinations. *Id.*

If the moving party carries its initial burden under Rule 56, the non-movant must identify "specific facts which demonstrate that there exists a genuine issue for trial." *Orson, Inc. v. Miramax Film Corp.*, 79 F.3d 1358, 1366 (3d Cir. 1996) (citing *Celotex*, 477 U.S. at 323). They must respond "by pointing to sufficient cognizable evidence to create material issues of fact concerning every element as to which the nonmoving party will bear the burden of proof at trial." *Simpson v. Kay Jewelers, Div. of Sterling, Inc.*, 142 F.3d 639, 643 n.3 (3d Cir. 1998). Where there are no disputed material facts and the question presented is one of pure law, the undisputed evidence must still be construed in the light most favorable to the non-movant. *Rea v. Cincinnati Ins. Co.*, No. CIV.A. 3:13-21, 2014 WL 4198059, at *4 (W.D. Pa. Aug. 22, 2014).

***3** The facts material to the Defendant's Motion are for the most part undisputed. While the Defendant denies all facts underpinning the Plaintiff's age discrimination claims, (*see* Answer, ECF No. 18), for purposes of the instant Motion the Defendant essentially argues that, even if the Plaintiff's claims are valid, he is barred from asserting them in this Court by virtue of the bankruptcy proceedings in New York. (ECF No. 32, at 9 n.7.) Thus, the Court is left to resolve the legal question of whether the Plaintiff's employment discrimination claims in this Court are completely barred or discharged by the Defendant's bankruptcy.

III. STATEMENT OF THE FACTS

Some fourteen (14) months after WEC filed its bankruptcy petition and two (2) months after the Defendant's bankruptcy plan was confirmed by the bankruptcy court, the Plaintiff's employment with WEC was terminated on or about May 31, 2018. (Complaint, ECF No. 1, at 2.) As outlined above, the bankruptcy petition was filed on March 29, 2017, Plan was confirmed on March 28, 2018, and became effective by its terms on August 1, 2018. The Plaintiff's claim therefore arose post-petition, post-Confirmation and pre-Effective-Date.[3] During the pendency of the bankruptcy action, the Defendant caused to be served on the Plaintiff three pertinent notices: (1) Notice of Deadline for Filing Proofs of Claim, served before the Plaintiff was fired; (2) Notice of Hearing on Confirmation of Plan and Procedures for Objecting to the Confirmation of Plan, also served before the Plaintiff's discharge from employment; and (3) Notice of Effective Date of the Plan, served after the Plaintiff was dismissed. *See supra* Procedural Posture, Part I (demonstrating that the affidavits of service included the Plaintiff's name as a recipient).

The first Notice of Deadline for Filing Proofs of Claim provided that a potential claimant, other than a "governmental unit" as defined by the Bankruptcy Code, must assert a prepetition claim by filing a Proof of Claim by September 1, 2017—the "General Bar Date." (ECF No. 34-2, at 3.) The second Notice of Hearing on Confirmation of Plan and Procedures for Objecting to the Confirmation of Plan provided that a "Confirmation Hearing" would occur on March 27, 2018, and detailed the procedures for voting and filing objections to the then-proposed bankruptcy plan. (ECF No. 34-4, at 3–5.) The Plan was later confirmed by the bankruptcy court on March 28, 2018. The Confirmation Order and the Plan set an Effective Date, which would be the date in the future when "all conditions to the effectiveness of the Plan set forth in Section 10 hereof have been satisfied or waived in accordance with the terms of the Plan." (ECF No. 34-7, § 1.60 [hereinafter "Plan"].) During this period, after the Plan was confirmed but before the Effective Date had occurred, the Defendant terminated the Plaintiff's employment. The third Notice of the Effective Date of the Plan was sent after the conditions precedent for the Effective Date had been met and the Effective Date had thus occurred. This Notice provided that the Effective Date of the Plan was August 1, 2018 and that "all requests for payment of Administrative Expense Claims must be filed and served on the Debtors **no later than August 31, 2018**"—the so-called "Administrative Expense Claims Bar Date." (ECF Nos. 34-8, at 3 (emphasis in original); 34-9, at 2; *see also* Plan, § 1.3 (defining the Administrative Expense Claims Bar Date as "the first Business Day that is 30 days following the Effective Date").) The Notice further provides that:

> ***4** Holders of Administrative Expense Claims that ... do not file and serve such a request by the Administrative Expense Claims Bar Date shall be forever barred, estopped, and enjoined from asserting such Administrative Expense Claims against the Debtors, or their property and such Administrative Expense Claims shall be deemed discharged as of the Effective Date.

(*Id.*) An Administrative Expense Claim is defined in the Plan as:

> any Claim against a Debtor for payment of an administrative expense of a kind specified in section 503(b) of the Bankruptcy Code and entitled to priority or superpriority pursuant to sections 364(c)(1), 507(a)(2), 507(b), or 1114(e)(2) of the Bankruptcy Code, including (a) the actual and necessary costs and expenses incurred on or after the Petition Date and through the Effective Date of preserving the Estates and operating the Debtors' businesses (such as wages, salaries, or commissions for service rendered after the Petition Date, and payments for goods and other services), (b) all fees and charges assessed against the Estates pursuant to sections 1911 through 1930 of chapter 123 of the title 28 of the United States Code, 28 U.S.C. §§ 1-1401, and (c) all Allowed Claims that are to be treated as Administrative Expense Claims pursuant to a Final Order of the Bankruptcy Court under section 546(c)(2) of the Bankruptcy Code.

(Plan, § 1.2.) An Affidavit of Service for the Notice of the Effective Date of the Plan was filed with the bankruptcy court on August 9, 2018, certifying that the Notice was mailed on August 2 to the exhibited list of recipients. *WEC Bankr.*, ECF No. 3724. The period of time between the Confirmation Order and the Effective Date, roughly four (4) months, was due primarily to the time it took to consummate a $3.8 billion stock sale of WEC and some of its subsidiaries under a Plan Funding Agreement, which was a "key condition" to the Effective Date. (ECF No. 32, at 4.) No party avers that the Plaintiff had any ability to influence the occurrence of that condition, or the setting of the Effective Date.

The Plaintiff admits receiving the first two Notices, but does not admit receiving the third Notice, which contained notice of the Effective Date and the Administrative Expense Claims Bar Date. (Pl. Resp., ECF No. 44, at 10.) However, as noted above, the Plaintiff was listed as a recipient in the Affidavits of Service for all three Notices. Further, he admits to reviewing "all mail addressed to him and received at his home." (Pl.'s Counter Statement of Material Facts, ECF No. 45, ¶ 36.) In a supplemental filing, the Defendant provided an affidavit affirming that all three notices were sent to the Plaintiff's home address and that none of them were returned undeliverable. (ECF No. 50-1, at 2–3.) The Plaintiff also avers that the Defendant did not cause a copy of the Notice of the Effective Date to be served on his counsel, which the Defendant does not deny. At the time, the Plaintiff's lawyer was already representing him in connection with the charge the Defendant had filed with the Equal Employment Opportunity Commission ("EEOC") and served on the Defendant. (ECF No. 45, ¶¶ 39–42.) The Defendant responds that Plaintiff's counsel was aware of the Notice of the Effective Date because his law firm entered an appearance on behalf of another creditor in WEC's bankruptcy matter. (ECF No. 49, ¶ 39; *see also* ECF No. 50-2, at 6 (excerpting the Affidavit of Service filed in the bankruptcy court and listing Plaintiff's counsel's law firm as a recipient on behalf of another creditor).) The Defendant also avers that the Plaintiff never filed a request to have Notices sent to an authorized agent, as would be required to have any Notices sent to his lawyer under Bankruptcy Rule 2002(g). (ECF No. 49, ¶ 42.)

***5** In addition, the Plaintiff claims to have brought the second Notice[4] to the Defendant's Human Resources ("HR") Director. (ECF No. 44, at 13.) The Defendant's HR Director purportedly told the Plaintiff that the Defendant's bankruptcy did not involve him and therefore the Notice did not apply to him. (*Id.*) This allegedly occurred on or about March 12, 2018, about two and a half months *before* the Plaintiff's employment was terminated.

The Confirmation Order and the Plan contain several terms and provisions which the Defendant says discharges the

Plaintiff's claims. Section 11.3 of the Plan, as adopted by the bankruptcy court in the Confirmation Order, dealt with the discharge of claims:

> Except as otherwise expressly provided in the Plan, upon the Effective Date, in consideration of the distributions to be made under the Plan, each holder of a Claim or Interest and any Affiliate of such holder shall be deemed to have forever waived, released and discharged the Debtors, Wind Down Co, and the Reorganized Debtors, to the fullest extent permitted by section 1141 of the Bankruptcy Code, of and from any and all Claims, Interests, rights and liabilities that arose prior to the Effective Date; *provided, however*, that the DIP Claims shall not be waived, released and discharged unless and until the DIP Claims are indefeasibly repaid in full in Cash in accordance with Section 2.4. Upon the Effective Date, all such persons shall be forever precluded and enjoined, pursuant to section 524 of the Bankruptcy Code, from prosecuting or asserting any such discharged Claim or Interest against the Debtors, Wind Down Co and the Reorganized Debtors.

(Plan, § 11.3 (emphasis in original).) The "Debtors" include, among many other entities and subsidiaries, Westinghouse Electric Company LLC (the Defendant). (Plan, § 1.43.) "Reorganized Debtor" or "Reorganized Debtors" refer to "individually, any Debtor and, collectively, all Debtors, in each case as reorganized under the Plan from and after the Effective Date." (*Id.* § 1.120.) A "Claim" is defined to have the meaning set forth in section 101(5) of the Bankruptcy Code. (*Id.* § 1.28.) That Code section defines a claim as a:

> (A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or
>
> (B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured.

11 U.S.C. § 101(5). Any such claims are discharged, as stated in the Plan, to the extent permissible under section 1141 of the Bankruptcy Code. (Plan, § 11.3.) The Plan also contains language (1) barring and enjoining any Administrative Expense Claims filed after the Administrative Expense Claims Bar Date, (Plan, § 2.1); (2) discharging Claims and terminating Interests, (Plan, § 11.1); and (3) providing releases by Holders of Claims and Interests, (Plan, § 11.7). The Plan also enjoins any Holder of a Claim from bringing any action against the Debtors discharged under the terms of the Plan and Confirmation Order.

> **EXCEPT AS OTHERWISE PROVIDED IN THE PLAN OR THE CONFIRMATION ORDER, FROM AND AFTER THE EFFECTIVE DATE, (1) TO THE EXTENT A PARTY'S CLAIM IS DISCHARGED PURSUANT TO THE PLAN OR CONFIRMATION ORDER, SUCH PARTY SHALL BE PERMANENTLY ENJOINED FROM PUSUING** [sic] **SUCH CLAIM AGAINST THE PARTIES THAT HAVE BEEN DISCHARGED PURSUANT TO THE PLAN OR CONFIRMATION ORDER, AND (2) TO THE EXTENT A PARTY'S CLAIM HAS BEEN RELEASED PURSUANT TO THE PLAN OR CONFIRMATION ORDER, SUCH RELEASING PARTY SHALL BE PERMANENTLY ENJOINED FROM PURSUING SUCH CLAIM AGAINST THE APPLICABLE RELEASED PARTY ...**

***6** (Plan, § 11.9 (emphasis in original).)

In light of the fact that his employment was terminated after the bankruptcy court entered its Confirmation Order, the Plaintiff did not file a Proof of Claim by the General Bar Date —which occurred some nine (9) months prior to the date his claim arose on May 31, 2018. He also filed no objections to the Plan in time for the Confirmation Hearing on March 27, 2018—some two (2) months before his claim arose. This is not surprising. At each of those points, the Plaintiff had no reason to believe that he had any claim against the Defendant because by not having yet been fired from his job, he had no such claims. However, the Plaintiff also failed to file a request for payment of an administrative expense claim by the August 31, 2018 Administrative Expense Claims Bar Date. This was in spite the fact that his discrimination claim arose about two (2) months before the Effective Date of August 1, 2018, and three (3) months before the Administrative Expense Claims Bar Date.

Instead, the Plaintiff filed an administrative discrimination charge with the EEOC on or about July 3, 2018 and the Defendant was served with the charge on or about the same day. (ECF No. 45, ¶ 39.) The Plaintiff avers that the Defendant thereafter defended against the charge prior to the Effective Date on August 1, 2018. (*Id.* ¶ 41.) However, the Defendant says it did not actually receive the charge until July 31, 2018, one (1) day before the Effective Date. (ECF No. 49, ¶ 41.) In any case, after the Complaint was filed in this Court and this case was stayed for approximately seven (7) months to allow for the exhaustion of certain state law administrative remedies related to the underlying discrimination claims, (ECF Nos. 8, 10), the issue of the Defendant's bankruptcy was raised to the Court for the first time by the Defendant in the initial case management conference, (ECF No. 24). There were no defenses or issues relative to the effect of the bankruptcy on the Plaintiff's claims in the Defendant's Answer. Specifically, no defense was asserted that the Plaintiff's claims were discharged by the bankruptcy, or otherwise barred by the Plan. (ECF No. 18.); *see* Fed. R. Civ. P. 8(c)(1).

IV. DISCUSSION & ANALYSIS

The Plaintiff argues that either the notice of the Administrative Expense Claims Bar Date was deficient or that the Bankruptcy Code via the Plan does not discharge his claims mainly because his claims arose after Plan confirmation. The Defendant argues that notice was proper and that either or both of section 503 and section 1141 of the Bankruptcy Code discharge its liability for the Plaintiff's claims mainly because they arose prior to the Plan's Effective Date. The arguments of each party are appealing in their directness and simplicity. However, upon consideration of the record and applicable law, the Court concludes that the answers here are not nearly as straightforward as either party posits. Upon consideration of the record and the arguments of the parties, the Court concludes that the notices provided to the Plaintiff were not (as he argues) defective, but that the Bankruptcy Code does not discharge the Plaintiff's post-confirmation employment discrimination claims in the circumstances of this case.

1. <u>Notice</u>

***7** It appears to the Court that there are three (3) issues relating to notice advanced by the Plaintiff. First, the Plaintiff avers that the Defendant failed to provide actual or constructive notice of the Effective Date and Administrative Expense Claims Bar Date. The Plaintiff further argues that whether he received proper notice is a question of fact for the jury. As discussed, the Plaintiff admits receiving the first two Notices, but not the third Notice regarding the Effective Date and Administrative Expense Claims Bar Date. Specifically, the Plaintiff does not “recall” receiving that third notice. (ECF No. 44, at 10.)

There is a well-established rebuttable presumption that notice was received by an addressee when the party seeking the presumption provides evidence that that the notice was actually mailed. *In re Dalton*, No. BR 12-20004 JKF, 2012 WL 3648139, at *1 n.1 (W.D. Pa. Aug. 23, 2012) (citing *Philadelphia Marine Trade Association–International Longshoremen's Ass'n Pension Fund v. C.I.R.*, 523 F.3d 140, 147 (3d Cir. 2008) (citing *Rosenthal v. Walker*, 111 U.S. 185 (1884); *Hagner v. United States*, 285 U.S. 427 (1932))).

WEC provided an affidavit of the Director of WEC's claims and noticing agent, KCC. (ECF No. 50-1.) The affidavit states under penalty of perjury that KCC sent all three (3) Notices to the Plaintiff by First Class Mail. (*Id.*) Further, KCC's Director affirms that KCC sent all three (3) Notices to the same address —the address at which the Plaintiff admits receiving the first two (2) Notices. (*Id.*) The affidavit also avers that none were returned as undeliverable. (*Id.*)

Generally, once a party seeking the presumption shows (through an affidavit) that notice was timely and accurately sent to a creditor, the presumption of receipt arises and the burden shifts to the other party to provide some objective evidence *beyond a bald statement of non-receipt. Peralta,* 599 B.R. 759, 763 n.5 (Bankr. D.N.J. 2019); *In re Johnson*, No. 02-34686-SR, 2004 WL 5856051, at *3 n.3 (Bankr. E.D. Pa. Dec. 2, 2004); *In re Parquet Grp., Inc.*, 477 B.R. 454, 462 n.7 (Bankr. S.D.N.Y. 2012). The Plaintiff here offers no evidence to rebut these claims other than his inability to “recall” receiving the notice despite reviewing “all mail that is delivered to [his] home,” including “every piece of mail sent to [him] in August 2018.” (Ellis Aff., ECF No. 46-1, ¶ 7.). Thus, he has not provided evidence sufficient to rebut the presumption of receipt.

This stringent approach to the bankruptcy version of this receipt rule is predicated on avoiding conflict with bankruptcy law. The United States Bankruptcy Court for the Eastern District of New York observed:

> To apply a weaker presumption of receipt to notices sent by mail in bankruptcy cases would, moreover, be at odds with the Bankruptcy Rules, which prescribe service of notices by mail, and define mail as “first class, postage prepaid.” It would mean that, where a bar order or other notice is served in accordance with the Bankruptcy Rules, any party could potentially avoid the effect of failure to meet the deadline by claiming non-receipt. This would defeat, or at least substantially undermine, the purpose of the noticing scheme established under the Bankruptcy Code and Bankruptcy Rules.

In re Greenberg, 526 B.R. 101, 107–08 (Bankr. E.D.N.Y. 2015) (citations omitted) (citing Fed. R. Bankr. P. 2002; 9001(8)); *see In re A&P*, 604 B.R. 650, 658 (Bankr. S.D.N.Y. 2019). Thus, even viewing the evidence in the light most favorable to the Plaintiff under the rule's presumption of receipt, a presumption that the record does not demonstrate has been rebutted, the Court presumes that the Plaintiff was provided with the third notice, that is Notice of the Effective Date of the Plan.[5]

***8** The second issue as to notice is, presuming the Plaintiff received the Third Notice, whether it was insufficient either (1) because it failed to satisfy the requirements of due process or (2) due to the actions of WEC's HR Director. With respect to due process, the Plaintiff notes that the Notice did not mention Administrative Expense Claims on the first page or identify him as a holder of such a claim. (ECF No. 44, at 11.) Furthermore, he says that the term "Administrative Expense Claim" is left undefined and the Administrative Expense Claims Bar Date is "hidden" in the middle of the second page. (*Id.* at 11–12.) Lastly, he says the language is overly broad and not reasonably calculated to put the Plaintiff, a layperson, on notice of his rights under the Plan. (*Id.* at 11.) The Plaintiff, however, cites no case law to support these alleged constitutional deficiencies.

The Third Circuit has held that a plaintiff's "degree of sophistication is an issue that is relevant to the adequacy of the notice of bankruptcy proceedings they received." *Jones v. Chemetron Corp.*, 212 F.3d 199, 205 n.6 (3d Cir. 2000) (citing *In re Grand Union Co.*, 204 B.R. 864, 872, 880 (Bankr. D. Del. 1997)). While it may be assumed that the majority of the population is unfamiliar with and untrained in the intricacies of bankruptcy law, that issue on its own is not enough to defeat proper notice. *See Peralta,* 599 B.R. at 764. Furthermore, the Plaintiff had already retained counsel in the related matter of filing a charge with the EEOC. Thus, he could have reasonably consulted with his lawyer about the import of the Notice. *Id.* at 764–65 ("The fact remains that the notice Movants received was sufficient to prompt them to seek the advice of a legal professional. Accordingly, the notice was adequate and Movants were not denied due process in these bankruptcy proceedings."); *see also In re Bi-Lo, LLC*, No. 09-02140 HB, 2010 WL 3340521, at *6 (Bankr. D.S.C. Feb. 2, 2010) ("it is not unreasonable to expect a party, sophisticated or not, to contact his or her attorney regarding information received via mail in either form, and the notice given supplied adequate time to do so"). Thus, the Court will not conclude that the notice was constitutionally deficient on this basis.

The Plaintiff also avers that around March 12, 2018 he brought the Notice of Hearing on Confirmation of Plan and Procedures for Objecting to the Confirmation of Plan ("the Second Notice") to the Defendant's HR Director. (ECF No. 44, at 13.) She allegedly informed him that he did not need to take any action because the Defendant's bankruptcy, and therefore the Second Notice/had nothing to do with him.[6] (*Id.*; *see also* Ellis Aff., ECF No. 46-1, ¶ 6.) The Plaintiff argues that this had the effect of misleading him and vitiating the later notice of the Administrative Expense Claims Bar Date. (ECF No. 44, at 12 (citing *In re Collier*, 307 B.R. 20, 25–26 (Bankr. D. Mass. 2004)).) However, the Court concludes that the alleged actions by the Defendant's agent would not vitiate the later Notice.

The *Collier* case that the Plaintiff cites involved a debtor sending creditors a "cover sheet" containing highly misleading language, which the Court held obfuscated the earlier notice of the bar date. 307 B.R. at 27. Thus, the sufficiency of the *previous* notice was destroyed. However, the argument here is that the HR Director's actions rendered the *later* third notice defective. The Defendant cogently retorts that constitutionally sufficient notice cannot be so easily viewed as having been "pre-obfuscated." (ECF No. 48, at 15.) Neither party provides any case law directly addressing the notion of "pre-obfuscation" and the Court cannot uncover any either. However, the Court finds no basis here to conclude that the actions of the H.R. Director rendered the later Notice constitutionally infirm. The *Collier* Court stated that "[t]he only relevant question is whether the actions of the Debtor, intentional or not, so affected notice of the bar date that a creditor was denied due process," and said that such must be analyzed under a totality of the circumstances. *Collier*, 307 B.R. at 26. However, the events here, viewed in their totality, do not weigh in favor of a similar finding. The Court concludes that the HR Director could not have caused the later Notice to be ineffective given the fact that (1) the Court does not find, and the Plaintiff does not aver, that the later Notice contained any false or misleading statements of a similar kind to those in *Collier* and (2) to the extent the alleged comments of the HR Director could have caused the Plaintiff to lower his guard, the Plaintiff was, at the time he received the third notice, represented by counsel with whom he could have consulted upon receiving the later Notice. *Peralta,* 599 B.R. at 764–65.

***9** The final notice issue is whether the Defendant was required to send the Notice of the Effective Date to the Plaintiff's attorney, rather than to him. This argument is of no moment as "[t]here is simply no basis in the Bankruptcy Code or Rules for requiring service on a creditor's attorney."

Peralta, 599 B.R. at 766 (citing *In re Stauffer*, 378 B.R. 333, 338 (Bankr. D. Utah 2006)). In order to have notices sent to an address other than that of the creditor, Bankruptcy Rule 2002(g) requires a creditor to file a notice in the bankruptcy court. Fed. R. Bankr. P. 2002(g). "Most courts have not interpreted [Rule] 2002(g) to require debtors to serve creditors' counsel, even in instances when debtors knew counsel represented creditors in pre-petition matters regarding the debt in question." *Peralta*, 599 B.R. at 766 (alteration omitted) (citing *In re Brunswick Baptist Church*, No. 03-13719, 2007 WL 160749, at *3 (N.D.N.Y. Jan. 16, 2007) (collecting cases); *In re Bi-Lo, LLC*, No. 09-02140, 2010 WL 3340521, at *5). For all of the forgoing reasons, the Court concludes as a matter of law that notice was proper.

2. Discharge

The remaining question is whether the Plaintiff's claims were discharged by operation of the Plan and Confirmation Order, and whether he is thus permanently enjoined from pursuing those claims here or anywhere else. As the Defendant points out repeatedly, "[t]he principal purpose of the Bankruptcy Code is to grant a fresh start to the honest but unfortunate debtor." (*See e.g.* ECF No. 32, at 9 (quoting *Marrama v. Citizens Bank of Mass.*, 549 U.S. 365, 367 (2007)).) The results of bankruptcy can be "harsh," both to debtors and creditors, but the Bankruptcy Code's procedures and deadlines must strike "a delicate balance between the competing interests of creditors pursuing their claims and debtors in obtaining a fresh start and finality." *In re Bugarenko*, 373 B.R. 394, 400 (Bankr. E.D. Pa. 2007). The Defendant argues that the allegedly harsh outcome of dismissing the Plaintiff's federal and state discrimination claims is exactly the result contemplated by the Bankruptcy Code in striking that balance. Importantly, the Defendant contends that both of sections 503 and 1141 lead to this result, and the Court must and will consider the application of those provisions separately.

On the other hand, the Plaintiff argues that the Defendant is looking for a windfall, not a fresh start, when it comes to him and the disposition of the Plaintiff's claims. He argues that the Bankruptcy Code (either or both of sections 503 and 1141) and the Plan by their terms do not and *cannot* discharge a discrimination claim that arises after plan confirmation, but before the effective date. For the following reasons, the Court concludes that while the Plaintiff's argument overstates the principles of bankruptcy law at issue here, the Plaintiff's claims in this specific case nonetheless were not discharged by virtue of the cited provisions of the Bankruptcy Code.

a. Section 503

The Defendant argues that either 11 U.S.C. § 503 or 11 U.S.C. § 1141, or both, discharge and bar the Plaintiff's claims. The Court will consider the section 503 arguments first.

Section 503 pertains to the allowance of "administrative expense claims." Ordinarily, section 503 gives creditors payment priority for these claims, which arise post-petition and constitute actual and necessary costs of preserving the bankruptcy estate. *In re Goody's Family Clothing Inc.*, 610 F.3d 812, 817 (3d Cir. 2010). The Plan defines Administrative Expense Claims, in part, as those claims against the Debtor "specified in section 503(b)." (Plan, § 1.2.) Section 503(b) reads, in relevant part:

> (b) After notice and a hearing, there shall be allowed administrative expenses, other than claims allowed under section 502(f) of this title, including—
>
> ***10** (1)
>
> (A) the actual, necessary costs and expenses of preserving the estate ...

However, the full definition in the Plan includes a period of time applicable to administrative expense claims—"the actual and necessary costs and expenses *incurred on or after the Petition Date and through the Effective Date of preserving the Estates and operating the Debtors' businesses* (such as wages, salaries, or commissions for service rendered after the Petition Date, and payments for goods and other services)." (Plan, § 1.2 (emphasis added).)

The Defendant argues that the Plaintiff's claims[7] fall under the umbrella of administrative expense claims under the Bankruptcy Code. The "general rule" for administrative expense claims under section 503(b) is that the claimed expense "must (a) confer an actual and demonstrable benefit on the debtor's estate, the creditors, and to the extent relevant, the stockholders, and (b) arise from a transaction with a bankruptcy estate." *Sanchez v. Nw. Airlines, Inc.*, 659 F.3d 671, 677 (8th Cir. 2011) (citations, quotations, and alterations omitted); *see also Pennsylvania Dep't of Envtl. Res. v. Tri-State Clinical Labs., Inc.*, 178 F.3d 685, 689–90 (3d Cir. 1999) [hereinafter *Pa. DER*] ("Thus, the language of § 503(b), read as a whole, suggests a quid pro quo pursuant to which the estate accrues a debt in exchange for some consideration necessary to the operation or rehabilitation of the estate."). On their face, the Plaintiff's claims here do not fit this mold.

His allegations that the Defendant discriminated against him based on his age did not arise from any "transaction" with the estate, nor was any "benefit" conferred upon the estate, creditors, or stockholders by virtue of this alleged discrimination.

However, the Supreme Court and several Courts of Appeals have held that administrative expense claims can also encompass tort and other claims arising during the pendency of Chapter 11 proceedings. The Supreme Court in *Reading Company v. Brown*, 391 U.S. 471, 483–85 (1968), held that "actual and necessary costs" of preserving the bankruptcy estate can include tort claims for damages caused by a receiver's negligence. Such is the case because tort claims against the estate constitute "costs ordinarily incident to [the] operation of a business." *Id.* at 483. This pre-Bankruptcy Code Opinion has survived the Code's enactment in 1978 and has since been expanded to include other types of claims. To wit, some courts have held that employment discrimination claims like the Plaintiff's, in addition to tort claims, can be brought as administrative expense claims under *Reading.* In *In re Zilog*, the Court of Appeals for the Ninth Circuit observed that "under *Reading* and its progeny, discrimination claims that arise post-petition but pre-confirmation can be filed as administrative expenses against the debtor's estate." 450 F.3d 996, 999 n.1 (9th Cir. 2006). The plaintiffs there alleged, in part, sex discrimination claims against the debtor. *Id.* at 999.

***11** Thus, *Reading* operates as an exception or at least an explanation as to section 503's usual requirements of a transaction with and to benefit to the estate. What cases like *Reading* and *Zilog* do not resolve, however, is the validity of the two central premises of the Defendant's section 503 argument. First, while pre-confirmation employment discrimination claims can be advanced as administrative claims, can *post*-confirmation claims also be brought as administrative claims? Second, if the answer to that question is "yes", then the next question is whether they *must* be brought as administrative claims or suffer being discharged by virtue of section 503? As discussed below, the former premise appears to be correct. But the Court concludes as to the second premise, such does not require that the claims here be so asserted or face discharge by operation of section 503.

Post-Confirmation Claims as Administrative Expenses

Administrative expense claims, by definition, must relate to the preservation of the bankruptcy estate. *See* 11 U.S.C. § 503(b)(1)(A). By default, confirmation of the plan "vests all of the property of the estate in the debtor," unless otherwise provided in the confirmation order or plan. 11 U.S.C. § 1141(b). Thus, confirmation typically closes the door on any further administrative expense claims because the estate ceases to exist. However, where a plan specifies that the estate will vest on a later effective date, some courts have held that post-confirmation claims can be brought as administrative expenses if those claims arose before the effective date, while the bankruptcy estate was still in existence. *In re WorldCom, Inc.*, No. 02-13533(AJG), 2009 WL 2959457, at *3 (Bankr. S.D.N.Y. May 19, 2009); *Hillis Motors, Inc. v. Hawaii Auto. Dealers' Ass'n*, 997 F.2d 581, 588 (9th Cir. 1993).

Here, the Plan does specify a post-confirmation vesting date:

> ***On the Effective Date***, pursuant to sections 1141(b) and (c) of the Bankruptcy Code, ***all property of the Debtors' Estates ... shall vest in the Reorganized Debtors free and clear of all Claims***, liens, encumbrances, charges and other interests.

(Plan, § 5.1 (emphasis added).) Therefore, the Plaintiff's post-confirmation, but *pre-effective-date* claims arose when the Defendant's bankruptcy estate was still in existence. Thus, the Defendant says that according to the reasoning in *WorldCom* and cases like it, the Plaintiff's claims are "subject to classification as an administrative expense, i.e., an actual, necessary cost and expense of preserving [the] estate." *WorldCom*, 2009 WL 2959457, at *3. Proceeding on this logic, which is the essence of the Defendant's section 503 argument, it appears that the Plaintiff *could have* filed an administrative expense claim through the Effective Date in the Plan.

Discharge of a Post-Confirmation Administrative Expense Claim

While the Plaintiff may have been able to file an administrative expense claim under the terms of the Plan and relevant Bankruptcy Code provisions, the proposition that his failure to file his post-confirmation claim as such therefore discharged and barred that claim pursuant to section 503 is less than clear. Many of the administrative expense claim cases cited by the Defendant do not *require* that post-confirmation, pre-effective-date employment discrimination claims be filed as administrative expense claims or be forever barred by virtue of Section 503. Of critical note, in the cases relied on by the Defendant, the claim holders *affirmatively sought* payment by filing administrative expense claims.[8] *See Reading*, 391 U.S. at 473–74; *Matter of Whistler Energy II, L.L.C.*, 931 F.3d 432, 440 (5th Cir. 2019); *Collins v. J&N*

Rest. Assocs., Inc., 676 F. App'x 18, 20 (2d Cir. 2017); *In re 800Ideas.com, Inc.*, 496 B.R. 165, 168 (B.A.P. 9th Cir. 2013); *In re Goody's Family Clothing Inc.*, 610 F.3d at 814–15; *In re Zilog*, 450 F.3d at 999; *Matter of P.C., Ltd.*, 929 F.2d 203, 204 n.1 (5th Cir. 1991); *In re Charlesbank Laundry, Inc.*, 755 F.2d 200, 201–02 (1st Cir. 1985); *In re Eagle-Picher Indus., Inc.*, 278 B.R. 437, 446 (Bankr. S.D. Ohio 2002), *rev'd* 447 F.3d 461 (6th Cir. 2006); *In re Megafoods Stores, Inc.*, 163 F.3d 1063, 1067 (9th Cir. 1998); *Wiler v. Meridian Auto. Sys., Inc.*, No. 1:08-CV-21, 2008 WL 4682435, at *1 (W.D. Mich. Oct. 21, 2008); *In re B. Cohen & Sons Caterers, Inc.*, 143 B.R. 27, 27–29 (E.D. Pa. 1992) (citing *In re N.P. Mining Co., Inc.*, 963 F.2d 1449, 1454 (11th Cir. 1992)); *In re Cont'l Airlines, Inc.*, 148 B.R. 207, 208 (D. Del. 1992). The central issue in these cases was not whether the underlying claims were barred by operation of Section 503 if not asserted as administrative claims, but whether the claimant was entitled to the priority payment of an administrative claim. A notable exception is *Sanchez v. Nw. Airlines, Inc.*, *supra*, in which the plaintiff was not seeking to bring his claim as an administrative expense. However, unlike the situation here, the *Sanchez* plaintiff held a *pre-confirmation* claim and, in any case, the Court held that the plaintiff was not required to file an administrative expense claim due to defects in the notice to creditors. 659 F.3d at 673–74.

***12** The *Sanchez* Court also cast considerable doubt over categorizing even pre-confirmation employment discrimination claims as administrative expenses for purposes of discharge. The court observed that *Reading* created a singular exception for administrative expense claims for the purposes of providing priority payment status for tort claims, but not for "purposes of dischargeability." *Sanchez*, 659 F.3d at 678 (citing *Boeing N. Am., Inc. v. Ybarra (In re Ybarra)*, 424 F.3d 1018, 1025 (9th Cir. 2005)). The purpose of administrative expense claims in the first instance is to encourage third parties to enter into contracts with bankruptcy estates in order to facilitate the rehabilitation of insolvent businesses. *Id.* at 677. In order to spur them to do that, their claims for payment are permitted to move closer to the front of the payment line by being denominated as "administrative expense claims." By contrast, in the discharge context the inquiry is into whether the debtor should be released from debts and provided a "fresh start." *Id.* at 678. So, according the *Sanchez* Court, the *Reading* Court "arrived at its conclusion after balancing the objective of the debtor's rehabilitation against the desirability of allowing those injured by the operation of the business during the bankruptcy process to recover ahead of those for whose benefit the business was carried out." *Id.* at 677; *see also Pa. DER*, 178 F.3d at 691 ("The [*Reading*] Court's holding was motivated by the considerations of fairness and practicality which underlie the purposes of the bankruptcy laws.... The Court concluded that it simply is not fair to deny innocent victims compensation for injuries they would not have incurred had the law not allowed the debtor to continue operating its business."). "Thus, *Reading*'s rationale to benefit creditors with claims against the insolvent entity would be undercut, not furthered, by the rule permitting discharge of such claims if not submitted by the bar date created by the debtor." *Sanchez*, 659 F.3d at 678. That is the Eighth Circuit appeared to say, albeit in dicta, that the *Reading* exception to section 503 *permits* administrative expense *priority* for tort and/or statutory claims but should not likewise make them *dischargeable* by virtue of section 503.[9] And such would appear to be inconsistent with the Supreme Court's concerns of "fairness and practicality." *Pa. DER*, 178 F.3d at 691.

The Defendant submits other cases to support that administrative expense claims are "discharged" under section 503, as opposed to section 1141, and that bankruptcy courts and debtors may properly establish bar dates after which administrative expense claims are discharged. *See, e.g.*, *Collins*, 676 F. App'x at 20; *Eagle-Picher*, 447 F.3d at 465. However, those cases are inapposite here.

In *Collins*, the plaintiff, having had notice and an opportunity to respond to the debtor's reorganization plan, nonetheless affirmatively sought payment for a *pre-confirmation* administrative expense claim nearly a year after the date of confirmation. 676 F. App'x at 20–21.[10] Here, the Plaintiff possesses a *post*-confirmation claim and, for the reasons discussed in the following subsection of this Opinion, the pre-confirmation notices here did not bind him to the terms of the Plan here, or even put him in a position to assert his rights in the confirmation process since he then possessed no such claims as he had not been fired from his job. While the *Collins* Court appeared to express the view that a pre-confirmation administrative expense claims are not discharged by section 1141, *id.* at 20, the cases the *Collins* court cites for that proposition do not squarely support that proposition, *see In re Ames Dep't Stores, Inc.*, 582 F.3d 422, 429 (2d Cir. 2009) (noting that "requests for" and "allowance" of administrative expense claims are governed by section 503, but falling short of saying that 503 *actually discharges* any administrative expense claim); *Eagle-Pitcher*, 447 F.3d at 464–65 (discussed below); *Sanchez*, 659 F.3d at 677 (discussed above).

In *Eagle-Pitcher*, another case where the claims arose before confirmation, the court stated that section 503 "does permit *the parties* to establish a bar date by which time all administrative expenses must be asserted against the debtor or face discharge." 447 F.3d at 465 (emphasis added). However, like *Collins, Eagle-Pitcher* really does not fit here, because the Plaintiff here had no claim until after the Plan was drawn up by the debtor and later confirmed by the bankruptcy court. While *Eagle-Pitcher* appears to stand for the proposition that the "parties" can engage in pre-confirmation proceedings to establish a bar date, to which creditors would have the opportunity to object, one "party" here, the Plaintiff, had no reason to take any action to ensure his interests were represented until well after the ink was dry on WEC's Plan. *See infra* Part IV.2.b (discussing this issue in depth).

***13** Further, *Eagle-Pitcher* does not explicitly state that the authority for discharging an administrative expense claim actually stems from section 503. Rather, the court stated that section 503 authorizes establishing a bar date after which a claim "could face" discharge. *Eagle-Pitcher*, 447 F.3d at 465; *see also* *Collins*, 676 F. App'x at 20 (citing *Eagle-Pitcher*, 447 F.3d at 461, 464–65, and *Sanchez*, 659 F.3d at 671, 677, for a similar proposition). In fact, there is some authority in this Circuit that while section 503 permits debtors to establish procedures and bar dates for filing of administrative expenses, the discharge is nonetheless effectuated by section 1141 and not section 503. *See* *In re Benjamin Coal Co.*, 978 F.2d 823, 827 (3d Cir. 1992) (citing solely to section 1141 and holding that "the discharge of all existing claims, *including administrative claims*, upon confirmation of a Chapter 11 plan is unambiguous both in the Bankruptcy Code and in [the debtor's] own reorganization plan" (emphasis added)); *In re Polysat, Inc.*, 152 B.R. 886, 893 (Bankr. E.D. Pa. 1993) ("administrative expense claim arising from the debtor's postpetition, preconfirmation use or possession of the tank cars was discharged pursuant to section 1141(d) of the Code upon confirmation of the debtor's plan.") (citing *In re Benjamin Coal Co.*, 978 F.2d at 827). And as discussed in the following subsection, the discharge provision of section 1141 does not reach the post-confirmation claims here.

For the forgoing reasons, while it may have been possible (although not conclusively so) for the Plaintiff to file his discrimination claims as an administrative expense claim in order to try and obtain entitlement to priority payment, the Court concludes that the Plaintiff was not required to do so and his post-confirmation statutory discrimination claims are not extinguished by virtue of section 503 due to his failure to file them in the bankruptcy court by the Administrative Expense Claims Bar Date. But that is not the end of the matter since the Defendant also relies on the provisions of section 1141 to seek to extinguish the Plaintiff's discrimination claims. The Court next turns to an analysis of that provision in the context of this case.

b. Section 1141

Although the Defendant argues that Section 503 should control, it also claims that section 1141 discharges the instant claims. Section 1141(d)(1) provides that upon *confirmation* of the plan, the debtor is discharged from all debts "that arose before the date of such confirmation." 11 U.S.C. § 1141(d)(1). However, subsection (d) begins with the qualifier, ***"[e]xcept as otherwise provided*** in this subsection, ***in the plan, or in the order confirming the plan***."[11] *Id.* (emphasis added). Here, the Plan did provide "otherwise." Section 11.3 of the Plan reads:

> Except as otherwise expressly provided in the Plan, **upon the Effective Date,** in consideration of the distributions to be made under the Plan, **each holder of a Claim or Interest and any Affiliate of such holder shall be deemed to have forever waived, released and discharged the Debtors**, Wind Down Co, and the Reorganized Debtors, to the fullest extent permitted by section 1141 of the Bankruptcy Code, of and **from any and all Claims, Interests, rights and liabilities <u>that arose prior to the Effective Date</u>**.

(Plan, § 11.3 (emphasis added).) Thus, the Defendant argues that the Plan's discharge provision properly extended coverage to any liabilities that arose *prior to the Effective Date*, thereby sweeping in the Plaintiff's claims here.

***14** But there a number of problems with the Defendant's argument. First, the Defendant has not shown or argued that there is any limiting principle to its reading of section 1141. Thus, taken to its logical conclusion, such an interpretation would permit a plan or confirmation order to push out its discharge timeframe for months or even years to a distant post-confirmation "effective date", so long as the bankruptcy judge approved that duration. As the Defendant stated, the span of four (4) months between the Confirmation Order and the Effective Date was primarily due to the intricacies of consummating the Plan Funding Agreement and the occurrence and timing of events over which the Plaintiff had no control at all. (ECF No. 32, at 4.) And, importantly, that effective date was not by any means a date certain, and was instead wholly dependent on the occurrence of one or more subsequent events, the timing of which were definitionally uncertain and outside of the control or influence of the Plaintiff Were it to take one or more years for a debtor to reach the effective date, the Defendant would necessarily be arguing that every post-confirmation/pre-effective date claim —whether tort or statutory—would either have to be pursued only as an administrative expense or be discharged, even though the timing of that discharge date was wholly uncertain.

At the other end of the spectrum, applying the Defendant's argument, the same would logically hold true if the claim arose the very day before the Effective Date; e.g., that in this case, if the Plaintiff had been fired on July 31, 2018, he would not have known until receiving notice that the Effective Date was actually the next day. The only remedy in that instance, which the Defendant acknowledged at oral argument, would be for the plaintiff to forfeit his right to a jury trial under the ADEA and file an administrative expense claim within thirty (30) days—applicable administrative statutes of limitation for the underlying claim notwithstanding (which for claims arising in Pennsylvania, is 300 days after the alleged act of age discrimination if a complaint is filed with the Pennsylvania Human Relations Commission[12]). That period of time, provided in the federal anti-discrimination laws to permit the EEOC and its parallel state agencies to investigate and seek to informally resolve such claims, would by virtue of a private party's bankruptcy plan be reduced by 90%, all without the involvement of the EEOC or any aggrieved party. Beyond the concerns that the Court has identified above, the Defendant's interpretation of section 1141 does not square with: (1) the Supreme Court's decision in *Holywell Corp. v. Smith*, as construed by our Court of Appeals in *In re Arctic Glacier*; (2) considerations *of res judicata* focused upon by the *In re Arctic Glacier* Court; and/or (3) available case law construing the temporal limits of the discharge provisions of section 1141.

Holywell* and *In re Arctic Glacier

While the Defendant may in theory be correct that discharge of the Plaintiff's claims would be a harsh but nonetheless permitted impact of the application of the Plan's provisions and section 1141, it would also seem to the Court that further definitive authority for that proposition must exist, at least in the context of a post-confirmation statutory discrimination claim, before that result obtains. The Court has located none, and the relevant caselaw strongly counsels the opposite outcome.

To the Court's knowledge, this precise question is unsettled and has not been directly addressed by our Court of Appeals. However, the Court's view that the Defendant's broad reading of section 1141 is problematic is echoed elsewhere, to include by the Supreme Court. In *Holywell Corp. v. Smith*, Justice Thomas, delivering the opinion for a unanimous Court, wrote, "[e]ven if § 1141(a) binds creditors of the corporate and individual debtors with respect to claims that arose before confirmation, *we do not see how it can bind the United States or any other creditor with respect to postconfirmation claims*." 503 U.S. 47, 58 (1992) (emphasis added) (noting parenthetically that "creditor" as used in section 1141 is defined in section 101(10) as an entity with various kinds of *preconfirmation* claims[13]).

***15** The Plaintiff contends that this language concludes the issue in his favor. The Defendant argues the opposite, namely that the Supreme Court was speaking imprecisely in *Holywell*, and that that statement from that case is inapplicable here because the claim in *Holywell* arose not only after the plan's confirmation, but also after its effective date. (ECF No. 48, at 6 n.3.) Therefore, the Defendant says *Holywell* actually stands for the unexceptional proposition that claims arising after the *effective date* are not subject to discharge, notwithstanding Justice Thomas' focus on the confirmation date as the key measuring mark.[14] (*Id.*) And the Defendant's argument that *Holywell* has more limited applicability than the Opinion's actual language is not without support.

In a precedential Opinion, our Court of Appeals rejected the idea that *Holywell* prohibits bankruptcy plans from barring liability for *any* post-confirmation acts. *In re Arctic Glacier Int'l, Inc.*, 901 F.3d 162, 166 (3d Cir. 2018).[15] In *Arctic*, the appellants had purchased shares from shareholders (or "unitholders") of the reorganized debtor after confirmation of its bankruptcy plan. *Id.* at 163–65. The appellants claimed to be owed a dividend under the bankruptcy plan's distribution scheme, but that they were not paid—actions which the appellants argued constituted post-confirmation conduct from which their claim arose. *Id.* at 165–66. Therefore, the appellants cited *Holywell* to argue that a bankruptcy plan can never insulate a debtor from liability arising from post-confirmation conduct. The Third Circuit rejected this argument. The *Arctic* Court held that the appellants were "transferees" of their claim, because they had purchased their shares from shareholders that were represented in the bankruptcy proceedings and had the opportunity to object to the plan prior to its confirmation. *Id.* at 167–68. Due to the fact that the initial shareholders were subject to the *res judicata* effects of the confirmed bankruptcy plan, any burdens imposed by the plan "ran" with the shares, so to speak. *Id.* at 168. Thus, the limitations on claims assertion that the appellants assumed upon purchasing the shares were as binding on them as transferees as they would have been on the initial shareholders. *Id.* (citing *In re KB Toys Inc.*, 736 F.3d 247, 249–52 (3d Cir. 2013)). Accordingly, the plan's terms controlled, which included waivers of liability for "all claims arising out of the bankruptcy, including distributions under the [p]lan." *Id.* at 167. The Court of Appeals also held that the forgoing did not offend considerations of due process. *Id.* at 168.

***16** The *Arctic* Court also distinguished the facts of its case from *Holywell*, noting that *Holywell* involved a Chapter 11 plan that set up a trust and trustee to oversee liquidation of the debtor's property. *Id.* at 166. The plan in *Holywell* was silent as to whether the trustee had to file and pay taxes, and the trustee accordingly claimed that the United States, as a creditor, should have objected to the plan if it wanted to preserve the right to collect taxes on income from the liquidation. *Id.* The Supreme Court rejected that argument, specifically noting that the tax liability itself arose after confirmation. *Id.* at 166–67. By contrast, the *Arctic* Court noted that the appellants in its case were directly challenging how the trustee *implemented* the confirmed plan by not paying out certain dividends the appellants said they were owed under the plan. *Id.* at 167. Thus, *Holywell*'s "facts, its language, and its logic do not apply to post-confirmation acts that carry out a bankruptcy plan," otherwise the *res judicata* effect of confirmed bankruptcy plans would be effectively nullified. *Id.* Therefore, a bankruptcy plan's terms can authorize or limit liability for post-confirmation acts that implement the plan. *Id.* This preemption of laws that would otherwise apply to the claims is permitted so long as the plan's preemptive scope in that regard covers laws related to "financial condition." *Id.* (citing 11 U.S.C. § 1142(a)) ("This is not to say that a plan's preemptive scope can be unlimited. The Code authorizes preemption of laws related to financial condition, but preemption beyond that line is suspect."). In sum, *Arctic* seems to stand for the proposition that a bankruptcy plan can, by virtue of section 1141, release/bar/discharge claims based on post-confirmation conduct if: (1) that conduct relates to implementation of the Plan; (2) the terms of the Plan release those claims; (3) the holder of the claim is bound to the terms of the plan under principles of *res judicata*, and (4) the preemptive scope of the Plan does not go beyond laws related to financial condition.

Res Judicata

On the issue of *res judicata, Arctic* cuts in Plaintiff's favor, since "[w]hen a bankruptcy court enters a confirmation order, it renders a final judgment. That judgment, like any other judgment, is *res judicata.* It bars all challenges to the plan that ***could have been raised***." *Id.* at 166 (citations omitted) (emphasis added). Of course, the Plaintiff could not have known at the time of the confirmation hearing that he would later have a discrimination claim against the Defendant, so he had no claim or objection to raise when confirmation occurred. Even after confirmation occurred, his claim did not arise for another two (2) months. Further, he did not acquire his claim from or stand in the shoes of a party that *did* have the opportunity to challenge the plan, as in *Arctic.* It was created by the post-confirmation conduct of the Defendant in dismissing him from employment.

Res judicata in this context was discussed in depth in the *WorldCom* bankruptcy cases. *Res judicata*, or "claim preclusion," only bars subsequent litigation if "(1) the prior decision was a final judgment on the merits, (2) the litigants were the same parties or in privity, (3) the prior court was of competent jurisdiction, and (4) the causes of action were the same." *In re WorldCom, Inc.*, 401 B.R. 637, 648 (Bankr. S.D.N.Y. 2009) (alteration omitted) (quoting *Corbett v. MacDonald Moving Servs.*, 124 F.3d 82, 88 (2d Cir. 1997)); *see also CoreStates Bank, N.A. v. Huls Am., Inc.*, 176 F.3d 187, 194 (3d Cir. 1999) ("Claim preclusion requires: (1) a final judgment on the merits in a prior suit involving; (2) the same parties or their privities; and (3) a subsequent suit based on the same cause of action.").

The *WorldCom* Court analyzed whether *res judicata* bound a creditor's bankruptcy trustee (who held a post-confirmation/pre-effective-date claim) to the terms of WorldCom's bankruptcy plan. *Id.* at 647–51. After the WorldCom plan was confirmed but before its effective date, a petition for involuntary Chapter 7 bankruptcy was filed against one of WorldCom's creditors, OneStar. *Id.* at 640. Sometime later, a trustee was elected to manage OneStar's bankruptcy. *Id.* Prior to OneStar's involuntary petition, a WorldCom subsidiary provided telecom services to OneStar, for which OneStar continued to pay after WorldCom filed its bankruptcy petition. *Id.* The OneStar trustee sought avoidance and recovery of some of those payments in an adversary proceeding in another court, which stayed the matter pending the outcome of the *WorldCom* decision. *Id.* The *WorldCom* Court had to determine if the OneStar trustee was bound by the discharge provisions of the WorldCom plan. The court tee'd up the central question as: "whether a bankruptcy trustee seeking to pursue an avoidance action is bound by the notice of the confirmation order that the debtor [OneStar] received in another bankruptcy case [WorldCom's], when the debtor received the notice before it became a debtor by its filing of a bankruptcy case while it was a creditor in that other bankruptcy case." *Id.* at 641.

***17** Ultimately, the court concluded that the plan *could not bind* a party that was neither the same party nor in privity with a party to the bankruptcy proceedings leading up to confirmation. There, the OneStar trustee and OneStar were not the same party or in privity, nor was the OneStar trustee a successor in interest of OneStar. *Id.* at 644. While the relationship between the parties here is far less complex, applying *WorldCom* here, the Plaintiff would not bound by the Plan for similar reasons—he was not a creditor, holder of a claim, or otherwise a party, at the time that the bankruptcy court entered its Confirmation Order. Further, the Plaintiff is not in privity with any such party, since broadly speaking, "privity is defined as mutual or successive relationships to the same right of property, or such an identification of interest of one person with another as to represent the same legal right." *Greenway Ctr., Inc. v. Essex Ins. Co.*, 475 F.3d 139, 149 (3d Cir. 2007). The Defendant has not proffered any record facts that demonstrate privity between the Plaintiff and a party to the bankruptcy matter prior to confirmation such that the Plaintiff would be bound by virtue of privity and *res judicata* to the Confirmation Order and the Plan, nor would such logically exist as a result of the Plaintiff's post-confirmation discrimination claim. Without demonstrating the Plaintiff was a party or in privity with a party, it is "axiomatic" that he did not have a full and fair opportunity to weigh in on the Plan's provisions prior to the Plan confirmation. *Id.* at 151.

The fact that the Plaintiff received notice of confirmation proceedings is not enough to carry this argument for the Defendant in this instance. "Under fundamental notions of procedural due process, a claimant who has no appropriate notice of a bankruptcy reorganization cannot have his claim extinguished in a settlement pursuant thereto." *Jones v. Chemetron Corp.*, 212 F.3d 199, 209-10 (3d Cir. 2000). Of course, the Plaintiff here admits receiving the first two notices relating to the Proofs of Claims, the General Bar Date, and the confirmation hearing. However, in *Wright v. Owens Corning*, our Court of Appeals at least implicitly held that if a potential claimant correctly believes it does not have a claim prior to the confirmation, then generalized notice alone is insufficient to bind the Plaintiff to the Plan's terms. 679 F.3d 101, 108 (3d Cir. 2012). The *Wright* Court held that while the publication notices issued in its case were sufficient for most unknown claimants, the notice was insufficient as to the plaintiffs in that case because they did not know they had dischargeable claims at the time they received their notices. *Id.* In *Wright*, the claims at issue arose from an intervening change in Third Circuit law, after which the plaintiffs "unexpectedly [held] 'claims' that arguably could be discharged in the proceedings addressed in the notices." *Id.* However, by the time the law changed and the plaintiffs realized they had "arguably" dischargeable claims, the bar date had passed and the plan was confirmed. *Id.* Because the *Wright* plaintiffs accurately believed that their claims were not affected by the bankruptcy under then-current law, they, "correctly, would not have taken any action to ensure that their interests were represented." *Id.* So, the court fashioned a rule that "for persons who have 'claims' under the Bankruptcy Code based solely on the retroactive effect of the [intervening] rule announced in *Grossman's*, those claims *are not discharged when the notice given to those persons was with the understanding that they did not hold claims.*" *Id.* (emphasis added).

Thus, by extension of the reasoning in *Wright*, the two pre-confirmation notices that the Plaintiff received here were also insufficient to bind him to the Plan because he would have correctly believed that he did not have a claim at the time he received the pre-confirmation/pre-employment-termination notices. Simply put, the Plan and Confirmation Order are not *res judicata* as to the Plaintiff because he was not a party or in privity with a party to the bankruptcy proceedings leading up to confirmation, *and* because he received the pre-confirmation notices at a moment in time when he did not have a claim and thus had no reason to take "any action to ensure that [his] interests were represented." *Id.*

However, even if the Plan were binding on the Plaintiff, the Court still concludes that the terms of the Plan do not discharge the Plaintiff's claims under section 1141. Here, more akin to *Holywell than Arctic*, the post-confirmation conduct that is the foundation of the Plaintiff's claim (his termination of employment) had nothing to do with "implementation" of the bankruptcy plan. Whereas the bankruptcy trustee (or "monitor") in *Arctic* was set to make distributions to the shareholders under the terms of the plan —distributions that did not occur and were thus the genesis of the claims being asserted—no provisions of the Plan in this case made "firing Timothy Ellis" part and parcel of the Plan's implementation. *See Arctic*, 901 F.3d at 167 ("Unlike the [appellants] here, the government in *Holywell* did not directly challenge how the trustee implemented the plan.”). The Plaintiff's claims of discrimination facially have nothing to do with the implementation or accomplishment of any provision of the Plan. Put another way, the Plaintiff's claim did not arise out of the bankruptcy itself, as in *Arctic*, and they did not arise from or relate to laws regarding the bankrupt's financial condition, as was the case in *Arctic*.

Temporal Limits of Section 1141

18** Furthermore, unlike the *Arctic* plan's discharge of “claims in any way related to the bankruptcy” provision, section 11.3 of the Plan which the Defendant highlights here does not, by its terms, mandate the discharge of the instant claims. At the end of the day, no matter the wording of section 11.3 of the Plan, the provision nonetheless states that it applies “to the fullest extent ***permitted by section 1141 of the Bankruptcy Code.” (Plan, § 11.3 (emphasis added).) Putting aside the hypothetical permissible reach of Justice Thomas' broad language in *Holywell* in the present matter, at least two other courts have expressed substantial doubt that section 1141 permits temporal expansion of the debtor's discharge protection via the definition of an extended “effective date” by virtue of terms of the plan of reorganization, at least in the context the Defendant advances here. That is, those courts have declined to hold that the “except as otherwise provided ... in the plan” language in section 1141(d)(1) permits a debtor to discharge debts other than “any debt that arose *before* the date of such confirmation.” 11 U.S.C. § 1141(d)(1) (emphasis added).

The Ninth Circuit in *Zilog* suggested that the more plausible reading of section 1141 is that the “except as otherwise provided” language refers to “any debt” and not to a power to indefinitely extend the discharge date under section 1141 by setting a later arriving effective date. The *Zilog* Court addressed this question in a footnote:

> We are uncertain whether post-confirmation debts can in fact be discharged in bankruptcy. The “[e]xcept as otherwise provided” clause in section 1141 can be read in either of two ways. One way would be to read the clause as modifying the words “any debt.” Under that reading, all pre-confirmation debts are dischargeable, except as limited by the plan or the code. Alternatively, one could read the “[e]xcept as otherwise provided” clause as modifying the phrase “before the date of such confirmation.” Under that reading, even post-confirmation debts could be discharged if that were provided for in the reorganization plan.
>
> We have not located a case addressing which reading is correct. Nor have we found an answer in the statute's legislative history. ***Although we find the first alternative more plausible***, we need not decide the matter here.

Zilog, 450 F.3d at 1001 n.5 (citations omitted).

While the Ninth Circuit demurred, the United States Bankruptcy Court for the Western District of Michigan more directly rejected the Defendant's interpretation as advanced here. In *Matter of Holly's, Inc.*, the court took the same view as the Ninth Circuit expressed and held, “Section 1141(d)(1) allows the Plan to except certain preconfirmation debts from discharge; it does not empower the Debtor to rewrite the Code and discharge debts that arise postconfirmation.” *Matter of Holly's, Inc.*, 172 B.R. 545, 561 (Bankr. W.D. Mich. 1994), *aff'd sub nom. In re Holly's, Inc.*, 178 B.R. 711 (W.D. Mich. 1995). The *Holly's* Court expressed the same difficulties that this Court has with the Defendant's interpretation:

> This analysis comports with common sense and notions of due process. For example, suppose the only debt owed by the Debtor to Kentwood were one arising on the effective date of the Third Amended Plan. Under this scenario, Kentwood would have had its debt discharged without any notice of the discharge. Kentwood would not have been scheduled by the Debtor. After all, how could the Debtor schedule a creditor that did not even exist at the time of the bankruptcy filing? In addition, Kentwood would not have filed a claim by the bar date established by the bankruptcy court. As a result, Kentwood would not have been able to vote on the plan of reorganization or object to the fact that the plan of reorganization would seek to discharge its prospective debt without providing Kentwood with the right to any payment on that debt.
>
> ***Thus, this court concludes that the Bankruptcy Code establishes the date of confirmation, not the effective date, as the post-filing cleavage date for chapter 11 dischargeable claims.*** Any claim that arises after confirmation is by definition a postconfirmation claim. Delaying or making conditional the operation of the effective date or the Debtor's discharge does not alter the date of confirmation and the nature of the claims that arise after that date.

***19** *Id.* (citations omitted) (emphasis added). This reading is consistent with the broad language in *Holywell*, and with the analysis of our Court of Appeals in *Artic*. This Court agrees and concludes that the Defendant's interpretation of section 1141's “as otherwise provided” provision is not borne out by the case law, and the Plan does not discharge the Plaintiff's employment discrimination claims that arose post-confirmation. And the *Arctic* case, for the reasons discussed above, does not change this outcome.

V. CONCLUSION

The Bankruptcy Code does not empower the Defendant to in essence make the Plaintiff "an offer he can't refuse" by discharging post-confirmation claims that arose prior to the more distant and wholly uncertain effective date of the plan. And in these circumstances, sections 503 and 1141 do not require that the Plaintiff's statutory discrimination claims arising post-confirmation be filed as priority administrative expenses or else face discharge. While bankruptcy can be unforgiving in its pursuit of providing a "fresh start," the temporal limits of discharge are not unbounded and in the Court's estimation, cannot be extended simply by virtue of a distant "effective date" as has been argued here. Simply put, in the circumstances present in this case, the Plaintiff was not forced to file his statutory discrimination claims, which arose post-confirmation, within weeks of his claimed injury, or face losing all recourse. For the foregoing reasons, the Defendant's Motion for Summary Judgment, (ECF No. 31), will be denied, and on this issue, summary judgment will be granted in favor of the Plaintiff.

But, for the reasons noted above, this issue is certainly a "gateway" issue in this civil action and is one that occupies the intersection of two vital federal statutory schemes of importance to American society. As noted above, one of the central principles underlying the uniform bankruptcy system under federal law is the conclusive wrap up of the debtor's financial challenges, and the provision of a "fresh start" unencumbered by those obligations discharged via the bankruptcy process. Conflicting with those principles in this case is the mission of the federal (and supplemental state) anti-discrimination laws to both eradicate unlawful discrimination were it to occur, and to provide an administrative mechanism for the resolution of such claims by a federal agency so charged, or, if necessary, in the federal courts. That intersection of important statutory schemes generates a legal issue that can easily arise again in the context of bankruptcy proceedings yet to be filed. From the Court's perspective, it is certainly a "controlling" question of law, one as to which there is a "substantial ground" for difference of opinion, and in the Court's estimation, given its "gateway" nature, an immediate appeal from this Court's Order may materially advance the ultimate termination of the litigation. *See* 28 U.S.C. § 1292(b). And, in the Court's judgment, it is a legal question of considerable significance to the sound administration of both federal bankruptcy law and federal anti-discrimination laws. Therefore, the Court's Order will include in its Order a certification of such for immediate interlocutory appeal to the United States Court of Appeals for the Third Circuit pursuant to 28 U.S.C. § 1292(b), specifically as to the following controlling question of law:

"Where a plaintiff's claim under the Age Discrimination in Employment Act (and parallel provisions of state law) arises after the confirmation of an approved bankruptcy plan of reorganization, but prior to the effective date of the plan and the vesting of the bankruptcy estate as set forth and defined in such plan by order of the bankruptcy court: (1) is the plaintiff's claim barred by the provisions of 11 U.S.C. § 503 if the plaintiff did not file such employment discrimination claim as a claim for an administrative expense prior to the post-confirmation administrative claim bar date under the plan; and/or (2) is such employment discrimination claim discharged by the provisions of 11 U.S.C. § 1141, and/or under the principles of *res judicata*, if such claim was not filed in the bankruptcy court prior to the post-confirmation effective and discharge dates set out in the plan?"

***20** To permit the process contemplated by 28 U.S.C. § 1292(b) to play out, all further proceedings in this civil action will be stayed to the date falling fifteen (15) days after the date of this Court's Order, to permit the Defendant to file a petition for permission to appeal pursuant to § 1292(b) should it elect to do so. Should the Defendant file such a petition for leave to appeal, then such stay shall continue in full force until the later of fifteen (15) days after the denial of any such petition for leave to appeal by the Court of Appeals, or, if such petition is granted by the Court of Appeals, until such later date as may be ordered by the Court of Appeals or this Court. The Defendant shall promptly file a notice on the docket in this civil action of the filing of any petition for leave to appeal that it files under § 1292(b) or of its election to not file such a petition, and a second notice of the action of the Court of Appeals on any such petition.

All Citations

Slip Copy, 2020 WL 4499931, 69 Bankr.Ct.Dec. 41

Footnotes

1 And, because it became apparent that the issues central to the Defendant's Summary Judgment Motion were ones of law, the Court gave notice to the parties, (ECF No. 47), that it reserved the right to grant summary judgment in favor of the Plaintiff if it determined that there were no genuine issues of material fact, and the Plaintiff was entitled to judgment in its favor as a matter of law on the question of whether his claims as asserted in this Court were barred or discharged by the Defendant's bankruptcy. Because the Court concludes that that standard has been met on this issue, summary judgment will be granted in favor of the Plaintiff as to these issues.

2 The Court notes that as a practical matter, the Defendant could have withdrawn the instant Motion and proceeded in the bankruptcy court in Manhattan alone, assuming that the bankruptcy court maintains jurisdiction to enjoin this matter, as the Defendant contended that it did and as the Plaintiff vigorously contended it did not due the application of a variant of the "first filed rule" in light of the proceedings in this Court. Be that as it may, the Defendant nonetheless elected to proceed with its Motion here. So the Court advised the parties that it would act to ensure its ability to properly resolve the issues that the parties put before this Court.

3 The Defendant avers, and the Plaintiff agrees, (ECF No. 45, ¶ 34), that May 31, 2018 is the date upon which the claim arises for purposes of the Plaintiff's discrimination claims. *Anderson v. Acme Markets, Inc.*, 287 B.R. 624, 630 (E.D. Pa. 2002) ("[a]n employment discrimination suit accrues as of the date of the alleged adverse employment action").

4 The "Notice of Hearing on Confirmation of Plan and Procedures for Objecting to the Confirmation of Plan."

5 The Court does note a nuance with regard to this rule in the Third Circuit. Unlike the bankruptcy cases cited above, the Third Circuit sometimes applies a different, two-tiered rule. As before, once the party seeking the presumption proves mailing, "the presumption of receipt imposes the burden of production on the party against whom it is directed." *Lupyan v. Corinthian Colleges Inc.*, 761 F.3d 314, 320 (3d Cir. 2014) (quotations and alterations omitted) (citing *McCann v. Newman Irrevocable Trust*, 458 F.3d 281, 287 (3d Cir. 2006)). However, the Third Circuit has held that the presumption is "weaker" when the delivery is sent by regular mail rather than by certified mail, which would generate a receipt or other proof of delivery. *Id.* at 319. Viewed in the light most favorable to the Plaintiff, the Defendant would not be afforded the "strong presumption" associated with certified mail, *see id.*, because neither the affidavit by KCC's Director nor the affidavit of service filed in the bankruptcy court state that the Notice was sent by certified or registered mail, (*see* ECF Nos. 50-1, 50-2). Thus, the quantum of evidence to overcome the presumption and to defeat summary judgment under this rule would be "minimal" and could "consist solely of the addressee's positive denial of receipt [through sworn affidavit], creating an issue of fact for the jury." *Lupyan*, 761 F.3d at 320–21. The same would hold true "even if the affidavit is 'self-serving.' " *Id.* at 321 (citing *Kirleis v. Dickie, McCamey & Chilcote, P.C.*, 560 F.3d 156, 161–63 (3d Cir. 2009)). However, *Lupyan* addressed a Family and Medical Leave Act ("FMLA") claim and based this weaker presumption at least in part on the fact that "there is no language in the FMLA or its regulations that suggests a legislative intent to create a stronger presumption there than would otherwise apply in under [sic] Rule 301." *Id.* at 321 (referring to Fed. R. Evid. 301, "Presumptions in Civil Cases Generally"). The Third Circuit has applied this weaker presumption in the Truth in Lending Act ("TILA"), immigration, and equitable liens contexts as well. *Cappuccio v. Prime Capital Funding LLC*, 649 F.3d 180, 190 (3d Cir. 2011) (TILA); *Santana Gonzalez v. Attorney Gen. of U.S.*, 506 F.3d 274, 279 (3d Cir. 2007) (immigration proceedings); *U.S. Renal Care Inc. v. WellSpan Health*, 709 F. App'x 160, 162 (3d Cir. 2018) (equitable lien). The Court is unable to identify a Third Circuit case applying this weakened presumption to bankruptcy. Thus, as the Third Circuit did in *Lupyan*, this Court looks to the principles of the Bankruptcy Code and agrees with the *Greenberg* Court that a weaker presumption would be at odds with the noticing scheme established by Congress in the Bankruptcy Code. *In re Greenberg*, 526 B.R. at 107–08. In addition, here the Plaintiff has not offered a "positive statement of denial of receipt" but has instead simply stated that he did not "recall" receiving it. For all of these reasons, a weaker presumption for non-registered mail is not applicable in this context.

6 The record does not reflect why the Plaintiff was placed on the creditor mailing list to receive these Notices relating to the Defendant's bankruptcy, and no party advances any contentions in such regards.

7 "Claim" under the Bankruptcy Code is defined broadly to include, "right(s) to payment" and "right(s) to an equitable remedy for breach of performance." 11 U.S.C. § 101(5). "Under this broad definition of claim, all legal obligations of the debtor,

no matter how remote or contingent, will be able to be dealt with in the bankruptcy case." *In re First Jersey Sec., Inc.*, 180 F.3d 504, 510 (3d Cir. 1999) (internal quotations omitted).

8 In the portion of Defendant's Brief in Support of its Motion, (ECF No. 32, at 17–18), where the Defendant argues in the alternative that section 1141 also discharges the claims here, the Defendant cites a case cutting against its argument under section 503. In *Mohammed v. Great Atl. & Pac. Tea Co., Inc.*, No. 13 CIV. 2248, 2014 WL 4058708 (S.D.N.Y. Aug. 15, 2014), *aff'd*, 607 F. App'x 77 (2d Cir. 2015), the court addressed a motion to dismiss a claim for employment discrimination. There, the plaintiff filed his complaint in the district court after the defendant's plan was confirmed and the effective date had elapsed. *Id.* at *1–2. Unlike here, that claim arose post-petition, but pre-confirmation. *Id.* The defendant argued that the claim was thus discharged by its bankruptcy. *Id.* at *1. Under the authority discussed above, it is evident that the *Mohammed* plaintiff could have sought payment for his claim as an administrative expense in the defendant's bankruptcy proceeding under the *Reading* exception. Notwithstanding that fact, the court did not dismiss the complaint for failure to file the claim as an administrative expense by the bar date, but under the normal discharge provisions of section 1141. *Id.* at *3. While the *Mohammed* Court used language seeming to indicate that the plan could discharge claims that arose up until the effective date, the claim there arose pre-confirmation and thus fell squarely within the language of section 1141, which discharges debts that "arose before the date of such confirmation." 11 U.S.C. § 1141(d)(1)(A). In any event, the court never stated that the plaintiff's claim, by dint of arising post-petition and during the pendency of the bankruptcy, *had* to be filed as an administrative expense claim under *Reading.*

9 The *Sanchez* Court ultimately did not have to make this ruling. The court based its holding on the fact that the notice the debtor served on the plaintiff excluded administrative expense claims for liabilities incurred in the ordinary course of business, not on whether his claim could be discharged under section 503. *Sanchez*, 659 F.3d at 679–80.

10 *See also* *Collins v. J&N Rest. Assocs., Inc.*, No. 3:15-CV-178(BKS), 2016 WL 1248888, at *2 (N.D.N.Y. Mar. 28, 2016) (providing a more detailed factual background of the case).

11 Section 1141(d)(1) in its entirety reads:

> Except as otherwise provided in this subsection, in the plan, or in the order confirming the plan, the confirmation of a plan—
>
> > (A) discharges the debtor from any debt that arose before the date of such confirmation, and any debt of a kind specified in section 502(g), 502(h), or 502(i) of this title, whether or not—
> >
> > (i) a proof of the claim based on such debt is filed or deemed filed under section 501 of this title;
> >
> > (ii) such claim is allowed under section 502 of this title; or
> >
> > (iii) the holder of such claim has accepted the plan; and
> >
> > (B) terminates all rights and interests of equity security holders and general partners provided for by the plan.

12 *Cicchiello v. SEIU 1199P Union Serv. Employees Int'l Union, No. 361 M.D. 2015*, 2016 WL 1639015, at *7 (Pa. Commw. Ct. Apr. 26, 2016)

13 The Supreme Court cited 11 U.S.C. § 101(10) of the 1988 edition of the U.S. Code. The current version is not materially different in any respect.

14 The Defendant proffers other cases in pursuit of its argument under section 1141. However, despite the language of those cases, which appear to advance the Defendant's argument that a bankruptcy plan can discharge claims that arise after plan confirmation and before a later effective date, all of those cases involved post-petition claims that arose *pre-confirmation*, rather than post-confirmation and pre-effective-date, as is the case here. *See* *McSherry v. Trans World Airlines, Inc.*, 81 F.3d 739, 740 (8th Cir. 1996) (claim arose in September 1992 and the plan was confirmed in August 1993); *Cost v. Super Media*, 482 B.R. 857, 859, 862 (S.D.N.Y. 2012) (claim arose in April 2007 and the plan was confirmed in December 2009); *Holmes v. Air Line Pilots Ass'n, Int'l*, 745 F. Supp. 2d 176, 187, 197 (E.D.N.Y. 2010) (claims arose in October 2006 and the plan was confirmed in April 2007); *In re Orleans Homebuilders, Inc.*, No. 10-10684 (KJC), 2017 WL

665953, at *1 (Bankr. D. Del. Feb. 17, 2017) (claims arose in June 2010 and the plan was confirmed in December 2010); *Mohammed v. Great Atl. & Pac. Tea Co., Inc.*, No. 13 CIV. 2248, 2014 WL 4058708, at *1 (claims arose in September 2011 and the plan was confirmed in February 2012). One case the Defendant cited involved claims which arose pre-petition. *Gilbert v. N. Am. Airlines*, No. 12-CV-523 KAM JMA, 2014 WL 1271057, at *7 (E.D.N.Y. Mar. 26, 2014) (claims arose in August 2011 and the debtor filed for bankruptcy in February 2012). Thus, notwithstanding the broad verbiage of those cases, they do not follow the same fact pattern as here and the Court thus finds them unpersuasive in answering the question presented.

15 In their arguments to this Court, the Plaintiff did not cite to *Arctic*, and the Defendant did so only in passing. (ECF No. 60, at 2.)

End of Document

Moot Ain't Cute: Equitable Mootness

Bruce A. Markell
Sigmund J. Beck Advanced Chapter 11 Bankruptcy Roundtable
West Baden Springs Resort
West Baden Springs, Indiana
August 19-20, 2022

Materials:

Excerpts from *The Needs of the Many: Equitable Mootness' Pernicious Effects,* 93 Am. Bankr. L.J. 377 (2019)

Questions:

1. Why hasn't the Supreme Court taken certiorari on this issue? It's had opportunities.
2. Does equitable mootness give bankruptcy judges too much power?
3. What should a bankruptcy court take into account when setting a bond amount on a motion for a stay pending appeal?
3. What should be the right rule(s)?

The American Bankruptcy Law Journal

Cite as:
AM. BANKR. L.J.

Volume 93
Issue 3
2019

954 La Mirada Street
Laguna Beach, CA 92651-3751

Excerpts Reprinted With Permission from the American Bankruptcy Law Journal

Excerpts From

The Needs of the Many: Equitable Mootness' Pernicious Effects

by

*Bruce A. Markell**

*Professor of Bankruptcy Law and Practice, Northwestern University Pritzker School of Law. A much earlier and more limited version of this paper was presented at a celebration of the scholarship of Professor Jay Lawrence Westbrook, held at The University of Texas at Austin on February 3, 2018. Thanks to all the participants for their helpful comments. Special thanks to James Pfander, Whitman Holt, and Emily Kadens for kindly reading the text and for their helpful suggestions and to Khadija Lalani for her research assistance. Errors which remain are mine alone.

I. INTRODUCTION

Business bankruptcies typically move fast. In many cases, this is desirable.[1] Fragile finances deteriorate quickly, reducing recoveries for creditors and eliminating value for owners. Congress thus intended chapter 11, the primary vehicle for business reorganizations, to process distressed entities quickly and decisively. Compared to routine civil litigation, chapter 11 procedures are speedy. This results from estate representatives being statutorily empowered to resuscitate the debtor by means entirely foreign to nonbankruptcy law.[2]

The reorganization process centers around a chapter 11 plan of reorgani-

[1] *See* Mark J. Roe, *Bankruptcy and Debt: A New Model for Corporate Reorganization*, 83 COLUM. L. REV. 527, 529 (1983) (identifying speed as one of "three principal characteristics desirable for a reorganization mechanism").

[2] These means include the powers (1) to transfer property free of existing liens, 11 U.S.C. § 363 (2012), (2) to disallow claims otherwise valid under state law, 11 U.S.C. § 502(b)(2), (6) (2012), (3) to discount and alter existing debt, 11 U.S.C. §§ 1123(a) & (b)(2012), (4) to recover transfers and set aside

zation, a document that adjusts and alters the rights of creditors and owners. Instead of a statutory form, Congress largely left the structure and content of such plans to the parties. As a result, creditors will enthusiastically endorse some plans and strenuously scorn others. One issue, then, is how to handle a feasible and sensible plan opposed by a minority of creditors.

Congress answered this question in part by arming plan proponents with "cramdown" powers;[3] that is, an otherwise appropriate plan that is opposed by one or more classes may be confirmed so long as it is fair and equitable and does not discriminate against a dissenting class.[4] As Congress placed the bankruptcy power in a court system rather than in an administrative process, judges rather than administrators apply the rules of cramdown. That is, judges apply the law to the facts, and in theory confirm and approve only those plans that conform to Congress' cramdown and other confirmation requirements.

Judges, however, can and do make mistakes. Congress realized as much and authorized appeals of bankruptcy court final orders.[5] These appeals correct errors in discrete cases; but they also assure the uniform implementation of bankruptcy law.[6]

A disturbing trend in bankruptcy litigation, however, challenges this notion of the proper role of appeals. The judge-made doctrine of equitable mootness allows appellate courts to dismiss meritorious appeals in order to

---

liens otherwise valid under state law, 11 U.S.C. §§ 545, 547, 726(b), and (5) to accomplish as much without the unanimous consent of all creditors, 11 U.S.C. §§ 1129(a)(8), (b)(1) (2012).

[3]This is a reference to the § 1129(b)(1) power to confirm a plan over the dissent of a class of creditors or, in common parlance, to cram it down their throats. This article uses the portmanteau form "cramdown." Courts tend to use the terms "cramdown," "cram down," and "cram-down" interchangeably. Indeed, a Justice of the Supreme Court has used both "cramdown" and "cram-down" in the same sentence. Blanchette v. Conn. Gen. Ins. Corp., 419 U.S. 102, 167 (1974) (Douglas, J., dissenting).

[4]11 U.S.C. § 1129(b)(1) (2012).

[5]28 U.S.C. § 158(a) (2012); *see* ACC Bondholder Grp. v. Adelphia Commc'ns. Corp. (*In re* Adelphia Commc'ns. Corp.), 361 B.R. 337, 342 (S.D.N.Y. 2007) ("The ability to review decisions of the lower courts is the guarantee of accountability in our judicial system. In other words, no single judge or court can violate with impunity the Constitution and laws of the United States, or the rules that govern court proceedings, because nearly all decisions are subject to appellate review. At the end of the appellate process, all parties and the public accept the decision of the courts because we, as a nation, are governed by the rule of law. Thus, the ability to appeal a lower court ruling is a substantial and important right.").

[6]*See generally* Cassandra Burke Robertson, *The Right to Appeal*, 91 N.C. L. REV. 1219, 1246 (2013) (discussing generally the nature of an appeal). I acknowledge that there is no constitutional right to an appeal. The Supreme Court has stated that a right of appeal is "not essential to due process, provided that due process has already been accorded in the tribunal of first instance." Ohio *ex rel.* Bryant v. Akron Metro. Park Dist., 281 U.S. 74, 80 (1930); *see also* McKane v. Durston, 153 U.S. 684, 688 (1894).

It is of some note that, under prior bankruptcy statutes, the Supreme Court held it did not have appellate jurisdiction over "pure" bankruptcy issues such as resolution of an individual proof of claim. *See* Wiswall v. Cambell, 93 U.S. (3 Otto) 347, 348 (1876) (dismissing appeal for lack of jurisdiction with respect to order disallowing "a claim presented by a supposed creditor against the estate of a bankrupt.").

preserve the expectations of the other participants in the reorganization.[7]

In other words, the needs of the many justify running roughshod over the rights of the few, a perverted implementation of utilitarianism.[8] Not surprisingly, especially given the previous sentence, I believe that appellate courts have used equitable mootness too broadly and in ways that undermine tenets central to our jurisprudential and bankruptcy systems.

This article explores the contours of equitable mootness to illustrate the untenable position in which it places meritorious appellants. It will then demonstrate how this process is corrosive to the role of our courts and how it can undermine the very principles it purports to protect. The article closes with some radical suggestions for reform.

II. EQUITABLE MOOTNESS[9]

As Judge Posner has put it, equitable mootness "is perhaps best described as merely an application of the age-old principle that in formulating equitable

[7]There are a host of articles devoted to the doctrine of equitable mootness, most of which attempt to describe or explain the doctrine. *See, e.g.,* Dennis J. Connolly & Sage M. Sigler, *The Issue is Moot. Or is it? Rethinking the Application of Equitable Mootness to Bankruptcy Appeals*, 2016 ANN. SURV. OF BANKR. LAW 2 (2016); Ross E. Elgart, *Bankruptcy Appeals and Equitable Mootness*, 19 CARDOZO L. REV. 2311 (1998); Katelyn Knight, *Equitable Mootness in Bankruptcy Appeals*, 49 SANTA CLARA L. REV. 253 (2009); George W. Kuney, *Understanding and Taming the Doctrine of Equitable Mootness*, 2018 NORTON ANN. SURV. OF BANKR. LAW 1 (2018); David S. Kupetz, *Equitable Mootness: Prudential Forbearance from Upsetting Successful Reorganizations or Highly Problematic Judge-Made Abstention Doctrine?*, No. 4, J. BANKR. L. & PRAC. NL Art. 2 (2016); Robert Miller, *Equitable Mootness: Ignorance is Bliss and Unconstitutional*, 107 KY. L.J. 269 (2018-19); Ryan M. Murphy, *Equitable Mootness Should Be Used as a Scalpel Rather than an Axe in Bankruptcy Appeals*, 19 J. BANKR. L. & PRAC. 1 Art. 2 (2010); Matthew D. Pechous, *Walking the Tight Rope and Not the Plank: A Proposed Standard for Second-Level Appellate Review of Equitable Mootness Determinations*, 28 EMORY BANKR. DEV. J. 547 (2012); Caroline L. Rosiek, *Making Equitable Mootness Equal: The Need for a Uniform Approach to Appeals in the Context of Bankruptcy Reorganization Plans*, 57 SYRACUSE L. REV. 685 (2007); Chad Shokrollahzadeh, *Equitable Mootness and its Discontents: The Life of the Equitable Mootness Doctrine in the Third Circuit After* In re One2One Communications L.L.C. and *In re* Tribune Media Co., 18 DUQ. BUS. L.J. 129 (2016); R. Jake Jumbeck, Comment, *"Complexity" as the Gatekeeper to Equitable Mootness*, 33 EMORY BANKR. DEV. J. 171 (2016); Paul A. Avron, *Equitable Mootness: Is it Time for the Supreme Court to Weigh in?,* AM. BANKR. INST. J., Mar. 2017, at 36; Lenard Parkins et al., *Equitable Mootness: Will Surgery Kill the Patient?*, AM. BANKR. INST. J., Sept. 2010, at 40; *see also* WILLIAM L. NORTON, 8 NORTON BANKR. L. & PRAC. 3d § 170:87 (2017); 13B CHARLES ALAN WRIGHT, ET AL., FED. PRAC. & PROC. § 3533.2.3 (3d ed. 2018 & Supp. 2019).

[8]I say "perverted" because most iterations of utilitarianism contain a version of the "harm principle," which does not permit unilateral reallocation of resources for the greater good when such reallocation harms others. As stated by John Stuart Mill: "The only purpose for which power can be rightfully exercised over any member of a civilized community, against his will, is to prevent harm to others. His own good, either physical or moral, is not sufficient warrant." JOHN STUART MILL, ON LIBERTY 21-22 (2d ed. 1859).

[9]This and the two subsequent sections are based upon, and draw heavily from, Bruce A. Markell, *Equitable Cuteness: Of Mountains and Mice*, BANKR. L. LETTER (Nov. 2015), and from 7 COLLIER ON BANKRUPTCY ¶ 1129.09 (Richard Levin & Henry J. Sommer eds., 16th ed. 2019). The author is the principal contributing author for section 1129 in *Collier on Bankruptcy*.

relief a court must consider the effects of the relief on innocent third parties."[10] The main consideration inherent in equitable mootness is the effect of the implementation of an order confirming a plan of reorganization on those not directly involved in any appeal of that order.[11]

When equitable mootness is invoked, appellate courts often reach an extraordinary conclusion: even if the appellant has a meritorious case, the court will decline to hear the appeal.[12] This leaves aggrieved appellants with no recourse for even profound errors made during the confirmation process. Especially given the Supreme Court's broad interpretation of the preclusive effect of confirmation orders,[13] this doctrine can work significant hardship on innocent creditors.

* * * * *

[Next page is page 397]

[10]*In re* Envirodyne Indus., Inc., 29 F.3d 301, 304 (7th Cir. 1994); *see also In re* Tribune Media Co., 799 F.3d 272, 287 (3d Cir. 2015) (Ambro & Vanaskie, JJ., concurring) (collecting cases); Search Mkt. Direct, Inc. v. Jubber (*In re* Paige), 584 F.3d 1327, 1335 n.7 (10th Cir. 2009) ("[T]he doctrine of equitable mootness is rooted, at least in part, in the court's discretionary power to fashion a remedy in cases seeking equitable relief."); *In re* AOV Indus., Inc., 792 F.2d 1140, 1147–48 (D.C. Cir. 1986) ("[T]here exists . . . a melange of doctrines relating to the court's discretion in matters of remedy and judicial administration. Even when the moving party is not entitled to dismissal on [A]rticle III grounds, common sense or equitable considerations may justify a decision not to decide a case on the merits."); 13B Charles Alan Wright et al., Fed. Prac. & Proc. § 3533.1 (3d ed. 2018).

[11]Bate Land Co. LP v. Bate Land & Timber LLC (*In re* Bate Land & Timber LLC), 877 F.3d 188, 195 (4th Cir. 2017) ("Equitable mootness is a pragmatic doctrine 'grounded in the notion that, with the passage of time after a judgment in equity and implementation of that judgment, effective relief on appeal becomes impractical, imprudent, and therefore inequitable.'") (quoting Mac Panel Co. v. Va. Panel Corp., 283 F.3d 622, 625 (4th Cir. 2002)).

Courts have extended equitable mootness to appeals from cash collateral orders, sales, settlements, liquidations (both under chapter 7 and chapter 11), and equity receiverships. 7 Collier on Bankruptcy ¶ 1129.09[8] (Richard Levin & Henry J. Sommer eds., 16th ed. 2019). This article focuses only on appeals from chapter 9 and chapter 11 confirmation orders.

[12]This facet of the doctrine has not gone unnoticed. *See, e.g., In re* MPM Silicones, L.L.C., 874 F.3d 787, 805 (2d Cir. 2017); *cert. denied sub nom.* BOKF, N.A. v. Momentive Performance Materials, Inc., 138 S. Ct. 2653 (2018) and *cert. denied sub nom.* Wilmington Tr., N.A. v. Momentive Performance Materials, Inc., 138 S. Ct. 2653 (2018) ("It is generally considered inappropriately harsh to deny relief to which one is entitled on the purportedly equitable ground that the unfair (or illegal) plan has been put into effect, especially where a creditor took all appropriate steps to secure judicial relief. In such a case, we have held that it is proper to 'provide relief if it is at all feasible.'") (quoting *In re* Metromedia Fiber Network, *Inc.*, 416 F.3d 136, 144 (2d Cir. 2005)).

[13]*See, e.g.,* United Student Aid Funds, Inc. v. Espinosa, 559 U.S. 260 (2010); Stoll v. Gottlieb, 305 U.S. 165 (1938).

41917-abk_93-3 Sheet No. 6 Side A 01/21/2020 14:38:48

III. THE PERNICIOUS EFFECTS

These differences belie the uncomplicated fact that equitable mootness is an extraordinary remedy that, by design, denies review of meritorious appeals. To summarize and simplify, equitable mootness expressly provides that a meritorious individual claim of trial court error should not be heard, let alone decided, if the plan has been consummated and reversal would unsettle reasonable reliance interests of "innocent" creditors. Although the Bankruptcy Code provides for analogous treatment with respect to certain sales and loans,[94] it does so within a statutory framework established by Congress exercising its bankruptcy power.

By contrast, equitable mootness is a judge-made doctrine that cuts off appeal rights. Moreover, the doctrine is structured to be keenly sensitive to the facts in any particular case. This sensitivity leads to fine distinctions in applying precedent, which gives rise to diverging lines of cases. As shown in the last Section, these factors lead to confusion in the development of a consistent and coherent doctrine.

Finally, the doctrine also generates more work for an appellate court. Courts often choose to augment their equitable mootness dismissal with a review of the merits. The reasons are more equitable than legal; as one court put it: "The Court provides this alternative analysis because of the high burden that exists for equitable mootness, the parties have devoted a great deal of attention to these additional issues, and the appeal has been pending for quite a while."[95]

This state of affairs has led to confusion. This confusion has a cost that exceeds the benefit of insulating consummated plans from alteration after ap-

[94] 11 U.S.C. §§ 363(o), 364(m) (2012).

[95] *In re* Millennium Lab Holdings II, LLC, 591 B.R. 559, 583 n.32 (D. Del. 2018); *see also In re* Nuverra Envtl. Sols., Inc., 590 B.R. 75, 89 (D. Del. 2018) ("although I find the appeal meets the criteria for equitable mootness, the Court can 'readily resolve the merits of [the] appeal against the appealing party,' so I hold, in the alternative, that the Confirmation Order is affirmed.").

peal. In particular, there are at least eight ways in which the current application of equitable mootness has a pernicious effect. These are:

- an undermining of the standard of review regarding facts and law;
- a perversion and disruption of appellate jurisdiction;
- the placing of unfair burdens on appellants with meritorious cases;
- a destabilization of the special status Congress gave to sales and lending appeals;
- a discounting of courts' ability to fashion remedies in complex cases;
- a subversion of the ability to rely upon contracts;
- a dilution and impoverishment of the sources of interpretation of the Bankruptcy Code, and, last but not least;
- the perpetuation of a possibly unconstitutional deference by Article III courts to courts not possessed of the judicial power of the United States.

A. Undermining the Fact/Law Distinction

It is well-settled that while little deference is paid to a trial court's interpretation of law, great deference is given to its findings of fact. Factual findings made during confirmation proceedings stand unless they are "clearly erroneous."[96]

In a world without equitable mootness, an appeal from a confirmation order would be subject to these principles. Issues of fact—such as whether administrative expenses are paid at confirmation[97] or the complicated issue of feasibility[98]—would be given deference, whereas issues regarding interpretation of what, for example, section 1129(a)(10) requires if the plan contemplates substantive consolidation, would not.

This distinction permits courts to develop consistent doctrine. It allows for different interpretations to percolate up for resolution by higher courts with broader geographic jurisdiction. In a word, it prevents Balkanization.

Equitable mootness undercuts this process. If parties can block appellate review by quickly consummating a plan, then each bankruptcy district—if not each bankruptcy judge—becomes an independent fief. The judge can es-

[96] A confirmation hearing at which an objection is heard is a contested matter under Fed. R. Bankr. P. 9014. Fed. R. Bankr. P. 3020(b). Under Rule 9014(c), Rule 7052 applies to the confirmation hearing; that rule in turn incorporates Fed. R. Civ. P. 52, which states that "Findings of fact, whether based on oral or other evidence, must not be set aside unless clearly erroneous, and the reviewing court must give due regard to the trial court's opportunity to judge the witnesses' credibility." Fed. R. Civ. P. 52(a)(6).

[97] 11 U.S.C. § 1129(a)(9) (2012).

[98] 11 U.S.C. § 1129(a)(11) (2012).

sentially create rules for his or her court that go unchallenged even if they are objectively incorrect. It thus gives trial courts' interpretations of legal rules a different standard and status than those courts' findings of fact.

One response to this might be to decline to use equitable mootness if the appeal primarily involves issues of law. One reason for this suggestion is that decisions on legal issues have far more impact and relevance nationally than do contested factual issues, and therefore there is more national interest in having appeals involving disputed legal issues heard. But the essence of many equitable mootness cases is reliance, and reliance can hinge on a conclusion of law just as much as on an issue of fact. If reliance interests are to be protected, equitable mootness must have a broad sweep. It thus lessens the doctrine's effectiveness to suggest its restriction.

B. Perverting Appellate Jurisdiction

The process of equitable mootness highlights and exacerbates a feature of normal appeals. Once a notice of appeal is filed, standard appellate doctrine is that the jurisdiction for all matters covered by the appealed order transfers to the appellate court.[99] In short, once a party appeals from a final order (and despite confusion in other areas, an order confirming a plan is about as final as an order gets in bankruptcy),[100] a trial court can no longer alter or modify the substance of its ruling.

One exception to this, however, is the determination of whether to stay the consummation of the plan pending appeal. In bankruptcy, confirmation orders are stayed for 14 days unless otherwise ordered by the court;[101]and

[99]*In re* Adams Apple, Inc., 829 F.2d 1484, 1489 (9th Cir. 1987); *In re* G-I Holdings, Inc., 568 B.R. 731, 764 (Bankr. D.N.J. 2017) (stating, "[A]n appeal of a bankruptcy order will not only divest the bankruptcy court of jurisdiction if the issues on appeal are identical to the issues presently before the bankruptcy court, but also if the bankruptcy court's determination of the issues before it would interfere with or undermine the appellate process."); *In re* Winimo Realty Corp., 270 B.R. 99, 105 (S.D.N.Y. 2001) ("It is well established that the filing of a notice of appeal 'confers jurisdiction on the [appellate court] and divests the [trial] court of control over those aspects of the case involved in the appeal.'") (quoting United States v. Rodgers, 101 F.3d 247, 251 (2d Cir.1996)); *In re* FBI Distrib. Corp., 267 B.R. 655, 656 (B.A.P. 1st Cir. 2001) ("The general rule is that once a notice of appeal has been filed, the lower court loses jurisdiction over the subject matter of the appeal. Since the filing of a notice of appeal is an event of jurisdictional significance, the bankruptcy court no longer has control over those aspects of the case involved in the appeal.").

[100]"'A confirmed reorganization plan operates as a final judgment with res judicata effect.'" *In re* City of Stockton, Calif., 909 F.3d 1256, 1263 (9th Cir. 2018) (quoting Unsecured Creditors Comm. v. Southmark Corp. (*In re* Robert L. Helms Constr. & Dev. Co.), 139 F.3d 702, 704 (9th Cir. 1998) (en banc)); *see also* United Student Aid Funds, Inc. v. Espinosa, 559 U.S. 260 (2010) (chapter 13); Chicot Cty. Drainage Dist. v. Baxter State Bank, 308 U. S. 371, 376 (1940) (Chapter IX; Court refused to permit review of a plan of debt adjustment, even though the statute upon which the adjustment was based had been held unconstitutional in another case); Stoll v. Gottlieb, 305 U. S. 165, 171–172 (1938).

[101]Fed. R. Bankr. P. 3020(e). In bankruptcy generally, there is no automatic stay of the enforcement of a bankruptcy court order. Rule 9021 clearly states that "[a] judgment or order is effective when entered . . . ." Fed. R. Bankr. P. 9021.

courts are often asked to "otherwise order," and make the plan effective immediately.[102] After that 14-day period, the confirmation order is effective, meaning that the plan can be consummated in full reliance on the effectiveness of the confirmation order. The plan proponent can cause money and property to be transferred and ownership of the debtor to change. These actions, of course, form the basis for the request for dismissal on equitable mootness grounds.

But these actions can be stayed under Rule 8007.[103] The appellant may seek to hold in abeyance the actions that might moot its appeal. The rub is the general rule that any stay should "ordinarily" be directed to the bankruptcy court first, before the appellate court reviews the matter.[104] In essence, this asks the bankruptcy judge, who has just ruled in favor of confirmation and against the appellant, if she or he "really meant it." Of course, in most cases, the judges tend to confirm that they did.

Viewed differently, this procedure asks the bankruptcy judge to review his or her order through an appellate prism, especially if denial of a stay leads to equitable mootness and absence of review. While this might not pose a practical problem with factual issues, it unduly imbues the bankruptcy judge with a sense of invulnerability on issues of law.

The confusion follows the appeal to the first appellate level, the district court. Is that court now reviewing the stay request as a new and separate matter? Or is it reviewing the bankruptcy court's initial determination to not issue a stay? Is that "review" an appeal?" If so, should the court defer to the bankruptcy court's factual findings? If not, what is the precedential or persuasive effect of the bankruptcy court's decision?

If the first level appellate court denies the stay, does the circuit court, as the next higher court, have any different issues? Is it bound by factual findings by either the bankruptcy or the district court? And what about an application to an associate justice of the Supreme Court?[105]

The argument might be made that this procedure is standard practice for all civil appeals in which a stay is sought.[106] A key difference is in the scope

---

[102] *See, e.g.*, Bennett v. Jefferson Cty., 899 F.3d 1240, 1244 (11th Cir. 2018), *cert. denied,* 139 S. Ct. 1305 (2019); *In re* ADPT DFW Holdings LLC, 577 B.R. 232, 243 (Bankr. N.D. Tex. 2017); *In re* Rubicon U.S. REIT, Inc., 434 B.R. 168, 191 (Bankr. D. Del. 2010).

[103] FED. R. BANKR. P. 8007.

[104] Rule 8007(a)(1) states, "*Ordinarily*, a party must move first in the bankruptcy court for the following relief: [¶] (A) a stay of a judgment, order, or decree of the bankruptcy court pending appeal; . . . ." (emphasis supplied).

[105] Recall that one of the first equitable mootness cases indicated that an aggrieved appellant would have to seek relief "even to the extent of applying to the Circuit Justice for relief." Trone v. Roberts Farms, Inc. (*In re* Roberts Farms, Inc.), 652 F.2d 793, 798 (9th Cir. 1981).

[106] Rule 8007 is an adaptation of Appeals Rule 8, which also indicates that the trial court "ordinarily" should be the first court requested to issue a stay. FED. R. APP. P. 8(a)(1)(A).

of relief that a confirmation order can effect. A confirmation order seismically impacts all debts of and claims against the debtor. In stays involving most routine civil litiation, the issues are not so much about the correctness of the rulings made, but on the amount of the bond necessary to protect the prevailing party.

C. Unfairly Burdening the Right of Appeal

The uniqueness of confirmations is in tension with the procedures in standard civil post-judgment stays pending appeal. In damage cases, an appellant obtains a stay by posting a bond, usually in the amount of 100% to 200% of the judgment, plus costs and fees.[107] The requirement protects the prevailing party's liquidated right to compensation for past damage and ensures the ability of the appellee to pay the judgment assessed if an affirming mandate issues.[108] In a chapter 11 confirmation, however, an appellant's bond flips the protection: rather than pay for its transgressions, the appellant is bound to guaranty the rights of the appellees and other creditors for the benefits that they would have received had the plan been consummated.

The general standard governing a stay pending appeal has borrowed the four-factor standard for issuing a preliminary injunction in civil cases.[109] The Third Circuit has refined this analysis in the context of an appeal from a bankruptcy court order and restated the standard as follows:

> [A]ll four stay factors are interconnected, and thus the analysis should proceed as follows. Did the applicant make a sufficient showing that (a) it can win on the merits (significantly better than negligible but not greater than 50%) and (b) will suffer irreparable harm absent a stay? If it has, we "balance the relative harms considering all four factors using a 'sliding scale' approach. However, if the movant

---

[107]*See* Olcott v. Del. Flood Co., 76 F.3d 1538, 1559 (10th Cir. 1996) ("Typically, the amount of the bond matches the full amount of the judgment."); Cal. Civ. Proc. Code § 917.1(b) ("The undertaking shall be for double the amount of the judgment or order unless given by an admitted surety insurer in which event it shall be for one and one-half times the amount of the judgment or order.").

[108]Olcott v. Del. Flood Co., 76 F.3d 1538, 1559 (10th Cir. 1996) ("The purpose of requiring a supersedeas bond pending appeal 'is to secure the judgment throughout the appeal process against the possibility of the judgment debtor's insolvency.'") (quoting Grubb v. FDIC, 833 F.2d 222, 226 (10th Cir. 1987)).

[109]That standard requires a determination of "(1) whether the stay applicant has made a strong showing that he is likely to succeed on the merits; (2) whether the applicant will be irreparably injured absent a stay; (3) whether issuance of the stay will substantially injure the other parties interested in the proceeding; and (4) where the public interest lies." Nken v. Holder, 556 U.S. 418, 434 (2009) (quoting Hilton v. Braunskill, 481 U.S. 770, 776 (1987)). I note the standard for stay of an action and for a prelimimnary injunction are not entirely coextensive. *See, e.g.,* Winter v. Nat. Res. Def. Council, Inc., 555 U.S. 7, 22 (2008) ("Issuing a preliminary injunction based only on a possibility of irreparable harm is inconsistent with our characterization of injunctive relief as an extraordinary remedy that may only be awarded upon *a clear showing* that the plaintiff is entitled to such relief.") (emphasis in original).

> does not make the requisite showings on either of these [first] two factors, the [ ] inquiry into the balance of harms [and the public interest] is unnecessary, and the stay should be denied without further analysis." . . . . But depending on how strong a case the stay movant has on the merits, a stay is permissible even if the balance of harms and public interest weigh against holding a ruling in abeyance pending appeal.[110]

While some courts indicate that a likelihood of equitable mootness equates to the irreparable harm or forfeiture of appeal rights,[111] most have not,[112] and thus the Third Circuit's formulation initially focuses on the merits. Since that question is generally posed first to the bankruptcy judge, who has already spoken on the matter, an appellant's hopes generally lie with the appellate court and, in some circuits, the bankruptcy court's determination on the matter is entitled to deference.

Although this standard does not refer to an appeal bond, bankruptcy courts nonetheless often require one in order to balance the equities. And in large cases, the bond requirement has been large: the bond in *Tribune* was set at $1.5 billion;[113] in *Adelphia* it was $1.3 billion.[114]

As these examples illustrate, the amount can often be ruinous to the point of significantly burdening—if not crushing—the ability to appeal an erroneous ruling. Even if available, at 1%[115] the cost of the bonds in *Tribune* and

---

[110]Revel AC, Inc. v. IDEA Boardwalk LLC, 802 F.3d 558, 571 (3d Cir. 2015) (quoting *In re* Forty-Eight Insulations, Inc., 115 F.3d 1294, 1300-01 (7th Cir. 1997). *But see* Richard S. Kanowitz & Michael A. Klein, *The Divergent Interpretations of the Standard Governing Motions for Stay Pending Appeal of Bankruptcy Court Orders*, 17 J. BANKR. L. & PRAC. 4 (2008).

[111]*In re* DAEBO Int'l Shipping Co., No. 15-10616 (MEW), 2016 WL 447655, at *3, 2016 Bankr. LEXIS 356, at *8 (Bankr. S.D.N.Y. Feb. 4, 2016) ("SPV has alleged that the appeal could be rendered moot in the absence of a stay; courts have reached different conclusions as to whether such a risk amounts to irreparable injury, but this Court agrees that the 'loss of appellate rights is a 'quintessential form of prejudice' warranting a finding of irreparable harm.'") (quoting ACC Bondholder Group v. Adelphia Commc'ns Corp. (*In re* Adelphia Commc'ns Corp.), 361 B.R. 337, 347–48 (S.D.N.Y. 2007); Beeman v. BGI Creditors' Liquidating Tr. (*In re* BGI, Inc.), 504 B.R. 754, 763 (S.D.N.Y. 2014) ("In my view, 'where the denial of a stay pending appeal risks mooting any appeal of significant claims of error, the irreparable harm requirement is satisfied.' But 'the seriousness of that threat is inextricably related to the appellants' likelihood of success on the merits.'").

[112]*In re* Sports Auth. Holdings, Inc., No. 12-13262 (BLS), 2016 WL 3041846, at *1 (D. Del. May 27, 2016) (stating "[E]quitable mootness of an appeal, without more, does not constitute irreparable harm"); *In re* Sabine Oil & Gas Corp., 548 B.R. 674, 682 (Bankr. S.D.N.Y. 2016) ("A majority of courts have held that a risk of mootness, standing alone, does not constitute irreparable harm.") (quoting *In re* General Motors Corp., 409 B.R. 24, 31 (Bankr. S.D.N.Y. 2009); *In re* Sunflower Racing, Inc., 225 B.R. 225, 228 (D. Kan. 1998) (collecting cases).

[113]*In re* Tribune Co., 477 B.R. 465, 482 (Bankr. D. Del. 2012), *aff'd*, *In re* Tribune Media Co., 799 F.3d 272, 276 (3d Cir. 2015).

[114]ACC Bondholder Group v. Adelphia Commc'n. Corp. (*In re* Adelphia Commc'n. Corp.), 361 B.R. 337, 368 (S.D.N.Y. 2007).

[115]The 1% rate assumes that the bond can be fully collateralized and that discounts available to pub-

Adelphia would have been $15 million and $13 million respectively. And while winning appellants receive the cost of their bond back from the appellees as costs,[116] they do not receive the borrowing and other costs of obtaining the funds to pay for the bond, the expense of collateralizing the bond, the attorneys' fees for prosecuting the appeal, and related customary costs.[117]

Through the bonding process in equitable mootness cases, the appellant from a confirmation order is required to protect not only the plan proponent, but all the other beneficiaries of the plan (without those beneficiaries necessarily being made formal appellees). Bankruptcy courts thus impose upon appellants the protection of those who are not parties to the appeal—parties whose reliance interests often factor into the equitable mootness decision. There is irony here; if the appellant prevails, the appellate court will have no jurisdiction to disgorge from these relying parties whatever benefits they may have received from an improperly confirmed plan.

This perspective leads to requests for bonds in huge amounts, as does the fact that the plan proponent will be arguing for lightening-quick actions to forestall the debtor's financial ruin, and a court might thus err on the side of a large bond to protect the reorganization. To make matters worse, there is no concomitant upside to the appellant. If it wins, its attorneys' fees in pursuing the appeal are its own cost, as are the costs of financing its appeal bond, and cannot be shifted. The appellant gets, at best, only a shot at a different plan that better addresses its concerns.

D. Erosion of Exceptional Nature of Statutory Mootness Provisions

The urgency driving much of equitable mootness is present in other procedures under the Bankruptcy Code. In sales of assets, and in the granting of post-petition credit, Congress found a need to protect the reliance interests of those who buy and lend.

To address this need, Congress created provisions imposing statutory mootness in specific situations. Sections 363(m) and 364(o) provide that certain components of sales and loans cannot be attacked on appeal if undertaken in good faith.

Congress did not enact similar provisions with respect to confirmations of

---

licly-traded companies are not available. *See* Stay Pending Appeal Bond, https://jurisco.com/what-is-surety-bond-definition/defendants-bonds/stay-pending-appeal-bond/ (last visited March 26, 2019).

[116] Fed. R. Bankr. P. 8022(c)(4).

[117] Lerman v. Flynt Distrib. Co., 789 F.2d 164, 167 (2d Cir. 1986) ("FDC's borrowing expense, sought in addition to the premium on a supersedeas bond, is not a permissible item of taxable appellate costs . . . ."); Klapmeier v. Cirrus Indus., Inc., 900 N.W.2d 386, 393–96 (Minn. 2017).

These direct costs are supplemented by the added indirect costs of expedited treatement, from the rushed briefing to the urgent demands on court time; this fire-drill process that equitable mootness creates is unparalled in other civil litigation.

chapter 11 plans. The simple argument is that this lacuna means that confirmation orders should not have the presumptions of finality without review that sale orders and lending orders enjoy. Judge Krause of the Third Circuit succinctly put forth this argument:

> But then-Judge Alito aptly explained why we should reject this argument in his *Continental Airlines* dissent: "[N]arrow provisions" such as §§ 363(m) and 364(e), "which merely prevent the upsetting of certain specific transactions if stays are not obtained," cannot support the broad doctrine of equitable mootness.[118]

Congress' omission may or may not be telling, depending on one's view of statutory interpretation.[119] What is concerning, however, is that courts, not Congress, have developed an analogous immunity for confirmation orders as exist for sales and lending appeals. While Congress, vested with its bankruptcy power, unquestionably has the ability to immunize from appeal those bankruptcy-created rights arising from sales and loans, a like authority for an Article III, not to mention an Article I, court is opaque. It may very well be that, for issues controlled by non-bankruptcy rules, the flux of events in bankruptcy cases may render the remedy of reversal useless or futile. But it is not so clear that appeals from bankruptcy court orders that restructure state law rights, and impose releases and injunctions on third parties, are subject to such common-law principles.

---

[118] One2One Comm., LLC v. Quad/Graphics, Inc., 805 F.3d 428 (3d Cir. 2015) (Krause, J., concurring) (quoting *In re* Continental Airlines, 91 F.3d 553, 570 (3d Cir.1996) (en banc) (Alito, J., dissenting)).

[119] A recent example is *Mission Products Holdings, Inc. v. Tempnology, LLC,* 139 S. Ct. 1652 (2019). There the Court was asked whether the exclusion of trademarks from the definition of "intellectual property" in section 101(35A) affected rejections of trademark licenses The Court held that, given Congress' intentional omission of trademarks from section 101(35A), which definition section 365(n) incorporates to give special protections to licensees of rejected patent and copyright licenses, no special treatment should be given to the rejection of a trademark licenses. As the Court put it:

> That section's special provisions, as all agree, do not mention trademarks; and the general provisions speak, well, generally. So Tempnology is essentially arguing that distinctive features of trademarks should persuade us to adopt a construction of Section 365 that will govern not just trademark agreements, but pretty nearly every executory contract. However serious Tempnology's trademark-related concerns, that would allow the tail to wag the Doberman.

Id. at 1665. The Court thus found that trademark licenses are subject to the regular rules relating to rejection of executory contracts. *Id.* at 1666.

Were similar arguments used with respect to equitable mootness, Congress' removal of review of certain sale and lending orders from appeallate review under sections 363(o) and 364(m) would preclude extending removal of appellate review of other orders such as confirmation orders under section 1129. One main difference in extending *Tempnology's* analysis, however, would be that there is no evidence that Congress considered excluding confirmation orders from review in the same way Congress rejected inclusion of trademarks in the definition of intellectual property.

E. Improperly Discounting Courts' Ability to Fashion Remedies

A different concern is the attitude of some appellate courts that it is just too difficult to revisit plan confirmations. The analogy to unscrambling eggs comes to mind.

This is true to a point. A plan is a complex thing; so requiring the parties to reboot the process will never restore them to the exact position they occupied before the adjudicative error.

But I question if that perspective correctly frames the concern. To be sure, plans eliminate and create debt, often replacing one complex corporate financial structure with another. Then again, that is an insufficient reason to avoid hearing a meritorious appeal. As Judge Frank Easterbrook has written, "Unscrambling a transaction may be difficult, but it can be done. No one (to our knowledge) thinks that an antitrust or corporate-law challenge to a merger becomes moot as soon as the deal is consummated. Courts can and do order divestiture or damages in such situations."[120]

Judge Easterbrook has the proper view. The Clayton Antitrust Act,[121] for example, authorizes injunctive relief that can include an order obliging the acquiring company to divest the assets of the acquired firm, even when the plaintiff is a private party.[122] Indeed, although a "far-reaching and drastic remedy,"[123] the Supreme Court has described divestiture as "the most important of antitrust remedies."[124] The Department of Justice has promulgated guidelines for this remedy, which at least theoretically can "unscramble" the eggs.[125]

Courts that are, in effect, purporting to exercise the Constitution's bankruptcy power should not be restricted to remedies that are easy to implement. If an error has occurred, and relief of some type is possible, it should be no objection that the relief sought would be too difficult or complicated to

[120] *In re* Resource Tech. Corp., 430 F.3d 884, 886–87 (7th Cir. 2005) (Easterbrook, J.); *see also In re* Kmart Corp., 359 F.3d 866 (7th Cir. 2004) (Easterbrook, J.) ("Money had changed hands and, we are told, cannot be refunded. But why not? Reversing preferential transfers is an ordinary feature of bankruptcy practice, often continuing under a confirmed plan of reorganization.") (citation omitted); *In re* Envirodyne Indus., Inc., 29 F.3d 301, 304 (7th Cir. 1994) (Posner, J.) ("We could order the bankruptcy judge to modify the plan of reorganization to reallocate $20 million worth of the stock that the 14% noteholders received to the appellants, the 13.5% noteholders. Some of the 14% noteholders, it is true, have already sold their stock, but they could be ordered to surrender some or all of the proceeds to the appellants.").

[121] Clayton Antitrust Act of 1914, 15 U.S.C. §§ 12–27, 29 U.S.C. §§ 52–53 (2012).

[122] *See* California v. Am. Stores Co., 495 U.S. 271, 295–96 (1990); Steves & Sons, Inc. v. Jeld-Wen, Inc., 292 F. Supp. 3d 656, 673–74 (E.D. Va. 2018).

[123] United States v. Coca-Cola Bottling Co., 575 F.2d 222, 229 (9th Cir. 1978).

[124] United States v. E.I. du Pont de Nemours & Co., 366 U.S. 316, 330 (1961).

[125] U.S. Dep't of Justice, *Antitrust Division Policy Guide to Merger Remedies* (June 2011), http://www.justice.gov/atr/public/guidelines/272350.pdf.

implement. The Supreme Court has invoked the All Writs Act[126] to give effect to antitrust laws;[127] courts administering the Bankruptcy Code might similarly consider the bankruptcy analogue, section 105, even as limited in recent decisions.[128]

An example of the timid and jumbled decisionmaking in this area is *Hargreaves v. Nuverra Env'tl Solutions, Inc.*[129] In *Nuverra*, the plan provided for horizontal gifting—a senior class proposed to transfer part of its plan distribution to a prechosen subset of the general class of unsecured creditors. The result was that creditors with equal priority against the debtor would have received unequal distributions depending on the whim of a senior creditor.

A non-favored creditor appealed. After failing to obtain a stay, the court found that, because the plan had been consummated, trade creditors paid, and new stock issued, the case was equitably moot as there was no longer any effective remedy.[130] Respecting the argument that recovery of the amounts paid might be ordered, the court responded:

> [D]isgorgement would require the claw back, not only of cash payments made to hundreds of individual creditors, but also . . . stock that is trading on the national stock exchange, and which now may be held by third parties who purchased those securities in the ordinary course.[131]

This view seems to adopt the perspective that the remedies could only be property based—why else would the court mention "clawing back" stock? But that ignores the fact that if the appeal were granted, the estate had non-property remedies. It could simply sue those who received distributions under the improper plan. Stock would not have to be clawed back; rather, the estate could simply seek restitution from the initial recipient and let that person worry about recovering its payments from its buyer. Similarly, the

---

[126] 28 U.S.C. § 1651(a) (2012): "The Supreme Court and all courts established by Act of Congress may issue all writs necessary or appropriate in aid of their respective jurisdictions and agreeable to the usages and principles of law."

[127] In *F.T.C. v. Dean Foods Co.*, 384 U.S. 597 (1966), the Court used the All Writs Act to justify an injunction issued by the Court of Appeals to prevent a corporate combination.

[128] 11 U.S.C. § 105(a) (2012): "The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title."

The objection might be raised that a limited remedy for appellants is often worse for all other creditors, and thus should be avoided. But that argument is based upon crabbed and specious logic. It absolves the plan proponent for responsibility for promulgating a plan that should not have been confirmed. In other cases, creditors take the risk of their debtor's incompetence, see 11 U.S.C. § 1112(b)(4), and that risk should not be immunized by the bankruptcy court's error in confirming a plan that should not have been confirmed.

[129] 590 B.R. 75 (D. Del. 2018).

[130] Hargreaves v. Nuverra Env'tl Solutions, Inc. (*In re* Nuverra Env'tl Solutions, Inc.), 590 B.R. 75, 89 (D. Del. 2018).

[131] *Id.* at 88.

fact that "hundreds" of lawsuits would have to be brought should not factor into denial of the appellant's right to be heard. In any event, the estate could calculate and pursue only those recoveries that made economic sense.[132] Full and precise relief is not required.[133]

To hold otherwise is to enfeeble and erode courts' abilities to remedy wrongs. It is insufficient reason to withhold a remedy because it would be incomplete or imprecise. But that is where equitable mootness leads. Courts pervert the "irreparable injury" requirement to preclude reversals that would result in incomplete or imprecise remedies. In one respect, that is not the court's concern. If an appellant with a meritorious appeal wishes to press it, even in light of less-than-perfect remedies, it should have that choice.

F. Subversion of the Reliance on Contracts Generally

Equitable mootness also saps the sanctity of contract. Contract rights are fundamental rights. Indeed, the Constitution protects them from undue impairment by the states.[134] And many equitable mootness cases focus on third-party contractual reliance as grounds for discarding meritorious appeals.

In the long run though, the doctrine of equitable mootness will have the opposite effect. If contract rights can be ignored and countermanded by an unreviewable and erroneous trial court ruling, the ability to rely on contracts generally is lessened.

This is different than the general argument made that contracts implicitly incorporate the law in effect at the time of formation. Lenders lend knowing about cramdown and how it can alter their rights. Landlords know that ipso facto clauses will not be enforced in bankruptcy. But such risks are known and, if known, can be calculated and provided for by other terms in the contract, including price.

Equitable mootness injects terminal uncertainty into this calculus. The

[132] *Nuverra* is also notable for allowing over $7 million in unsecured claims (out of an initial indication of $12 million) to be paid before plan confirmation. Permission to pay such pre-petition claims without a plan was based solely on the testimony of the debtor's president who indicated need, but who also indicated that neither he nor his staff had contacted any prepetition creditors regarding the necessity of payment. 3 Appendix of Appellant David Hargreaves at Tab 28, pp. A1753-54, *In re* Nuverra Environmental Solutions, Inc., 590 B.R. 75 (D. Del. 2018) (reprinting Transcript of the Con?rmation Hearing held on July 21, 2017, pp. 32–33); *see* Bruce A. Markell, *The Clock Strikes Thirteen: The Blight of Horizontal Gifting*, Bankr. L. Letter 4–5 (Dec. 2018).

[133] Indeed, in the area of constitutional mootness, the Court has recently indicated that the practical aspects of recovery matter little so long as a right to recovery at least theoretically exists. *See* Mission Prod. Holdings, Inc. v. Tempnology, LLC, 139 S. Ct. 1652, 1661 (2019) ("But courts often adjudicate disputes whose "practical impact" is unsure at best, as when "a defendant is insolvent." . . . And Mission notes that if it prevails, it can seek the unwinding of prior distributions to get its fair share of the estate. . . . So although this suit "may not make [Mission] rich," or even better off, it remains a live controversy—allowing us to proceed.").

[134] U.S. Const., art. I, § 10.

doctrine basically permits a bankruptcy court to alter a non-debtor's contract rights in a manner contrary to law and then bars any appeal therefrom. Moreover, this alteration cannot be anticipated, since whether an appeal will be available at all could turn on whether third parties once or more removed will have relied on the improper alteration.

That such alterations will be the exception rather than the rule is no defense. The precautions or pricing used to protect against this unreviewable alteration risk will, almost by definition since the risk is incalculable, be noneconomic. To protect themselves, parties to the types of financial contracts capable of being restructured have to calculate the unknowable. This calculation adds (if they are risk averse) terms and pricing to such contracts likely to be out of proportion to the actual risk.

G. Diluting Sources of Interpretation and Perceptions of Justice

One by-product of equitable mootness is that the development and evolution of precedent is stunted, due to the concentration of major chapter 11 cases in New York and Delaware. Of the 6,078 business chapter 11 cases filed in the United States in 2018,[135] 626 were filed in the Southern District of New York (10.3%), and 615 were filed in the District of Delaware (10.1%).[136] These two districts have but 17 bankruptcy judges[137] out of the 354 total bankruptcy judges in the United States.[138] Accordingly, roughly 5% of the bankruptcy judges in the United States decide more than 20% of all business chapter 11 cases,[139] and those cases comprise a large majority of the chapter 11 publicly-held and mega-cases.

The limited number of bankruptcy courts is mirrored by the limited number of district court and circuit court judges. There are 673 positions for

[135] The numbers are taken from Administrative Office of the United States Courts, Table F-2 Quarterly: U.S. Bankruptcy Courts—Business and Nonbusiness Cases Commenced, by Chapter of the Bankruptcy Code, During the Three-Month Period Ending March 31, 2019, Based on Data Current as of March 31, 2019, *available at* https://www.uscourts.gov/file/26267/download.

[136] The third runner up was the Southern District of Texas with 453 cases, although that may be because that district has created a complex chapter 11 sub-group of judges, consisting of two of the six authorized judges. *See* General Order 2018-1, Order Regarding Complex Case Assignment (Bankr. S.D. Tex., Jan. 28, 2018).

[137] The Southern District of New York has nine authorized judgeships, 28 U.S.C. § 152(a)(2) (2012), and Delaware has one. *Id.* Delaware, however, has seven temporary judgeships allocated to it. *See* Bankruptcy Judgeship Act of 2005, Pub. L No. 109-8, § 1223, 119 Stat. 23, 196–98 (2005); Temporary Bankruptcy Judgeships Extension Act of 2012, Pub. L. No. 112-121 (2012); and Bankruptcy Judgeship Act of 2017, Pub. L. No. 115-72, § 1003, 131 Stat. 1224, 1231 (2017).

[138] This number includes all 38 temporary judgeships, including the seven in Delaware.

[139] If the two specialist judges of the Southern District of Texas and their case loads are considered, the comparison is that about 5.4% of judges decide 28% of all business chapter 11 cases.

district court judges; 179 authorized positions for circuit judges.[140] The Southern District of New York and the District of Delaware have 32 district court judges combined,[141] while the Second and Third Circuits account for 27 circuit judges.[142] These allocations mean that about 5% of all district court judges, and about 15% of all circuit judges, decide appeals from the 20% of bankruptcy cases mentioned above.

These imbalances reduce the number of qualified decisionmakers regarding interpretation of the Bankruptcy Code. If each of the judges has different bits of information or insight about the proper construction of the Bankruptcy Code, the best estimate of value is, other things being equal, that value estimated by the median judge. This is a standard observation from "wisdom of the crowds" literature.[143]

The narrowed and concentrated nature of the judiciary reviewing bankruptcy appeals also has an effect on perceived system fairness. As noted by Professor Melissa Jacoby:

> The prospect of appellate review by a multi-judge court fosters confidence in the system. Indeed, "the value of the appellate system's ability to increase public trust in judicial outcomes may exceed the amount of error correction actually accomplished." Judith Resnik has emphasized the importance of public participation (including observation) in adjudicatory processes as a democratic practice. As a result of equitable mootness, even fewer people get to tell their

---

[140] *See* Authorized Judgeships, https://www.uscourts.gov/file/document/all-authorized-judgeships-1789-present (last visited July 2, 2019).

[141] 28 U.S.C. § 133(a) (2012).

[142] 28 U.S.C. § 44.

[143] *See, e.g.*, James Surowiecki, The Wisdom Of The Crowds: Why The Many Are Smarter Than The Few And How Collective Wisdom Shapes Business, Economies, Societies, And Nations 3–22 (2005) (providing an overview of the wisdom of the crowds principle in action); *see also* Douglas G. Baird *et. al.*, *The Bankruptcy Partition*, 166 U. Pa. L. Rev. 1675, 1714 n.30 (2018). For a thoughtful consideration of the many factors involved in deferring to the "wisdom of the crowds," see Lyon Aidan & Eric Pacuit, *The Wisdom of Crowds: Methods of Human Judgement Aggregation*, *in* Handbook of Human Computation 599-614 (2018).

Recent literature indicates that it may be the case that "[w]hen expertise is not evenly spread throughout the crowd, it is better to focus on the concentration of the expertise as opposed to diluting it with experts of a lower quality. As a result, the wisdom of the experts in the crowd can beat the wisdom of the whole crowd." Daniel G. Goldstein, R. Preston McAfee & Siddharth Suri, *The Wisdom of Smaller, Smarter Crowds*, *in* Proceedings of the Fifteenth Ass'n for Computing Machinery Conference on Economics and Computation 471, 487 (2014); *see also* Clintin P. Davis-Stober, David V. Budescu, Stephen B. Broomell & Jason Dana, *The Composition of Optimally Wise Crowds*, 12 Decision Analysis 130 (2015). There is nothing in the current system, however, to indicate that the judges in this small subset of bankruptcy judges are any better (or worse) at interpreting the law than all bankruptcy judges generally.

> stories to a court of higher authority, or to observe an appellate court considering the matter.[144]

As a result, a small sample of available decision makers formulate the confirmation policies protected by equitable mootness. This weakens the long-term quality of Code interpretations while undermining public perception of bankruptcy as an objectively fair system.[145] Neither consequence is desirable.

H. Constitutional Issues?

* * * * *

[Next page is page 414]

IV. RECONCEPTUALIZING EQUITABLE MOOTNESS

Despite these many failings, equitable mootness does have some utility. To repeat Judge Posner's characterization, equitable mootness "is perhaps best described as merely an application of the age-old principle that in formulating equitable relief a court must consider the effects of the relief on innocent third parties."[174] Aside from tinkering with how best to bestow the "innocent" label, the cynosure of many equitable mootness cases has been the need to seek a stay of the confirmation order.

A. Summary of the Issues

While this centrality may appear useful in theory, it stinks in practice. As indicated above, unlike normal civil litigation in which the damage of a stay can be localized and quantified by the money judgment appealed, confirmations in chapter 11 are different. As a condition of obtaining a stay, appellants are asked to provide possible compensation not only to the transgressors—the plan proponents—but also every interested party in the reorganization. In essence, this treats plan proponents as agents and representatives of the entire remainder of the creditor body, without those parties being named as appellees. Such reasoning leads to the exorbitant bonds mentioned earlier in *Tribune* and *Adelphia*.[175] At some point, the question needs to be raised as to whether the price of seeking an appeal should impose upon an appellant the cost of protecting absent non-appellees.[176]

The magnitude of the cost of appeal also affects other aspects. An increase in non-localized costs of appeal deters effective appeals and thus enhances the importance and immunity of the non-Article III judge's initial

[171]One2One, 805 F.3d 428, 444 (Krause, J., concurring).

[172]Sur Pet. for Reh'g, *In re* Tribune Media Co., 799 F.3d 272, ECF No. 003112071981 (3d Cir. 2015)

[173]136 S. Ct. 1459 (2016).

[174]*In re* Envirodyne Indus., Inc., 29 F.3d 301, 304 (7th Cir. 1994).

[175]*In re* Tribune Co., 477 B.R. 465, 482 (Bankr. D. Del. 2012), *aff'd In re* Tribune Media Co., 799 F.3d 272, 276 (3d Cir. 2015); ACC Bondholder Group v. Adelphia Commc'n. Corp. (*In re* Adelphia Commc'n. Corp.), 361 B.R. 337, 368 (S.D.N.Y. 2007).

[176]This point is explored thoughtfully in Eleanor H. Gilbane, *Investing in an Appeal: The Dilemma Facing an Appellant of Confirmation Orders*, Am. Bankr. Inst. J. 38 (May 2013).

decision. Put differently, a bankruptcy judge's confirmation decision is given greater effect and authority than other orders because it is less likely to be disturbed. Given the immense effect a confirmation order has, it is perversely ironic that it cannot be reviewed, while a host of more common and mundane decisions can be. In addition, the increased costs decrease appellate decisions on the merits, which effectively decreases the effective oversight of the Article III Judiciary.

Even if these concerns can be addressed, the amassing of chapter 11 cases in a small number of jurisdictions and judges correspondingly concentrates the general interpretation process in comparatively few appellate judges and even fewer bankruptcy judges. The resulting illusion of certainty corrodes the systemic process of reaching consensus on disputed provisions of the Bankruptcy Code.

B. Radical Proposals

To redress these pernicious effects, Congress could of course amend the Bankruptcy Code to provide confirmation orders with the type of immunity conferred upon sale and financing orders. But Congress did not and has not; and only Rebecca of Sunnybrook Farm or Professor Pangloss would conceive that Congress, as currently constituted, would enact such an amendment, assuming that its members could first apprecate the need for it.

As I have argued, however, such immunity is not only unnecessary, it is dangerous to parties with meritorious arguments and to the court system in general.

So how does one approach the issue? I suggest a package of changes, phrased mainly as interpretive presumptions. These changes focus on the procedure of processing the appeal, with the intent of preserving the ability of litigants to have issues heard on the merits in a manner designed to reach the best result.

1. *Reforms Regarding Stays*

The first subset of these practices examines the stay pending appeal. The current state of the law on stays is the crux of the problem with equitable mootness; the doctrine has its strongest justification when an appellate court, regardless of the magnitude of any error that might have been made, cannot restore the parties to anything like their original positions. It is at its weakest when the appeal, if denied, will simply lead to another similar, reorganization.

Stays are governed by Rule 8007, which mirrors Rule 8 of the *Federal Rules of Appellate Procedure* and Rule 62 of the *Federal Rules of Civil Procedure*.[177] Courts approach a request for a stay pending appeal under those

[177]As stated in the Advisory Committee Notes to the Rule: "This rule is derived from former Rule

rules by noting:

> [T]he factors relevant under Civil Rule 62(c) and Appellate Rule 8 "are generally the same:" (1) whether there is a strong showing of likelihood of success on the merits; (2) whether there will be irreparable injury absent a stay; (3) whether a stay would substantially injure other interested parties; and (4) the public interest. The analysis thus somewhat resembles the test applied in the district court when evaluating a request for a preliminary injunction, though the differences in posture mean that the two tests are not identical.[178]

In an appeal from confirmation, the likelihood of success factor is odd—at most, it should be an initial test to see if the appellant has a good faith chance at reversal. The Third Circuit recognizes as much. It asks whether the "applicant ma[de] a sufficient showing that (a) it can win on the merits (significantly better than negligible but not greater than 50%). . . ."[179]

The irreparable injury inquiry cuts many different ways. The plan proponent is usually heard to argue that its plan is the only possible plan, and the only alternative is liquidation. Although such "Chicken Little" claims usually are not taken at face value, they often find their way into opinions.[180] But on the appellant's side, the loss of a meritorious right without a hearing on the merits is a concrete irreparable injury, usually subject to determination with greater certainty than claims of future illiquidity. Standard doctrine is that when considering these factors, there "should be balance[ ]; thus, for example, if the balance of harms tips heavily enough in the stay applicant's favor then the showing of likelihood of success need not be as strong, and vice versa."[181]

Against this background, I offer three suggestions regarding the granting of stays of a confirmation order entered by a bankruptcy judge:

- A stay should presumptively issue if confirmation was made possible only by adoption of a disputed rule of law;
- Given the extraordinary nature of equitable mootness, and the time pressures surrounding confirmation, appel-

8005 and F.R.App.P. 8." Advisory Comm. Notes to Rule 8007 (2014); *see also* Advisory Comm. Notes to Rule 8007 (2018) ("The amendments to subdivisions (a)(1)(B), (c), and (d) conform this rule with the amendment of Rule 62 F.R.Civ.P., which is made applicable to adversary proceedings by Rule 7062.").

[178] 16A Charles Alan Wright, et al., Fed. Prac. & Proc. § 3954 (4th ed. 2009 & Supp. 2018).

[179] Revel AC, Inc. v. IDEA Boardwalk LLC, 802 F.3d 558, 571 (3d Cir. 2015) (quoting *In re* Forty-Eight Insulations, Inc., 115 F.3d 1294, 1300–01 (7th Cir. 1997)).

[180] *See, e.g.*, ACC Bondholder Group v. Adelphia Commc'ns Corp. (*In re* Adelphia Commc'ns Corp.), 361 B.R. 337, 350 (S.D.N.Y. 2007) (assuming, without much evidence, that amount necessary to protect a decline in property value was close to equity value under plan appealed from).

[181] 16A Charles Alan Wright, et al., Fed. Prac. & Proc. Juris. § 3954 (4th ed. 2009 & Supp. 2019).

lants should automatically be able to present their stay requests in the first instance to the reviewing court, and should not be bound by the Rules' direction that "ordinarily" such requests should go first to the trial court; and

- If the appeal is nonfrivolous and in good faith, there should be no bond imposed as a condition of a stay.

Each of these is explored in detail below.

a. Presumptive Grant of Stay If Appeal Turns on Substantial Question of Law

The first suggestion is that a stay should be presumptively granted if confirmation was made possible only by adoption of a disputed issue of law—one which I loosely define as an issue upon which courts or commentators have disagreed as to scope or content.

A current example might be a plan of a group of companies that could only be confirmed by adopting the interpretation that section 1129(a)(10) applies on a plan rather than on an entity basis.[182] Section 1129(a)(10) does not address the complex issues arising when a plan proposes to substantively consolidate several debtors into one or more reorganized debtors. The issue presented is, however, easily defined: Does section 1129(a)(10) require one consenting impaired class from each of the pre-petition debtors ("per debtor" application), or does it simply require one impaired consenting class from the classes as specified in the plan sought to be confirmed ("per plan" application)?[183]

Bankruptcy courts in the Southern District of New York, in significant and large chapter 11 cases, have adopted the "per plan" interpretation, especially in cases in which the plan proposes to substantively consolidate affiliated debtors.[184] Bankruptcy courts in Delaware, however, have not followed suit and have adopted a "per debtor" construction.[185]

[182]Another issue current in the courts might well be the proper characterization of make-whole premiums as unmatured interest or liquidated damages. *See, e.g.*, Ultra Petroleum Corp. v. Ad Hoc Comm. of Unsecured Creditors of Ultra Res., Inc. (*In re* Ultra Petroleum Corp.), 913 F.3d 533, 547-49 (5th Cir. 2019).

[183]*See In re* Tribune Co., 464 B.R. 126, 180 (Bankr. D. Del. 2011), *on reconsideration*, 464 B.R. 208 (Bankr. D. Del. 2011). These issues are explored in Suzanne T. Brindise, Note, *Choosing the "Per-Debtor" Approach to Plan Confirmation in Multi-Debtor Chapter 11 Proceedings*, 108 Nw. U.L. Rev. 1355 (2014).

[184]JPMorgan Chase Bank, N.A. v. Charter Communs. Operating, LLC (*In re* Charter Communs.), 419 B.R. 221, 266 (Bankr. S.D.N.Y. 2009); *In re* Enron Corp., 2004 Bankr. LEXIS 2549, *234–236 (Bankr. S.D.N.Y. July 15, 2004); *see also In re* SGPA, Inc., No. 1-01-02609, 2001 Bankr. LEXIS 2291 (Bankr. M.D. Pa. Sept. 28, 2001). The Ninth Circuit has held that there had to be at least one impaired creditor class that had accepted the plan, applied on a per-plan, rather than on a per-debtor basis. JPMCC 2007-C1 Grasslawn Lodging, LLC v. Transwest Resort Prop. Inc. (*In re* Transwest Resort Props., Inc., 881 F.3d 724 (9th Cir. 2018).

[185]*In re* JER/Jameson Mezz Borrower II, LLC (*In re* JER/Jameson), 461 B.R. 293, 300–02 (Bankr. D.

Those favoring the "per plan" interpretation point to the plain language of section 1129(a)(10) and the fact that it applies to the plan proposed by the plan proponent, not other, hypothetical, plans regarding other affiliated debts.[186] In response, those favoring the "per debtor" approach observe that in cases in which there has not been substantive consolidation before confirmation, "each joint plan actually consists of a separate plan for each debtor."[187] This view allows a plan proponent to achieve substantive consolidation through a plan only if (1) the creditors of each debtor consent to the consolidation (through voting as set forth in section 1129(a)(8)), or (2) if entity separateness would not be respected by nonbankruptcy law. In other words, the legitimate expectations of creditors regarding such separateness cannot be overcome or disturbed by those who are not creditors of their debtor.[188]

In these cases of disputed interpretation, the issue is legitimate and deserves more consideration than just the isolated bankruptcy judge relying on self-selected authorities.[189] If this type of plan is denied review due to the cost of an appeal bond, it deprives Article III courts the ability to review and develop precedent in a timely and orderly fashion.

b. Stays of Confirmation Orders Should Be Directed Initially to the Reviewing Court

A second suggestion is that the stay application not be addressed to the trial court in the first instance. This rule might work with respect to appeals in traditional civil litigation, but it is less effective when the issue affects not only parties to the appeal but also every other creditor. At this point, local lore and practice cannot be allowed to influence decision. A new perspective is needed.

Fortunately, the system already has the ability to accommodate this suggestion; the appellate court can be the first instance court. Rule 8007(a)(1) simply states that "*[o]rdinarily*, a party must move first in the bankruptcy

Del. 2011); *In re* Tribune Co., 464 B.R. 126, 180 (Bankr. D. Del. 2011), *on reconsideration*, 464 B.R. 208 (Bankr. D. Del. 2011).

[186] *See, e.g.*, JPMCC 2007-C1 Grasslawn Lodging, LLC v. Transwest Resort Props., Inc. (*In re* Transwest Resort Props., Inc.), 554 B.R. 894, 901 (D. Ariz. 2016), *aff'd*, 881 F.3d 724 (9th Cir. 2018) ("unlike the *Tribune* court, this Court finds the plain language of the statute to be dispositive.").

[187] *In re* Tribune Co., 464 B.R. 126, 182 (Bankr. D. Del. 2011), *on reconsideration*, 464 B.R. 208 (Bankr. D. Del. 2011). The court rebutted the "plain meaning" argument by noting that section 102(7) permits singular terms to be read as plural, thus the use of the singular term "plan" in section 1129(a)(10) is not to be read as applying to only one plan. *Id.*

[188] *In re* Tribune Co., 464 B.R. 126, 182–84 (Bankr. D. Del. 2011), *on reconsideration*, 464 B.R. 208 (Bankr. D. Del. 2011).

[189] Congress has acknowledged that some bankruptcy appeals present significant issues that require a prompt decision from a circuit court, with one of the grounds being that that "the judgment, order, or decree involves a question of law requiring resolution of conflicting decisions." *See, e.g.*, 28 U.S.C. § 158(d)(2)(A)(ii) (2012).

court . . . ."[190] Equitable mootness, however, is anything but ordinary. The present system's direction to apply first to the bankruptcy court will almost always lead to a second application at the reviewing court as the bankruptcy court has, as part of confirmation, already weighed and taken a considered position on the overall effect of the stay; in essence, its confirmation is its ruling that a stay is not appropriate—otherwise the court would have delayed confirmation on its own.[191]

Adoption of this suggestion may require changing existing precedent. In the Second Circuit, for example, "the applicant must first move for the stay in bankruptcy court. . . . 'If the party improperly bypasses the bankruptcy court and seeks a stay first from the district court, the district court lacks the jurisdiction to hear the matter.'"[192] Initially, this line of authority seems suspect. The applicable rule permits application to the reviewing court, and only indicates that, in the ordinary case, one seeking a stay should start at the trial court. This stated preference falls far short of a jurisdictional rule. And once that false consequence is dissolved, the argument returns to whether equitable mootness is outside of the mine run or "ordinary." As I suggest, it is.

Another concern addressed by this bypass is constitutional. As supervision is a key component to the legitimacy of the bankruptcy court system,[193] it is essential that an Article III court conduct the review.[194] In this way, a district judge or the motions panel of several circuit judges can weigh in and leave no doubt concerning *Stern* compliance.

---

[190]FED. R. BANKR. P. 8007(a)(1) (emphasis supplied).

[191]*See generally In re* Anderson, 560 B.R. 84, 89 (S.D.N.Y. 2016) ("the Court has already determined that Credit One failed to succeed on the merits. Asking the . . . court to then find that . . . Credit One is likely to succeed on the merits on appeal . . . would require the district court to find that its own order is likely to be reversed. This is a standard that is rarely going to be satisfied."). Anderson cited *In re* A2P SMS Antitrust Litig., No. 12 Cv. 2656 (AJN), 2014 WL 4247744, at *2 (S.D.N.Y. Aug. 26, 2014), which holds a similar view:

> A "serious questions" standard is particularly appropriate when a district court is asked to stay its own order; under such circumstances, the court has already determined that the applicant failed to succeed on the merits. Asking the district court to then find that the movant is likely to succeed on the merits on appeal would require the district court to find that its own order is likely to be reversed—a standard that for practical purposes is rarely going to be satisfied.

[192]*In re* Anderson, 560 B.R. 84, 90 (S.D.N.Y. 2016) (quoting *In re* BGI, Inc., 504 B.R. 754, 761 (S.D.N.Y. 2014), which in turn cited *In re* Taub, 470 B.R. 273, 276 (E.D.N.Y. 2012)).

[193]*See* Section III.H, *supra; see also* Wellness Int'l Network, Ltd. v. Sharif, 135 S. Ct. 1932, 1944 (2015) ("allowing Article I adjudicators to decide claims submitted to them by consent does not offend the separation of powers so long as Article III courts retain supervisory authority over the process."); Pacemaker Diagnostic Clinic of America, Inc. v. Instromedix, Inc., 725 F.2d 537, 544 (9th Cir. 1984) (en banc) (Kennedy, J.) (magistrate judges may adjudicate civil cases by consent because the Federal Magistrates Act "invests the Article III judiciary with extensive administrative control over the management, composition, and operation of the magistrate system").

[194]This may not be the case when the appeal is to be heard by a Bankruptcy Appellate Panel.

c. Eliminate Bonds

A third suggestion is to eliminate any rule requiring appeal bonds from confirmation orders. Typically, a bond is required to ensure that an appellant, typically found to owe money, will pay that money if the appeal is unsuccessful. In routine civil litigation, an appellant has been found to bear some blame or owe some amount, and thus is required to provide some security that it will pay or perform if it loses on appeal.[195]

But in an appeal from a confirmation order there is no blame, and typically no order to pay money by creditors. The appeal focuses not on what the appellant owes the appellee, and is delaying, but what the appellee owes the appellant. A bond under such circumstances essentially forces a party without blame to insure, at potentially great cost, the correctness of its views.

This change of circumstances should cause a similar reappraisal of the presumptive correctness of a bankruptcy court's ruling that forms the basis for bonding rules. Putting appeals involving issues of fact aside—since they will always be subject to a clearly erroneous standard of review—an appeal from a confirmation order is simply an appeal over the correct view of the law; it is not an appeal over a legal determination that the appellant owes someone else money. In short, the plan proponent as appellee is simply backing the correctness of the trial court's view.

With this change of circumstances, a bond would insure the speculative injury that might arise if the parties could not replicate a reorganization of equal value if the appellant loses. But why should the appellant insure this loss? It typically does not owe money to the estate; the reverse is true. The debtor has essentially filed a declaratory class action against all of its creditors to determine what it, the debtor, owes each of them. If the appeal is in good faith, all the appellant seeks is correction of an erroneous legal decision as to the amount owed; at the extreme, it seeks to stop the needs of the many from improperly impinging on its rights of the few.

This should cause pause in requiring a bond to insure the ability to pay damages assessed, or what might be called a supersedeas bond. Such a bond would serve no purpose, and the confirmation order does not determine that the appellant owed money or obligations to the estate that it would have to pay if it loses the appeal. *Collier* recognizes this situation when it says, "Generally courts are more inclined to consider not requiring a bond or other security when the order does not involve a monetary judgment."[196]

Courts that have visited this issue have focused on the wrong type of

[195] At least one state has capped appeal bonds to avoid ruinous costs of appeal. *See* FLA. STAT. ANN. § 45.045 (capping maximum supersedeas bond at $50 million).

[196] 10 COLLIER ON BANKRUPTCY ¶ 8007.09 (Richard Levin & Henry Sommer, eds., 16th ed., 2019).

41917-abk_93-3 Sheet No. 25 Side B 01/21/2020 14:38:48

harm. In *Tribune*, for example, the bankruptcy court stated that the test for a bond amount should be undertaken as follows:

> In determining whether a bond should be ordered, the court looks to whether the bond would be necessary to protect "against diminution in the value of property pending appeal" and to "secure the prevailing party against any loss that might be sustained as a result of an ineffectual appeal." Moreover, the posting of a bond "guarantees the costs of delay incident to the appeal."[197]

The only authority cited for this standard was *ACC Bondholder Group v. Adelphia Communications Corp.*,[198] which stated the exact same principles.[199] *Adelphia* supported these principles, however, by uncritically relying on two other district court cases, both of which denied the request for a stay,[200] and thus provided no analogous issues. *Adelphia* then conflated the loss of value of specific property (as might be the subject of adequate protection of collateral) with the loss of the debtor's entire reorganization value. This not only ignored, for example, the liquidation value of the debtor, but also made the puzzling assumption that the plan the bankruptcy court approved was the only and best possible plan—a proposition rebutted entirely if the appellant's appeal had any merit. In short, *Adelphia* assumed the lost opportunity costs for the entire bankruptcy estate to be equal to the entire value of the estate, and assumed that an appeal would wipe out the entire amount of value.

Tribune then uncritically adopted *Adelphia*'s view, and took extensive evidence as to the costs to be incurred by the debtor during the period of an appeal. But what was not considered was the cost to the appellant: the forfeiture of its rights to have its appeal heard, a concern arguably required by a faithful application of the balancing process of Rule 8007.[201]

---

[197] *In re* Tribune Co., 477 B.R. 465, 478 (Bankr. D. Del. 2012) (quoting ACC Bondholder Group v. Adelphia Commc'ns Corp. (*In re* Adelphia Commc'ns Corp.), 361 B.R. 337, 350 (S.D.N.Y.2007)).

[198] 361 B.R. 337 (S.D.N.Y. 2007).

[199] *In re* Adelphia Commc'ns Corp., 361 B.R. 337, 350 (S.D.N.Y. 2007) (quoting *In re* Sphere Holding Corp., 162 B.R. 639, 644 (E.D.N.Y. 1994) and *In re* Suprema Specialties, Inc., 330 B.R. 93, 96 (S.D.N.Y. 2005)).

[200] *In re* Suprema Specialties, Inc., 330 B.R. 93, 96 (S.D.N.Y. 2005) (stating "the Court approves the stay without requiring Movants to post a bond."); *In re* Sphere Holding Corp., 162 B.R. 639, 644 (E.D.N.Y. 1994) ("This case does not require a bond (nor have any interested parties asked for one) because little or no damage will be incurred as a result of the stay.").

[201] At most, the court could request an appeal bond under Rule 7 of the Federal Rules of Appellate Procedure. Under those rules, "courts typically consider (1) the appellant's financial ability to post a bond; (2) the risk that the appellant would not pay appellee's costs if the appeal is unsuccessful, (3) the merits of the appeal, and (4) whether the appellant has shown any bad faith or vexatious conduct." *In re* Polyurethane Foam Antitrust Litig., 178 F. Supp. 3d 635, 638 (N.D. Ohio 2016) (first quoting Gemelas v.

One untenable consequence of the *Tribune/Adelphia* approach to bonds is that the successful appellant becomes surety for the consequences of an improper plan. If anything, the interest to be protected is the equity interests of the plan proponent under the plan confirmed, including the losses to any other group mismatching the harm.

Without a bond, the court must then critically examine, as would any court, the four factors traditionally associated with stays pending appeal on their own, and without introducing a "damage" element.

2. *Reforms to Type of Review*

Once a reviewing court has jurisdiction of an appeal, and a stay request is made, one of the first issues is the weight, if any, to give to the bankruptcy court's determination. This question is typically presented as either deferring to the bankruptcy court's determination under an abuse of discretion standard or by treating the stay request as a separate action and reviewing it de novo. As noted above, the circuits "are split."[202] The Second, Third, and Tenth Circuits apply an abuse-of-discretion standard,[203] while the Fifth, Sixth, Ninth, and Eleventh Circuits review equitable mootness dismissals de novo.[204]

The reason is simple. An appeal is often the first time a court vested with the Article III judicial power has looked at a case. The duty to decide cases thus compels a thorough and comprehensive review. Deference to a bankruptcy court at this point runs contrary to the supervision responsibilities assumed by Article III courts over the bankruptcy court system.

3. *Reforms Regarding Procedure — Withdrawal of the Reference*

* * * * *

[Next page is page 427]

---

[202]Search Mkt. Direct, Inc. v. Jubber (*In re* Paige), 584 F.3d 1327, 1334–35 (10th Cir. 2009).

[203]*See* R2 Invs., LDC v. Charter Commc'ns, Inc. (*In re* Charter Commc'ns, Inc.), 691 F.3d 476, 483 (2d Cir. 2012); Search Mkt. Direct, Inc. v. Jubber (*In re* Paige), 584 F.3d 1327, 1335 (10th Cir. 2009); *In re* Continental Airlines, 91 F.3d 553, 560 (3d Cir. 1996) (en banc).

[204]*See* Curreys of Nebraska, Inc. v. United Producers, Inc. (*In re* United Producers), 526 F.3d 942, 946–47 (6th Cir. 2008) (acknowledging conflict with Third Circuit); United States *ex rel.* FCC v. GWI PCS 1, Inc. (*In re* GWI PCS 1 Inc.), 230 F.3d 788, 799–800 (5th Cir. 2000); Baker & Drake, Inc. v. Pub. Serv. Comm'n of Nevada (*In re* Baker & Drake, Inc.), 35 F.3d 1348, 1351 (9th Cir. 1994); First Union Real Estate Equity & Mortg. Invs. v. Club Assocs. (*In re* Club Assocs.), 956 F.2d 1065, 1069 (11th Cir. 1992).

V. CONCLUSION

Equitable mootness arose as a response to the desire for finality in corporate reorganizations. The cost of going back and "doing it right" was perceived to exceed the cost of tolerating the loss of dissenters' rights. In some cases that calculation might prove true. But in other cases, it may not, and the nature of the beast is that we cannot truly know if and when the needs of the many justify eviscerating the rights of the few.

In this article, I have tried to show that the doctrine of equitable mootness tramples meritorious actions of the few simply to protect the needs of the many. It is thus a perverse form of utilitarianism that has long-term costs which courts have not considered.[226] For too long, we have unwittingly engaged in an experiment in which a reorganization result is given decisive weight to the detriment of holders of meritorious legal claims. Moreover, by not considering or weighing the long-term costs to the legal system, we may have incurred unknown costs to the stability of contracts, and ultimately, a legal system based on contracts.

The reaction may be to say that courts should consider reducing or eliminating equitable mootness from their reorganization tool kits. The Third and Ninth Circuits have recently made moves in this direction. The result of reducing or eliminating equitable mootness may be that some businesses do not reorganize, and that reorganization value may be lost. Some may recoil in horror at that thought. My response: so be it.

My cynical side suspects that the result of eliminating or reducing equitable mootness in most chapter 11 cases will not be the immediate liquidation of debtors or the loss of substantial reorganization value. Rather, the likely consequence will be different deals, deals made with less emphasis on expediency and more deference to dissenters' legal claims. And if that is not the consequence, the option is always open for Congress to exercise its bankruptcy powers to add confirmation orders to the list of orders statutorily immune from appeal. Until then, however, we are left with a system infested with a pernicious doctrine that, in the long run, costs more than it saves.

[226]To repeat the "harm principle" of utilitarianism: "The only purpose for which power can be rightfully exercised over any member of a civilized community, against his will, is to prevent harm to others. His own good, either physical or moral, is not sufficient warrant." JOHN STUART MILL, ON LIBERTY 21-22 (2d ed. 1859).