American Bankruptcy Institute

2025 Winter Leadership Conference

The Top 10 Cases You Should Be Reading About but Aren't

Bill Rochelle, Moderator
American Bankruptcy Institute | Alexandria, Va.

Hon. Daniel P. Collins
U.S. Bankruptcy Court (D. Ariz.) | Phoenix

Hon. Laurel Myerson Isicoff
U.S. Bankruptcy Court (S.D. Fla.) | Miami

Hon. Christopher M. Lopez
U.S. Bankruptcy Court (S.D. Tex.) | Houston

Hon. Sage M. Sigler
U.S. Bankruptcy Court (N.D. Ga.) | Atlanta

Hon. Elizabeth S. Stong
U.S. Bankruptcy Court (E.D.N.Y.) | Brooklyn

PLENARY SESSION

2025

Big Stories That Didn't Get Traction

ABI's Winter Leadership Conference
Tucson Arizona; December 6, 2025

Bill Rochelle • Editor-at-Large
American Bankruptcy Institute
bill@abi.org • 703. 894.5909
© 2025
99 Canal Center Plaza, Suite 200 • Alexandria, VA 22314 • www.abi.org

Table of Contents

Supreme Court 5
Next Term 6
Supreme Court Grants '*Cert*' in a Bankruptcy Case on Rule 60(b)(4) 7
Last Term 10
Does the Supreme Court's *Trump v. Casa* Say Anything About Bankruptcy Injunctions? 11
Supreme Court Holds: § 106(a) Doesn't Waive Sovereign Immunity for § 544(b) Suits 14

Reorganization 19
Solvent Companies and Bad Faith 20
Third J&J Filing Dismissed on Grounds Different from the First Two Dismissals 21
Fourth Circuit Rules on Jurisdiction, not 'Financial Distress' for a Chapter 11 Debtor 25
Bestwall Dissenting Opinion Reads Like Dismissal of *LTL Mgmt* for a Bad Faith Filing 28
Bestwall Concurrence Believes in 'Liberalization' of Bankruptcy Powers 32
Chapter 11 by a Newly Created Debtor Dismissed in Delaware for a Bad Faith Filing 34
On a Split, Ninth Circuit BAP Holds: Misconduct in '11' Doesn't Prevent Conversion to '7' 37
Executory Contracts & Leases 41
Second Circuit Takes Sides on a Section 365(d)(5) Circuit Split 42
Circuits Are Split on Assuming a Franchise Agreement when the Franchisor Objects 46
Venue, Jurisdiction & Power 49
A Bankruptcy Case on Rule 60(b) Could End Up in the Supreme Court Next Term 50
Judge Ambro Writes a Treatise on a Board's Residual Authority During a Receivership 53
Third Circuit Judge Krause Believes State Choice of Law Always Applies in Bankruptcy 58
Circuit Judge Ambro Believes Bankruptcy Cases Could Use Federal Choice-of-Law Rules 61
On Panel Rehearing, Third Circuit Permits Reopening a 22-Year-Old Case 64
Third Circuit: Confirmation Order Was *Res Judicata* Between Third Parties 68
Third Circuit Dissenter Says that Bankruptcy Judges 'Assist' Article III Judges 71
Seventh Circuit Dismisses Based on 'Person Aggrieved' Without Citing *Truck Insurance* 74
Opposing Relief, a Creditor Isn't Required to Show Constitutional Standing 77
Constitutional and Prudential Standing Survived *Truck Insurance*, Judge Kinsella Says 80
Third Circuit Holds: Magistrate Judges May Issue Final Orders on Bankruptcy Appeals 84
A Plan Appeal Wasn't Equitably Moot, Even Though Reversal Might Rejigger New Equity 87
District Court Doesn't Say Whether 'Person Aggrieved' Survived *Truck Insurance* 90
A Final Order in a Contested Matter Isn't Necessarily a 'Final Order' for Appeal 94
On a Split, the Deadline for Withdrawals Is 30 Days, not the 90 Days in Rule 9027 96
No Second Restructuring of the Same Debt in a Different Venue 99
Plans & Confirmation 102
Third Circuit Upholds Boy Scouts' Nonconsensual Releases, *Purdue* Notwithstanding 103
As to Appealing Insurers, the *Boy Scouts* Plan Was Not Equitably Moot 108
'Dissent' in *Boy Scouts* Favored Using Equitable Mootness to Uphold Nondebtor Releases 111
Fifth Circuit Bans Uptier Financings for Violating the Principle of Ratable Treatment 114
Fifth Circuit Holds that Equitable Mootness Doesn't Protect Parties to the Appeal 119
Another Fifth Circuit Humdinger: This Time, Limiting Gatekeeping 123
On Remand from the Supreme Court in *Truck Ins.*, Fourth Circuit Upholds Confirmation 127

Opt-Out Plan Confirmed with Impaired Creditors Almost Unanimous in Support 132
Opting Out Is Consent for Nondebtor Chapter 11 Releases, New York Judge Says 136
Bankruptcy Courts Don't Agree on What's a 'Consensual' Nondebtor Release 140
Stays & Injunctions 144
Fifth Circuit Arguably Expands the *Barton* Doctrine's *Ultra Vires* Exception 145
Purdue Preliminary Injunction Protecting Nondebtors Upheld on Appeal 148
A Magistrate Judge Refuses to Enforce an Order Staying Actions Against Nondebtors 151
District Courts Disagree on Enforcing an 'Automatic Stay' Protecting Nondebtors 153
No More Injunctions Barring Suits Against Nondebtors in a Diocese Sexual Abuse Case 155
Bankruptcy Has No General Exception to an Automatic Stay After Denial of Arbitration 158
Retention & Compensation 161
Fate of Jackson Walker Is Now in the Hands of a District Judge from Another District 162
It's Really Over. No Refunds for Overpayment of Nonuniform U.S. Trustee Fees 165
Preferences, Fraudulent Transfers & Claims 167
Fifth Circuit Bans Uptier Financings for Violating the Principle of Ratable Treatment 168
Third Circuit Upholds PBGC's Rulemaking Authority in Calculating Withdrawal Claims 173
In Lender-on-Lender Violence, an 'Uptier' Financing Bites the Dust, this Time in Houston 176
Second Circuit Doesn't Compel a Liquidating Trustee to Arbitrate with an Insurer 179
Circuit Judges Disagree: Can an Investment Be So Risky that It's a Fraudulent Transfer? 181
Applying Pressure on the Debtor Obviates the 'Ordinary Course' Defense to a Preference 185
A Lender Can't Have a Lien on Avoidance Actions, District Judge Says 188
A District Court Decision Implies that Marshaling Is Impermissible in Bankruptcy 190
Sufficiency of Preference and Fraudulent Transfer Complaints Described by Judge Goldblatt 193
Delaware Judge Writes a Treatise for Avoiding WARN Act Liability 196
In Pari Delicto Defense Doesn't Apply to a Trustee Exercising Avoidance Powers 200
Sales 204
In '363' Sales, Three Courts Say *Purdue* Doesn't Bar Injunctions Protecting Buyers 205
Bankruptcy Judge Rejects a District Court's Narrow View of Sales Free and Clear 207
Trustee May Not Liquidate Estate Property Solely to Benefit a DSO Creditor 210
Small Biz. Reorg. Act 213
Two Courts Hold: Injunctions Are Ok to Protect Nondebtors for the Life of a Plan 214
Another Court Approves a Nondebtor Injunction for the Five-Year Life of a Sub V Plan 217
Purdue Doesn't Preclude Injunctions from Protecting Nondebtors for the Life of a Plan 219
Judge Isicoff Describes Limited Times When Committees Are Appointed in Subchapter V 222
Texas Courts Are Split on Ignoring Nonvoting Classes in Confirming a Sub V Plan 225
No Circuit Split: Sub V Corporate Debtors Can Have Nondischargeable Debts 228
Judge Oldshue Splits with Two Circuits: No Nondischargeability for Sub V Corporations 231
Denver Judge Sides with the Circuits: Nondischargeability Infects Subchapter V 234
Chicago District Judge Decides that Sub V Debtors Can Have Nondischargeable Debts 237
Nondischargeability in Sub V Only Applies When It's a Nonconsensual, Cramdown Plan 240
A Business that Never Generated Income Is Eligible for Subchapter V, Judge Norman Says 243
To Dismiss for 'Loss or Diminution,' the Focus Is on Losses After Filing, BAP Says 245

Consumer Bankruptcy 248
Discharge/Dischargeability 249
Disciplinary Costs Are Nondischargeable in California But Dischargeable in Nevada 250
Debt Held Nondischargeable as to Someone Who Didn't Commit a Defalcation 253

For Nondischargeability, a Bankruptcy Court Can Find a Securities Law Violation 256
Student Loans for a Professional Degree Weren't Business Debts to Qualify for Sub V..........258
Debtor Not Compelled to Arbitrate Automatic Stay or Discharge Violations..........................260

Automatic Stay **262**
A Disguised Loan Agreement Didn't Create a 'Fair Ground of Doubt' Under *Taggart* 263
A Promise Not to Enforce a Judgment Meant There Was No Discharge Violation 266
A Suit Nominally Against a Debtor Does/Doesn't Violate the Discharge Injunction...............270
Barring Use of an Online Payment Platform Was an Automatic Stay Violation......................273
The Supreme Court's *Acevedo* Doesn't Preclude Annulling the Stay, Eleventh Circuit Says ..278

Jurisdiction **281**
Third Circuit Has a Broad View of 'Related To' Jurisdiction After Plan Confirmation 282
Circuit Judge Ambro Scribes the Boundaries Between *Rooker-Feldman* and Preclusion.........284
Reimposing the Stay Is a Final Order to Be Appealed Immediately, Ninth Circuit Says..........288
Courts Must Use Inherent Powers for Sanctions on *Pro Se* Litigants, Eleventh Circuit Says...291
A Disappointed Bidder Didn't Have Prudential Standing in a Chapter 7 Case 294
Allowed Claim Can't Be Used Offensively, Second Circuit Says..298
Even if Ineligible for Chapter 13, Ninth Circuit Says the Debtor Can Still Dismiss.................302
Judge Goldblatt Engrafts the Standing Rules from *Truck Insurance* onto Chapter 7 305
Married Immediately Before Bankruptcy, the 'Household' Is Two, Not One..........................308
Claim Preclusion Didn't Preclude Making Successive Exemption Claims, Circuit Says 310

Plans & Confirmation **314**
Sixth Circuit Restricts Ability to Surrender Collateral and Modify a Chapter 13 Plan 315
Four Circuits Align: Section 1322(c)(2) Permits Bifurcating a Short-Term Mortgage 318
Fifth Circuit: Repayment of Unsecured Term Loan Sometimes Must Be Accelerated in '13' .321
Barring Use of an Online Payment Platform Was an Automatic Stay Violation......................326
Debtor's Appeal from Chapter 13 Plan Confirmation Held Equitably Moot 330

Compensation...**333**
Debtors' Lawyer Has No 7th Amendment Right to Sue for Post-Petition Fees, Circuit Says...334
No Circuit Split: 4 Circuits Say No '13' Trustee Fees if Dismissal Precedes Confirmation.....341
Bankruptcy Courts Disagree on Paying a '7' Trustee Who Made No Distributions 346

Estate Property **349**
Eleventh Circuit: Chapter 13 Debtor Keeps Settlement of a Personal Injury Claim 350
A Retirement Plan that's Not 'Tax-Qualified' Is Still Excluded from Estate Property 353
A Transfer from the Debtor to a Constructive Trust Isn't a Transfer of Debtor's Property 356
Although Exempt, Social Security Benefits Must Be Reported in Subchapter V......................358

Claims **360**
Ninth Circuit Primed to Decide Whether Emotional Distress Damages Survived *Taggart* 361
On a Split, First Circuit Holds that Deadlines to Join Involuntary Petitions Are Permissible...365
Fully Secured, Nonrecourse Creditors Can Be Involuntary Petitioners, BAP Says 368
Lender Collects Only Once When Both Spouses Personally Guarantee a Debt........................371
Even Expecting Profit on the Investment, a Home Mortgage Is Still Consumer Debt..............373

Cross-Border Insolvency **376**
Second Circuit Extends the Section 546(e) Safe Harbor to Cover Foreign Law 377
Puerto Rico's Debt-Adjustment Proceedings Weren't Unconstitutional 'Takings'...................381
Forum Non Conveniens Applied When Chapter 15 Would Have Been a Better Fit 384
Foreign Main Recognition in Chapter 15 Is Easy When No One Objects................................387

After *Purdue*, Two Courts Still Permit Broad Nonconsensual Releases in '15'........................390
Should Property in the U.S. Be a Requisite for Chapter 15 Recognition?.................................394
Nondebtor Releases Are Still Permissible in Chapter 15, Delaware Judge Says.......................398
U.S. Incorporated Subsidiaries 'Likely' Have Chapter 15 COMI in Canada, Not the U.S. 402

Supreme Court

Next Term

Coney Island is a bankruptcy case, but the question is whether there is a time limit for a Rule 60(b)(4) motion to set aside a judgment for lack of personal jurisdiction over the defendant.

Supreme Court Grants '*Cert* in a Bankruptcy Case on Rule 60(b)(4)

To resolve a split of circuits, the Supreme Court granted *certiorari* on Friday in a bankruptcy case, but the question does not turn on bankruptcy law. Rather, the Court will decide whether there is a time limit under Rule 60(b)(4) to set aside a default judgment for lack of personal jurisdiction.

However, key precedent for the Court will include a bankruptcy case, *United Student Aid Funds, Inc. v. Espinosa*, 559 U.S. 260, 275 (2010), where the Court said that "Rule 60(b)(4) does not provide a license for litigants to sleep on their rights," perhaps suggesting there can be a limit for Rule 60(b)(4) motions.

Still, constitutional law was not a focus in *Espinosa*. In the case the Court will review this fall, *Coney Island Auto Parts Unlimited Inc. v. Burton*, 24-808 (Sup. Ct.), the Constitution and the Due Process Clause will be at the forefront. *Coney Island* involved a default judgment where, allegedly, there never was personal jurisdiction over the defendant.

The Court's opinion in *Coney Island* will say whether there is a time limit for moving to set aside a judgment that was allegedly void because there never was personal jurisdiction over the defendant.

The Default Judgment

A chapter 11 debtor had filed an adversary proceeding to recover some $50,000 in unpaid invoices. The debtor mailed the summons and complaint addressed to the defendant at the corporation's address, but the papers were not addressed to any corporate officer because the corporation had listed itself as the agent for the service of process.

The bankruptcy court had entered a default judgment in favor of the debtor before the chapter 11 case was converted to chapter 7. Five years after entry of the default judgment, the chapter 7 trustee attached the defendant's bank account. Six years after the entry of judgment, the defendant moved under Bankruptcy Rule 9024 and Federal Rule 60(b)(4) to set aside the judgment.

The bankruptcy court never reached the question of whether the judgment was void for failure to address the papers to a corporate officer. Rather, the bankruptcy court denied the motion to void the judgment on the grounds that the delay in filing the Rule 60(b)(4) motion was unreasonable.

The rule allows the court to "relieve a party . . . from a final judgment [or] order." Rule 60(c) goes on to say, "A motion under Rule 60(b) must be made within a reasonable time . . . ."

The district court affirmed, and so did the Sixth Circuit, over a dissent. *Burton v. Coney Island Auto Parts Unlimited Inc. (In re Vista-Pro Automotive LLC)*, 109 F.4th 438 (6th Cir. July 26, 2024). To read ABI's report on the Sixth Circuit decision, click here.

The case before the Supreme Court will say whether "reasonable time" applies to void judgments for which there never was personal jurisdiction.

The Question

The parties disagree about the extent of a circuit split. The defendant, as petitioner in the Supreme Court, contends that all circuits aside from the Sixth believe there is no time limit for setting aside a judgment that was void for lack of personal jurisdiction.

The chapter 7 trustee, as respondent, disagrees and says, "at least seven circuits join the Sixth Circuit in finding Rule 60(b)(4) motions untimely in appropriate cases."

Aside from the circuits that have opined on the question, two Supreme Court decisions will be at the forefront. In *Kemp v. United States*, 596 U.S. 528, 533 (2022) the Court said, "All [Rule 60(b) motions] must be filed 'within a reasonable time.' Rule 60(c)(1)."

Espinosa is close but not on point. The holder of student loans had notice but did not object when the debtor's chapter 13 plan discharged student loans. Later, the lender moved to set aside the discharge of the student loans under Rule 60(b)(4), because the debtor had not prosecuted an adversary proceeding to establish that the loans imposed an "undue hardship" under Section 523(a)(8).

Espinosa upheld the discharge of the student loans, improper procedure notwithstanding.

While *Espinosa* does say that "Rule 60(b)(4) does not provide a license for litigants to sleep on their rights," the case did not deal with personal jurisdiction. In *Espinosa*, the lender had notice. Personal jurisdiction was not an issue. The alleged defect was procedural: the failure to conduct an adversary proceeding.

In *Coney Island*, the alleged defect was the alleged lack of personal jurisdiction, thus raising a constitutional question not present in *Espinosa*.

If there are no delays in the submission of briefs, oral argument in *Coney Island* could be held not long after the new term begins in October. Near or soon after the new year, we could have a decision saying whether the constitutional right to Due Process can be waived by delay in asserting the right.

The case is *Coney Island Auto Parts Unlimited Inc. v. Burton*, 24-808 (Sup. Ct.).

Last Term

Generally speaking, Casa doesn't impair bankruptcy injunctions but may inform courts on what is required to obtain consensual, nondebtor releases after Purdue.

Does the Supreme Court's *Trump v. Casa* Say Anything About Bankruptcy Injunctions?

On Breakaway Day, the Supreme Court handed down *Trump v. Casa Inc.*, the most consequential opinion of the 2024 term. The 6/3 opinion by Justice Amy Coney Barrett held that federal courts have no power to issue what she called "universal injunctions." *Trump v. Casa Inc.*, 24A884, 2025 BL 222886, 2025 US Lexis 2501 (Sup. Ct. June 27, 2025) (*slip op.* at 4).

The injunctive powers in the Bankruptcy Code and those exercised by bankruptcy courts are especially broad, extending to those who have not submitted to the bankruptcy court's personal or subject matter jurisdiction. Loosely speaking, some might say that injunctive bankruptcy powers are universal injunctions.

The question is this: Does *Casa* say anything about injunctive bankruptcy powers? Generally, the answer is "no," but "maybe" in some circumstances.

Injunctions as Exercises of Equity Powers

Casa arose from the administration's emergency applications to set aside injunctions barring enforcement of a presidential executive order trimming back so-called birthright citizenship arising from Section 1 of the Fourteenth Amendment and Section 201 of the Nationality Act of 1940.

In an opinion joined by Chief Justice John G. Roberts, Jr., and Justices Clarence Thomas, Samuel A. Alito, Jr., Neil M. Gorsuch and Brett M. Kavanaugh, Justice Barrett framed the question as follows:

> The issue before us is one of remedy: whether, under the Judiciary Act of 1789 [Section 11, 1 Stat. 78], federal courts have equitable authority to issue universal injunctions.

Casa, *supra*, *slip op.* at 4.

Justice Barrett went on to say "that the statutory grant encompasses only those sorts of equitable remedies 'traditionally accorded by courts of equity' at our country's inception," quoting

Grupo Mexicano de Desarrollo, S. A. v. Alliance Bond Fund, Inc., 527 U.S. 308, 319 (1999). *Casa*, *supra*, *slip op.* at 6. She said that universal injunctions are permissible only when they "are sufficiently 'analogous' to the relief issued 'by the High Court of Chancery in England at the time of the adoption of the Constitution and the enactment of the original Judiciary Act.' *Id*. at 318 - 319." *Id*.

Justice Barrett held that universal injunctions are not permissible because neither they "nor any analogous form of relief was available in the High Court of Chancery in England at the time of the founding." *Id*.

Bankruptcy Powers Aren't Exclusively Equitable

Does *Casa* mean anything about bankruptcy practice, since bankruptcy entails injunctions and powers reaching those who have not voluntarily submitted to the bankruptcy court's jurisdiction?

Casa in its breadth does not govern bankruptcy, because the Court was construing available remedies under the Judiciary Act of 1789. Bankruptcy powers derive from *in rem*, personal and subject matter jurisdiction that is more expansive and more specific than the Judiciary Act of 1789.

Exercising *in rem* jurisdiction, bankruptcy courts have powers over those who have not submitted to the court's jurisdiction. Likewise, the Bankruptcy Code itself grants subject matter jurisdiction and powers under the Bankruptcy Clause to affect those who do not submit to jurisdiction.

As a general principle, this writer does not believe that *Casa* disfunctions the bankruptcy process.

Casa May Inform Nondebtor Releases

There may be one area, however, where *Casa* is instructive: consensual releases and injunctions in chapter 11 plans barring actions against nondebtors. We shall refer to them as nondebtor injunctions. At times, nondebtor injunctions can be more extensive than discharges granted to individuals.

This writer views nondebtor injunctions as reverse class actions. In a typical class action, the injured person decides when and where to sue the person or entity who caused the alleged damage.

With nondebtor injunctions, the entity that would be a defendant in a class action decides when and where to obtain the equivalent of a final judgment against potentially injured parties. Apart from asbestos cases where there is regulation under Section 524(g), nondebtor injunctions are not subject to the rigors of Federal Rule 23, unless applied analogously by a court.

The question of personal jurisdiction has increasingly come to the forefront with regard to consensual nondebtor injunctions. That is to say, must the protected party cause the court to obtain personal jurisdiction over creditors or noncreditors before entry of a nondebtor injunction? Does the bankruptcy court's *in rem* jurisdiction supplant personal jurisdiction, or is notice by publication somehow sufficient by analogy to Rule 23?

Assuming there is both personal and subject matter jurisdiction (that is, the statutory power in the Bankruptcy Code to issue nondebtor injunctions), this writer believes that *Casa* has something to say about nondebtor injunctions.

Justice Barrett's discussion of Federal Rule 23 on page 14 of the slip opinion is striking. She said,

> Rule 23's limits on class actions underscore a significant problem with universal injunctions. A "properly conducted class action," we have said, "can come about in federal courts in just one way — through the procedure set out in Rule 23." [citations omitted] . . . . Why bother with a Rule 23 class action when the quick fix of a universal injunction is on the table . . . ? The principal dissent's suggestion that these suits could have satisfied Rule 23's requirements simply proves that universal injunctions are a class-action workaround.

It is possible to read Justice Barrett's opinion to mean that courts should examine reverse class actions in terms of compliance with Rule 23 or some equivalent that courts perhaps may or may not be authorized to invent on their own.

Casa might also cast doubt on the procedure for obtaining temporary and preliminary injunctions early in bankruptcy cases to halt lawsuits against nondebtors. However, the early-case injunctions could be seen as relying more on *in rem* jurisdiction than do nondebtor injunctions under chapter 11 plans.

The opinion is *Trump v. Casa Inc.*, 24A884, (Sup. Ct. June 27, 2025).

In an 8-1 opinion, the Supreme Court holds that the waiver of sovereign immunity under Section 106(a) does not extend to suits brought by a trustee under state law standing in the shoes of an actual creditor.

Supreme Court Holds: § 106(a) Doesn't Waive Sovereign Immunity for § 544(b) Suits

In an 8-1 decision written by Justice Ketanji Brown Jackson, the Supreme Court resolved a split of circuits by holding that Section 106(a) does not permit a bankruptcy trustee to sue the federal government for receipt of a fraudulent transfer under state law and Section 544(b)(1), because no actual creditor could sue the government outside of bankruptcy.

In her 19-page opinion for the Court on March 26, Justice Jackson saw the "actual creditor" requirement in Section 544(b)(1) as bringing sovereign immunity back into play as a defense for the Internal Revenue Service, even though Section 106(a) waives sovereign immunity for suits under Section 544.

The Fraudulent Transfer to the IRS

The case arose from an often-occurring fraudulent transfer to the Internal Revenue Service: A corporation paid $145,000 in federal income taxes owed by one of its owners. The corporation ended up in bankruptcy three years later. Because the transfer did not occur within two years of filing, the chapter 7 trustee could not sue under Section 548(a)(1)(B).

The 7 trustee therefore invoked Section 544(b)(1) to sue the IRS for receipt of a fraudulent transfer under Utah law. The section allows a trustee to "avoid any transfer of an interest of the debtor in property . . . that is voidable under applicable law by a creditor holding an [allowable] unsecured claim."

The government agreed there was an actual creditor and admitted the elements of a constructively fraudulent transfer. However, the government contended that sovereign immunity would have prevented an actual creditor from suing the IRS outside of bankruptcy, thus disabling the trustee from suing under Section 544(b)(1).

Responding, the trustee argued that the waiver of sovereign immunity as to Section 544 contained in Section 106(a) allowed suit based on a state-law claim. The subsection provides that

"sovereign immunity is abrogated as to a governmental unit to the extent set forth in" 59 sections of the Bankruptcy Code, including Section 544.

On cross motions for summary judgment, Bankruptcy Judge R. Kimball Mosier of Salt Lake City ruled in favor of the trustee and entered judgment for $145,000. *Miller v. United States (In re All Resort Group Inc.)*, 617 B.R. 375 (Bankr. D. Utah 2020). The district court affirmed. *See U.S. v. Miller*, 20-00248, 2021 BL 340200 (D. Utah Sept. 08, 2021). To read ABI's report on the district court's affirmance, click here. The IRS appealed to the circuit.

Tenth Circuit Affirms

The Tenth Circuit affirmed in *U.S. v. Miller*, 71 F.4th 1247 (10th Cir. June 27, 2023). Focusing on the language in Section 106(a), the Denver-based appeals court noted that Congress "abrogated" immunity "with respect to" Section 544. The circuit court cited Supreme Court authority for the proposition that "with respect to" has a "broadening effect." To read ABI's report, click here.

The Tenth Circuit's opinion deepened an already existing circuit split. The Ninth and Fourth Circuits had already held that the waiver of immunity in Section 106(a) allows claims against the government under state law for recovery of fraudulent transfers. *See In re DBSI, Inc.*, 869 F.3d 1004 (9th Cir. 2017); and *Cook v. U.S. (In re Yahweh Center Inc.),* 27 F.4th 960 (4th Cir. 2022). To read ABI's reports, click here and here.

The Seventh Circuit held to the contrary in 2014 in *In re Equip. Acquisition Res. Inc.*, 742 F.3d 743 (7th Cir. 2014). The Seventh Circuit reasoned that Section 106(a) did not modify the actual creditor requirement in Section 544(b). As it turns out, Justice Jackson followed the Seventh Circuit's approach.

To resolve the circuit split, the Court granted the government's petition for *certiorari*. The appeal was argued on December 2, 2024. To read ABI's report on oral argument, click here.

Section 106 Is Only Jurisdictional

Justice Jackson began her analysis of the merits by citing the *Collier* treatise for the idea that a trustee is "powerless" in the absence of an actual creditor who could have sued. "This 'actual creditor' requirement serves as an important check on the trustee's §544(b) powers," she said.

Justice Jackson saw the "dispute [as] turn[ing] on the interplay between §106(a) and §544(b) of the Bankruptcy Code." Referring to Section 548(a), she conceded that "§106(a) waives the Government's sovereign immunity with respect to the federal cause of action created by §544(b)."

Justice Jackson began her analysis from the proposition that waivers of sovereign immunity are jurisdictional "but do not themselves typically create any new substantive rights against the Government."

On the topic of substantive rights, Justice Jackson said that Section 106 is "merely jurisdictional." She quoted Section 106(a)(5), which says, "Nothing in this section shall create any substantive claim for relief or cause of action not otherwise existing under this title, the Federal Rules of Bankruptcy Procedure, or nonbankruptcy law." The trustee's theory, she said, "would thus transform that statute from a jurisdiction-creating provision into a liability-creating provision."

The 'Text' and 'Structure'

Having decided that Section 106 does not create substantive rights, Judge Jackson turned to the "text and structure of §106 and §544[, which] make clear that §106(a)'s waiver of sovereign immunity does not operate to modify §544(b)'s substantive requirements."

If Section 106(a) were to modify the elements of a claim under Section 544(b), Justice Jackson said it "would necessarily give the trustee a substantive claim for relief against the Government that does not 'otherwise exis[t]' under §544(b) or Utah law."

Justice Jackson noted that the actual creditor requirement is "unique" to Section 544(b) and "reflects a deliberate congressional choice to tie the trustee's rights under subsection (b) to the rights of an actual creditor under 'applicable law.'" She observed that "Section 544(b) was expressly 'derived' from §70e of the Bankruptcy Act of 1898, which had long been understood to give trustees the same rights as creditors under state law."

Given the "long-settled understanding of the trustee's §544(b) powers," Justice Jackson said it "would be so anomalous to treat §106(a) as expanding the trustee's rights beyond those of an actual creditor."

"Even if the language and logic of §544 and §106(a)" broadened the sovereign immunity waiver, Justice Jackson said "that our precedents would still foreclose that reading," because "Congress must use unmistakable language to abrogate sovereign immunity." *Financial Oversight and Management Bd. for P. R. v. Centro De Periodismo Investigativo, Inc.*, 598 U.S. 339, 342 (2023)."

'Close, but No Cigar'

Justice Jackson said that the trustee had a "slightly" better argument in saying that a narrow "reading of §106(a) would blunt the impact of Congress's decision to include §544 on the list of provisions subject to §106(a)'s immunity waiver." She paraphrased the trustee as contending that

"the Government's reading of §106(a) effectively robs the immunity waiver of any meaningful purpose with respect to §544; it simply grants federal courts jurisdiction over a set of inherently unwinnable claims."

Justice Jackson was "not persuaded." Even if Section 106(a) would let the trustee win "under §544(b), [the trustee] might still prevail against the Government under §544's other subprovision — subsection (a)." She noted that "subsection (a), unlike subsection (b), does not contain an actual-creditor requirement."

In addition, Justice Jackson said that Section 106(a) has an "independent function" by "grant[ing] federal courts jurisdiction to hear §544(b) claims brought against state governments" in states that have waived sovereign immunity "under their own fraudulent-transfer statutes."

Justice Jackson ended her opinion by reversing the Tenth Circuit and holding:

> Section 106(a) of the Bankruptcy Code abrogates sovereign immunity for the federal cause of action created by §544(b). It does not take the additional step of abrogating sovereign immunity for whatever state-law claim supplies the "applicable law" for a trustee's §544(b) claim.

The Dissent

Justice Neil M. Gorsuch wrote a three-page dissent.

Apart from the question of sovereign immunity, Justice Gorsuch began from the concession that a fraudulent transfer claim existed under Utah law. He continued:

> Thus, under "applicable law," the relevant transfers are "voidable," and the bankruptcy trustee can use §544(b)(1) to set them aside. That remains true even though the trustee must sue the United States to void the relevant transfers, because §106(a)(1) bars the government from raising a sovereign-immunity defense in the trustee's action.

Justice Gorsuch asked whether "the federal government [could] defeat the claim by raising the affirmative defense of sovereign immunity?" He answered his own question by saying, "With respect to a private creditor pursuing relief in state court, the answer is yes. With respect to a trustee pursuing relief in a federal bankruptcy proceeding, the answer — thanks to §106(a)(1) — is no."

Justice Gorsuch "respectfully" dissented, saying he would "agree with the majority of circuits to have considered the question that bankruptcy trustees may avoid fraudulent transfers to the United States under §544(b)."

The opinion is *U.S. v. Miller*, 23-824 (Sup. Ct. March 26, 2025).

Reorganization

Solvent Companies and Bad Faith

Houston's Bankruptcy Judge Christopher Lopez decided that the newest plan by a Johnson & Johnson subsidiary didn't qualify for nondebtor releases permissible in asbestos cases.

Third J&J Filing Dismissed on Grounds Different from the First Two Dismissals

Dismissing Johnson & Johnson's third attempt at extinguishing talc claims through chapter 11, Bankruptcy Judge Christopher Lopez of Houston nixed theories for evading the *Purdue* prohibition of nondebtor releases.

In his March 31 opinion, Judge Lopez put strictures on releases for nondebtors that can sometimes be permissible in asbestos cases under Section 524(g)(4)(A)(ii). The product of a two-week trial, his 57-page, single-spaced opinion is the definitive, detailed, inside history of J&J's efforts at obtaining absolution for talc claims through creative legal theories.

After saying that J&J was willing to commit $9 billion to discharge 90,000 claims, Judge Lopez opened his opinion by describing the previous chapter 11 cases that ended in two dismissals in New Jersey that were upheld in the Third Circuit. For those without time to read the entire 57 pages, the first five pages provide a workable summary of the findings and holdings to follow. He pointed out, "This case is different. It is not like *Boy Scouts*, *Purdue Pharma*, or *Imerys*."

The Third Chapter 11 Case

Immediately after the second dismissal in New Jersey was upheld in the Third Circuit, Judge Lopez described the negotiations leading to a new chapter 11 plan and the third filing in Houston in September 2024.

With a contribution of $9 billion from J&J over time, the new plan would have released claims against all J&J entities, not only the newly formed subsidiary named Red River Talc that became the debtor after being created under a Texas divisional merger. Hundreds of nondebtors also would be released, including retailers. Creditors were not given the option of opting out and would be bound by releases even if they voted against the plan.

Aiming for nondebtor releases that are permissible in an asbestos case under Section 524(g), the debtor needed 75% of the affected class to accept the plan. When the vote first came in, only 70% were accepting. The acceptance level jumped to 83% after a law firm purportedly changed the votes of its 11,000 clients from reject to accept.

The chapter 11 filing in Houston brought a motion to transfer venue to New Jersey, which Judge Lopez denied. Then, the U.S. Trustee and "many parties" objected to confirmation of the plan and sought dismissal of the case.

The Defective Vote on the Plan

Judge Lopez devoted the largest part of his opinion to explaining how "over 90,000 votes were cast, but at least half of them cannot count. There were numerous prepetition voting irregularities and solicitation hiccups that make it impossible certify the vote." Consequently, he found that "the requisite 75% claimant support has not been met for plan confirmation purposes."

Although voting ended too quickly, the major flaw resulted from lawyers who purported to vote on behalf of their clients. Judge Lopez gave examples explaining why "the majority of these votes were not supported by a power of attorney."

For instance, Judge Lopez said that thousands of votes submitted by two law firms based on their retention agreements "do not give them express authority to vote on behalf of their clients in this bankruptcy." "With one or two exceptions," he said, "the majority of the engagement letters for the law firms that" voted on behalf of their clients had the same flaws.

"Another reason these votes cannot be certified is that the lawyers," Judge Lopez said, "were likely settling claims without client approval."

With regard to the law firm whose clients switched from reject to accept, Judge Lopez said that "women with cancer had two business days and a weekend to respond and indicate their votes. This is an 'unreasonably' short time for a creditor vote under Bankruptcy Rule 3018(b), and therefore, regardless of the other issues the Court has discussed, these votes cannot be counted."

Judge Lopez ruled that "the entire vote cannot be certified." The master ballots used by law firms to vote for hundreds or thousands of clients "would have worked, but it was not carefully followed."

The *Purdue* Violation

Beyond the vote, "The Plan contains improper nonconsensual third-party releases," Judge Lopez said. He identified releases in favor of "hundreds of nondebtor third parties related to J&J." In addition, he said, "There is no dispute that voters had no opportunity to opt in or opt out of these releases. Thus, voters who affirmatively voted to reject the Plan would still be bound by the Third-Party Releases."

The debtor contended that the *Purdue* prohibition did not apply because it was a "full pay" plan, possibly carved out by the Supreme Court from the nondebtor release proscription. *See Harrington v. Purdue Pharma L.P.*, 602 U.S. 204, 226-27 (2024). Judge Lopez did "not read *Purdue* as implicitly endorsing the third-party releases in this case because this is not a 'full pay' case." Moreover, he said, "the Fifth Circuit has stated many times that nonconsensual third-party releases are not permissible."

Nondebtor Releases Under Section 524(g)

In asbestos cases, Section 524(g) can permit nondebtor releases. In the debtor's plan, there would have been releases for 700 entities, including retailers who sold the J&J product. The plan would not be feasible without the nondebtor releases, because retailers would have indemnification claims against J&J.

For permissible nondebtor releases, Judge Lopez cited the Second and Third Circuits for holding "that § 524(g)(4)(A)(ii) only enjoins actions against third parties that are derivative of claims against the debtor." He held that claims against retailers were not derivative claims qualifying for releases under Section 524(g)(4)(A)(ii).

Dismissal or 'Redo'?

Judge Lopez ended his opinion by addressing the question of dismissal for "cause" under Section 1112(b)(1).

Regarding the Third Circuit's dismissal of prior filings for lack of "financial distress," Judge Lopez said that the Philadelphia-based court's "decision is not binding on this Court. But, under Fifth Circuit precedent, a debtor's financial condition is a factor a court can consider in its analysis." He went on to say in a footnote that the Houston case had "countless factual differences" from the prior New Jersey cases, so that the third filing could not be dismissed "under the doctrine of collateral estoppel."

Turning to the facts of the third filing with regard to dismissal, Judge Lopez said that the debtor "unnecessarily rushed the solicitation process at the cost of obtaining actual votes from creditors." He said that the plan was not feasible since retailers could not be given releases.

Normally, Judge Lopez said that a court would deny confirmation, then call for a new disclosure statement, a new plan and new solicitation, with opt in or opt out for nondebtor releases. "But that will not work here," he said. "There is no way to confirm the solicited plan or the amended versions. The entire construct of the Plan requires re-thinking from a post-*Purdue* perspective."

Judge Lopez found that it was "in the best interests" of the debtor and creditors "to dismiss this case for cause." He mentioned the "prepetition voting and solicitation irregularities, including the unreasonably short voting time for thousands of creditors [that were] all done to get to 75% at any cost."

Judge Lopez dismissed the case, saying that "not any one individual factor . . . requires this result" but that it is "all of them together that require the Court to dismiss this case."

The opinion is *In re Red River Talc LLC*, 24-90505 (Bankr. S.D. Tex. March 31, 2025).

Fourth Circuit majority and dissenting opinions might be read to suggest that Bestwall could have tough sledding on an appeal from confirmation since the debtor is solvent.

Fourth Circuit Rules on Jurisdiction, not 'Financial Distress' for a Chapter 11 Debtor

Remember *LTL Management*, where the Third Circuit dismissed the chapter 11 case of a Johnson & Johnson subsidiary for lack of "financial distress"?

In a split decision, the Fourth Circuit held that the bankruptcy court has subject matter jurisdiction resulting from the Bankruptcy Clause even when the debtor is solvent.

Do the Third and Fourth Circuits disagree about financial distress as a requisite for a chapter 11 debtor?

Answer: No!

As Fourth Circuit Judge A. Marvin Quattlebaum, Jr., said for the majority in an opinion on August 1, the Third Circuit "dismissed *LTL'*s bankruptcy petition as a bad faith filing" because the J&J subsidiary "was not in financial distress." In contrast, Judge Quattlebaum's opinion for the Fourth Circuit opinion isn't about a bad faith filing. The Fourth Circuit's majority opinion only deals with jurisdiction, not bad faith, and holds that a debtor's solvency does not divest the bankruptcy court of subject matter jurisdiction.

We recommend reading the Fourth Circuit opinions in full text at first opportunity. Although the appeals court did not order dismissal of the reorganization of an eminently solvent company, readers might conclude that all three Fourth Circuit judges would dismiss the case when solvency is presented in a different context.

The Fourth Circuit opinion deals with the chapter 11 reorganization of Bestwall, created as a subsidiary of solvent Georgia-Pacific to deal with the companies' asbestos liability. Given the gravity of the opinions, we will offer three reports. Today, we report the majority opinion. Tomorrow, it's the dissent. The day following will be the concurrence.

Bestwall Reborn

Georgia-Pacific, a pulp and paper company, acquired and merged with Bestwall in 1965. Bestwall's products, wallboard and related products, generated decades of asbestos litigation, resulting in $558 million in defense and indemnity costs between 2014 and 2017, according to Judge Quattlebaum's recitation of the facts.

With 64,000 claims pending, Georgia-Pacific effected a Texas divisional merger in 2017. Most of the assets went to Georgia-Pacific along with some liabilities, but Bestwall became the repository for asbestos liability.

Bestwall had some cash and the gypsum plaster business that generated annual cash flow of $18 million. Of significance, Georgia-Pacific agreed to pay Bestwall's expenses of administration in chapter 11 and, if necessary, to fund a Section 524(g) trust to pay asbestos claims in a confirmed chapter 11 plan.

After Bestwall filed a chapter 11 petition in 2017, the official committee of asbestos claimants filed a motion to dismiss, alleging a bad faith filing "because Bestwall wasn't really bankrupt," Judge Quattlebaum said. The bankruptcy court granted Bestwall's motion enjoining suits against Georgia-Pacific and denied the dismissal motion by finding a valid reorganization purpose.

Years later, the committee filed another dismissal motion, this time based on a lack of subject matter jurisdiction. Judge Quattlebaum characterized the committee as arguing "that Bestwall was not 'bankrupt' according to a founding-era understanding of the word" and that bankruptcy was a "constitutional requirement for jurisdiction" that "precedes any statutory requirements for debtors."

In the16-page majority opinion for himself and Circuit Judge G. Steven Agee, Judge Quattlebaum described the bankruptcy court as having denied the motion to dismiss "because the history of bankruptcy legislation has been one of liberalizing bankruptcy access." The bankruptcy court certified a direct appeal, which the circuit accepted.

The Question on Appeal

On the merits, Judge Quattlebaum said that the appeal "is not about the validity of the controversial Texas two-step maneuver . . . [n]or is it about whether a debtor's ability to pay its debts is relevant in a bankruptcy case." He said that solvency or bad faith "may come up at future junctures — at plan confirmation, for example."

"Instead," he said that the "narrow question" on appeal was whether "federal courts have subject-matter jurisdiction over bankruptcy cases filed by debtors who may be able to pay their obligations."

The Appeal Is About Jurisdiction, Not 'Financial Distress'

Addressing the merits, Judge Quattlebaum quoted the Bankruptcy Clause in Article I, Section 8 of the Constitution as authorizing Congress to "establish . . . uniform Laws on the subject of Bankruptcies throughout the United States." He described the committee as contending that "the meaning of 'bankruptcy' at the founding did not include those able to pay their debts."

Judge Quattlebaum said that the committee was not questioning Bestwall's Article III standing but was "convert[ing] a challenge to the Bankruptcy Code's constitutionality into a jurisdictional question." Jurisdiction, he said, is governed by 28 U.S.C. § 1334, which confers "original and exclusive jurisdiction of all cases under title 11 . . . or arising in or related to cases under title 11."

Refining the question on appeal, Judge Quattlebaum it "really is about Congress's power under Article I of the Constitution to make parties eligible for bankruptcy protection. It's not a question of subject-matter jurisdiction." He immediately said that "no court has ever adopted the Committee's view."

In *LTL*, Judge Quattlebaum said, the Third Circuit "didn't decide the case on subject-matter jurisdiction grounds" but "determined that LTL — the company formed to own and resolve Johnson & Johnson's talc liabilities — was not in financial distress" and "dismissed LTL's bankruptcy petition as a bad faith filing." *In re LTL Mgmt., LLC*, 64 F.4th 84, 106 - 110 (3d Cir. Jan. 20, 2023). To read ABI's report on *LTL*, click here.

"Importantly," Judge Quattlebaum said, the Third Circuit "determined that it had jurisdiction of the appeal under 28 U.S.C. § 158(d)(2)(A) and that the bankruptcy court had jurisdiction under § 157(a) and § 1334(a). *See id.* at 99." The Third Circuit "said nothing about the Constitution or its bearing on subject-matter jurisdiction over bankruptcies."

Affirming the bankruptcy court's denial of the motion to dismiss, Judge Quattlebaum that that the "Committee may have another chance to renew that argument — at plan confirmation" and "will then have a final order to appeal."

The opinion is *Official Committee of Asbestos Claimants of Bestwall LLC v. Bestwall LLC (In re Bestwall LLC)*, 24-1493 (4th Cir. Aug. 1, 2025).

The Bestwall dissenter understands the Bankruptcy Clause as having the 18th century definition of 'bankruptcy,' thus requiring insolvency or inability to pay debts.

Bestwall Dissenting Opinion Reads Like Dismissal of *LTL Mgmt* for a Bad Faith Filing

Yesterday, we reported how the Fourth Circuit's 16-page majority in *Bestwall* decided that a chapter 11 debtor's solvency doesn't deprive the bankruptcy court of subject matter jurisdiction under 28 U.S.C. § 1334. In other words, filing a petition gives rise to jurisdiction simply because Section 1334 confers "original and exclusive jurisdiction of all cases under title 11."

Today, we report the 22-page dissent by Circuit Judge Robert Bruce King.

Recall that Bestwall was a creature of a Texas divisional merger where Georgia-Pacific split apart. Asbestos liability went to Bestwall, while parent Georgia-Pacific took most of the assets and gave Bestwall an undertaking to pay the expenses of Bestwall's chapter 11 case and to fund an asbestos trust to be created under a plan confirmed in accord with Section 524(g). Evoking *In re LTL Mgmt., LLC*, 64 F.4th 84 (3d Cir. Jan. 20, 2023), the majority hinted that solvency might result in dismissal for a bad faith filing, but not for lack of subject matter jurisdiction.

Respectfully dissenting, Judge King opened his opinion by saying that "the majority approves a legal maneuver that fundamentally departs from the central purpose of our Nation's bankruptcy system," which heretofore has provided "a 'fresh start' to the 'honest but unfortunate debtor.'" He said that Bestwall, the debtor, "is no such debtor" but was "an entity manufactured in a corporate boardroom, rather than amid a genuine financial crisis."

To the same effect, Judge King said,

> Bestwall entered bankruptcy not because it was financially distressed, but because its parent corporation, Georgia-Pacific, sought to evade tort liability for harm caused by decades of manufacturing and selling dangerous products containing asbestos . . . . In effect, a financially healthy company has placed its tort liabilities to thousands of workers behind a wall of bankruptcy protection, without itself undergoing the scrutiny, transparency, or risk that bankruptcy typically entails.

Later, Judge King said that the right of victims of asbestos exposure "to pursue justice through the tort system of the civil courts . . . has been put on hold by a solvent and profitable enterprise acting through a wholly manufactured bankruptcy proceeding."

Section 1334 Bends to the Bankruptcy Clause

After an opening statement that reads like dismissal for bad faith, Judge King turned to the question on appeal: Does the Bankruptcy Clause of the Constitution mean that insolvent companies alone are eligible for bankruptcy relief? Relevant factually, he noted that Georgia-Pacific paid a $2 billion dividend to its owner before filing and had assets worth $23.8 billion.

Judge King said that the "central flaw . . . in the majority's reasoning is its assumption that Congress's broad grant of jurisdiction under 28 U.S.C. § 1334 can override the Constitution's more limited delegation of power under the Bankruptcy Clause." He said that "Section 1334 does not — and cannot — independently determine what constitutes a 'case' that Congress may authorize under Article I."

By sidestepping the constitutional issue, Judge King said that "the majority permits bankruptcy jurisdiction to be extended to parties who are not actually bankrupt — and, in doing so, open the courthouse doors to a new kind of forum shopping by solvent corporations." Then, he turned to history.

"At the time of the Founding and for well over a century thereafter," Judge King cited authorities for the idea that "bankruptcy was available only to those who could not pay their debts." He said that a "debtor who could pay his debts, therefore, was not what the Founders would have ever considered 'bankrupt.'" As in England, he said that "solvent individuals simply had no claim to protection under such laws. They remained subject to the full force of the ordinary legal processes."

Alluding to the first federal bankruptcy statute adopted in 1800, Judge King said that it "provided no protection to debtors who remained able to meet their obligations." From relevant history, he said,

> Bankruptcy, as the Founders understood it, was meant for the financially distressed. It was never intended as a mechanism by which profitable enterprises could transform an honest but unfortunate debtor's shield into a sword for solvent corporations to cut down the rights of injured Americans.

"This historical understanding," Judge King said, "should constrain the modern interpretation of the [Bankruptcy] Clause and the permissible scope of federal bankruptcy jurisdiction." The clause "clearly refers to a legal regime designed only for insolvent debtors, not solvent corporations seeking to evade mass tort liability through complicated corporate restructuring."

"In sum," Judge King said,

> [O]ur history and tradition does not support the majority's extension of bankruptcy protections to solvent tort defendants who seek a strategic advantage over their creditors and victims. When bankruptcy is used in that manner, it departs not only from historical practice but from the constitutional limits of the Bankruptcy Clause itself.

Ending his opinion, Judge King said,

> [A]ny profitable business facing legal risk could simply offload its tort liabilities into a subsidiary or sister entity, file for bankruptcy, and invoke an automatic stay of litigation, not because it is unwilling or unable to pay its debts, but because it prefers to evade the scrutiny of a jury — as required by the Seventh Amendment — and shirk accountability for its civil wrongdoing.

Appearing to say he would have dismissed the chapter 11 case, Judge King said,

> The Bankruptcy Clause should not tolerate a system where a rich and powerful corporate defendant can invoke federal bankruptcy jurisdiction in order to suppress the tort claims of sick and dying victims and evade responsibility for harms caused.

Observations

Although Judge King was unable to persuade his colleagues about jurisdiction, it is difficult to imagine an opinion giving more reasons for dismissing a chapter 11 case as a bad faith filing, akin to the Third Circuit's dismissal in *LTL Management* for lack of "financial distress."

Judge King seems to have the view that Section 1334 was unconstitutional as applied to *Bestwall*. If so, is it a constitutional question, a jurisdictional question or a merits question, because he doesn't seem to say that Section 1334 is unconstitutional on its face?

Section 1334 creates federal jurisdiction for "all cases under title 11" and does not seem to be unconstitutional on its face, because title 11 deals with bankruptcies. The constitutional question thus points toward pertinent provisions in the Bankruptcy Code.

Regarding involuntary cases, Section 303(h)(1) seems to require insolvency because it provides that a petition may be filed "only if . . . the debtor is generally not paying such debtor's debts as such debts become due . . . ."

On the other hand, a voluntary petition may be filed under Section 301 "by an entity that may be a debtor under such chapter." Chapters 7, 11 and 13, generally speaking, say nothing about insolvency as a requisite.

Whether or not there's a general requirement for insolvency calls for looking at the words in Section 301 about an entity "that may be a debtor." In nonconstitutional terms, courts could address the merits by deciding whether financial distress or an equivalent is implied by use of the words "may be a debtor." Addressing the merits, courts could avoid the constitutional question of whether the Bankruptcy Clause requires insolvency.

The dissent raises the overriding question of whether constitutional powers granted to the federal government are confined to those within the contemplation of founders in the 18th century, or whether language employed 235 years ago can have modern meanings.

The opinion is *Official Committee of Asbestos Claimants of Bestwall LLC v. Bestwall LLC (In re Bestwall LLC)*, 24-1493 (4th Cir. Aug. 1, 2025).

The concurring opinion in Bestwall could be read to suggest that Circuit Judge G. Steven Agee might have an open mind if a confirmed plan comes to the Fourth Circuit on appeal.

Bestwall Concurrence Believes in 'Liberalization' of Bankruptcy Powers

In our previous two reports, we covered *Bestwall's* majority and dissenting opinions. The majority did not see insolvency as a condition to federal bankruptcy jurisdiction under Section 1334. The dissenter believes that the Constitution's Bankruptcy Clause demands insolvency to invoke bankruptcy jurisdiction.

Today, we cover the seven-page concurring opinion by Circuit Judge G. Steven Agee, who refuted the dissent's belief that the 18th century understanding of "bankruptcy" connotes insolvency in modern times.

Judge Agee began by saying that he "completely agree[d]" with the majority's holding that "'federal courts have subject-matter jurisdiction over bankruptcy cases filed by debtors who may be able to pay their obligations.'" He characterized the dissenter, Circuit Judge Robert Bruce King, as believing that "Congress exceeded its authority under the Bankruptcy Clause in crafting Section 1334" to permit filings by solvent entities.

Judge Agee cited the Supreme Court in 1935 as having said that the power of Congress under the Bankruptcy Clause is not limited by English or colonial law in effect at the time of the adoption of the Constitution. *Cont'l Ill. Nat. Bank & Tr. Co. of Chi. v. Chi., Rock Island & P. Ry. Co.*, 294 U.S. 648, 669 (1935). He quoted the Court for having said that "'the tendency of legislation and of judicial interpretation has been uniformly in the direction of progressive liberalization in respect of the operation of the bankruptcy power.'" *Id*. at 668.

More recently, Judge Agee said that the Supreme Court "reiterated that bankruptcy is difficult to define and includes 'nothing less than "the subject of the relations between [a] debtor and his creditors."'" *Siegel v. Fitzgerald*, 596 U.S. 464, 473–74 (2022).

Judge Agee said that the dissenter "fails to identify any historical precedent that — as a *jurisdictional* matter, lest we forget the question presented — applies to support its position." [Emphasis in original.] After 235 years, he thought "there would be at least one case supporting the dissent's vague view; but there are none."

Although chapter 9 requires insolvency, Judge Agee observed that "neither Chapter 7, Chapter 11, nor Chapter 13 includes such a requirement." Given the million cases under chapters 11 and 13 that have been filed in the last five years, he said that "all of these would be unconstitutional and therefore void" if the dissenter's analysis were to prevail.

Judge Agee read the dissent as "simply disagree[ing] with what has colloquially become known as the Texas Two-Step, which it characterizes as 'a corporate sleight-of-hand maneuver.'" He said that "the Texas Two-Step's validity is irrelevant in evaluating whether federal courts have subject-matter jurisdiction over bankruptcy cases filed by debtors who may be able to pay their obligations."

Judge Agee "fully concur[red]" with the majority opinion.

Observation

Among the three opinions, the concurrence by Judge Agee could be read as being most hospitable toward the debtor. Regarding the merits of the Texas Two-Step, he said, "that is a matter within the province of the Congress, not the judiciary."

Was Judge Agee suggesting that a Texas divisional merger gives rise to no offense requiring dismissal and no intentional fraudulent transfer?

In a footnote, he said that "the Committee has filed multiple challenges that have impeded progression to a plan and confirmation hearing." He criticized the committee, "in the eleventh hour," for having moved "to dismiss for lack of subject-matter jurisdiction."

In the same footnote, Judge Agee asked whether delay occasioned by the committee was calculated to raise "valid claims" or reflected a "desire for perceived higher attorneys' fees should the claims be removed and be adjudicated outside of bankruptcy." "Perhaps future review will answer that question," he said.

This writer lauds Judge Agee for not hinting at how he might rule on issues not yet before the court.

The opinion is *Official Committee of Asbestos Claimants of Bestwall LLC v. Bestwall LLC (In re Bestwall LLC)*, 24-1493 (4th Cir. Aug. 1, 2025).

Building on LTL Management (a/k/a Johnson & Johnson), a chapter 11 case was dismissed because the newly formed debtor was designed to rid the larger enterprise of 'toxic' leases for the benefit of equity holders.

Chapter 11 by a Newly Created Debtor Dismissed in Delaware for a Bad Faith Filing

Building on the Third Circuit's landmark decisions in *LTL Management (*a/k/a Johnson & Johnson*)* and *SGL Carbon*, Bankruptcy Judge J. Kate Stickles of Delaware dismissed a chapter 11 case as a bad faith filing when the debtor was created six days before bankruptcy "to take advantage of the provisions of the Bankruptcy Code" by capping lease-rejection damages "for the benefit of its shareholders, not to maximize the value for the Debtor's creditors."

The debtor's parent was formed in 2020 to purchase and lease sites to be used for manufacturing plants or laboratories. The original $2 billion in equity proved insufficient, but alternative financings did not come to pass. When new long-term financing was out of reach by mid-March 2025, the company was left with $100 million in cash, maybe three months of liquidity.

At that point, the company had two options: a chapter 11 reorganization for the entire enterprise, or a divisive merger under Section 18-217 of the Delaware LLC Act. A divisive merger would split the business into two parts, creating a good company and a bad company.

Deciding on a divisive merger, the bad company was given seven "toxic" leases plus $41.4 million in cash and receivables, among other assets. The bad company filed a chapter 11 petition in Delaware six days after formation. At the time, there were no defaults on the leases.

Immediately after filing, the debtor filed a chapter 11 plan where equity holders and all creditors would be unimpaired. There were no secured creditors. The plan would have reinstated equity holdings and paid landlords the full amount of their lease-rejection claims that aggregated about $32 million after being capped under Section 502(b)(6).

The U.S. Trustee and several landlords filed motions to dismiss the case for "cause" as a bad faith filing under Section 1112(b). Judge Stickles granted the dismissal motions for reasons explained in her 42-page opinion on August 29.

Third Circuit Law on Good Faith Filings

Citing and quoting *LTL Mgmt., LLC v. Those Parties Listed on Appendix A to Complaint (In re LTL Mgmt., LLC)*, 64 F.4th 84, 100 (3d Cir. 2023), Judge Stickles said that the "Third Circuit recognizes that a 'lack of good faith' constitutes cause for dismissal of a chapter 11 petition," and that the two factors "relevant to the good faith inquiry [are]: '(1) whether the petition serves a valid bankruptcy purpose' and '(2) whether [the petition] is filed merely to obtain a tactical litigation advantage.'" Of greatest renown, she quoted *LTL*, where the Third Circuit said, "A valid bankruptcy purpose 'assumes the debtor is in financial distress.'" To read ABI's report on *LTL*, click here.

LTL was a development from *Off. Comm. of Unsecured Creditors v. Nucor Corp. (In re SGL Carbon Corp.)*, 200 F.3d 154, 161–62 (3d Cir. 1999), where Judge Stickles cited the Third Circuit for holding that a "valid bankruptcy purpose includes preserving a going concern or maximizing the value of the estate."

Synthesizing *LTL* and *SGL*, Judges Stickles said, "A debtor who is not in financial distress cannot establish that its petition serves a valid bankruptcy purpose supporting good faith."

Newly Created Just for Bankruptcy

The debtor contended there was financial distress because the total lease liability before the cap was $372 million, vastly more than the assets. The debtor also argued that full payment of the capped lease claims would be a better outcome for landlords than a bankruptcy by the entire enterprise.

To the contrary, Judge Stickles found "that although the Debtor may have been allocated greater liabilities than assets, the financial health of the Debtor was not authentic, but rather structured, by design, by the [affiliates and equity holders] in conjunction with the [divisive merger] to facilitate the bankruptcy filing and jettison lease liabilities." More specifically, she found that the "toxic" leases and related guaranties were removed from the nondebtor affiliates and allocated to the debtor for "the benefit of its shareholders[,] not to maximize the value for the Debtor's creditors."

Judge Stickles pointed out that financing for the chapter 11 case was provided by shareholders "to take advantage of the Bankruptcy Code's redistributive provisions." She was unwilling to give "the benefits of the Bankruptcy Code provisions absent [a] bankruptcy filing" by all of the related companies. She therefore held that the "Debtor has failed to establish that this Chapter 11 Case serves a valid bankruptcy purpose."

Because the "Debtor was formed solely to file bankruptcy and rid the Enterprise of liabilities for the benefit of the Enterprise's shareholders," Judge Stickles also concluded that the filing was designed for a "tactical advantage."

Since a bankruptcy by the entire enterprise might entail a worse outcome, the debtor contended that dismissal was improper because Section 1112(b)(2) bars conversion "if the court finds and specifically identifies unusual circumstances establishing that . . . dismissing the case is not in the best interests of creditors and the estate . . . ."

Finding "no unusual circumstance [to] overcome the manufactured financial distress," Judge Stickles granted the motions to dismiss.

Question

Would bankruptcy courts in other circuits reach the same result?

The opinion is *In re Bedmar LLC*, 25-11027 (Bankr. D. Del. Aug. 29, 2025).

Given that chapter 7 has remedies like denial of discharge for a debtor's misconduct, bad faith in chapter 11 doesn't allow dismissal on conversion to chapter 7.

On a Split, Ninth Circuit BAP Holds: Misconduct in '11' Doesn't Prevent Conversion to '7'

On a question where the circuits are split, the Ninth Circuit Bankruptcy Appellate Panel hewed to Ninth Circuit precedent by holding that a debtor's bad faith in chapter 11 does not preclude the debtor from converting the case to chapter 7 under Section 1112(a). Even if the case already has been converted to chapter 7, the debtor's conduct in the prior chapter 11 case does not allow dismissal of the chapter 7 case under Section 707.

To put the BAP's rationale into a few words, chapter 7 has remedies like denial of discharge to account for a debtor's bad faith. Consequently, the existence of a statutory remedy for bad faith does not allow bad faith to represent "cause" for dismissal under Section 707, especially since chapter 7 can benefit creditors generally.

The Debtor's Misbehavior in Chapter 11

The individual debtor in chapter 11 had "failed to provide the type of complete disclosures contemplated by the Code," the BAP said in a nonprecedential, *per curiam* opinion on April 8. Despite being "repeatedly warned . . . that his case was subject to dismissal," the debtor persisted with "incomplete and conflicting disclosures."

The bankruptcy court entered an order directing the debtor to show cause why his case should not be converted or dismissed. Before the hearing, the debtor filed a request for conversion to chapter 7.

The court converted the case to chapter 7, but the conversion order directed the debtor to show cause why the chapter 7 case should not be dismissed. At the ensuing hearing, the bankruptcy court dismissed the chapter 7 case under Section 707(a).

The debtor appealed to the BAP.

Prior Ninth Circuit Authority

In pertinent part, Section 707(a) provides that the "court may dismiss a case under this chapter only after notice and a hearing and only for cause, including — (1) unreasonable delay by the debtor that is prejudicial to creditors . . . ."

The BAP described the bankruptcy court as having dismissed on "two related grounds: (i) that Debtor's conduct was an abuse of the bankruptcy process that qualified as 'cause' under § 707(a); and (ii) that Debtor's conduct qualified as 'unreasonable delay by the debtor that [was] prejudicial to creditors' under § 707(a)(1)."

In view of the subsequent decision by the Supreme Court in *Marrama v. Citizens Bank of Mass.*, 549 U.S. 365 (2007), the BAP was tasked with deciding whether it remained bound by two Ninth Circuit decisions, *Neary v. Padilla (In re Padilla)*, 222 F.3d 1184 (9th Cir. 2000); and *Sherman v. S.E.C. (In re Sherman)*, 491 F.3d 948 (9th Cir. 2007).

In *Padilla*, the Ninth Circuit held "that bad faith *per se* can properly constitute 'cause' for dismissal of a Chapter 11 or Chapter 13 petition but not of a Chapter 7 petition under § 707(a)." *Padilla*, *supra*, 222 F.3d at 1192-93.

In *Padilla*, the Ninth Circuit explained why bad faith was not available for dismissing a chapter 7 case: In chapters 11 and 13, the appeals court said that the debtor "retain[s] its assets [to] reorder its contractual obligations to its creditors. In return for these benefits, the debtor must approach its new relationship with the creditors in good faith." *Id*. By contrast, the circuit court said that chapter 7 "requires no ongoing relationship between the debtor and its creditors and should be available to any debtor willing to surrender all of its nonexempt assets, regardless of whether the debtor's motive in seeking such a remedy was grounded in good faith . . . ." *Id*.

In *Sherman*, the chapter 7 debtor's misconduct was misrepresentation of liabilities and expenses. The BAP characterized the circuit court as "holding that such misrepresentations did not provide 'cause' for dismissal under § 707(a)" because "§ 727(a)(4)(A) [denial of discharge for knowingly and fraudulently making a false oath] covered the specific conduct by the debtor."

In *Sherman*, the BAP characterized the Ninth Circuit as having "held that the proper remedy was to deny the debtor a discharge under § 727(a)(4)(A), not dismiss the case under § 707(a)."

With six circuits having held to the contrary, the BAP admitted that "*Padilla* represents a minority view" and that those circuits decided that bad faith is grounds for dismissal under Section 707(a).

Marrama

Marrama "complicat[es] our analysis," the BAP said. The panel described the Supreme Court in *Marrama* as having "held that the debtor's bad faith conduct with respect to his chapter 7 filing

precluded conversion to a chapter 13," in part because bankruptcy is reserved for honest but unfortunate debtors.

Later, the Supreme Court handed down *Law v. Siegel*, 571 U.S. 415 (2014). There, the BAP described the Court as holding that Section 105(a) "does not authorize courts to take action in contravention of the Code."

While there was no dispute that Section 707(a) controlled, the BAP said that "we must contend with *Marrama*" but decided "that we are bound by *Padilla* notwithstanding the Supreme Court's decision in *Marrama*."

To begin with, *Marrama* involved conversion from chapter 7 to chapter 13. The BAP mentioned how the Supreme Court "itself noted that allowing a chapter 7 debtor an absolute right to convert to a chapter 13 case would provide the debtor an opportunity to retake control of property of the estate and potentially 'take actions that would impair the rights of creditors.' *Marrama*, 549 U.S. at 375 n.13."

Similarly, the BAP noted how the Ninth Circuit in *Padilla* mentioned that, "unlike chapter 7, chapters 11 and 13 allow debtors not only to retain assets but to continue their relationship with creditors . . . . And, while chapters 11 and 13 explicitly invoke good faith as a requirement to plan confirmation, chapter 7 is silent with respect to good or bad faith."

Furthermore, there is a difference in the conversion statutes. The BAP said:

> Unlike § 707(a), § 1112(b) and § 1307(c) allow for dismissal **or conversion to a chapter 7 case** for cause. While this difference may seem elementary, it is integral to why conversions **to** chapter 7 are different from conversions **from** chapter 7. [Emphasis in original.]

The BAP decided that "these distinctions place *Padilla* beyond the holding of *Marrama,*" because "a chapter 7 case is itself a remedy to bad faith conduct in a chapter 11 or chapter 13 case, and because of the different relationship a chapter 7 debtor has with the estate as compared to chapter 11 and chapter 13 debtors." It was therefore "unlikely" that *Marrama* "overruled Padilla," the BAP said. Indeed, the BAP said, "*Law* actually bolsters the holding in *Padilla*."

Remaining bound by *Padilla*, the BAP saw "no meaningful distinction between the conduct at issue in this case and the conduct at issue in *Sherman*." Likewise bound by *Sherman*, the BAP reversed the bankruptcy court's holding that the debtor's misconduct in chapter 11 amounted to "cause" for dismissal under Section 707(a).

Section 707(a)(1)

The bankruptcy court also based dismissal on “unreasonable delay” under Section 707(a)(1).

The BAP once again observed “that chapter 7 contains alternative remedies for courts and parties in interest to police abuse by debtors” and that “dismissal of a chapter 7 case is an extraordinary remedy.” Furthermore, “§ 707(a)(1) does not specify whether ‘delay’ includes preconversion delay of the case under a different chapter.”

The BAP held “that Congress likely intended § 707(a)(1) to apply only to conduct that delays a chapter 7 case.” In other words, “the court must analyze whether the delay caused by the debtor delayed the **chapter 7** case, and whether such delay caused prejudice to creditors in the chapter 7 context.” [Emphasis in original.]

The BAP reversed and remanded for the bankruptcy court to determine “whether Debtor’s conduct caused unreasonable delay to the **chapter 7 case**.” [Emphasis in original.]

The opinion is *White v. U.S. Trustee (In re White)*, 24-1154 (B.A.P. 9th Cir. April 8, 2025).

Executory Contracts & Leases

The 'billing approach,' not the 'accrual approach,' decides whether there is a priority claim for personal property and real estate leases more than 60 days after filing.

Second Circuit Takes Sides on a Section 365(d)(5) Circuit Split

In a fine example of statutory construction taking sides on an issue where circuits are split, the Second Circuit concluded that the "billing approach" is the proper method for interpreting Section 365(d)(5).

When a chapter 11 debtor is subject to an unexpired lease for personal property, Circuit Judge Gerard E. Lynch held in his February 3 opinion that Section 365(d)(5) requires "the debtor to pay obligations once they come due under the operative lease, regardless of when the obligation can be said to have accrued." The holding has the effect of expanding the right to a priority claim.

The same rule presumably applies to real property leases covered by Section 365(d)(3).

Given the split of circuits, the decision is a prime candidate for a *certiorari* petition.

Brokerage Fees for Aircraft Leases

The chapter 11 debtor was an airline that, of course, leased aircraft. Before bankruptcy, a broker had arranged for the airline to lease 20 aircraft. To avoid having the airline pay the brokerage fees in full when entering into the leases, the leases characterized the brokerage fees as "additional rental payments" to be paid in a schedule over the term of the leases. The leases referred to the "additional rental payments" as "unconditional obligations" of the airline.

Once in chapter 11, the airline did not assume the leases. As required by Section 365(d)(5), the airline began paying the aircraft lessors 60 days after filing. However, the airline did not pay "additional rent" to the broker.

Over time, the airline eventually rejected all of the aircraft leases.

Not having been paid, the broker filed proofs of claim and a motion under Section 365(d)(5) to compel payment as priority claims. In pertinent part, the subsection provides:

> The trustee shall timely perform all of the obligations of the debtor, except those specified in section 365(b)(2), first arising from or after 60 days after the order for relief in a case under chapter 11 of this title under an unexpired lease of personal property . . . , until such lease is assumed or rejected . . . , unless the court, after notice and a hearing and based on the equities of the case, orders otherwise with respect to the obligations or timely performance thereof.

The airline objected to the motion to compel payment, contending that Section 365(d)(5) did not require payment as a priority claim because the broker performed no services after bankruptcy. Based on the "plain meaning" of the statute and "commercial realities," Bankruptcy Judge David S. Jones of New York ruled in favor of the broker and compelled payment of about $4.3 million. He discerned that the additional rent came due on the dates specified in the leases. *In re Avianca Holdings S.A.*, 20-11133, 2023 BL 26972, 2023 WL 494255 (Bankr. S.D.N.Y. Jan. 26, 2023).

The airline appealed, but District Judge Katherine Polk Failla affirmed. *In re Avianca Holdings S.A.*, 23-1211, 2023 BL 472816, 2023 WL 9016495 (S.D.N.Y. Dec. 29, 2023). To read ABI's report, click here.

District Judge Failla succinctly described Section 365(d)(3) as meaning that the debtor "must perform all of the debtor's obligations under any unexpired lease of personal property arising after the expiration of the sixty-day grace period until that lease is assumed or rejected — unless the court orders otherwise." Even more tersely, she said that "an obligation may be entitled to such priority if it 'aris[es]' after the bankruptcy filing."

The airline appealed to the circuit.

The Circuit Split on Section 365(d)(5)

Judge Lynch characterized the appeal as presenting "a single question: did [the airline's] obligation to pay the additional rental payments 'first aris[e] from or after 60 days after the order for relief in a case under chapter 11 of this title'?" As a question of statutory interpretation, he undertook *de novo* review.

Judge Lynch wrote his opinion to be intelligible for readers who know nothing about bankruptcy. With regard to executory contracts and leases, he explained that "the debtor is generally not required to make a decision about its executory contracts immediately after filing for Chapter 11, or even within any set time frame before plan confirmation." During the interregnum, he said, "creditors sit in limbo."

Lessors of nonresidential real property and personal property, Judge Lynch said, "are granted enhanced protections during the waiting period following the initial bankruptcy filing." He explained that "the debtor must resume making any contractually set payments that arise after a

certain period of time during the bankruptcy before the relevant lease is assumed or rejected, *regardless of whether the debtor is receiving a post-petition benefit*." [Emphasis added.]

Because the broker performed no services after filing, Judge Lynch said that the broker was not entitled to administrative claims under Section 503(b). The broker's "sole path to a priority claim here is through Section 365(d)(5)."

For the broker to have priority claims, Judge Lynch said that the broker must "show that [the airline's] obligation to pay the additional rental payments first arose at least 60 days after the petition date."

Judge Lynch described "a deep, pre-existing split of authority regarding the proper method for determining when a debtor's obligation arises." On one side of the fence is the "accrual approach," advocated by the airline, which "requires the debtor to pay only those obligations that accrued post-petition, irrespective of when those obligations come due under the operative lease."

The accrual approach, Judge Lynch said, has been followed by several bankruptcy and district courts in New York, along with the Seventh Circuit and the Tenth Circuit Bankruptcy Appellate Panel.

Espoused by the broker, the "billing approach" is on the other side of the fence. Judge Lynch said it "requires the debtor to pay obligations once they come due under the operative lease, regardless of when the obligation can be said to have accrued."

Judge Lynch cited the Third and Sixth Circuits plus the Eighth Circuit Bankruptcy Appellate Panel for adopting the billing approach, along with a decision by Justice Sonia Sotomayor when she was on the district court in New York.

Judge Lynch said that both approaches are "plausible" because "Section 365(d)(5) does not explicitly specify when an obligation can be said to have arisen."

The Billing Approach

To decide which approach to adopt, Judge Lynch found the answer in "two contextual clues." In the subsection, the words "timely perform" require "the existence of some presently existing duty that the debtor must fulfill." The word "obligations" refers to an act for which someone is legally bound.

From dictionaries, Judge Lynch said that the statutory language — "first arising from or after 60 days after the order for relief" — "is best understood as specifying that the duty the debtor must perform has to 'originate from' or 'come into being' under an unexpired lease of personal property 60 days after the order for relief or later."

"That is the 'billing date' approach," Judge Lynch said.

Judge Lynch said there is a "critical difference between when a creditor's claim arises and when a debtor's obligation arises, while [the airline's] position conflates them." Furthermore, he said that the airline's "approach would reimpose Section 503(b)(1)'s requirement that there be a post-petition benefit to the estate." He emphasized "that Section 365(d)(5) speaks in terms of the *debtor's obligations*, not the *creditor's claims*." [Emphasis in original.]

Judge Lynch noted how Section 365(d)(5) has different requirements for priority treatment than Section 503(b), because "365(d)(5) explicitly requires priority payment of the debtor's obligations first arising 60 days post-petition '*notwithstanding* section 503(b)(1) of this title.'" [Emphasis in original.] He added that Section 365(d)(5) "refocuses the relevant inquiry on whether the debtor has a performance obligation, instead of on whether the debtor receives a post-petition benefit."

Judge Lynch said that his reading "aligns with sound bankruptcy policy," as shown in the 1994 House Report, which he characterized as saying that the amendment "tip[s] the balance slightly in favor of creditor protection." In other words, "Section 365(d)(5) is best understood as a specific intervention that grants creditors under unexpired leases of personal property priority treatment, over other general unsecured creditors."

Judge Lynch ended his opinion by saying that the airline did not avail itself of "two safety valves." First, the debtor had a 60-day grace period when payments were not required. Second, the debtor could have petitioned "the bankruptcy court for a hearing to amend its payment obligations after the 60-day grace period elapses." The debtor, he said, "chose not to use either of the safety valves that Congress built into Section 365(d)(5)."

Judge Lynch affirmed the judgment of the district court.

The opinion is *Avianca Holdings S.A. v. Burnham Sterling & Co. LLC (In re Avianca Holdings S.A.)*, 24-255 (2d Cir. Feb. 3, 2025).

Once affirmed in the Ninth Circuit, the debtor could file a petition for certiorari to resolve an important circuit split on assumption of intellectual property contracts.

Circuits Are Split on Assuming a Franchise Agreement when the Franchisor Objects

Developing Ninth Circuit law, Bankruptcy Judge René Lastreto, II, of Fresno, Calif., ruled under the federal Lanham Act and California's Franchise Relations Act that a franchisee cannot assume a franchise agreement if the franchisor objects.

The corporate debtor owned and operated six fast-food restaurants under a franchise agreement. The debtor intended to confirm a chapter 11 plan and continue operating the restaurants by assuming the franchise agreement under Section 365(a). The debtor did not intend to assign or sell the assets or the franchise agreement. The debtor pledged to cure monetary defaults promptly and to demonstrate adequate assurance of future performance.

The franchisor objected to the debtor's motion to assume. The October 10 opinion by Judge Lastreto leaves the impression that the franchisor did not want the debtor to continue operating restaurants under its flag. However, the franchisor had identified a third party to whom the debtor could sell the locations with the franchisor's blessing.

The franchisor contended that Section 365(c)(1), combined with the Lanham Act and the CFRA, allows a franchisor to nix the assumption of a franchise agreement, even if the debtor does not intend to assign or sell the business. The subsection provides that a debtor or trustee

> may not *assume or assign* any executory contract . . . , whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties, if — (1) (A) applicable law excuses a party, other than the debtor . . . from accepting performance from or rendering performance to an entity other than the debtor . . . , whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties; and (B) such party does not consent to such assumption or assignment. [Emphasis added.]

The Two Tests

Judge Lastreto explained how the circuits are split on the interpretation of Section 365(c)(1). Under the so-called hypothetical test adopted in the Third, Fourth, Ninth and Eleventh Circuits, a

debtor may not even assume a contract if the trademark holder objects, because the subsection says that the debtor "may not assume *or* assign." [Emphasis added.] The Ninth Circuit authority is *Catapult Entertainment, Inc. v. Perlman (In re Catapult Enter.)*, 165 F.3d 747 (9th Cir. 1999).

Under the so-called actual test, the First and Fifth Circuits interpret the subsection to mean that a debtor may assume an agreement if the trademark holder objects, but may not assign the agreement over objection.

Judge Lastreto admitted that the "hypothetical test often has devastating effects on the ability of Chapter 11 debtors to reorganize, especially when a debtor franchisee depends upon maintenance of the franchise for any kind of reorganization." However, he said that "the Ninth Circuit has spoken to this issue unambiguously in *Catapult*, and the court is obligated to apply the hypothetical test to this case."

Significance of the Word 'Or'

Catapult barred assumption of a nonexclusive patent license, leaving Judge Lastreto to decide whether the hypothetical test also applies to franchise agreements covered by the Lanham Act and the CFRA.

Judge Lastreto found no controlling Ninth Circuit law to say whether federal trademark law qualifies as "applicable law" under Section 365(c)(1). However, a Nevada district court decision persuaded him to conclude that trademark law is "applicable law." *N.C.P. Mktg. Grp. v. Blanks (In re N.C.P. Mktg. Grp.)*, 337 B.R. 230, 236 (D. Nev. 2005), *aff'd* 279 Fed. Appx. 561 (9th Cir. 2008), *cert. denied*, 556 U.S. 1145 (2009).

Judge Lastreto held that the franchisor's "rights under the Lanham Act represent 'applicable law' that excuses [the franchisor] from accepting performance from or rendering performance to an entity other than [the debtor] under § 365(c)(1)." He reached the same conclusion regarding the CFRA.

Under the CFRA, he said that the "relevant question" was whether there was "a hypothetical third party to whom [the debtor] might be excused from accepting or rendering performance because such a hypothetical third party might not qualify for [the franchisor's] standards for approval under CFRA." Consequently, state law was an alternative ground for denying the motion to assume.

Judge Lastreto denied the debtor's motion to assume the franchise agreement.

Note

We reported a decision handed down in July by Bankruptcy Judge Mina Nami Khorrami of Columbus, Ohio, who took sides with the minority of circuits and predicted that the Sixth Circuit would adopt the "actual test" for Section 365(c)(1). Judge Nami Khorrami held that "the plain language of the statute" does not prohibit a debtor "from assuming an executory contract if it does not intend on assigning it." *In re Welcome Group 2 LLC*, 660 B.R. 874 (Bankr. S.D. Ohio July 10, 2024).

No appeal was taken from Judge Nami Khorrami's decision. In her opinion, she noted that a majority of bankruptcy courts follow the actual test. To read ABI's report on *Welcome Group*, click here.

Chances are the debtor in the case before Judge Lastreto will sell the business and moot the assumption question, obviating the possibility of bringing the circuit split to the Supreme Court on a petition for *certiorari*. Too bad. Circuit splits like this need to be resolved.

The opinion is *Pinnacle Foods of California LLC*, 24-11015 (Bankr. E.D. Cal. Oct. 10, 2024).

Venue, Jurisdiction & Power

Deciding a bankruptcy appeal, the Sixth Circuit deepened an existing circuit split on time limitations for Rule 60(b)(4) motions.

A Bankruptcy Case on Rule 60(b) Could End Up in the Supreme Court Next Term

A bankruptcy decision from the Sixth Circuit could result in a grant of *certiorari* to resolve a circuit split on a nonbankruptcy question: Is there any time limit under Rule 60(b)(4) to set aside a default judgment for lack of personal jurisdiction?

The circuits are split, with six circuits and the leading treatise saying there is no time limitation when a judgment was entered without subject matter or personal jurisdiction. Over a dissent, the Sixth Circuit is the only circuit believing that a motion to set aside a void judgment must be made within a "reasonable time."

The Default Judgment

A chapter 11 debtor filed an adversary proceeding to recover some $50,000 in unpaid invoices. The debtor mailed the summons and complaint addressed to the defendant at the corporation's address, but the papers were not addressed to any corporate officer because the corporation had listed itself as the agent for the service of process.

Eventually, the bankruptcy court entered a default judgment in favor of the debtor. The debtor's chapter 11 case was converted to chapter 7. Five years after entry of the default judgment, the trustee attached the defendant's bank account. Six years after the entry of judgment, the defendant moved under Bankruptcy Rule 9024 and Federal Rule 60(b)(4) to set aside the judgment.

The bankruptcy court never reached the question of whether the judgment was void for failure to address the papers to a corporate officer. Instead, the bankruptcy court denied the motion to void the judgment on the grounds that the delay in filing the Rule 60(b)(4) motion was unreasonable. The district court affirmed.

Rules 60(b) and 60(c)

Under Rule 60(b)(4), the court may relieve a party of a final judgment if "the judgment is void." With regard to the timing, Rule 60(c)(1) says that a "motion under Rule 60(b) must be made within a reasonable time — and for reasons (1), (2), and (3) no more than a year after the entry of

the judgment or order or the date of the proceeding." The one-year requirement does not apply to a Rule 60(b)(4) motion to set aside a void judgment.

The question is: Does the "reasonable time" requirement in Rule 60(c)(1) apply to a judgment that is void under Rule 60(b)(4), or is there no time limit to set aside a judgment that is void for lack of subject matter or personal jurisdiction?

There is no time limit to set aside a void judgment, according to the *Wright & Miller* treatise along with First, Fifth, Seventh, Ninth, Tenth and District of Columbia Circuits.

The Majority on the Panel

Unable to set aside a judgment that might have been void for lack of personal jurisdiction, the defendant appealed to the Sixth Circuit. On appeal, Circuit Judge Joan Larsen affirmed for a split panel in an opinion on July 26, once again making the Sixth Circuit the only Court of Appeals requiring void judgment to be set aside within a "reasonable time."

Citing Sixth Circuit precedent saying that a Rule 60(b)(4) motion must be filed within a "reasonable time," Judge Larsen said,

> Rule 60(c)(1) speaks in plain terms: "All" Rule 60(b) motions "must be filed 'within a reasonable time.'"

Judge Larson spent the bulk of her opinion rebutting arguments by the dissenter, Circuit Judge David W. McKeague. Among other things, she said that the Supreme Court's bankruptcy decision in *United Student Aid Funds, Inc. v. Espinosa*, 559 U.S. 260, 271 (2010), "did not consider whether the motion was timely under Rule 60(c)(1); it simply decided what kinds of defects make a judgment void within the meaning of Rule 60(b)(4)."

Judge Larson "acknowledge[d] that our circuit appears to be out of step with the majority view, which holds that Rule 60(b)(4) motions may be brought at any time," but she saw the panel as bound by prior Sixth Circuit precedent holding that the "plain terms" of Rule 60(c))(1) "impose[] a reasonable-time requirement on each of the enumerated grounds in Rule 60(b)." In her view, "a reasonable time limitation . . . comports with basic equitable principles."

The Dissent

"Respectfully" dissenting, Judge McKeague said that he "firmly" believed that "this Court should renounce that rule and join every other federal circuit in holding that the mere passage of time cannot render a void judgment valid." He said, "Courts have no power to enforce void judgments" because "the passage of time cannot render it valid."

Judge McKeague cited *Espinosa* for the proposition “that untimeliness alone cannot be the basis for denying a motion to vacate a void judgment.” He said he “would vacate the bankruptcy court’s determination that [the defendant’s] motion was untimely and remand for the court to consider whether the judgment was, in fact, void.” To his way of thinking, “[e]nforcement of a legal nullity is a true injustice. Where a judgment is void, it cannot stand.”

Observations

Based entirely on the rule, timeliness applies to motions under Rule 60(b)(4) even though the one-year limitation does not. Is the rule nonetheless unconstitutional as applied or beyond the rulemaking power when applied to a case like this?

Or, perhaps a Rule 60(b)(4) motion is timely no matter the length of the delay? Holding that a Rule 60(b)(4) motion is always timely would avoid reaching constitutional or rulemaking questions.

The opinion is *Burton v. Coney Island Auto Parts Unlimited Inc. (In re Vista-Pro Automotive LLC)*, 23-5881 (6th Cir. July 26, 2024).

Tomorrow, we deal with the divergent beliefs of Circuit Judges Ambro and Krause about state choice-of-law rules in bankruptcy cases.

Judge Ambro Writes a Treatise on a Board's Residual Authority During a Receivership

In three brilliant opinions totaling 88 pages, judges on the Third Circuit wrote treatises on three topics central to the administration of bankruptcy cases: (1) When, if ever, can appointment of a receiver deprive the corporate board of the authority to file bankruptcy; (2) do claims for successor liability belong to the debtor or to creditors; and (3) do state choice-of-law rules always govern in bankruptcy cases, or can there be circumstances where federal courts may craft choice-of-law rules in bankruptcy cases?

Today, we cover the unanimous opinion by Circuit Judge Thomas L. Ambro dealing with a corporate board's residual authority to file a bankruptcy petition following appointment of a receiver. In his September 10 opinion, Judge Ambro also confirmed existing Third Circuit authority for the proposition that claims for successor liability belong to the debtor, not to creditors.

Tomorrow and the day following, we will cover the concurring opinions by Judge Ambro and by Circuit Judge Cheryl Ann Krause on choice of law. Although all 53 pages of their opinions are *dicta*, they stake out opposing positions on the question of whether state choice of law always applies in bankruptcy cases. Their opinions are a plea for the Supreme Court to grant *certiorari* in an appropriate case and decide whether there sometimes can be federal choice-of-law rules in bankruptcy cases.

In the appeal before the Third Circuit, choice of law was not before the court because the parties agreed that New Jersey's choice of law governed.

The Talc Receivership

The debtors manufactured industrial minerals and chemicals, including talc. They sold all of their businesses in 2004 and agreed to indemnify the buyer for asbestos-related talc claims. After the sale, the relevant debtors were essentially shell companies.

Years later, the debtors were beset with asbestos claims, culminating in a $29 million verdict in a state court in South Carolina. The South Carolina judgment creditor immediately moved in the South Carolina court for appointment of a receiver.

The South Carolina court appointed a receiver with authority to “fully administer all assets” and to take “any and all steps to protect the interests” of the judgment debtor. Soon after appointment of the receiver, the judgment debtor filed a chapter 11 petition in New Jersey, where the debtor was incorporated. The debtor filed its petition without approval from or consultation with the receiver.

The receiver moved in the New Jersey bankruptcy court to dismiss the petition, contending there was no authority for the board to file the petition. The bankruptcy court declined to dismiss the petition, concluding that the receivership had not displaced the board. The district court affirmed on appeal, prompting the receiver’s appeal to the circuit.

Meanwhile in bankruptcy court, the debtor had filed an adversary proceeding and eventually won a judgment declaring that the debtor’s successor-liability claims against the buyer were estate property and not claims that creditors could prosecute individually. The bankruptcy court certified a direct appeal, which the circuit accepted.

The two appeals tasked the Third Circuit with deciding whether the board had authority to file bankruptcy after appointment of a receiver and whether successor-liability claims belonged to the debtor.

Jurisdiction

First, Judge Ambro dealt with subject-matter jurisdiction. He analyzed whether the bankruptcy court was deprived of jurisdiction if the board did not have authority to file bankruptcy, a question he raised because the Supreme Court could be read as having said in 1945 under the Bankruptcy Act that the bankruptcy court lacks jurisdiction if there was no authority to file. *Price v. Gurney*, 324 U.S. 100, 107 (1945).

Judge Ambro said that more recent Supreme Court cases “exercise greater care before hanging the ‘jurisdictional label’ on a statutory provision.” Today, he said, the standard “is an exacting one.” Under the latest authority, nothing “short of a clear indication” shows that “‘Congress imbued a procedural bar with jurisdictional consequences.’” *Boechler, P.C. v. Comm’r*, 596 U.S. 199, 203 (2022).

“The statutes granting federal courts jurisdiction over bankruptcy cases do not attach jurisdictional significance to the propriety of a debtor’s petition,” Judge Ambro said. Provisions like 28 U.S.C. § 157 do not “condition that grant [of jurisdiction] on a properly filed petition.”

Judge Ambro held that “an improperly filed bankruptcy petition constitutes ‘cause’ to dismiss a bankruptcy case, 11 U.S.C. § 1112(b)(1), but it does not strip bankruptcy courts of subject matter jurisdiction.”

Choice of Law Agreed

Turning to the board's authority to file a petition after appointment of a receiver, Judge Ambro said that "local law" controls a debtor's authority to file a petition in the absence of federal incorporation. "But," he said, "which state's law governs?" Was it South Carolina, where the receiver was appointed, or New Jersey, where the debtor was incorporated and the bankruptcy case was pending?

"Fortunately," Judge Ambro said, "the parties make answering this question easy," because they "agree that New Jersey law governs the authority of [the debtor's] board over its internal affairs, like petitioning for bankruptcy."

Although the parties had no dispute about choice of law, Judges Ambro and Krause used the opportunity to write *dicta* at length espousing their opposing positions regarding choice of law in bankruptcy cases, as we shall see tomorrow.

New Jersey Law on Receiverships

Judge Ambro said that New Jersey law recognizes that comity requires aiding a foreign receiver, but not to the disadvantage of New Jersey creditors. When there is a receiver appointed in another state, New Jersey law therefore permits appointment of an "ancillary receiver" so that assets will be administered alike for creditors in New Jersey and elsewhere.

Citing New Jersey statutes, Judge Ambro concluded that "New Jersey law permits its courts to recognize foreign receivership orders and appoint an ancillary receiver to aid in the execution of foreign judgments, including by enjoining the corporation and its board from taking specific actions and exercising specific powers."

Reading New Jersey law, Judge Ambro ruled that "the South Carolina Receiver needed to move for, and be granted, recognition in New Jersey and the appointment of an ancillary receiver to displace [the debtor's] board's control over, *inter alia*, the company's privileges, franchises and assets."

Because there was no ancillary receiver appointed in New Jersey, Judge Ambro held that the debtor's "board retained authority over those corporate decisions reserved to it by New Jersey law, including the decision whether to reorganize by filing for bankruptcy."

The Full Faith and Credit Statute

The receiver resisted the conclusion by pointing to the Full Faith and Credit statute, 28 U.S.C. § 1738. Judge Ambro dismissed the Section 1738 argument on three grounds.

First, the South Carolina receivership order gave the receiver authority over assets but not over "corporate affairs, including the board's authority under New Jersey law to decide whether to file for bankruptcy," Judge Ambro said.

Even if the receivership order did extend to corporate affairs, Judge Ambro said that the receiver was required to, but did not, employ New Jersey enforcement mechanisms by appointment of an ancillary receiver. The lack of an ancillary receiver was the second ground for deciding that the Full Faith and Credit statute did not apply.

Third, and "more fundamentally," Judge Ambro doubted the South Carolina court's ability to place the New Jersey debtor's corporate affairs in the hands of a South Carolina receiver as a matter of the Due Process Clause of the Fourteenth Amendment and its "limitations on state courts' authority to determine non-resident parties' rights," citing Supreme Court authorities from 1877 to 2021.

Judge Ambro quoted *Edgar v. MITE Corp.*, 457 U.S. 624, 645–46 (1982), for saying that "a state 'has no interest in regulating the internal affairs of foreign corporations.'"

Judge Ambro upheld the lower courts for concluding that the debtor's board retained the authority to file because "New Jersey law governs and sanctions the [debtor's] board's authority to petition for bankruptcy," and because the South Carolina "Receivership Order did not purport to divest that body of the authority to seek bankruptcy protection."

Ownership of Successor-Liability Claims

Concluding his opinion for the circuit, Judge Ambro upheld the lower courts' decisions that successor-liability claims belong to the debtor under *In re Emoral*, 740 F.3d 875 (3d Cir. 2014). For a claim to belong to the estate, he read *Emoral* to mean that the claim must have existed at the time of filing and that it was a "general" claim "with no particularized injury arising from it."

General claims, Judge Ambro said, are those based on facts generally available to any creditor. Personal claims, on the other hand, are specific to individual creditors and are claims in which other creditors "generally have no interest." He said that the successor-liability claims in *Emoral* belonged to the bankruptcy estate and not to individual creditors because the creditors did not allege any direct injury to them, nor demonstrate how any factual allegations were unique to them as compared to other creditors.

In the case on appeal, Judge Ambro said that the "talc claimants' injuries do not stem from the nucleus of facts that underlay [the buyer's] status as a successor to the Debtors," but rather "trace only to the exposure to asbestos-contaminated products manufactured by the Debtors at a time before [the buyer] was even in the picture."

"Those claims," Judge Ambro said, "are quintessentially 'general'" and belong to the estate. He upheld the judgments of the lower courts on two grounds: The South Carolina receivership did not divest the board of authority to file a bankruptcy petition, and the successor-liability claims belonged to the debtor.

Observation

If New Jersey law is emblematic of corporate law in other states, Judge Ambro's opinion seems to mean that courts in the state of incorporation alone have authority to divest a corporate board of authority to file a bankruptcy petition.

Note

The docket indicates that the official talc committee will be filing a motion for rehearing and rehearing *en banc*.

The opinion is *In re Whittaker Clark & Daniels Inc.*, 24-2210 (3d Cir. Sept. 10, 2025).

Third Circuit judges write dueling treatises on a choice-of-law issue that seldom arises in bankruptcy cases.

Third Circuit Judge Krause Believes State Choice of Law Always Applies in Bankruptcy

Yesterday, we reported on a Third Circuit opinion of practical significance in bankruptcy cases where Circuit Judge Thomas L. Ambro appears to have held that courts in the state of incorporation alone have authority to divest a corporate board of authority to file a bankruptcy petition, if New Jersey corporate law is representative of corporate law in other states.

From the same case, we next report two extraordinary concurring opinions by Circuit Judges Ambro and Cheryl Ann Krause that are *dicta* from top to bottom. On a question of almost purely academic interest, the two Third Circuit judges take divergent positions on whether state choice-of-law rules always apply in bankruptcy cases, or whether federal courts in some circumstances may devise their own standards to govern choice of law.

Both opinions read like treatises or casebooks on federal courts.

The Two Theories

Today, we report on the concurrence by Judge Krause, who believes that bankruptcy courts in all cases must follow the "forum state" rule about choice of law from a diversity case, *Klaxon Co. v. Stentor Elec. Mfg. Co.*, 313 U.S. 487 (1941).

However, Judge Krause began her concurrence by saying, "I join the majority opinion in full," because "New Jersey law governs the authority of [the debtor's] board to exercise corporate authority, and the South Carolina Court did not — and likely could not — unilaterally divest the board of that authority."

Judge Krause then said she wrote separately "to address which choice-of-law rules govern in bankruptcy — an issue that both looms in the background of this case and … has divided courts for decades." She explained the two theories: the "forum state" rule in *Klaxon*, and the federal common law choice of law. In the case on appeal, there was no dispute because the two theories "converge," since the forum state was New Jersey and the debtor was a New Jersey corporation.

The Split

Federal courts most often face choice-of-law questions when sitting in diversity jurisdiction. In bankruptcy cases, Judge Krause said that the Third Circuit has not taken sides, although other circuits have arrived at "differing conclusions" in a split that has existed "for decades."

Judge Krause said that the Eighth Circuit follows *Klaxon* in bankruptcy cases and applies the choice-of-law rules of the forum state, except when a federal interest requires a different result. In those cases, though, the Eighth Circuit believes it's not a choice-of-law question; rather, it's a rule of decision where federal law ousts state law.

The Ninth Circuit, and "possibly" the Fifth Circuit, Judge Krause said, reject *Klaxon* and require federal choice-of-law rules. The Second and Fourth Circuits employ a "hybrid approach" by applying *Klaxon* in the absence of a compelling federal interest.

Judge Krause devoted her 38-page opinion to explaining why "there is no basis to depart from the established rule from *Klaxon*, and, consistent with the Eighth Circuit's approach, any conflict-of-laws issue is properly resolved as a matter of rule of decision, not choice of law."

Reasons to Follow *Klaxon*

Judge Krause gave reasons for following *Klaxon*. First, she said that "parties find[ing] themselves wound up in a bankruptcy case should not work to alter the law that would otherwise govern their rights . . . . But adopting a choice-of-law rule unique to bankruptcy risks just that and would subject identically situated parties to different governing laws simply by virtue of one dispute occurring in bankruptcy court while the other unfolds in run-of-the-mill civil litigation."

Second, Judge Krause cited the work of "renown[ed] scholars." Third, extending *Klaxon* is consistent with *Erie R.R. Co. v. Tompkins*, 304 U.S. 64 (1938), and the Rules of Decision Act, 28 U.S.C. § 1652. When a provision in the Bankruptcy Code governs, "the Supremacy Clause obviates any choice-of-law analysis, for federal law always trumps conflicting state law."

Critiquing the Other Circuits

Aside from the Eighth Circuit, which follows *Klaxon*, Judge Krause explained why, in her view, the Second, Fourth and Ninth Circuits demonstrated "an unwarranted suspicion of *Klaxon*'s relevance beyond diversity cases." To begin with, federal jurisdiction "is not in itself a mandate" to follow federal law in all cases. By "reflexively employing a federal common law choice-of-law rule, the Ninth Circuit's approach risks altering parties' rights by selecting different law than would govern outside of bankruptcy."

In the Second and Fourth Circuits, Judge Krause said, there can be "exceptional cases" where a "compelling federal interest" requires a federal common law choice-of-law rule. Neither circuit,

she said, "has actually identified — much less confronted — such a situation." She said that *Butner v. United States*, 440 U.S. 48 (1979), "is not to the contrary."

Butner taught that property interests are defined by state law, unless a federal interest requires a different result. *Id*. at 55. Although *Butner* might seem to support the Second and Fourth Circuits, Judge Krause said, "*Butner* cannot reasonably be read to suggest that federal law provides the choice-of-law rule to decide among conflicting non-federal laws when it is those laws that provide the rule of decision."

Judge Krause summarized her critique of the other circuits as follows:

> [T]he Ninth Circuit's departure from *Klaxon* is misguided. As for the Second, Fourth, and Eighth Circuits, their approaches in practice always have, and always will, lead to the same result — *Klaxon* applies in bankruptcy, but federal law necessarily provides the rule of decision "when some federal interest requires a different result." [Citation omitted.] But by framing the question as choice-of-law instead of rule-of-decision and leaving the door open for a different choice-of-law rule in theory, the Second and Fourth Circuits invite needless litigation over *Klaxon*'s applicability and leave lingering uncertainty about which law will govern parties' disputes.

Judge Krause therefore believes that the "rule from *Klaxon* extends to bankruptcy cases." However, the "question of *Klaxon*'s applicability to bankruptcy has persisted for nearly 80 years."

Rather than "elide the question of which choice-of-law methodology to employ," Judge Krause saw a "responsibility not to perpetuate this uncertainty" but, "in the appropriate case, [to] resolve this question and give guidance to bankruptcy and district courts in our Circuit in a way that is consistent with the Bankruptcy Code, *Erie* and the Rules of Decision Act, and the policies underlying the grant[ing] of bankruptcy jurisdiction to federal courts."

Tomorrow

Tomorrow, we will report on Judge Ambro's concurrence with his own opinion where he differs from his colleague's belief that *Klaxon* should apply across the board in bankruptcy cases.

The opinion is *In re Whittaker Clark & Daniels Inc.*, 24-2210 (3d Cir. Sept. 10, 2025).

Judge Ambro reads Erie and Butner to mean there could be unusual cases where a bankruptcy court should apply federal choice-of-law rules and not state choice of law.

Circuit Judge Ambro Believes Bankruptcy Cases Could Use Federal Choice-of-Law Rules

Day before yesterday, we reported on the Third Circuit opinion where Circuit Judge Thomas L. Ambro held, among other things, that a "foreign" court's appointment of a receiver cannot deprive the corporate board of authority to file a bankruptcy petition. Yesterday, we recounted the concurrence by Circuit Judge Cheryl Ann Krause, who gave reasons in 38 pages of *dicta* for believing that *Klaxon Co. v. Stentor Elec. Mfg. Co.*, 313 U.S. 487 (1941), should require bankruptcy courts to implement the forum state's choice-of-law rules across the board.

Today, we report on Judge Ambro's concurrence with his own opinion. He was "uncomfortable" with Judge Krause's views and believes there could be cases in which *Klaxon* should not govern in bankruptcy cases.

Judge Ambro began his concurrence by describing how the Supreme Court decided in *Klaxon* that *Erie R.R. Co. v. Tompkins*, 304 U.S. 64 (1938), requires employing state choice-of-law rules in diversity cases. He then posed the question, "What force, if any, does *Klaxon* have in bankruptcy, where the parties' primary rights and interests are often governed by state law?"

In the case on appeal, Judge Ambro said that the circuit was not required to answer the question because the parties agreed that New Jersey law applied with regard to a receiver's capacity for depriving a corporate board of authority to file a bankruptcy petition. His concurring opinion was an analysis of what the circuit's answer would have been were there no agreement on choice of law.

Erie and *Klaxon*

Judge Ambro described *Erie* as standing for "three basic propositions." First, there is no federal general common law. Second, "without a federal statute or constitutionally authorized federal common-law rule, the Rules of Decision Act, 28 U.S.C. § 1652, commands federal courts to apply the rules of decision of their forum states 'in cases where they apply.'"

Third, when a federal rule like the Federal Rules of Civil Procedure conflicts with state law, Judge Ambro said that "the Rules Enabling Act, 28 U.S.C. § 2072, not the Rules of Decision Act

as construed by *Erie* and other cases, determines which law applies . . . . The Rules Enabling Act is also irrelevant for our purposes."

While *Erie* ended the idea of general federal common law, Judge Ambro said that "the Supreme Court has been unequivocal in recognizing that the *Erie* doctrine does not entirely displace federal common law." Citing Justice Brandeis in a decision handed down the same day as *Erie*, he said that "federal courts may still formulate special federal common law on issues of uniquely federal interest." *Hinderlider v. La Plata River & Cherry Creek Ditch Co.*, 304 U.S. 92, 110 (1938).

"Even after *Erie*," Judge Ambro said, "federal courts retain the power to promulgate special federal common-law rules when a strong federal interest requires such rules. Those cases, however, are rare."

The Circuit Split

Like Judge Krause, Judge Ambro laid out the circuit split. He described the Ninth Circuit as limiting *Klaxon* to diversity cases, thus requiring federal courts to apply federal choice-of-law rules in bankruptcy cases. He said that the Eighth Circuit "arguably held" that *Klaxon* applies in bankruptcy cases "without exception." The Second and Fourth Circuits "have held that *Klaxon* applies in federal bankruptcy proceedings unless a strong federal interest justifies creating federal choice-of-law rules as a matter of federal common law."

Explaining where he stood, Judge Ambro said,

> I believe that the Second and Fourth Circuits have it right. The Ninth Circuit is wrong because *Erie*, and thus *Klaxon*, is not limited to federal diversity jurisdiction. Whenever federal courts encounter an issue whose resolution is not a matter of federal law, the Rules of Decision Act compels them to use state substantive law, which includes choice-of-law rules. If the Eighth Circuit held that *Klaxon* applies without exception in federal bankruptcy cases, it is wrong as well.

"I believe it is wrong to conclude that *Erie* applies only in federal diversity cases," Judge Ambro said, because it applies to questions in federal court where the rule of decision is not federal law. He noted that questions arise in bankruptcy cases that are not based on federal law.

Agreeing with Judge Krause that "*Klaxon* applies in bankruptcy proceedings when addressing state-law questions," Judge Ambro said that the remaining question "is whether federal courts sitting in bankruptcy must *always* apply the forum state's choice-of-law rules when the underlying issue is governed by state law. That is where I part with our concurring colleague."

Addressing the five reasons underlying Judge Krause's analysis, Judge Ambro said that none of four "supports the claim that federal courts can never create choice-of-law rules in bankruptcy

— they support only the lesser claim that state choice-of-law rules will almost always apply." On that issue, he agreed.

Judge Ambro disagreed with Judge Krause's idea that "any federal interest strong enough to generate a federal choice-of-law rule would be explicit in the Bankruptcy Code itself; the absence of choice-of-law rules in the Code means there is never any such interest." He said that Judge Krause's "premise is faulty because it would apply with equal strength to the power of federal courts to create substantive common-law rules in bankruptcy."

The inability to craft substantive common-law rules in bankruptcy, Judge Ambro said, was rejected by the Supreme Court because *Butner v. United States*, 440 U.S. 48, 55 (1979), said, "'Property interests are created and defined by state law . . . [u]nless some federal interest requires a different result.'"

"At its core," Judge Ambro said, Judge Krause's "argument is merely that she cannot imagine a case in which a federal court would need to create a federal choice-of-law rule in bankruptcy. As she rightly notes, I cannot think of such a case either . . . . But this is not an argument that federal courts lack the authority to make choice-of-law rules in bankruptcy."

"If *Klaxon*'s application in bankruptcy becomes an issue," Judge Ambro said, he "would endorse the sensible, never-say-never approach of the Second and Fourth Circuits: Absent an 'overwhelming federal policy [that] requires us to formulate a choice-of-law rule as a matter of independent federal judgment, we adopt the choice-of-law rule of the forum state.'"

The opinion is *In re Whittaker Clark & Daniels Inc.*, 24-2210 (3d Cir. Sept. 10, 2025).

Reversing its prior decision after rehearing, the Third Circuit allowed a bankruptcy judge to interpret a confirmation decision made 12 years before by a district judge.

On Panel Rehearing, Third Circuit Permits Reopening a 22-Year-Old Case

Here's something you won't see again for years: The Third Circuit granted rehearing to reconsider a nonprecedential opinion handed down one year ago. In a split decision on August 22, the majority vacated last year's opinion and handed down a new decision with the polar opposite result. The majority reversed the prior opinion right down the line.

In his 32-page opinion for the majority, Chief Circuit Judge Michael A. Chagares broadened the ability of a bankruptcy court to reopen a chapter 11 case filed 22 years before. He also fortified the understanding of what a core proceeding is and the ability of a bankruptcy judge to interpret a confirmation order made by a different judge 15 years earlier. He even said that a bankruptcy judge has the right to interpret a decision by a district judge.

We will run three stories on the Third Circuit opinion. Today, we cover the circuit's opinion about the bankruptcy court's jurisdiction and discretion in reopening a chapter 11 case filed in 2003. Tomorrow, we will discuss the majority's conclusion that a finding in a 2010 confirmation order was *res judicata* and binding on a creditor.

On Monday, we will present the dissent by Circuit Judge Paul B. Matey, an interesting read. He describes the bankruptcy court as a "forum to assist federal judges . . . ."

Bankruptcy Court Finds *Res Judicata*

The debtor was a flooring manufacturer that had been operating since the 1880s. The products had contained asbestos. Facing almost 100,000 personal injury claims, the debtor filed a chapter 11 petition for the first time in 2003. The debtor had a former corporate sibling in the shipbuilding business.

As part of the plan for emerging from the first chapter 11 case, the debtor's insurer bought back its policies in a settlement that included an injunction barring anyone from bringing suit under the policies. As part of the settlement approved by the bankruptcy court, the debtor submitted a declaration saying that the shipbuilder had no responsibility for the asbestos claims.

After the settlement in bankruptcy court, the district court withdrew the reference and eventually confirmed a chapter 11 plan in 2010. The plan provided that confirmation would not release any liabilities under environmental law. The confirmation order nevertheless contained a finding that the shipbuilder had no liability for asbestos claims.

A neighboring landowner, whom we shall refer to as the creditor, had notice of the plan, the disclosure statement, the confirmation hearing and the confirmation order. The creditor did not appear at the confirmation hearing and did not object to the finding in the confirmation order that the shipbuilder had no asbestos liability. The plan went effective, and the district court referred the case once again to the bankruptcy court.

Seven years later in environmental remediation litigation, the creditor asserted claims against the shipbuilder.

The debtor filed a second chapter 11 petition in 2020 before a different bankruptcy judge. In the second bankruptcy, the shipbuilder filed an adversary proceeding against the creditor asserting that it had no environmental liability as a consequence of the finding in the 2010 confirmation order. Bankruptcy Judge Michael B. Kaplan of Trenton, N.J., granted summary judgment in favor of the shipbuilder, deciding that the shipbuilder's liability had been actually litigated in the first bankruptcy.

However, the creditor refused to dismiss the separate remediation suit against the shipbuilder. So, on motion by the shipbuilder, the bankruptcy court reopened the 2003 bankruptcy case, and the "old" case was transferred to Bankruptcy Judge Kaplan, who was presiding over the "new" case.

According to the majority opinion by Chief Circuit Judge Chagares, the bankruptcy judge decided that the shipbuilder's lack of liability was *res judicata* and bound the creditor as a consequence of the finding in the 2010 confirmation order. [Note: Throughout, Judge Chagares and the dissenter use the term *res judicata* rather than claim preclusion, so we shall also.]

The district court reversed on appeal, believing that the district court in the remediation litigation was in a better position to decide about the preclusive effect of the confirmation order. The first time around, the same Third Circuit panel affirmed in a nonprecedential opinion on August 1, 2024, by Circuit Judge Matey. To read the circuit's original opinion, click here. Judge Matey would become the dissenter after rehearing.

The shipbuilder moved for rehearing, which the panel granted and took under submission on June 12, 2025. With a dissent, the majority vacated the prior opinion on August 22 and reversed course. One of the judges on the original panel had taken inactive status. On the panel that heard reargument, he was replaced by Circuit Judge Cindy K. Chung.

Jurisdiction to Reopen

The majority first dealt with the bankruptcy court's jurisdiction and discretion to reopen the 2003 chapter 11 case.

On jurisdiction, Judge Chagares stated how the Third Circuit had "repeatedly held" that a bankruptcy court has jurisdiction to interpret its own orders. After confirmation, he said that bankruptcy courts retain "related to" jurisdiction over core matters like confirmation.

The creditor contended the bankruptcy court had no jurisdiction because the district court had entered the confirmation order. Judge Chagares rejected the argument, saying,

> [T]his distinction is of no significance because the District Court in this case entered the Confirmation Order while sitting in bankruptcy. Additionally, after the case was referred again to the Bankruptcy Court, it was the Bankruptcy Court, not the District Court, that was tasked with adjudicating the case.

Judge Chagares held that the "motion to reopen was plainly a core bankruptcy proceeding, which included disputes concerning the meaning of the Confirmation Order," because the shipbuilder had asked the Bankruptcy Court to "interpret and enforce" the confirmation order.

Notably, Judge Chagares rejected the creditor's contention that a later bankruptcy judge cannot reopen a case to interpret a different bankruptcy judge's order. He said, "The identity of the judge cannot be a jurisdictional prerequisite because the administrative needs of courts frequently require reassignment of cases."

Discretion to Reopen

Having found jurisdiction, Judge Chagares turned to the question of whether the bankruptcy court had abused discretion by reopening the 2003 case.

Judge Chagares observed that the bankruptcy judge had presided over a similar dispute in the newer case and that the district court had "no particular familiarity with the issues." He dismissed the idea that there was no reason to reopen the case when the outcome would not affect the debtor's estate. He said there was cause to reopen for the interpretation and enforcement of a previously approved settlement and confirmation order.

Judge Chagares found no abuse of discretion in the bankruptcy court's "well-reasoned decision to reopen bankruptcy proceedings."

Tomorrow

Tomorrow, we shall report on the majority's decision that the confirmation finding in 2010 was "*res judicata*" and bound the creditor.

The opinion is *In re Congoleum Corp.*, 23-1295 (3d Cir. Aug. 22, 2025).

The majority on a Third Circuit panel decided that a confirmation order many years earlier prevented one nondebtor from suing another nondebtor on an issue that wouldn't affect the debtor's estate but did entail interpreting the confirmation order.

Third Circuit: Confirmation Order Was *Res Judicata* Between Third Parties

Yesterday, we reported the Third Circuit's 2/1 decision on August 22 upholding the bankruptcy court's jurisdiction and exercise of discretion in reopening a 2003 case to interpret and enforce a chapter 11 confirmation order entered by a *district court* in 2010.

The debtor's chapter 11 plan and confirmation order in 2010 dealt with asbestos liability. The confirmation order included a finding that the debtor's affiliate, a shipbuilder, had no liability for asbestos. Years later, a creditor sued the shipbuilder to share the cost of asbestos remediation.

The bankruptcy court in the debtor's second bankruptcy reopened the 2003 case and decided that the 2010 confirmation order was *res judicata* and barred the creditor's assertion of remediation costs against the shipbuilder.

Today, we deal with the portion of the majority opinion by Chief Circuit Judge Michael A. Chagares concerning *res judicata*. [Note: Both Judge Chagares and the dissenter use the term *res judicata*, not claim preclusion, and so shall we.]

Sufficient Notice

The creditor contended it had not received adequate notice and that *res judicata* therefore could not apply. The creditor asserted that its nine boxes of records from the 2003 bankruptcy did not contain the motion to approve the settlement in which the shipbuilder was held to have no asbestos liability. However, the debtor's application for the settlement showed the creditor on two different service lists.

Judge Chagares found that "the record establishes by a preponderance of the evidence that [the creditor] was served with the motion for approval" of the settlement and the settlement order.

The creditor conceded that it had notice of the plan, the disclosure statement, the confirmation hearing and the confirmation order but argued that notice of the finding was not "conspicuous." To the contrary, Judge Chagares said that a "review of the draft Confirmation Order, which

included the [finding of no liability], would have alerted [the creditor] to the fact that the . . . Settlement included a determination of [the shipbuilder's] liability."

Judge Chagares said that the creditor's due process rights were "more than satisfied."

The Finding Covered Environmental Liabilities

Next, Judge Chagares addressed the question of whether the confirmation finding bound the creditor in the later remediation litigation because the finding said nothing about environmental liabilities. He quoted the finding, which said that the shipbuilder had "no responsibility for any of the liabilities of" the debtor. He went on to say that the finding was "not a third-party release but rather a determination that [the shipbuilder] was never responsible for the [debtor's] liabilities." He noted how the finding never used the word "release," and that the plan explicitly said there were no third-party releases.

Judge Chagares decided that the circuit "must enforce the Confirmation Order's plain, unambiguous meaning: [the shipbuilder] inherited none of the [debtor's] liabilities."

Res Judicata Applied

Having held that the confirmation finding was binding on the creditor, Judge Chagares analyzed whether it was *res judicata*. Quoting the Third Circuit, he said that *res judicata* applies to "'(1) a final judgment on the merits in a prior suit involving (2) the same parties or their privies and (3) a subsequent suit based on the same cause of action.'" Quoting the Supreme Court, he said that "no party may 'relitigat[e] issues that were or could have been raised in' an action resulting in 'a final judgment on the merits of the action.'"

Judge Chagares said that the creditor was a party in the bankruptcy proceedings and "had an opportunity" to litigate the finding, which became a final judgment binding on all creditors. He added that "the application of *res judicata* to confirmation orders occupies a position of 'high importance in the bankruptcy context' because all parties must be able to rely on a confirmation order without worry[ing] that the order is subject to change following post-confirmation challenges by dissatisfied creditors."

Because it was a creditor with notice, Judge Chagares said that the creditor's "lack of participation is irrelevant; 'a confirmation order is *res judicata* as to all issues decided or which could have been decided at the hearing on confirmation.'" He added that the finding in the confirmation order "resolved the same issue" as the one raised in the creditor's remediation lawsuit.

Judge Chagares held that the finding in the confirmation order "thus binds [the creditor] and has *res judicata* effect." He summarized the majority's holdings as follows:

> The Bankruptcy Court did not err in exercising its jurisdiction to reopen the bankruptcy case because it was asked to interpret and enforce the Confirmation Order, which was entered by a court sitting in bankruptcy. Because the . . . Finding conclusively determined that [the shipbuilder] did not inherit the liabilities of the [debtor] and was a final order binding [the creditor], which had notice of the confirmation and . . . Settlement proceedings, the Bankruptcy Court also did not err in holding that the . . . Finding barred [the creditor's] claims against [the shipbuilder].

On Tuesday, we cover the dissent.

The opinion is *In re Congoleum Corp.*, 23-1295 (3d Cir. Aug. 22, 2025).

The dissenter on rehearing believes there are narrow grounds for reopening a closed bankruptcy case.

Third Circuit Dissenter Says that Bankruptcy Judges 'Assist' Article III Judges

Third Circuit Judge Paul B. Matey dissented from his colleagues who held that a *bankruptcy judge* more than a decade later had the jurisdiction and authority to interpret and enforce a confirmation order signed by a *district judge* after withdrawal of the reference. Remember, the majority had granted panel rehearing and basically reversed a nonprecedential opinion from the year before.

Judge Matey said the panel "reconsidered when a few academics warned the sky was poised to fall." The sky had not fallen, "but still the panel changes course and empowers a congressionally created adjudicative body to wrest jurisdiction from an Article III court."

Judge Matey "respectfully" dissented because "Congress created the bankruptcy forum to assist federal judges, not usurp the Article III prerogative.

The Historical Power to Reopen

Judge Matey traced the history of the bankruptcy court's power to reopen closed cases and said that Congress did not write "on a clean slate" in 1978 with the adoption of the Bankruptcy Code. He began with the Bankruptcy Act of 1898 and said it allowed reopening a case that had not been "fully administered."

In 1938, the reopening power was expanded to allow reopening for "cause shown." "But broader did not mean boundless," Judge Matey said, "and interpretations soon agreed that cause existed when the bankruptcy estate had not been fully administered — much the same circumstances under which reopening was authorized under the 1898 Act."

Consequently, Judge Matey said, "courts allowed reopening when a debtor concealed assets in the bankruptcy or the assets were previously unreachable." In 1973, he explained, the Bankruptcy Rules added "other good cause," a concept carried over in the 1978 Bankruptcy Code. However, he interpreted the advisory committee's note to mean that "the drafters saw no need to expand the reopening power or remove its connection to administration of the bankruptcy estate, acting narrowly to clarify that reopening was proper to provide relief to the debtor."

"In sum," Judge Matey said, "section 350(b) incorporates the unbroken understanding of a restricted reopening power recognized for nearly ninety years." Section 350(b) provides, "A case may be reopened in the court in which such case was closed to administer assets, to accord relief to the debtor, or for other cause.

More Recent Precedent

"Our precedent does not disturb this conclusion," Judge Matey said. For instance, he said, "we have affirmed bankruptcy reopening for other cause under section 350(b) . . . to ensure [that] active state court actions did not intrude on federal bankruptcy cases."

However, Judge Matey said, "those cases cannot be read to countenance a bankruptcy judge wresting jurisdiction from an Article III court competent and capable of interpreting an order collateral to the bankruptcy."

Judge Matey also disagreed with the majority's belief "that the Bankruptcy Court was 'best suited' to consider the motion to reopen." The 2010 confirmation order, he said, "was entered by the District Court exercising its supervisory authority over the bankruptcy judge following a series of errors, leaving the trial judge well-suited to confirm its meaning."

In conclusion, Judge Matey said,

> Today's result stymies the District Court's constitutional and statutory authority while commanding future judges to make way for the "experts." Congress did not promote such protectionism from Article III officials and "the word 'cause' is too weak a reed upon which to rest so weighty a power." *Czyewski v. Jevic Holding Corp.*, 580 U.S. 451, 466 (2017).

Observations

In a footnote citing the withdrawal power of the district court under 28 U.S.C. § 157(d), the majority said, "we respectfully disagree with our dissenting colleague that our holding permits bankruptcy courts to usurp the Article III authority of district courts."

Prof. Ralph Brubaker provided ABI with the following commentary:

> Neither a bankruptcy court nor a district court sitting in bankruptcy can make a factual finding on a third-party claim between two nondebtors, much less enter a binding judgment on that claim, if that claim was never asserted in a way that would actually invoke the court's subject-matter jurisdiction over that claim, *i.e.*, by filing an adversary proceeding that names and serves the party against whom that third-party claim is being made. Bankruptcy discharge is an exception to that principle,

but the panel majority in the *Congoleum* case explicitly held that the confirmed plan did not purport to "release" or discharge the claim at issue.

Prof. Brubaker is the James H.M. Sprayregen Professor of Law at the University of Illinois College of Law.

The opinion is *In re Congoleum Corp.*, 23-1295 (3d Cir. Aug. 22, 2025).

A per curiam decision from the Seventh Circuit raises the question of whether Truck Insurance overruled 'person aggrieved' sub silentio.

Seventh Circuit Dismisses Based on 'Person Aggrieved' Without Citing *Truck Insurance*

Employing the "person aggrieved" standard for appellate standing, an opinion from the Seventh Circuit could be cited for the principle that an owner of a limited liability corporation has no standing to appeal the LLC's conversion from chapter 11 to chapter 7.

The Seventh Circuit's nonprecedential opinion raises the question of whether the Supreme Court's *Truck Insurance* decision last term silently overruled "person aggrieved."

Companion Chapter 11 Cases

An individual owned an LLC. Evidently, the individual and the LLC were insolvent, and both filed chapter 11 petitions. The owner and the LLC were represented by the same counsel, and the cases were substantively administered.

A creditor filed a motion to convert both cases to chapter 7, followed by motions for summary judgment in both cases. The LLC and the owner both opposed summary judgment in their own cases.

The *per curiam* opinion from the Seventh Circuit on October 23 says that the owner did not join the LLC's opposition to summary judgment, nor did the owner file an opposition to summary judgment in the LLC's case.

The bankruptcy court converted the LLC's case to chapter 7. The owner appealed, but the district court dismissed the appeal for the owner's lack of standing. The owner appealed to the circuit.

'Person Aggrieved' Lives in the Seventh Circuit

Addressing the merits, the appeals court began by citing and quoting decisions from the Seventh Circuit in 2010 and 2006:

> "Bankruptcy standing is narrower than Article III standing"; only a person "aggrieved" by an order of the bankruptcy court can appeal it.

The panel said that the owner had standing under the "person aggrieved" standard only if he had objected to conversion of the LLC's case and was "affected pecuniarily" by conversion. Even if the owner had appeared and opposed conversion of the LLC's case, the panel said he "lack[ed] standing to appeal for the reason that the order did not pecuniarily affect him."

Citing and quoting a Seventh Circuit opinion from 1998, the panel said, " An order pecuniarily affects him only if it diminishes his property, increases his burdens, or impairs his rights." Once again quoting the 1998 decision, the panel went on to say, "This rule limits appeals to 'only those persons whose interests are directly affected by a bankruptcy order to appeal.'"

The owner contended that he was directly affected because he lost his interest in the LLC's assets. The panel said that "he is incorrect," because the LLC's "property, rights, and burdens are legally distinct from" the owner's. In short, "the conversion order had no direct pecuniary effect on him," the panel said.

Nonetheless, the owner might have retained an interest in the LLC had it reorganized in chapter 11. The panel dispensed with the argument by saying that the "liquidation of [the LLC's] assets in Chapter 7 did not diminish the value of [the owner's] interest in those assets — the company's insolvency already did that."

The panel affirmed dismissal of the appeal, saying that injuries must be "imminent" and not "conjectural" to confer standing. "[W]ithout a pecuniary loss from the conversion order itself, [the owner] lacked standing to appeal it."

Observations

The panel does not cite *Truck Insurance Exchange v. Kaiser Gypsum Co.*, 602 U.S. 268 (2024), the Supreme Court's pronouncement on June 6 about standing in bankruptcy cases. *Truck Insurance* involved Section 1109(b), which gives standing in a chapter 11 case to 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." [Emphasis added.]

The unanimous Court in *Truck Insurance* said that the "text is capacious" and that "parties in interest" refers "to entities that are potentially concerned with or affected by a proceeding." *Id.*, 602 U.S. at 271, 276. To read ABI's report on *Truck Insurance*, click here.

Truck Insurance would mean that the owner indeed had standing in the bankruptcy court to oppose conversion of the LLC's case because he was the equivalent of an equity security holder. It is not clear whether *Truck Insurance* means that parties with standing in bankruptcy court always have standing to appeal anything that happens in a chapter 11 case. It is also unclear whether *Truck*

Insurance effectively overrules "person aggrieved," because the Court did not mention "person aggrieved" even once.

This writer believes that *Truck Insurance* should be read as having overruled "person aggrieved," *sub silentio*.

The insurance company's financial rights in *Truck Insurance* were not impaired by the debtor's chapter 11 plan, but the insurance company wanted the plan to be more favorable to it. If the "person aggrieved" standard were alive and well, the Supreme Court would not have heard the case.

In the comment box below, we invite readers to opine on whether *Truck Insurance* overrules "person aggrieved."

The opinion is *Young v. Lake County Treasurer*, 24-1415 (7th Cir. Oct. 23, 2024).

Delaware's Bankruptcy Judge Goldblatt explains why the Supreme Court's Truck Insurance opinion says nothing about Article III constitutional standing.

Opposing Relief, a Creditor Isn't Required to Show Constitutional Standing

The most important decision so far about the meaning of the Supreme Court's *Truck Insurance* opinion comes from the pen of Delaware Bankruptcy Judge Craig T. Goldblatt.

In his June 6 opinion, Judge Goldblatt explained why the Supreme Court's decision one year ago about Section 1109(b) was not an opinion about constitutional standing under Article III. Although explaining why a "party in interest" in a bankruptcy case is not required to demonstrate constitutional standing, he scribes boundaries to show when the court is not required to hear from someone who "truly is a stranger to the issue and appears to be pressing the objection for strategic advantage."

To read ABI's report on *Truck Insurance Exchange v. Kaiser Gypsum Company, Inc.*, 602 U.S. 268 (June 6, 2024), click here.

Article III Standing

The corporate debtor was seeking approval of a disclosure statement and voting procedures aimed at confirming a chapter 11 plan dealing with mass tort talc claims. Having proposed a plan that was insurance-neutral, the debtor and the official creditors' committee challenged the insurers' standing to assert objections to the disclosure statement and voting procedures.

Judge Goldblatt first dealt with the question of whether the insurers were required to demonstrate constitutional standing under Article III. He noted that "*Truck Insurance* itself never even discusses the question of Article III standing."

Judge Goldblatt said that the lack of discussion of constitutional standing was "unsurprising" because "only the party invoking the jurisdiction of a federal court — the one that is seeking relief — needs to have Article III standing." As a result, he said, "The question of who may be heard to oppose the relief sought poses no constitutional issue."

As the proponent of the disclosure statement and voting procedures, Judge Goldblatt said that the debtor had constitutional standing given its "concrete stake in the relief it is seeking." "How

and whether the court will consider an *opposition* to the relief being sought therefore does not present an Article III question," he said. [Emphasis in original.]

By analogy, Judge Goldblatt pointed to the Supreme Court's statement that "an intervenor of right must have Article III standing in order to pursue relief *that is different from* that which is sought by a party with standing." [Emphasis added.] *Town of Chester, NY v. Laroe Estates, Inc.*, 581 U.S. 433, 440 (2017). It "follows," he said, "that an intervenor that seeks the *same* relief as an existing party need not establish its separate constitutional standing." [Emphasis in original.]

Summing up constitutional standing in the case at hand, Judge Goldblatt said that the debtor supplied Article III standing and that the insurers were "essentially" defendants only opposing relief sought by the debtor. The insurers, he said, were not required to demonstrate standing because they were "not the party that is invoking this Court's jurisdiction by seeking relief."

Prudential Standing Is No More

The committee contended that prudential standing was an additional requirement that the insurers could not satisfy. Citing *Lexmark Int'l Inc. v. Static Control Components, Inc.*, 572 U.S. 118, 126 (2014), Judge Goldblatt explained why prudential standing "is a point that was once true but no longer is."

Lexmark "marked the death knell of the 'prudential standing' doctrine," Judge Goldblatt said.

In a bankruptcy case, Judge Goldblatt said that Section 1109(b) specifies that a "party in interest" may appear and be heard. "Once an objector is found to be a party in interest, there is no authority for courts to construct further obstacles to the party's participation," he said.

Outer Boundaries of 'Party in Interest'

Judge Goldblatt did not read *Truck Insurance* as "an invitation for parties without a legitimate interest in the bankruptcy case to weaponize the right to participate for improper purposes." For instance, he said that a disappointed bidder "generally" lacks standing to challenge a sale, except when contesting the "intrinsic fairness" of the sale.

As parties in interest, Judge Goldblatt said that the insurers had the right to lodge an objection to the timing of the confirmation hearing. The solicitation procedures, he said, "present a closer question," because an objector may assert its own rights but not those of others. He added, "[A] case can certainly be made that insurers do not have a legitimate interest in a plan's solicitation and voting procedures."

Judge Goldblatt decided to entertain the insurers' objections about plan solicitation given his "independent obligation to assure [himself] of the propriety of the orders [he] is being asked to enter . . . when the basic fairness and integrity of the judicial proceedings are at issue."

In the case at hand, Judge Goldblatt said he was "duty bound to ensure that the process [he] is superintending is an appropriate one," but that "does not mean that the party can hijack the proceeding or make it substantially longer or more expensive."

Judge Goldblatt overruled the insurers' objections, listing three principles: (1) In a close case, the court should err on the side of considering an objection; (2) the court may treat an application as uncontested if the objector is "truly a stranger to the issue and appears to be pressing the objection for strategic advantage," and (3) when the issues "bear on the fundamental fairness or integrity of the bankruptcy process, courts should address the merits without regard to whether the issue is presented by a 'party in interest' with standing to raise the objection."

The opinion is *In re AIO US Inc.*, 24-11836 (Bankr. D. Del. June 6, 2025).

Did the notion of 'prudential standing' in bankruptcy cases survive Truck Insurance?

Constitutional and Prudential Standing Survived *Truck Insurance*, Judge Kinsella Says

The Supreme Court held last term in *Truck Insurance* that a broadly defined party in interest under Section 1109(b) has the right to appear and be heard in a chapter 11 case. Bankruptcy Judge Wendy A. Kinsella of Syracuse, N.Y., interpreted the decision to mean that a Section 1109(b) party in interest will not have standing in a chapter 11 case without also satisfying the demands of prudential standing and Article III constitutional standing.

Like *Truck Insurance*, the case before Judge Kinsella involved insurance companies. Specifically, the debtor was a Catholic diocese dealing with sexual abuse claims in a chapter 11 reorganization.

With a plan on the table, insurers sought discovery, but the debtor contended that the insurance companies lacked standing because they have "not acknowledged or been found to be financially responsible for the survivors' claims," Judge Kinsella said in her December 9 opinion.

According to Judge Kinsella, the plan proponents contended that the insurers had no standing to undertake discovery without demonstrating that they would "suffer a concrete and particularized injury in fact that is actual and imminent, not speculative, as a result of plan confirmation." The plan proponents also took the position that the insurers "cannot object to confirmation on the ground that a plan infringes upon the rights of another non-objecting party."

Of course, the outcome would turn mostly, if not entirely, on *Truck Insurance Exchange v. Kaiser Gypsum Company, Inc.*, 602 U.S. 268 (June 6, 2024). To read ABI's report, click here.

Standing Under *Truck Insurance*

To rule on the insurers' standing to take discovery, Judge Kinsella first analyzed whether the insurance companies were "parties in interest" under the Supreme Court's interpretation of Section 1109(b) in *Truck Insurance*. The subsection gives standing in a chapter 11 case to 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."

Quoting the Supreme Court, Judge Kinsella said, "The inquiry of whether an entity is a party in interest is 'whether the reorganization proceedings might affect a prospective party, not how a particular reorganization plan actually affects that party.'" *Id.* at 283.

Although the insurers had not admitted liability, Judge Kinsella pointed out that the debtor had asserted that the insurance companies had financial responsibility, had filed an adversary proceeding claiming breach of contract, and had banked on assigning the insurance policies to the trust to be created under the plan.

Finding "that liability does not need to be acknowledged or adjudicated before the teachings of *Truck* apply," Judge Kinsella held that *Truck Insurance* was "directly on point [and that the insurers] are parties in interest in this case under § 1109(b) and *Truck*."

Constitutional and Prudential Standing Survived

Finding the insurers to be parties in interest "does not end the analysis," Judge Kinsella said. She went on to say,

> [N]either § 1109(b) nor the *Truck* holding satisfies or replaces constitutional and prudential standing requirements. In bankruptcy court, a party must satisfy (1) Article III Constitutional standing; (2) federal court prudential standing; and (3) the party in interest standing under § 1109(b).

The failure of the Supreme Court to discuss constitutional or prudential standing was not "an implicit rejection of these requirements," Judge Kinsella said. Believing that *stare decisis* applied because *Truck Insurance* was "void of any reference to Article III and prudential standing," the judge found herself required to "follow the existing Second Circuit precedent which not only requires party in interest standing, but constitutional and prudential standing as well."

Citing bankruptcy court decisions predating *Truck Insurance*, Judge Kinsella said that the Court's new pronouncement did "not overturn well established precedent recognizing that while '[a] party in interest may object to confirmation of a plan, 11 U.S.C. § 1128(b), it cannot challenge portions of the plan that do not affect its direct interests.'"

Acknowledging that she was citing precedent that "predates *Truck*," Judge Kinsella said that the authorities were "consistent with the Supreme Court's stated intention to allow the [insurers] a full and fair opportunity to be heard without allowing them to derail the confirmation process."

Constitutional and Prudential Standing Sometimes Satisfied

Having established that the concepts of constitutional and prudential standing still apply, Judge Kinsella turned to the question of whether the insurers met those standards.

Constitutional standing, or Article III standing, Judge Kinsella said, is "very generous" and requires only a "trifle" of injury. Generally, she said, a party in interest will also have constitutional standing.

In the diocese case, the insurers were alleging that the plan would alter their rights in "many specific ways." Finding "potential injuries," Judge Kinsella decided that the insurers had "constitutional standing to obtain *certain discovery* in connection with the Plan." [Emphasis added.]

Addressing prudential standing, "a judicially crafted doctrine," Judge Kinsella cited courts in the Second Circuit for having said "that '[p]rudential limitations on standing are especially important in bankruptcy proceedings which often involve numerous parties who may seek to assert the rights of third parties for their own benefit.'"

On prudential standing, the debtor and the insurers differed. The insurers took the position that they were entitled to discovery on all aspects of the plan, while the debtor contended that the insurers were not entitled to discovery that would only involve the survivors' treatment under the plan.

Generally, Judge Kinsella said, "most" of the insurers' discovery requests were relevant to confirmation issues that "may directly impact them." On the other hand, she said that the insurers had no standing to take discovery "where only the third-party survivors' rights are implicated."

Applying Rules 26 and 34 alongside the principles laid out in her opinion, Judge Kinsella granted or denied discovery requests in the final 48 pages of her opinion.

Observations

Interpreting *Truck Insurance*, Judge Kinsella is on the right track. She is correct that the Court's unanimous opinion does not mention Article III or constitutional standing.

Standing is a jurisdictional requirement arising from Article III of the Constitution. Common law or even a statute cannot confer standing that would give rise to jurisdiction beyond Article III. Understanding that Section 1109(b) cannot confer standing more than the Constitution allows, this writer interprets *Truck Insurance* as having recognized a presumption of standing under Section 1109(b).

A presumption of standing makes good sense in chapter 11. With thousands of parties sometimes involved in one case, a presumption of standing obviates the possibility of arguments over standing repeatedly in the reorganization.

Like any other, a presumption of standing can be overcome. It stands to reason, therefore, that a party in interest might lack constitutional standing in particular circumstances, just like Judge Kinsella said.

There is a point in Judge Kinsella's opinion where reasonable parties may disagree. She found no standing for the insurers regarding issues that affect only abuse survivors.

Understandably, the insurers would wish to kill any plan the diocese might offer. It would therefore be in their interest to defeat the plan by showing that any feature is impermissible under Section 1129.

Officious intermeddling can be ethically obnoxious, but when interjection would foster a party's justifiable ends, perhaps the Constitution grants standing.

The survival of prudential standing has been in doubt, even before *Truck Insurance*. In *Lexmark Int'l, Inc. v. Static Control Components, Inc.*, 572 U.S. 118 (2014), the Supreme Court decried the use of "prudential standing" and more recently said that federal courts have a "virtually unflagging obligation" to exercise Article III jurisdiction. *See, e.g.*, *Colorado River Water Conservation Dist. v. U.S.*, 424 U.S. 800, 817 (1976); and *FBI v. Fikre*, 601 U.S. 234, 240 (March 19, 2024).

If the issue were to reach the Supreme Court, the justices might decide that prudential standing in bankruptcy cases is a dead letter.

One final point. *Truck Insurance* only dealt with the peculiarities of Section 1109(b) in chapter 11 cases. The concept of a presumption of standing may not apply in chapters 7, 12, 13 and 15.

The opinions are of the writer, not ABI.

The opinion is *In re Roman Catholic Diocese of Syracuse, New York*, 20-30663 (Bankr. N.D.N.Y. Dec. 9, 2024).

The Third Circuit splits from Seventh and Tenth Circuit opinions dating from 1987 and 1990.

Third Circuit Holds: Magistrate Judges May Issue Final Orders on Bankruptcy Appeals

Creating a circuit split, the Third Circuit held that "a magistrate judge may enter final judgment in a bankruptcy appeal" if there is "consent of the parties and referral by a district court." The Seventh and Tenth Circuits had ruled to the contrary in 1987 and 1990, holding that magistrate judges may not enter final orders in bankruptcy appeals.

The Third Circuit remanded its case to the bankruptcy court for further, substantial proceedings. There may be no petition for *certiorari* or rehearing *en banc*, because both parties were in favor of a final order by the magistrate judge. The Third Circuit had appointed an *amicus* to argue against the appellate power of magistrate judges, but the *amicus* lacks standing to pursue the issue further.

The bankruptcy judge in Delaware was presiding over an adversary proceeding between the holder of a royalty interest in an oil and gas property and the operator of the site. The bankruptcy judge granted summary judgment in favor of the operator.

On the ensuing appeal, Judge Freeman said in her May 7 opinion said that "the parties consented to proceed before a Magistrate Judge for all proceedings, including final judgment." She went on to say that the magistrate judge raised the question of her own jurisdiction *sua sponte*.

On the merits, the magistrate judge affirmed the bankruptcy court, with a proviso that her decision should be taken as a report and recommendation if there were no power to enter a final order.

Pivotal Statutory Amendments

Judge Freeman said that the circuit's "jurisdiction to hear this appeal turns on whether the Magistrate Judge had jurisdiction to enter a final judgment in the bankruptcy appeal." She noted how the circuit had "appointed David R. Kuney, Esq. as *Amicus Curiae* to argue the position that a magistrate judge lacks jurisdiction to issue a final judgment in a bankruptcy appeal." She thanked the "*Amicus* for his service to the Court." Prof. Kuney is an Adjunct Professor at the Georgetown University Law School.

The outcome turned on 28 U.S.C. § 636(c), which provides:

> Notwithstanding any provision of law to the contrary — (1) Upon the consent of the parties, a full-time United States magistrate judge . . . may conduct any or all proceedings in a jury or nonjury civil matter and order the entry of judgment in the case, when specially designated to exercise such jurisdiction by the district court or courts he serves.

Immediately, Judge Freeman noted how the Third Circuit had ruled in 1983, soon after adoption of the Bankruptcy Code, that "a magistrate judge lacked jurisdiction under section 636(c)(1) to issue a final order in a bankruptcy appeal, notwithstanding the consent of the parties. *In re Morrissey*, 717 F.2d 100, 101 (3d Cir. 1983)." However, the statutes then were different.

Judge Freeman said that the appeals court ruled as it did in *Morrissey* because, at the time, 28 U.S.C. § 1334(c) was written to mean that a "district court may not refer an appeal under that section to a magistrate or to a special master." She referred to the preclusion of appeals to magistrate judges as the "Express Prohibition."

In response to the Supreme Court's *Northern Pipeline* decision in 1982 finding the bankruptcy court's jurisdiction to be unconstitutional, Judge Freeman said that Congress "completely rewrote" the bankruptcy court's jurisdiction in 1984 with a new Section 1334. She said that "[t]he Express Prohibition on the referral of bankruptcy appeals to magistrate judges 'was repealed by simple omission,'" quoting the Fifth Circuit in *Minerex Erdoel, Inc. v. Sina, Inc.*, 838 F.2d 781, 785 (5th Cir. 1988).

Judge Freeman said that the new jurisdictional statute presented the appeals court with "a question of first impression in this Circuit under the current statutory regime." Since 1984, she held that "there has been no barrier to magistrate judges' authority to enter final judgments in bankruptcy appeals pursuant to section 636(c) with the consent of the parties."

Citing a Third Circuit opinion in a criminal case, Judge Freeman said that a magistrate judge's jurisdiction is coextensive with the district court's jurisdiction when the parties consent.

Judge Freeman buttressed her reading of the statute "with the reality that magistrate judges function as part of a district court" and with the Third Circuit's holding "that entry of final judgment by a magistrate judge upon consent of the parties, as a general matter, does not violate Article III of the United States Constitution." Furthermore, she said, "The right to an Article III adjudicator is a personal right that is subject to waiver," according to Supreme Court precedent.

Judge Freeman said she "cannot agree" with the Seventh and Tenth Circuits, which held that magistrate judges are not permitted to enter final orders on bankruptcy appeals. *See In re Elcona Homes Corp.*, 810 F.2d 136, 139 (7th Cir. 1987); and *Virginia Beach Fed. Sav. & Loan Ass'n v. Wood*, 901 F.2d 849 (10th Cir. 1990).

Having found jurisdiction, Judge Freeman affirmed in part and remanded in part for further proceedings on issues other than jurisdiction.

The opinion is *Chenault-Vaughan Family Partnership Ltd. V. MDC Reeves Energy LLC (In re MTE Holdings LLC)*, 23-1916 (3d Cir. May 7, 2025).

A district court in Houston denied a motion to dismiss a confirmation appeal as equitably moot, although reversal might alter ownership of the reorganized debtor.

A Plan Appeal Wasn't Equitably Moot, Even Though Reversal Might Rejigger New Equity

A district judge in Houston decided that an appeal from confirmation of a chapter 11 plan was not equitably moot, even though reversal could mean redistribution of the new debtor's equity.

The debtor, a software developer, negotiated a restructuring support agreement before filing with the holders of 80% of the first- and second-lien notes. The plan eliminated $1.6 billion in secured debt. Unsecured creditors were to be paid in full.

First-lien holders took back debt and had the right to receive new equity at a discount in an equity rights offering. Second-lien holders were slated to receive new equity.

To supply the cash required to operate the reorganized business and to confirm and consummate the plan, a majority of the lenders backstopped the equity rights offering. In return, the majority were to receive some of the new equity.

A minority of the lenders objected to the plan because they had not been given the opportunity to participate in the backstop. They contended that the plan violated Section 1123(a)(4), which requires the same treatment for every claim in a class.

The bankruptcy court confirmed the plan. The minority filed an appeal. Waiting several days, the minority filed a motion for a stay pending appeal in the district court. District Judge Andrew S. Hanen denied the stay motion, finding, among other things, that the appellants lacked a likelihood of success on appeal.

Following denial of the stay motion, the debtor and the majority lenders filed a motion to dismiss the appeal as equitably moot. Judge Hanen denied the motion in an opinion on October 23.

The Origins of Equitable Mootness

Accepted in "virtually every circuit," Judge Hanen said that equitable mootness was "a concept in bankruptcy law that has existed for approximately four decades," going back to a decision from

the Ninth Circuit in 1981. Although widely used, he said that courts have "cautioned against its widespread use."

In the Fifth Circuit, Judge Hanen said that equitable mootness "is looked at with great scrutiny, especially when it involves appeals concerning the rights of secured creditors."

To establish equitable mootness, Judge Hanen said that the debtor must show that (1) the plan was not stayed pending appeal; (2) the plan was substantially consummated; and (3) reversal "would either affect the rights of third parties or the success of the Plan." In the case on appeal, he said that the first two requirements were "certainly met."

The minority lenders were complaining on appeal that they had not been given an opportunity to invest in the equity backstop, for which they would have had a better recovery on their claims. The minority argued that the majority could be ordered to sell some of the extra equity to the minority.

No Stay and Substantial Consummation

The debtor and the majority argued on appeal that the lack of a stay pending appeal *per se* weighed in favor of dismissal.

Judge Hanen said that the injury to the minority "seems plainly remedial with either a monetary award or a redistribution of the equity allocation and would not require an unwinding of the plan that would affect the debtor." For that reason, he said that "denying the stay in this case weighs *against*" dismissal. [Emphasis in original.]

Substantial consummation "weighs in favor of equitable mootness," Judge Hanen said, because the plan "certainly has been substantially consummated."

Partial Relief Is a Big Deal

Citing the Fifth Circuit, Judge Hanen said that "[n]umerous courts" have held that the availability of partial relief would not disturb a reorganization. "In short," he said, equitable mootness "is improper" if the "Court *can* fashion a remedy without upsetting the reorganization." [Emphasis in original.]

Were he to order the majority to sell a portion of the new equity to the minority, Judge Hanen said there would be "no need to upset the Plan or the actions of third parties." Consequently, he said that the third factor "weighs heavily against a finding of equitable mootness."

Judge Hanen denied the motion to dismiss for equitable mootness.

Observations

Equitable mootness is a prudential doctrine running against the Supreme Court's recent pronouncements that federal courts have a "virtually unflagging obligation" to exercise Article III jurisdiction. S*ee, e.g.*, *Colorado River Water Conservation Dist. v. U.S.*, 424 U.S. 800, 817 (1976); and *F.B.I v. Fikre*, 601 U.S. 234, 240 (March 19, 2024).

In equitable mootness cases, there is always an extant case or controversy conferring constitutional jurisdiction. In appeals like this, the question not about jurisdiction; the question is whether there is an available remedy.

Equitable mootness has retarded the development of bankruptcy law. Were there no such doctrine, critical questions like those answered by the Supreme Court last term in *Purdue* would have been resolved decades earlier. Indeed, the different composition of the Court in prior years might have led to a different result, given that *Purdue* was 5/4.

Because there will be constitutional jurisdiction, this writer would have appellate courts dispense with equitable mootness and rule on the merits. Often, the merits is an easier question than equitable mootness.

In the event of reversal, the appellate court could remand for the bankruptcy court to decide whether there is an available remedy, possibly partial. After all, deciding whether there is an available remedy sounds like a factual question that should be addressed in the trial court, which is already vastly more familiar with the case.

The foregoing opinions are those of the writer, not ABI.

The opinion is *Ad Hoc Group of Excluded Lenders v. Convergeone Holdings Inc.*, 24-02001 (S.D. Tex. Oct. 23, 2024).

District court upholds an 'opt-out' chapter 11 plan with releases for nondebtors.

District Court Doesn't Say Whether 'Person Aggrieved' Survived *Truck Insurance*

Upholding confirmation of an "opt-out" chapter 11 plan's nondebtor releases, a decision by a district court in Cedar Rapids, Iowa, underscores the need for an appellate court, somewhere, to decide whether the *Truck Insurance* decision last term in the Supreme Court extinguished the "person aggrieved" standard for appellate standing in bankruptcy cases.

A Catholic hospital sold the assets and confirmed a chapter 11 plan with two categories of nondebtor releases. In the first category, the debtor and creditors released the major players in the reorganization, such as official committees and their members, bondholder representatives and a related order of nuns.

The second category of releases ran in favor of the major players' current and former officers, directors, affiliates, employees, agents, financial advisors and consultants. In his March 3 opinion, Chief District Judge C.J. Williams referred to the second group as the Remote Released Parties.

The plan enabled creditors to opt out of releases by checking a box on the ballot. However, the plan provided that creditors who voted in favor of the plan or who did not vote would grant the releases, including the Remote Released Parties.

The hospital's former corporate manager had a general unsecured claim for more than $30,000. The former manager opted out and opposed confirmation, contending that the Supreme Court's *Purdue* decision precluded releases in favor of the Remote Released Parties. Chief Bankruptcy Judge Thad J. Collins overruled the objection and confirmed the plan.

The former manager appealed and was denied a stay pending appeal by both Judge Collins and the magistrate judge. On appeal, the former manager only challenged the releases in favor of the Remote Released Parties.

Standing to Appeal

Together, District Judge Williams considered both the merits and the debtor's motion to dismiss the appeal based on the former manager's lack of appellate standing.

In bankruptcy appeals, the Eighth Circuit historically employs the "person aggrieved" standard for deciding whether the appellant has standing to appeal. To be a person aggrieved, Judge Williams said that the appellant must be "directly and adversely affected pecuniarily." More particularly, he said that the "possibility of harm" is not enough.

Because the former manager had opted out, Judge Williams said that it never gave up its claims against the released parties. As a result, he said, "Any decision by this Court about the Third-Party Releases will not alter [the former manager's] ability to go after claims that it never lost in the first place."

Even so, the former manager contended that it had the right to appeal, alleging that the releases were not permissible following *Harrington v. Purdue Pharma L.P.*, 602 U.S. 204 (2024). To read ABI's report, click here. Responding, Judge Williams said, "The 'person aggrieved' standard, however, requires something more than a general objection that a plan is not confirmable."

More particularly, Judge Williams said that "only … those parties who have been directly harmed by a bankruptcy court's order" have appellate standing. "A general objection to a plan as unconfirmable, without showing how the party was harmed, does not meet this standard."

On that basis, Judge Williams concluded that the former manager had no appellate standing.

Nonetheless, the former manager contended that its recovery from the liquidating trust would be greater had the debtor not released the Remote Released Parties. Judge Williams said that the former manager had not identified a single claim against Remote Released Parties that could have increased the recovery. Consequently, he held that the "abstract possibility of a claim that might increase [the former manager's] recovery does not satisfy the person aggrieved standard."

For a last stab at standing, the former manager argued that its status as an impaired creditor by itself conferred appellate standing.

Judge Williams responded by saying that the Eighth Circuit "does not appear to have adopted a *per se* rule that grants an impaired creditor standing based on its status as an impaired creditor alone because, unlike the broad right of participation reflected in bankruptcy level standing, the 'person aggrieved' standard is much more restrictive and does not automatically apply to an entire class."

For lack of appellate standing, Judge Williams granted the motion to dismiss.

The Merits

To cover all bases, Judge Williams reviewed the merits in case it were later held that the former manager had appellate standing. The former manager took the position that releases in favor of the Remote Released Parties were impermissible following *Purdue*.

Judge Williams said that *Purdue* went to "great lengths" to say that the decision was narrow and that the Court was not addressing what consensual releases might be. Furthermore, he said, the *Purdue* plan had been stayed pending appeal, but the hospital's plan "has been at least partially consummated."

Even if *Purdue* were controlling, Judge Williams said that the releases "are permissible because they are consensual releases," citing bankruptcy court decisions from the Southern and Northern Districts of New York.

Judge Williams closed his opinion by deciding that releasing the Remote Released Parties was permissible under the five-part test followed by courts in the Eighth Circuit as set forth in *In re Master Mortgage Investment Fund, Inc.*, 168 B.R. 930 (Bankr. W.D. Mo. 1994). He granted the motion to dismiss the appeal and said he "would still affirm" if the former manager had standing.

Observations

With regard to standing, Judge Williams did not mention *Truck Insurance Exchange v. Kaiser Gypsum Company, Inc.*, 602 U.S. 268 (June 6, 2024), where the Supreme Court broadly defined parties in interest who have standing to appear and be heard in chapter 11 cases under Section 1109(b). In proceedings in bankruptcy court, someone has standing who might be "potentially" affected by the reorganization. To read ABI's report, click here.

Truck Insurance did not address appellate standing. The Court held that an insurance company had standing in bankruptcy court to challenge a chapter 11 plan even though the plan was "insurance neutral" and did not impair the insurance company's rights as an insurer.

Nonetheless, did *Truck Insurance* address person aggrieved *sub silentio*? As a matter of constitutional law under Article III, may courts contrive prudential notions of standing to narrow the scope of who may appeal?

Remember, in *Lexmark Int'l, Inc. v. Static Control Components, Inc.*, 572 U.S. 118 (2014), the Supreme Court decried the use of "prudential standing" and more recently said that federal courts have a "virtually unflagging obligation" to exercise Article III jurisdiction. *See, e.g.*, *Colorado River Water Conservation Dist. v. U.S.*, 424 U.S. 800, 817 (1976); and *FBI v. Fikre*, 601 U.S. 234, 240 (March 19, 2024).

Needless to say, there's good reason to narrow the scope of appellate standing, otherwise anyone associated with a chapter 11 case could appeal despite the lack of financial interest in the

outcome. Is it possible that the constitutional requirement of a case or controversy becomes more narrow when ascending the appellate ladder? Would an appeal be a mere advisory opinion or theoretical conjecture if the outcome of the appeal would not affect the rights of the appellant?

The opinion is *Mercy Health Network Inc. v. Mercy Hospital, Iowa City, Iowa*, 24-68 (N.D. Iowa March 3, 2025).

A final order in a contested matter raises tough questions about 'finality' for the purpose of appeal. For contested matters, should there be default rule that final orders in contested matters are interlocutory?

A Final Order in a Contested Matter Isn't Necessarily a 'Final Order' for Appeal

A final order terminating a contested matter isn't necessarily a "final order" when it comes to appealability, as shown by a decision from a district judge in Santa Ana, Calif.

The chapter 7 trustee commenced a contested matter asking for court authority to hire a real estate broker to sell the debtor's home through an exclusive listing arrangement. The debtor objected to the proposed retention, but Bankruptcy Judge Barry Russell overruled the objection and approved the retention application.

After the debtor appealed the retention order, the trustee filed a motion to dismiss the appeal.

District Judge Fred W. Slaughter dismissed the appeal in an opinion and order on July 15.

The district court's jurisdiction for the appeal was based on 28 U.S.C. § 158(a)(1), which gives district courts jurisdiction "from final judgments, orders, and decrees . . . of bankruptcy judges . . ." Judge Slaughter quoted authority from a district judge in the same district who said, "'The Bankruptcy Court order authorizing employment of a real estate agent is not a final order because it does not resolve and seriously affect substantive rights.'"

Similarly, Judge Slaughter quoted the Ninth Circuit Bankruptcy Appellate Panel for saying that "'the Modified Employment Order and the Order to Employ are interlocutory orders for which no motion for leave to appeal was filed in the main bankruptcy case.'"

Given that the retention order was interlocutory, Judge Slaughter dismissed the appeal "[b]ecause [the debtor] failed to move for leave of the court to appeal the Bankruptcy Order."

Of course, 28 U.S.C. § 158(a)(3) grants jurisdiction to appeal "with leave of the court, from other interlocutory orders and decrees . . . of bankruptcy judges . . . ." Even if the debtor had filed a motion to permit an interlocutory appeal, Judge Slaughter said that "the court would decline to exercise authority over the Bankruptcy Order."

Judge Slaughter said that leave to appeal can be granted when there are "substantial grounds for difference of opinion" over a "controlling question of law" where an immediate appeal could "materially advance the ultimate termination of the litigation."

Judge Slaughter declined to grant leave to appeal because he found "that exercising authority over the Bankruptcy Order would not 'materially advance the ultimate termination of the litigation'" given that "the bankruptcy court had already approved the sale and the sale had closed."

Observations

The application to employ the broker was a contested matter. Although the retention order was in final disposition of the contested matter, it wasn't appealable.

The opinion could stand for the proposition that final disposition of a contested matter isn't necessarily a final order when it comes to appeal.

So, when is a final order in a contested matter appealable? Is there no appeal when the contested matter is a subset of a larger dispute or process, like the sale of property in the case on appeal to Judge Slaughter? Where should the line be drawn?

Take the case of an application in a chapter 11 case to approve notice for disclosure statement approval. Should alleged defects in notice be appealed after disclosure statement approval but before plan confirmation, or should everything await appeal after plan confirmation?

In some circumstances, an appeal might deprive the bankruptcy court of jurisdiction to proceed with important matters. When an appeal can wait without foreclosing the rights of the appellant, perhaps orders are interlocutory. If resolution of the appeal would advance the overall litigation, perhaps an appeal is in order.

In borderline cases, maybe the default rule should dismiss an appeal as interlocutory. After all, there is a relief valve in Section 158(a)(3) allowing an interlocutory appeal when it makes good sense.

The opinion is *Alpha Beta Gamma Trust v. Avery*, 25-00150 (C.D. Cal. July 15, 2025).

The time to withdraw a lawsuit to bankruptcy court is governed by a general federal statute that doesn't refer to bankruptcy, not the Bankruptcy Rule that specifically governs withdrawals to bankruptcy cases, a district judge says.

On a Split, the Deadline for Withdrawals Is 30 Days, not the 90 Days in Rule 9027

On an issue where the lower courts are divided, District Judge Mark T. Pittman of Fort Worth, Texas, decided that removal of an action from state court is governed by Section 1446's 30-day time limit, not the 90-day deadline in Bankruptcy Rule 9027.

Judge Pittman's July 23 opinion merits reading in full text to comprehend the removal statutes' convoluted history resulting from the Supreme Court's decision in *Northern Pipeline* that the bankruptcy court's jurisdiction was unconstitutional as originally crafted.

Respectfully, the conundrum could and should be resolved either by the Supreme Court's grant of *certiorari* or, better yet, by an exercise of the Supreme Court's rule-making authority to modify Bankruptcy Rule 9027.

Removal More than 30 Days After Filing

After a jury trial, the corporate creditor won a judgment in state court against the individual debtor. The state appellate court reversed, telling the trial court to enter a "take nothing judgment" because the creditor-plaintiff had failed to present evidence establishing the existence of the claim underpinning the judgment. However, the state appellate court remanded for the creditor to pursue judgment on other claims. The Texas Supreme Court denied review.

Before the creditor could pursue other claims in the state trial court, the debtor filed a chapter 11 petition. Just before the ninetieth day after filing, the debtor removed the suit from state court under Bankruptcy Rule 9027. In the removed action, the bankruptcy court entered a "take nothing" judgment in favor of the debtor.

The creditor appealed and won in a July 23 opinion by District Judge Pittman.

What Governs, a Statute or a Rule?

On appeal, the creditor contended that the deadline for removal was 30 days under 28 U.S.C. § 1446. Since the removal was made almost 90 days after filing, the creditor argued that removal was untimely, that the bankruptcy court had no jurisdiction and that the bankruptcy court should have remanded the suit to state court.

The debtor, of course, said that removal was timely because Bankruptcy Rule 9027 has a 90-day deadline for removal.

Section 1446 deals with removals to federal courts generally. It permits a "defendant" to remove an action within 30 days. (Remember, the debtor was the plaintiff, not a defendant.) The section does not deal specifically with removals based on bankruptcy jurisdiction under Section 1334.

Bankruptcy Rule 9027 addresses only removals to bankruptcy cases. It does not limit the removal power to a "defendant." If the suit was pending when the bankruptcy was filed, the rule requires the filing of a notice of removal within "90 days after the order for relief in the bankruptcy case."

Because Section 1446 allows removals only by a "defendant" and Rule 9027 applies specifically to removals to bankruptcy court, the debtor contended that Rule 9027 must apply and that the removal was timely.

In deciding whether the statute or the rule governs, Judge Pittman began by saying,

> Generally, removals are governed by two sections. The first, Section 1441, lays out what types of cases can be removed. *See* 28 U.S.C. § 1441. The second, Section 1446, establishes the procedure and time deadline for removals. *See* 28 U.S.C. § 1446.

Before enactment of the Bankruptcy Code, Judge Pittman said that those two sections governed removal. After adoption of the Code, Interim Bankruptcy Rule 7004 had procedures and a 30-day time limit for removal. The interim rule was replaced by Bankruptcy Rule 9027 and its 90-day deadline.

Then came *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982), and its proclamation that the bankruptcy court's jurisdiction was unconstitutional. In the shadow of *Northern Pipeline*, Congress adopted 28 U.S.C. § 1452, which says that a "party" may remove an action in state court to the federal district court where the suit was pending, if the district court has jurisdiction under 28 U.S.C. § 1334, the newly crafted bankruptcy jurisdiction statute.

"Prior to the enactment of Sections 1334 and 1452," Judge Pittman said,

> the time deadline for removal was governed by Bankruptcy Rule 9027. However, since their enactment, there has been a dispute over whether Bankruptcy Rule 9027 or Section 1446 control[s] the removal time deadline.

Parsing the statutes, Judge Pittman said that because Section 1452 "is silent as to the time deadline for removal, it should be read in context with the rest of Title 28, Part IV, Chapter 89." Consequently, he said, "Section 1446 should be read to impose a thirty-day time deadline on removals under Section 1452."

Employing Section 1452, Judge Pittman said, was "bolstered" by *Things Remembered, Inc. v. Petrarca*, 516 U.S. 124 (1995), where he described the Supreme Court as having said "that 'there is no reason [the sections] cannot comfortably coexist in the bankruptcy context' because there is no indication Congress intended to exclude bankruptcy removals under Section 1452 from other provisions in Chapter 89." *Id*. at 129.

Judge Pittman said he was "unpersuaded by the contention that *Things Remembered* is inapplicable because it does not explicitly address the applicability of Bankruptcy Rule 9027 to a removal under Section 1452." In his view, "*Things Remembered* stands for the proposition that different provisions contained in the various Sections of Chapter 89 must be read together."

While Judge Pittman cited five district courts that ruled to the contrary, he said that "a finding that Bankruptcy Rule 9027's ninety-day time deadline supersedes or supplements Section 1446's time deadline is impermissible under the 'established principle that the jurisdiction of the federal courts is carefully guarded against expansion by judicial interpretation.'"

In a footnote, Judge Pittman said that having a rule govern, rather than a statute, "also violates the general principle that '[w]hen a statute and a rule directly conflict, the statute wins.' *See*, *e.g.*, *In re Asbestos Litig.*, 2002 WL 649400, at *3. If Congress intended to give bankruptcy removals an extended time deadline, then it was up to Congress to say so, not the courts."

Judge Pittman vacated the bankruptcy court's decision and remanded for the suit to be remanded to state court.

The opinion is *Tiburon Land & Cattle LP v. Stephens*, 24-01106 (N.D. Tex. July 23, 2025).

Delaware judge wouldn't allow a chapter 11 debtor to restructure the same secured debt a second time in a different venue.

No Second Restructuring of the Same Debt in a Different Venue

Bankruptcy Judge John T. Dorsey of Delaware had confirmed a corporate debtor's chapter 11 plan. He didn't permit the debtor to file another chapter 11 case in California for a second restructuring of the secured debt that had been restructured in the first reorganization in Delaware.

Employing Bankruptcy Rule 1014(b) and Section 1127(b) in his January 30 opinion, Judge Dorsey transferred the case to Delaware and dismissed the new California petition as a bad faith filing. The petition in California had been filed three years after the Delaware plan had become effective.

We invite our readers to compare the case before Judge Dorsey with Johnson & Johnson's newest shot at resolving talc liability with a third chapter 11 petition in Houston, following the dismissals of two chapter 11 filings in New Jersey. In making the comparison, note that J&J created a new, Texas-based debtor called Red River Talc LLC in place of LTL Management LLC, the subsidiary that the Third Circuit dismissed for having no "financial distress." Are the distinctions significant? Does it matter that one case was confirmed and the other dismissed?

The Second Chapter 11 Filing Three Years Later

A corporate debtor had filed a chapter 11 petition in Delaware encumbered with debt in the original principal amount of about $173.5 million secured by substantially all of the assets. The debtor owned a luxury hotel in California that fell on hard times during the pandemic.

In late 2021, Judge Dorsey confirmed a chapter 11 plan giving the lender a restructured secured loan in the principal amount of some $185 million. The good times didn't last long, though, because planned renovations of the hotel ran over budget, and business didn't improve as expected following the pandemic.

The lender had allowed the debtor to sell part of the project and put the remainder on the market. When a buyer didn't appear, the lender started foreclosure. The lender gave the debtor another chance by agreeing to take a haircut for being taken out. When a new lender didn't appear, the debtor filed a new chapter 11 case in California one day before the scheduled foreclosure sale.

The lender filed a motion in Judge Dorsey's court to transfer venue to Delaware and dismiss the new petition. Note: The original chapter 11 case in Delaware had not been closed.

Two Bites at the Apple Prohibited

The lender's motion to transfer venue was governed by Bankruptcy Rule 1014(b), which provides:

> If petitions commencing cases under the Code . . . are filed in different districts by, regarding, or against (1) the same debtor . . . on motion filed in the district in which the petition filed first is pending . . ., the court may determine, in the interest of justice or for the convenience of the parties, the district or districts in which the case or cases should proceed.

The lender's motion to dismiss was governed by Section 1112(b), under which "cause" for dismissal is shown if the petition was not filed in good faith.

The lender contended that the new petition was filed in bad faith because "the debtors' sole purpose in filing the new case was to evade the consequences of their defaults under the chapter 11 plan previously confirmed by this Court." In that vein, Judge Dorsey said,

> Courts have held that chapter 11 filings made for the purpose of modifying a previously confirmed and substantially consummated plan in violation of Section 1127(b) of the Code are made in bad faith and must be dismissed under Section 1112(b) of the Code.

In pertinent part, Section 1127(b) provides that a "reorganized debtor may modify [a confirmed] plan at any time after confirmation of such plan and before substantial consummation of such plan . . . ."

The debtor contended that Rule 1014(b) did not apply because the first case was "substantially complete" and the debt restructured in the prior case was new debt to be handled in a new chapter 11 case. Judge Dorsey disagreed, saying, "It is clear from the record in this case that the [debt restructured in the first case] arose out of the First Bankruptcy Case and is therefore governed by the [Delaware] Plan." He added that the debt restructured in Delaware was "not new debt that came into existence independent of the First Bankruptcy Case, but rather was a product of the bankruptcy process."

Having found the ability to transfer venue, Judge Dorsey held that the new petition, filed "for the purpose of restructuring the [debt restructured in the first case], would have the effect of modifying the substantially consummated Plan, contrary to the provisions of Section 1127(b) of the Code."

Judge Dorsey then turned to the question of whether there were "changed circumstances" justifying a new filing. He said that the "plain text" of Section 1127(b) does not allow any exception to the requirement that a modification must occur before "substantial consummation." Quoting a 1998 decision by Bankruptcy Judge Conrad B. Duberstein, he said that the section provides "finality" with respect to confirmation orders for both the debtor and creditors.

To protect finality, Judge Dorsey said that "Debtors must show e*xtraordinary, unforeseeable changed circumstances* to avoid dismissal under Section 1112(b) of a second chapter 11 case that would result in a de facto modification of a previous plan." [Emphasis added.]

Judge Dorsey went on to find that the debtor's financial problems occurring after confirmation in the first case "were foreseeable, and none rise to the level of extraordinary." He distinguished authorities proffered by the debtor to justify a new filing.

In one case, the debt to be affected was new debt unrelated to the first bankruptcy. In the second case, the plan had not been substantially consummated, and the court in the third case found that changed circumstances were "entirely unforeseeable."

Judge Dorsey granted the motion to transfer venue and dismissed the petition in the second case that had been filed in California.

The opinion is *In re SC SJ Holdings LLC*, 21-10549 (Bankr. D. Del. Jan. 30, 2025).

Plans & Confirmation

The Third Circuit majority upheld nondebtor, nonconsensual releases because they were part of a sale, making the appeal statutorily moot under Section 363(m).

Third Circuit Upholds Boy Scouts' Nonconsensual Releases, *Purdue* Notwithstanding

With a minor modification, the Third Circuit upheld confirmation of the Boy Scouts of America's chapter 11 plan and its nonconsensual, nondebtor, third-party releases that would no longer be permissible following the Supreme Court's *Purdue* decision, which came down while BSA's appeal was pending in the circuit.

In a 62-page opinion on May 13, Circuit Judge Cheryl Ann Krause decided that the Boy Scouts' plan was not equitably moot, even though the plan was substantially consummated. Nonetheless, she upheld the plan by ruling that confirmation of the plan was statutorily moot under Section 363(m) because insurance companies bought back their policies from the debtor.

"If proposed today," Judge Krause said, "the [BSA] Plan would be unconfirmable in the wake of *Purdue*." In other words, Section 363(m) allowed implementation of a plan that the Supreme Court no longer permits.

Circuit Judge Marjorie O. Rendell wrote a 16-page concurring opinion that reads like a dissent. In her view, the plan was not statutorily moot under Section 363(m). She would have reached the same result and upheld confirmation given her belief that the appeal was equitably moot. In other words, the judges were split on equitable mootness.

The Third Circuit's *Boy Scouts* decision ranks in importance with opinions from the Supreme Court and covers more territory than a typical Supreme Court decision. Given the breadth of the *BSA* decision, we will report today on Section 363(m), because statutory mootness was the principal basis for upholding confirmation. Subsequently, we will describe why the majority decided that equitable mootness did not require dismissal of the appeal. Separately, we will report the concurrence by Judge Rendell.

Will Section 363(m) become a workaround to permit nonconsensual, nondebtor releases? Will equitable mootness survive a trip to the Supreme Court?

The Insurance Policy Buyback

Laying out the facts and the plan in detail, Judge Krause said that the Boy Scouts had paid $150 million by 2019 to resolve 250 sexual abuse suits. When it became evident that the organization could not defend the suits individually, the Boy Scouts filed a chapter 11 petition in Delaware in early 2020. When the deadline for claims arrived, there were over 82,000 claims with a maximum value of $3.6 billion.

With help from mediation, the debtor constructed a plan with a trust funded by almost $2.5 billion in "noncontingent assets." The largest chunk, $1.6 billion, would come from insurance companies buying back their policies. In return for the $1.6 billion, the sale agreements required the insurers to have a "complete release" from abuse claims. Judge Krause described them as "nonconsensual third-party releases."

All nine classes of voting creditors were in favor of the plan. Dealing with objections, the bankruptcy court held a 22-day confirmation trial, heard from 26 witnesses and took more than 1,000 exhibits. The bankruptcy judge wrote a 269-page opinion confirming the plan in July 2022.

The district court upheld confirmation in a 155-page opinion in March 2023, given that nondebtor releases were permissible under Third Circuit precedent. *National Union Fire Insurance Co. of Pittsburgh v. Boy Scouts of America (In re Boy Scouts of America)*, 650 B.R. 8 (D. Del. March 28, 2023). To read ABI's report, click here.

Two groups of creditors with sexual abuse claims appealed, asking the Third Circuit to set aside confirmation altogether under the authority of *Purdue*, among other theories. Two insurance companies also appealed, seeking more narrow relief that would not overturn the entire plan.

Purdue came down from the Supreme Court in June 2024, after the district court's affirmance. The Third Circuit heard argument in the Boy Scouts' appeal in November 2024, following *Purdue*.

Jurisdiction

On the merits, Judge Krause first established that the bankruptcy court had "related to" jurisdiction to impose nondebtor releases. In the Third Circuit, the existence of "related to" jurisdiction turns on whether the outcome could have a "conceivable" effect on the bankruptcy estate.

Judge Krause had little difficulty finding effects on the estate. Were tort claimants at liberty to sue insurers, the pool of coverage would be reduced, leaving the Boy Scouts with less insurance to pay claims. Likewise, the Scouts had indemnity obligations to nondebtors that would arise were there lawsuits against nondebtors.

Finding conceivable effects, Judge Krause held that "the Bankruptcy Court properly exercised related-to jurisdiction over these third-party claims."

Statutory Mootness

The debtor's "first argument" to uphold confirmation, Judge Krause said, was based on statutory mootness under Section 363(m). The subsection reads:

> 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.

If other prerequisites for the application of Section 363(m) are present, Judge Krause said that the court cannot declare a sale moot if there is relief that would not affect the validity of the sale. On the other hand, if appellate relief "would necessarily affect the sale's validity, the relief is unavailable, so the appeal must be dismissed."

Quoting Third Circuit authority, Judge Krause said that the subsection "does not prohibit the appeal of challenges to all sales and leases, but 'only those challenges that would claw back the sale from a good-faith purchaser.'"

With regard to the appeals mounted by the two insurance companies, Judge Krause said they were not challenging the validity of the insurance policy buyback. Therefore, she said, "§ 363(m) poses no barrier to our consideration of the merits of their appeal."

It was a different story for the tort claimants aiming to overturn the entire plan. For them, Judge Krause had "little difficulty concluding that the relief they seek would affect the validity of the Insurance Policy Buyback authorized by the Confirmation Order" because they wanted to "vacate the Plan in its entirety" and in the process unwind "the sale of BSA's insurance policies."

Whether the sale of the insurance policies had actually occurred was a bone of contention, because most of the price paid by the insurance companies was being held in escrow until confirmation was upheld by a final order no longer subject to appeal. Judge Krause rejected the argument, saying that "the fact that every last cent has not been handed over does not mean a sale has not occurred."

Judge Krause also rejected the argument that Section 363(m) did not apply because the sale was part of a plan, not a freestanding sale. She said that the Third Circuit had "dispatched this argument years ago."

The tort claimants contended that they were not seeking to overturn the sale, only the nondebtor releases. Judge Krause dismissed the contention, saying that "the Settling Insurers would receive

less than they bargained for in exchange for their cash contribution to the Settlement Trust, which 'would materially increase . . . the purchase price.'"

Of perhaps more substance, the tort claimants argued that statutory mootness would immunize plans from appellate review whenever a plan was combined with a sale. Judge Krause responded as follows:

> Our decision does not read § 363(m) to immunize from appellate review all facets of a plan whenever a § 363(b) sale is involved. Put differently, a challenge to a § 363(b) sale that is "collateral" to or would not otherwise "affect the validity of the sale" falls outside the ambit of § 363(m) [citation omitted], and given the breadth of issues a reorganization plan may resolve that do not necessarily implicate the terms of a § 363(b) sale, *see* 11 U.S.C. § 1123(a) – (b), the vast majority of challenges, no doubt, will fall into this category.

Applying the principles to the case on appeal, Judge Krause said that "the nonconsensual third-party releases challenged by the [tort] Claimants go to the heart of the Bankruptcy Court's § 363(b) authorization, so § 363(m) prevents us from disrupting them on appeal."

Judge Krause dismissed the appeal by the tort claimants who "would strike at the heart of the Insurance Policy Buyback." The appeals by the insurance companies were in a different category that escaped dismissal because they were "collateral to the Insurance Policy Buyback."

At the conclusion of the discussion of statutory mootness, Judge Krause dropped a footnote that ranks as perhaps the most significant statement in the opinion.

It was an "unusual case," Judge Krause said, because the Supreme Court handed down *Purdue* and "abrogate[d] our precedent on that issue" while the appeal was pending. "So were the Plan proposed today," she said, "we harbor little doubt that the Bankruptcy Court would neither authorize the Insurance Policy Buyback nor confirm the Plan with its impermissible releases."

Next

On Monday, we will explain why Judge Krause decided that the appeal was not equitably moot as to the insurance companies who were appealing. She dismissed the appeal as statutorily moot as to the tort claimants who wanted to overturn confirmation altogether.

Question

Assume there's another mass tort case where confirmation requires an insurance buyback, but the insurers refuse to buy back their policies without nonconsensual, nondebtor releases. Are we

certain that no bankruptcy court will ever confirm such a plan and that an appellate court won't dismiss the appeal as statutorily moot? Does Section 363(m) override Supreme Court precedent?

The opinion is *In re Boy Scouts of America*, 23-1664 (3d Cir. May 13, 2025).

Holding $1.4 billion in escrow did not preclude invocation of equitable mootness, Third Circuit majority says.

As to Appealing Insurers, the *Boy Scouts* Plan Was Not Equitably Moot

We reported on Friday how the Third Circuit, despite the Supreme Court's *Purdue* decision, upheld nonconsensual, nondebtor releases in the Boy Scouts of America's chapter 11 plan because Section 363(m) meant that confirmation was statutorily moot.

Today, we describe how Circuit Judge Cheryl Ann Krause decided in her May 13 majority opinion that confirmation was not equitably moot and how she ruled on the appeals by the two insurers whose appeals avoided statutory mootness. Tomorrow, we will describe how Circuit Judge Marjorie O. Rendell effectively dissented by coming to the conclusion that all appeals should have been held to be equitably moot.

The Evolution of Equitable Mootness

Judge Krause began her discussion of equitable mootness by mentioning how the doctrine became law in the Third Circuit "by a slim margin." Indeed, it was the slimmest of margins. Equitable mootness was adopted by a 7/6 *en banc* decision in *In re Continental Airlines*, 91 F.3d 553 (3d Cir. 1996) (*en banc*). The dissenting opinion was written by then-Circuit Judge (now Justice) Samuel A. Alito, Jr.

Citing her concurrence in a 2015 Third Circuit decision and a dissent in the Sixth Circuit, Judge Krause said that the "doctrine [of equitable mootness] is not without its critics." The *Boy Scouts* case, she said, "highlights a potentially troubling aspect of adherence to the doctrine," because "Congress took great care to define the circumstances where appellate remedies are unavailable, *see* 11 U.S.C. §§ 363(m) [and] 364(e)."

Listing four denials of *certiorari* between 2016 and 2023, Judge Krause said that "the Supreme Court has yet to consider the question [of equitable mootness] — and not for lack of opportunity."

Mentioning how "[o]ur criteria for invoking the doctrine have shifted over time," Judge Krause said that invocation of equitable mootness requires a substantially consummated plan and a showing that relief on appeal would "'(a) fatally scramble the plan and/or (b) significantly harm third parties who have justifiably relied on plan confirmation.'"

Substantial Consummation

Judge Krause was not called upon to apply equitable mootness to the tort claimants because she had already dismissed their appeals for being statutorily moot. The insurance companies that had also taken appeals were not attempting to overturn the plan entirely, thus raising the question of equitable mootness as to their appeals.

First, Judge Krause inquired as to whether the plan had been substantially consummated given that the settling insurance companies had paid $200 million into the trust and had placed another $1.4 billion into escrow. Local scout councils, she said, had turned over $439 million of their required $500 million. She said that the payments into escrow by the insurers "qualifies as a 'transfer.'"

Plan distributions had already begun, with $18.5 million having been distributed to some 5,500 claimants. Judge Krause concluded that substantial consummation, the first prong of equitable mootness, had been shown.

Having found substantial consummation, Judge Krause turned to the question of whether the insurance companies' appeals would "imperil[] the Plan's success." She said that the two insurers "do not seek invalidation of the releases; instead, they ask us to grant them each narrow, cabined relief."

At the conclusion of her decision on equitable mootness, Judge Krause dropped another pregnant footnote. Not having applied equitable mootness to the appeals by the tort claimants, she said, "should not be read, by negative implication or otherwise, to suggest that those claims are equitably moot."

Judge Krause said that "we need not resolve whether" the appeals by the tort claimants are not equitably moot in view of the fact that settling insurers had "nearly $1.5 billion" in escrow that could be recovered were there a reversal of confirmation.

Given the narrow relief that the insurers sought on appeal, Judge Krause decided against dismissing the appeals as equitably moot and therefore turned to the merits of the insurers' two appeals.

The Merits

With regard to one of the appealing insurers, Judge Krause said that the plan left that insurer's "contractual rights and defenses intact." She rejected that insurer's appeal for more protection in the plan because "we decline to rewrite the Plan and fasten suspenders to this already well-secured belt."

The appeal by the second group of insurers was another matter. Relying on *Purdue*, those insurers complained that the plan "non-consensually release[d] their claims and vitiate[d] their ability to recover certain defense costs." Specifically, they argued that the plan "impermissibly releases and enjoins contribution and indemnity claims they could otherwise assert against the Settling Insurers."

Judge Krause determined that the plan in fact would not enable the appealing insurers to recover the full amount of their indemnification and contribution claims from the settling insurers. She "therefore conclude[d] that *Purdue* controls, and the judgment reduction provision is unlawful insofar as it operates to extinguish the [appealing insurers'] claims without their consent."

As she had done pages earlier in a footnote, Judge Krause said in her conclusion,

> If proposed today, the Plan would be unconfirmable in the wake of *Purdue* and the [tort claimants] could not have their claims released without their consent. And that temporal happenstance, we recognize, is a bitter pill to swallow, "but bankruptcy inevitably creates harsh results for some players." *In re Weinstein Co. Holdings LLC*, 997 F.3d 497, 511 (3d Cir. 2021).

Judge Krause reversed and remanded with instructions for the bankruptcy court to modify the confirmation order as requested by the appealing insurers whose contributions rights were cut off.

The opinion is *In re Boy Scouts of America*, 23-1664 (3d Cir. May 13, 2025).

The circuit courts are diverging on the utility of equitable mootness to avoid reversing confirmation of chapter 11 plans.

'Dissent' in *Boy Scouts* Favored Using Equitable Mootness to Uphold Nondebtor Releases

In the third and last of our reports on the May 13 *Boy Scouts of America* opinions by the Third Circuit, we're covering the 16-page concurrence by Circuit Judge Marjorie O. Rendell that reads like a dissent.

Judge Rendell reached the same result — upholding the plan's nonconsensual, nondebtor releases — by reaching the polar opposite conclusions on statutory mootness and equitable mootness. Where the majority saw the tort claimants' appeals as statutorily moot under Section 363(m), she said they weren't. Where the majority didn't see equitable mootness, she did.

Judge Rendell saw the majority's statutory mootness opinion as "fundamentally flawed." Instead, she said she would have dismissed the tort claimants' appeals as "equitably moot," because equitable mootness "is firmly rooted in our precedent, and, as counsel for [the debtor] urged at oral argument, if ever there were a case crying out for application of the doctrine, this is it."

Statutory Mootness

Judge Rendell explained why she was unwilling to "stretch" statutory mootness under Section 363(m). The subsection reads:

> 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.

Judge Rendell described the "first fundamental flaw in the majority's" opinion on Section 363(m) as follows:

> [T]he statute's clear indication [is] that it does not apply to sales in reorganization plans as well as the common sense observation that the non-consensual third-party releases were not accomplished by way of the purported § 363 authorization, but by way of plan confirmation.

Judge Rendell noted it was an "appeal from the confirmation order, not the sale," and that "the majority's opinion endorses an end run around Chapter 11's requirements, including the Supreme Court's holding in *Harrington v. Purdue Pharma L.P.*" She said that "§ 363 itself distinguishes between sales under § 363(b) and (c) and sales under a plan." Citing the Fifth and Eleventh Circuits, she said that "several courts have suggested that sales accomplished under plans do not fall within § 363(m)'s ambit."

"If that is not enough," Judge Rendell said, "some of the Settling Insurers constructed the 'sale' of their policies such that they will not occur until the Confirmation Order is affirmed on appeal, meaning that the majority's approach will not finally resolve this case." She added:

> This arrangement was almost certainly crafted in an attempt to insulate the Plan and Confirmation Order from appellate review — otherwise, the buybacks of the insurance policies would have been confirmed, as is typical, by § 1123(a)(5)(D), which allows a plan to sell "all or any part of the property of the estate, either subject to or free of any lien." 11 U.S.C. § 1123(a)(5)(D).

More succinctly, Judge Rendell said, "Using § 363(m) to avoid an appeal deprives the sale of any real scrutiny," "goes far beyond what § 363 contemplates," and "shields from review the non-consensual third-party releases that the Supreme Court invalidated in *Purdue*."

Judge Rendell said that the majority's opinion "sets a dangerous transactional precedent, one that will result in Article III courts not having the capacity to review Confirmation Orders if the parties agree to call key intra-plan transactions 'sales.' Indeed, today's decision relegates the Supreme Court's holding in *Purdue* to a mere plan-drafting guide."

Judge Rendell would have held that "Section 363(m) clearly contemplates not only an authorized sale, but a sale that has occurred." Observing that "some of the Settling Insurers' agreements included provisions that their sales will not be completed unless and until there is a successful appeal," she concluded that the tort claimants' "appeals are not statutorily moot as applied to those sales."

Equitable Mootness

Because "statutory mootness does not finally resolve this case" given that the buybacks of the insurance policies "have not occurred," Judge Rendell said, "[w]e can avoid these complications if we rely instead on equitable mootness," a "discretionary principle that the circuit courts have unanimously adopted."

"Even where it is applied," Judge Rendell said, "the reviewing court has discretion to address the merits of the appeal if it wishes." By contrast, she said that Section 363(m) operates as an "on-off" switch that can strip courts "of any ability to review that provision."

Judge Rendell saw "not only error, but mischief, in the majority's approach." She concurred in the result "but believe[d] that equitable mootness is the way we should reason through the dismissal of the [tort] Claimants' appeals."

Observations

Recall the *Serta Simmons* decision in late December, where the Fifth Circuit called equitable mootness a "judge-created doctrine of pseudo-abstention," not a matter of "real mootness" that "implicates our jurisdiction under Article III." *Excluded Lenders v. Serta Simmons Bedding LLC (In re Serta Simmons Bedding LLC)*, 125 F.4th 555, 585 (5th Cir. Dec. 31, 2024).

Although the Fifth Circuit's reversal of the *Serta Simmons* confirmation order might cost some secured creditors millions of dollars, the appeals court said, "We will not save such sophisticated parties from the consequences of their actions." *Id*. at 588.

By admitting that the plan flaunted *Purdue*, were all three Third Circuit judges on the *Boy Scouts* appeal politely recommending that the Supreme Court rule on equitable mootness?

The opinion is *In re Boy Scouts of America*, 23-1664 (3d Cir. May 13, 2025).

The Fifth Circuit declines to adopt a securities industry guidebook for what's a permissible financing.

Fifth Circuit Bans Uptier Financings for Violating the Principle of Ratable Treatment

In a remarkable opinion, the Fifth Circuit banned so-called uptier financings. The decision by Circuit Judge Andrew S. Oldham included an equally remarkable discussion of equitable mootness where the Fifth Circuit had no hesitation in reversing confirmation of a consummated chapter 11 plan that may mean millions of dollars in losses for some creditors.

Given the gravity of the December 31 opinion, we will deal with uptier financing today. Tomorrow, we will cover equitable mootness and issues related to relief that an appeals court can grant on reversing plan confirmation.

The Norm of Ratable Treatment

Judge Oldham began his opinion by saying, "Ratable treatment is an important background norm of corporate finance." It is, he said, "a lender's 'sacred right' under syndicated loan agreements."

"The norm of ratable treatment," Judge Oldham said, "provides that the borrower may not choose to repay only one of its lenders. Rather, it must proportionally allocate [the repayment] among the relevant lenders according to their share of the outstanding debt."

"Uptiers," Judge Oldham said, "are a relatively new and controversial exception to the ratable treatment norm . . . . They are controversial because, according to critics, uptiers create a zero-sum game of 'lender-on-lender violence.'"

Judge Oldham said that an uptier financing works by amending

> the terms of a credit facility to allow the issuance of new super-priority debt. Because a majority of lenders in the existing facility must typically consent to such an amendment, the borrower purchases consent by allowing these lenders to exchange their existing debt for new super-priority debt, often at an above-market price . . . . Since not all of the lenders participate in the uptier, the uptier is a non-*pro rata* transaction that violates the norm of ratable treatment.

Judge Oldham said that the advantages of an uptier include "play[ing] lender groups off of each other and avoid[ing] the expense of dealing with holdouts." Furthermore, "[t]he costs of an uptier transaction are borne entirely by the minority lenders, who end up with subordinated debt worth less than before."

The Serta Simmons Uptier Financing

Having extolled the virtues of ratable treatment, Judge Oldham described the uptier financing by bedding-maker Serta Simmons Bedding LLC.

In 2016, the company had sold a series of syndicated loans yielding $1.95 billion in first lien debt and $450 million in second lien loans.

To protect "the sacred right of *pro rata* sharing," Judge Oldham described the 2016 loan agreement as having a provision preventing the company from "pay[ing] its obligations to one lender while offering nothing to the rest." As further protection, he said that the agreement included another provision that "generally requires [the] unanimous consent of any affected lender to waive, amend, or modify" the *pro rata* sharing requirement. Other provisions in the agreement could be modified by a simple majority vote of lenders.

There were two exceptions to the *pro rata* repayment requirement. One was a "Dutch option," and the second was an "open market purchase." The loan agreement, Judge Oldham said, did not define "open market purchase." The "patent ambiguity in the undefined term," he said, "forms the foundation of this case."

With the company facing financial difficulty, Judge Oldham described how the company cobbled together an uptier financing in 2020 with some but not all of its first and second lien lenders. The parties and Judge Oldham called them the "Prevailing Lenders."

The Prevailing Lenders provided new $200 million financing in the form of first-out, super-priority debt. They traded $1.2 billion in existing financing for $875 million in second-out, super-priority debt. Overall, the deal gave the company more cash and less debt. However, Judge Oldham said that the deal allowed the Prevailing Lenders "to jump the creditor line and get paid before their erstwhile first and second lien comrades."

Anticipating litigation in the future, the Prevailing Lenders voted by a bare majority to amend the 2016 loan agreement to allow the uptier financing. They also labeled the uptier financing an "open market purchase."

There was more. The company agreed to indemnify the Prevailing Lenders for any losses or liabilities they might incur as a consequence of the uptier financing.

The Serta Simmons Chapter 11 Case

The company filed a chapter 11 petition in early 2023 in Houston. The case was assigned to Bankruptcy Judge David R. Jones, who resigned several months later.

Immediately, the debtor filed an adversary proceeding seeking a declaration that the uptier financing did not violate the 2016 loan agreement. Opposition came from lenders in the 2016 financing who were not among the Prevailing Lenders. The parties and Judge Oldham referred to the opponents as the "Excluded Lenders."

The bankruptcy court granted summary judgment to the Prevailing Lenders and held that the uptier financing was a permitted "open market purchase." The bankruptcy court certified a direct appeal, which the Fifth Circuit accepted.

After dismissing counterclaims for breach of contract asserted by the Excluded Lenders in the adversary proceeding, the bankruptcy court entered final judgment in favor of the debtor and the Prevailing Lenders. Again, the Fifth Circuit accepted a direct appeal.

The Chapter 11 Plan

Because the prepetition indemnification of the Prevailing Lenders would not survive confirmation of the debtor's chapter 11 plan, the plan gave the Prevailing Lenders a new indemnification. The bankruptcy court confirmed the plan and approved "the settlement indemnity [as] a fair and equitable component of a § 1123(b)(3) settlement," Judge Oldham said.

The Fifth Circuit accepted a direct appeal of the confirmation order.

Appellate Jurisdiction

Having consolidated four appeals, Judge Oldham first addressed the Fifth Circuit's appellate jurisdiction and the jurisdiction of the bankruptcy court. Meticulously but quickly, he decided that the bankruptcy court had jurisdiction and power to enter final judgments, with one exception.

The exception was state law breach-of-contract claims by the Excluded Lenders against the Prevailing Lenders, where the bankruptcy court did not have constitutional power to enter a final judgment under *Stern v. Marshall*, 564 U.S. 462, 482 (2011). However, Judge Oldham held that the lack of objection by the debtor and the Prevailing Lenders was implied consent under *Wellness International Network, Ltd. v. Sharif*, 575 U.S. 665 (2015), allowing the bankruptcy court to enter final judgment dismissing the Excluded Lenders' counterclaims.

Judge Oldham also held that the Fifth Circuit had appellate jurisdiction under 28 U.S.C. § 158(d).

It Wasn't an Open market Purchase

On the merits, Judge Oldham first undertook *de novo* review of the bankruptcy court's decision on summary judgment holding that the uptier financing was a permissible open market purchase. Under New York law governing the 2016 financing, he explained why the uptier financing was not an open market transaction.

By referencing dictionaries and by analogy to the Federal Reserve's open market activities, Judge Oldham concluded that "an open market purchase is a purchase of corporate debt that occurs on the secondary market for syndicated loans."

Judge Oldham added that "the words 'open market' point to a specific 'market,' not merely a general context where private parties engage in non-coercive transactions with each other." He rejected the idea "that there is an open market wherever there is competition." Properly, he said, "an open market is one tied to a specific market, like the stock market or the commodities market or the securities market."

Applied to the case at hand, Judge Oldham said that "an open market purchase occurs on the specific market for the product that is being purchased . . . , and the market for that product is the 'secondary market' for syndicated loans."

If the company had wanted to effect an "open market purchase and thereby circumvent the sacred right of ratable treatment," Judge Oldham said, "it should have purchased its loans on the secondary market. Having chosen to privately engage individual lenders outside of this market," he said that the debtor "lost the protection of" the provision in the 2016 loan agreement that gave an exception for open market purchases.

For the same reason that the uptier financing was not an open market transaction, Judge Oldham decided that it also was not subject to the exception for Dutch auctions.

Other Rejected Arguments

Of significance in future cases dealing with syndicated loans, Judge Oldham rejected the Prevailing Lenders' reliance on "a guide published by the Loan Syndications and Trading Association" (LSTA) to show "that industry usage supports their expansive definitions of 'open market purchase.'"

While the "LSTA guide carries some weight," Judge Oldham said, "it is not binding authority." Even if it were dispositive, he said that "its discussion of open market purchases does not support the 2020 Uptier."

Holding "that the 2020 Uptier was not a permissible open market purchase within the meaning of the 2016 Agreement," Judge Oldham reversed "the bankruptcy court's contrary ruling."

In one paragraph, Judge Oldham ruled in favor of the Excluded Lenders in their appeal from the bankruptcy court's denial of their counterclaims for breach of contract. He said that the counterclaims were "largely based" on the issue of open market purchases.

Judge Oldham reversed and remanded for reconsideration of the Excluded Lenders' breach of contract claims. In words the bankruptcy court likely will not ignore on remand, he added that "the Excluded Lenders have a strong case that [the debtor] and the Prevailing Lender plaintiffs breached the 2016 Agreement."

Observations

Prof. Stephen J. Lubben provided ABI with the following commentary:

> The Court's ruling on "open market purchases" was refreshingly sensible, compared to the typical hyper-literalism we normally see in corporate finance decisions. Too often courts say [that] "while the parties might not have intended this result, it was not technically prohibited, and the parties are sophisticated, so too bad for you."
>
> That just encourages even more outrageous abuse in the next case. I am hopeful that the *Serta* decision will reset the situation with regard to aggressive "liabilitymanagement transactions," which are often little more than a flagrant attempt to favor one group over another in the forthcoming chapter 11 case.

Among the commentators cited in his opinion, Judge Oldham included Prof. Lubben's "Holdout Panic," 96 AM. BANKR. L.J. 1 (2022). Prof. Lubben occupies the Harvey Washington Wiley Chair in Corporate Governance & Business Ethics at Seton Hall University School of Law.

The opinion is *Excluded Lenders v. Serta Simmons Bedding LLC (In re Serta Simmons Bedding LLC)*, 23-20181 (5th Cir. Dec. 31, 2024).

Fifth Circuit didn't permit plan proponents to structure a chapter 11 plan so that an appeal would be equitably moot.

Fifth Circuit Holds that Equitable Mootness Doesn't Protect Parties to the Appeal

Yesterday, we covered the *Serta Simmons* decision, where the Fifth Circuit decided that the company's uptier financing before bankruptcy was not a permissible "open market purchase" and thereby violated the Excluded Lenders' rights to ratable treatment.

Today, we cover the Fifth Circuit's narrowing of the doctrine of equitable mootness, thereby allowing the appeals court to set aside confirmation of the debtor's consummated chapter 11 plan at the cost of millions of dollars to some secured creditors.

Equitable Mootness Doesn't Protect Parties to the Appeal

Yesterday, we reported how the debtor's confirmed chapter 11 plan gave the Prevailing Lenders an indemnification by the debtor for any losses or liabilities they might incur for having participated in the prebankruptcy uptier financing. As we also reported yesterday, the Fifth Circuit decided that the uptier financing violated the rights of the Excluded Lenders.

The Prevailing Lenders argued that equitable mootness barred the appeals court from setting aside confirmation and granting relief to the Excluded Lenders.

Circuit Judge Andrew S. Oldham began his discussion of equitable mootness by calling it a "judge-created doctrine of pseudo-abstention," not a matter of "real mootness" that "implicates our jurisdiction under Article III."

Under Fifth Circuit authority, Judge Oldham said that equitable mootness turns on three factors: (1) whether there was a stay; (2) whether the plan was substantially consummated; and (3) whether granting relief would affect either the rights of parties not before the court or the success of the plan.

The plan had been substantially consummated, but the Excluded Lenders failed to obtain a stay pending appeal three times. Judge Oldham said that the Fifth Circuit "never said that the failure to obtain a stay mandates finding an appeal equitably moot."

Considering the rights of parties not before the court, Judge Oldham said that nixing the indemnification

> would affect [the debtor], which would no longer be on the hook for liability related to the 2020 Uptier, as well as those holders of super-priority debt who participated in the Uptier (*i.e.*, the Prevailing Lender plaintiffs). The former would benefit from excision; the latter would not. But both are present here.

In terms of affecting the plan, Judge Oldham said that the debtor "would face an easier future without a massive liability hanging over its head. So it is also unclear how excision [of the indemnification] would threaten the success of the Plan."

The debtor and the Prevailing Lenders contended that the appeals court could not excise the indemnification "without unwinding the entire Plan and triggering a whole new confirmation proceeding." Responding, Judge Oldham said, "[O]ur precedent does not indicate that the remedy of excision requires thus." Citing *In re Highland Cap. Mgmt. LP*, 48 F.4th 419, 430-31 (5th Cir. 2022), he added, "we have said just the opposite."

Given that removing indemnification would help the debtor, Judge Oldham said that "excision does not toll doom for the Plan, and the third factor properly weighs against equitable mootness."

Beyond the three factors pertaining to equitable mootness, the Prevailing Lenders contended that removing indemnification would be unfair because, as Judge Oldham said, they "agreed to support the Plan only because of the settlement indemnity."

Without indemnification, Judge Oldham recounted how the Prevailing Lenders said "they would have exacted some other consideration from [the debtor]." Accordingly, he said, they "contend it is unfair for this court to excise the indemnity now without letting them go back to the drawing board, which we cannot do without upending the Plan."

Judge Oldham gave the argument what he called "a full-throated rebuttal."

Were he to invoke equitable mootness, he said that "the appellees' argument would effectively abolish appellate review of even clearly unlawful provisions in bankruptcy plans. Parties supporting such provisions could always argue they would have done things differently if they had known the provisions would later be excised."

"From the moment the Prevailing Lender plaintiffs agreed to a controversial indemnity arising out of a contentious transaction," Judge Oldham said, "they could foresee the adverse consequences of an unfavorable appellate ruling."

Declining to dismiss the appeals as equitably moot, Judge Oldham said, "We will not save such sophisticated parties from the consequences of their actions."

Jevic Doomed the Plan's Indemnification

Having decided that the appeals were not equitably moot, Judge Oldham turned to the question of whether "the Plan's inclusion of the indemnity was an impermissible end-run around the Bankruptcy Code."

Citing Section 502(e)(1)(B), Judge Oldham said that "the bankruptcy court must disallow any contingent claim for reimbursement where the claiming entity is co-liable with the debtor." In fact, the Prevailing Lenders had filed proofs of claim based on their indemnification rights under the 2016 loan agreement, but they had agreed to disallow the claims under Section 502(e)(1)(B).

Judge Oldham said that the Prevailing Lenders "resurrected the pre-petition indemnity as a *settlement* indemnity." [Emphasis in original.] However, he said it was a "mistake" when the bankruptcy court approved the new indemnification as part of a settlement underlying the plan. It was, he said, "an impermissible end-run around § 502(e)(1)(B)'s disallowance of contingent claims for reimbursement."

To the Prevailing Lenders' contention that the indemnity was a settlement permissible under Section 1123(b)(3)(A), Judge Oldham said that "*Czyzewski v. Jevic Holding Corp.*, 580 U.S. 451 (2017)[,] is . . . directly applicable to these appeals." He "decline[d] to read § 1123(b)(3)(A) as an escape hatch from the Code's explicit disallowance of certain claims." [Recall that *Jevic* set aside a so-called structured dismissal that violated the rules of priority.]

Judge Oldham therefore held "that the Plan indemnity was an impermissible end-run around the Code."

The Indemnity Violated Equal Treatment

Even if the indemnity in the plan was a permissible settlement under Section 1123(b)(3)(A), Judge Oldham explained why "its inclusion in the Plan violated the Code's requirement of equal treatment." He said that the value of the indemnity "varied dramatically" depending on whether or not the lender had participated in the uptier financing.

For the Prevailing Lenders, Judge Oldham said that "the indemnity was potentially worth millions or even tens of millions of dollars." But for lenders who were not in the uptier, he said that "the indemnity was worth little or even nothing." He therefore held that "the Plan indemnity constituted impermissible unequal treatment."

The Remedy and the Admonition

Excising "the offending indemnity in . . . the Plan," Judge Oldham reversed "the bankruptcy court's final order confirming the Plan insofar as it approved the Plan's indemnity relating to the 2020 Uptier."

Judge Oldham said that the company's 2020 uptier "was the first major uptier . . . . But it was far from the last."

"Though every contract should be taken on its own, today's decision suggests that such exceptions will often not justify an uptier," Judge Oldham said.

Observations

Recall that Judge Oldham said, "We will not save such sophisticated parties from the consequences of their actions."

Judge Oldham's words should instill caution, if not fear, in the hearts of those contemplating chapter 11 plans in the Fifth Circuit with questionable provisions.

The bankruptcy court in Houston is considering a Johnson & Johnson subsidiary's third stab at a chapter 11 plan dealing with talc liability. If a plan is confirmed, an appeal presumably will find its way to the Fifth Circuit.

Does Judge Oldham's *Serta Simmons* opinion suggest that the Fifth Circuit might have a skeptical approach to a case that was twice dismissed in the Third Circuit on opinions by one of the circuits' foremost authorities on chapter 11?

The opinion is *Excluded Lenders v. Serta Simmons Bedding LLC (In re Serta Simmons Bedding LLC)*, 23-20181 (5th Cir. Dec. 31, 2024).

Picking up where Serta Simmons left off, the Fifth Circuit nixes another creative chapter 11 plan.

Another Fifth Circuit Humdinger: This Time, Limiting Gatekeeping

When it comes to limiting creative uses of chapter 11, the Fifth Circuit is on a roll.

On December 31, the Fifth Circuit barred so-called uptier financings that utilized creative drafting to evade provisions in bond indentures that demand "ratable treatment" whenever a debtor is paying some holders but not others. *Excluded Lenders v. Serta Simmons Bedding LLC (In re Serta Simmons Bedding LLC)*, 125 F.4th 555 (5th Cir. Dec. 31, 2024). To read ABI's report, click here.

In the reorganization of Highland Capital Management LP, the Fifth Circuit for the second time wrote an opinion on a direct appeal from confirmation. The circuit's first opinion in August 2022 authorized bankruptcy judges to be gatekeepers with power to stop groundless lawsuits aimed at people or entities involved in the reorganization. *NexPoint Advisors LP v. Highland Capital Management LP (In re Highland Capital Management LP)*, 48 F.4th 419, 424 (5th Cir. Aug. 19, 2022). To read ABI's report, click here.

In the second confirmation opinion on March 18, the Fifth Circuit said that gatekeeping "is patently beyond the power of an Article I court under § 105" if it protects anyone other than the debtor, independent directors, the creditors' committee and committee members for conduct within the scope of their duties.

In this writer's view, gatekeeping no longer has much practical significance in the Fifth Circuit, because those protected by gatekeeping are even better protected by exculpations.

The bigger question is this: After *Serta Simmons* and the new *Highland Capital* opinion, is the Fifth Circuit sending a message to bankruptcy judges about reining in exotic features of chapter 11 plans beyond uptier financings and gatekeeping?

In the Fifth Circuit's new *Highland Capital* opinion on March 18, only one circuit judge from the first panel was on the panel in the new case. One of the circuit judges from the *Serta Simmons* panel also was on the new *Highland Capital* panel.

Exculpations and Gatekeeping

In both *Highland Capital* opinions, the Fifth Circuit noted the "continued litigiousness" expected after confirmation from the debtor's former chief executive, who was forced out during the chapter 11 case. To head off continual litigation, the chapter 11 plan as originally confirmed included both exculpations and gatekeeping.

The exculpations, which might be viewed as equivalent to releases, were conferred on the debtors and its successors, the debtor's general partner, independent directors, the creditors' committee and its members, the professionals retained by the debtor and the committee, the debtor's new chief executive, and persons related to the foregoing.

The gatekeeping provisions were broader. No one could sue a "Protected Party" unless the bankruptcy court had first authorized the suit after deciding it made a "colorable claim."

The Protected Parties were broader than those receiving exculpations and included the debtor's subsidiaries, the reorganized debtor, the trust created by the plan, the trustees for the trust, and the creditors' oversight committee.

Entities related to the ousted chief executive took a direct appeal from confirmation of the plan containing exculpations and gatekeeping. In the 2022 opinion, the panel "reverse[d] only insofar as the plan exculpates certain non-debtors in violation of 11 U.S.C. § 524(e), str[uck] those few parties from the plan's exculpation, and affirm[ed] on all remaining grounds." *Highland Capital*, *supra*, 48 F.4th at 424. Specifically, the Fifth Circuit limited the exculpations to cover only the debtor, a trustee, the creditors' committee and committee members.

Following a motion for rehearing after the first opinion, Circuit Judge Jennifer Walker Elrod said in the new March 18 opinion that the appeals court granted panel rehearing and modified the original opinion. In the modified opinion, she said,

> We granted panel rehearing and made one substantive change to the opinion: deleting the sentence, "The injunction and gatekeeper provisions are, on the other hand, perfectly lawful," and replacing it with the sentence, "We now turn to the Plan's injunction and gatekeeper provisions." *Id.* at 438.

On remand in bankruptcy court, the debtor proposed amending the exculpations as directed by the Fifth Circuit. Over objection by entities related to the ousted chief executive, the bankruptcy court did not narrow "Protected Parties" to line up with those receiving exculpations. *See In re Highland Capital Management LP*, 2023 BL 66255 (Bankr. N.D. Tex. Feb. 27, 2023). To read ABI's report, click here.

For a second time, the Fifth Circuit accepted a direct appeal of the chapter 11 plan as modified.

Limits on Gatekeeping Power

On the second appeal, Judge Elrod stated the question as being "whether the bankruptcy court erred in failing to narrow the definition of 'Protected Parties' used in the Gatekeeper Clause coextensively with its narrowing of the definition of 'Exculpated Parties.'"

Citing Fifth Circuit authority, Judge Elrod said that Section 105(a) does not give a bankruptcy court a "roving commission to do equity." She added, "[W]e have always recognized and enforced limitations on bankruptcy courts' power to shield non-debtors from liability."

Citing the Supreme Court's *Purdue* opinion last term and the Fifth Circuit's opinions in *In re Pac. Lumber Co.*, 584 F.3d 229 (5th Cir. 2009), and *In re Zale Corp.*, 62 F.3d 746 (5th Cir. 1995), Judge Elrod said that the two courts "have definitively held that bankruptcy courts may not approve a confirmation plan that non-consensually releases non-debtors from liability related to a bankruptcy proceeding."

Taking a victory lap given that *Zale* and *Pacific Lumber* anticipated *Purdue* by decades, Judge Elrod said,

> [T]his court had held the same [as *Purdue*]: . . . any provision that non-consensually releases non-debtors from liability for debts and/or conduct, and any injunction that acts to shield non-debtors from such liability, must be struck from a bankruptcy confirmation plan.

Although the Fifth Circuit "recognized that bankruptcy courts have some power to perform gatekeeping functions," Judge Elrod said, "they nonetheless do not have unrestricted power to protect non-debtors from liability via a pre-filing injunction." She added, "[W]e have never extended the *Barton* doctrine to give bankruptcy courts gatekeeping power over claims against non-debtors."

The Holding

Drawing from the 2022 opinion in *Highland Capital* and the revised opinion after rehearing, Judge Elron held:

> The clear weight of Supreme Court and Fifth Circuit precedent dictates our holding: that a proper reading of *Highland I* requires that the definition of "Protected Parties" used in the Plan's Gatekeeper Clause be narrowed coextensively with the definition of "Exculpated Parties" used in the Exculpation Provision. Any other reading of *Highland I* would improperly grant the bankruptcy court authority to enforce what is *perhaps the broadest gatekeeper injunction ever written into a bankruptcy confirmation plan*. Such authority is patently beyond the power of an Article I court under § 105. [Emphasis added.]

To ensure there would be no mistake, Judge Elrod reversed and remanded for the district to:

> revise the Plan's definitions of both "Exculpated Parties" and "Protected Parties" to read simply: "collectively, (i) the Debtor; (ii) the Independent Directors, for conduct within the scope of their duties; (iii) the Committee; and (iv) the members of the Committee in their official capacities, for conduct within the scope of their duties."

Observations

In the comment box below, we invite readers to offer their views on questions like the following:

1. Are *Serta Simmons* and the new *Highland Capital* opinions remarkable, or are they nothing more than reflections of the Fifth Circuit's longstanding prohibition of nondebtor releases?
2. Do *Serta Simmons* and *Highland Capital* have significance beyond uptier financings and gatekeeping?
3. In *Serta Simmons* and *Highland Capital*, is the Fifth Circuit sending a message to bankruptcy judges in the Fifth Circuit to be leery about exotic features chapter 11 plans?
4. Do the two opinions suggest anything about how the Fifth Circuit will rule should opt in vs. opt out come up on appeal?

The opinion is *Highland Capital Management Fund Advisors LP v. Highland Capital Management LP (In re Highland Capital Management LP),* 23-10534 (5th Cir. March 18, 2025).

Fourth Circuit says there's nothing in the Bankruptcy Code requiring 'anti-fraud' provisions in a mass tort chapter 11 plan. The appeals court also holds that an 'asbestos' plan isn't filed in bad faith when the plan gives an insurer no more rights than the insurer has under its policy.

On Remand from the Supreme Court in *Truck Ins.*, Fourth Circuit Upholds Confirmation

On remand following the Supreme Court's reversal 11 months ago in *Truck Ins. Exch. v. Kaiser Gypsum Co.*, 602 U.S. 268 (Sup. Ct. June 6, 2024), the Fourth Circuit upheld confirmation of the debtor's chapter 11 plan dealing with asbestos claims.

The Supreme Court reversed last year, ruling that the insurer had standing to object to confirmation of the plan even though the plan was "insurance neutral."

On different issues arising on remand, the April 29 opinion by Circuit Judge G. Steven Agee holds that the plan was filed in good faith because it gave the insurer only the rights the insurer had under the existing insurance policy. Good faith does not require giving the insurer more rights than those already contained in the existing policy, even when other parties under the plan have more rights of defense than the insurer.

Among other things, the appeals court said that sending insured claims through the tort system rather than through the trust created by the plan was "not evidence of bad faith."

The Asbestos Plan

Facing 14,000 pending lawsuits, the corporate debtor proposed a chapter 11 plan under Section 524(g) to create a trust wiping away present and future asbestos claims. All asbestos claims were channeled to a trust.

The principal asset for the trust was the debtor's primary insurance policy, with a coverage limit of $500,000 per claim. The insurer was obliged by the policy to defend and indemnify the debtor, even if the claims were false or fraudulent. Defense costs were not counted against the policy limit for each claim, meaning that the policy was non-eroding. The policy had no maximum aggregate limit.

Asbestos claims under the plan were divided into two classes: (1) insured claims covered by the policy; and (2) uninsured claims not covered by the policy. Uninsured claims, of which there were few, were to be paid entirely by the trust.

Claims covered by insurance were to be litigated nominally against the debtor in the tort system, but subject to the coverage limit for each claim. The trust would pay a $5,000 deductible for each insured claim.

The claims covered by insurance remained subject to the insurer's prepetition coverage defenses. Thus, the insurer was liable for any claim that fell under the unmodified terms of the policy.

The trust was funded by the insurance policy, $49 million from the debtor's parent and a $1 million note issued by the debtor.

The uninsured claims were subject to anti-fraud provisions under the plan to protect the trust by requiring the claimants to provide disclosures designed to avoid fraud and duplicate claims. The plan had no anti-fraud provisions for insured claims.

Unsecured creditors were to be paid in full.

Asbestos claimants, the only class impaired by the plan, voted unanimously in favor of the plan. The only confirmation objection came from an insurer. The insurer was not entitled to vote because its unsecured claim would be paid in full. The insurer retained all its rights under the insurance policy.

Confirmation and Appeals

The insurer objected to confirmation, contending that the plan was not proposed in good faith and was not insurance neutral for lack of anti-fraud provisions covering insured claims. The bankruptcy court wrote an opinion recommending that the district court approve the plan, finding that it was insurance neutral and filed in good faith. The bankruptcy court also decided that the plan met all requirements for an asbestos plan under Section 524(g).

Because the plan was insurance neutral, the bankruptcy court concluded that the insurer was not a party in interest under Section 1109(b) and thus lacked standing to lodge an objection to the plan.

The district court confirmed the plan, adopting the bankruptcy court's findings *in toto* after *de novo* review. *In re Kaiser Gypsum Co.*, 16-31602, 2021 WL 3215102 (W.D.N.C. July 28, 2021).

On appeal, the Fourth Circuit affirmed. *Truck Insurance Exchange v. Kaiser Gypsum Co. (In re Kaiser Gypsum Co.)*, 60 F.4th 73 (4th Cir. Feb. 14, 2023), *cert. granted sub nom. Truck Ins. Exch. v. Kaiser Gypsum Co.*, No. 22-1079, 2023 WL 6780372 (Oct. 13, 2023). To read ABI's report on the Fourth Circuit affirmance, click here.

Finding the plan "insurance neutral," the Fourth Circuit believed that the insurance company had no standing in the bankruptcy court or on appeal to object to the merits of the plan pertaining to any aspects of the plan other than insurance neutrality. In a footnote, the appeals court said that the insurer had Article III, or constitutional, standing to challenge the finding of insurance neutrality.

The insurer filed a petition for *certiorari*, based on a split of circuits. The Court granted *certiorari* and heard argument in March 2024. The Supreme Court reversed on June 6, 2024.

For a unanimous Court, Justice Sonia Sotomayor explained why the insurer had standing even though the plan was insurance neutral:

> The fact that [the insurer's] financial exposure may be directly and adversely affected by a plan is sufficient to give [the insurer] . . . a right to voice its objections in reorganization proceedings.

Truck Ins. Exch., supra, 602 U.S. at 284. To read ABI's report on *Truck Insurance*, click here.

Dealing only with standing, the opinion was narrow and did not reach the merits regarding the insurer's plan objections. The Court reversed and remanded for further proceedings.

Good Faith

Reaching the merits for the first time on remand, Judge Agee said that the Fourth Circuit was confronted with two questions: (1) Was the plan proposed in good faith as required by Section 1129(a)(3), and (2) did the plan satisfy the four requirements for an asbestos plan under Section 524(g)?

On good faith, Judge Agee said that the Fourth Circuit has never declared what it means in the confirmation context. However, he said that the court "must consider the totality of the circumstances." The plan, he said, was found by the district court to be the product of arm's-length negotiations and comported "with the objectives of the Bankruptcy Code."

Judge Agee said that the "unchallenged" findings by the district court "satisfie[d] § 1129(a)(3)'s good faith requirement."

In derogation of the good faith findings, Judge Agee said that the insurer "bristles at the fact that insured asbestos claims — but not uninsured asbestos claims — are to be litigated in the tort system under the Plan." However, he said that "bankruptcy courts routinely allow claimants to pursue insured claims through the tort system, a fact that [the insurer] does not contest." Referring to the case at hand, he said that "the Debtors' refusal to add anti-fraud measures for the insured claims in the tort system, without more, does not signify bad faith."

"Simply put," Judge Agee said,

> the Debtors are merely utilizing the contractual insurance rights to which they are entitled. [The insurer's] dissatisfaction with this state of affairs does not give it a cognizable basis to rewrite the policy it freely entered under the guise of the Debtors' purported "bad faith."

In response to the insurer's contention that the tort system does not deal adequately with fraudulent claims, Judge Agee said, "The adversarial and discovery processes in state and federal courts are more than enough to protect [the insurer] from the fraudulent claims that it fears will occur." He added, "Unless and until [the insurer] provides concrete evidence to support its position, its concerns will remain purely speculative and thus cannot support its bad faith argument."

Stopping short of laying down a rule for all cases, Judge Agee said that "the necessity of [anti-fraud provisions] will inevitably vary on the facts of any given case." On the other hand, he said "there is nothing in the Bankruptcy Code that legally requires" anti-fraud provisions.

Judge Agee affirmed the district court's finding of good faith.

Section 524(g)

The final section of Judge Agee's opinion dealt with the issue of whether or not the plan satisfied the additional confirmation requirements for asbestos plans contained in Section 524(g).

Judge Agee conducted a detailed analysis of the plan and concluded that the plan complied with Section 524(g). Anyone confronting an asbestos plan should read the opinion in full text to understand how the debtor structured the plan to comply with Section 524(g).

Judge Agee's decision is a blueprint for drafting a mass tort plan in compliance with Section 524(g). He affirmed the judgment of the district court confirming the plan.

The Concurrence

Circuit Judge Arthur M. Quattlebaum, Jr., "joined the majority opinion" but wrote "separately to point out that [the insurer] has company in failing to point to evidence to support its position about good faith."

Judge Quattlebaum agreed that the district court's findings on good faith were not clear error. He said that the debtor had not given "much of a response" at oral argument to explain why the debtor "would not require or provide anti-fraud-related disclosures and authorizations to [the insurer]."

Judge Quattlebaum said that the information sought in the anti-fraud provisions was "so basic that any asbestos plaintiff would be required to provide it in discovery. So, I do not understand why [the debtor] would not agree to require claimants, at the outset, to provide the information [that the insurer] seeks."

Because the insurer "did not point to specific evidence of actual claimants committing fraud in this case," Judge Quattlebaum "concur[red] in the majority's decision."

The opinion is *Truck Insurance Exchange v. Kaiser Gypsum Co. Inc. (In re Kaiser Gypsum Co. Inc.)*, 21-1858 (4th Cir. April 29, 2025).

In the Spirit Airlines reorganization, no creditors with an economic interest had opposed confirmation of a plan with opt-out releases for nondebtors.

Opt-Out Plan Confirmed with Impaired Creditors Almost Unanimous in Support

Confirming the chapter 11 plan for Spirit Airlines, Bankruptcy Judge Sean Lane of New York wrote an opinion that could be read to mean that the Supreme Court's *Purdue* decision in June did not affect pre-existing authority in the Southern District of New York allowing so-called opt-out plans to confer releases on nondebtors.

The March 7 decision by Judge Lane differs from the *Smallhold* opinion by Delaware's Bankruptcy Judge Craig T. Goldblatt, who excised releases from creditors who did not vote and were not given a chance to opt out. However, Judge Goldblatt allowed releases to be given by creditors who voted for or against the plan, if they did not opt out. *In re Smallhold Inc.*, 665 B.R. 704 (Bankr. D. Del. Sept. 25, 2024). To read ABI's report, click here.

The Opt-Out Plan

The debtor negotiated a "prepackaged" chapter 11 plan. Among other things, the plan converted $800 million of notes into new equity, included a $350 million backstopped equity offering, was financed in part by a new revolving credit facility, and paid priority and unsecured claims in full or left them unimpaired.

Senior noteholders were impaired by the plan but voted 100% in favor of the plan. In another impaired class, holders of convertible notes voted 95.5% in number and almost 100% in amount in favor of the plan. Naturally, existing equity interests were extinguished and deemed to have rejected the plan.

Judge Lane had held a confirmation hearing and entered an order on February 20 confirming the plan. He found that the plan satisfied the requirements for confirmation. However, he left open the question of whether the plan's nondebtor releases were permissible following the Supreme Court's decision in *Harrington v. Purdue Pharma L.P.*, 144 S. Ct. 2071 (2024). To read ABI's report on *Purdue*, click here.

In his March 7 opinion, Judge Lane explained why the opt-out plan was permissible after *Purdue*.

SEC and U.S. Trustee Alone Object

The plan contained releases in favor of the major nondebtor players in the reorganization. With the opportunity to opt out, the plan contained releases binding unimpaired creditors along with the impaired senior and convertible noteholders. Notably, 98.1% of the senior and convertible noteholders had consented in writing to the releases by having signed the restructuring support agreement negotiated before filing.

Simplified, the plan provided that creditors would have consented to the nondebtor releases by (1) voting for or against the plan without checking the opt-out box on the ballot, (2) abstaining from voting but not checking the opt-out box, or (3) failing to submit a form with the opt-out box checked. Judge Lane said that 190 opt-out elections had been received.

The only objections to the releases came from the U.S. Trustee and the Securities and Exchange Commission. The U.S. Trustee took the position that *Purdue* requires affirmative consent. The SEC took a narrower approach by contending that the failure to return a ballot not was evidence of consent.

Almost All Impaired Creditors Had Written Consents

Addressing the objections, Judge Lane began by saying that "*Purdue Pharma* made it clear that *consensual* third-party releases were not the subject of its decision." [Emphasis in original.] He went on to say that "*Purdue Pharma* expressly declined to discuss how parties may manifest their consent to third-party releases."

Judge Lane defined an opt-out plan as one where the creditor doesn't return a form with the opt-out box checked. An opt-in plan is one where the party must return a form and check a box indicating consent to granting releases.

Reviewing cases decided before *Purdue*, Judge Lane said that "the majority of judges" in New York did not require opting in, as long as the parties were given "clear and prominent notice and explanation of the releases and [were] provided an opportunity to decline to grant them."

In cases decided after *Purdue*, Judge Lane cited *In re Roman Cath. Diocese of Syracuse*, 2024 Bankr. LEXIS 2807, at *5 (Bankr. N.D.N.Y. Nov. 14, 2024), as allowing creditors to evidence consent by having been given the opportunity to opt out. To read ABI's report, click here. Next, he cited *In re Tonawanda Coke Corp.*, 662 B.R. 220, 223 (Bankr. W.D.N.Y. 2024), where the ability to opt out wasn't enough. However, *Tonawanda* involved a chapter 11 plan with a tiny distribution and large tort claims. To read ABI's report, click here.

"Given the weight of the authority in this Circuit," Judge Lane held "that the proposed Third-Party Releases here are consensual — and the proposed opt-out mechanism permissible." Among

other things, he noted that the releases were "clearly worded and prominently presented in all of the Plan materials." Distinguishing *Tonawanda*, he said that the case before him was "not a situation where the affected parties have little or no economic incentive to pay attention to the bankruptcy, such as where a creditor is receiving no recovery or a *de minimus* one."

Of perhaps most importance, Judge Lane noted that the only impaired creditors granting releases were parties to the restructuring support agreement that had been signed by 98.1% of the holders of impaired claims. "As for parties who voted on the Plan but did not exercise the opt-out," he said, "those parties have manifested their intent by taking the affirmative act of voting on the Plan while declining to exercise the opt-out."

For Judge Lane, the "most difficult" category included creditors who were not voting but were deemed to have accepted the plan, and those who could have voted but didn't. For those groups, he said that they had been given "a clear and prominent vehicle for opting out." Furthermore, he said "that no concerns as to the Third-Party Releases were raised by the Committee, which represents all unsecured creditors (and thus all of the classes of creditors who are being asked to provide the Third-Party Releases)."

Factually, Judge Lane distinguished pre-*Purdue* cases relied on by the objectors.

Authorities Outside the Second Circuit

Following *Purdue*, Judge Lane said that "the majority of courts outside this jurisdiction have permitted an opt-out mechanism for a consensual release given circumstances similar to those presented here." He cited *In re Lavie Care Ctrs*., 2024 Bankr. LEXIS 2900 (Bankr. N.D. Ga. Dec. 5, 2024); and *In re Robertshaw US Holding Corp.*, 662 B.R. 300 (Bankr. S.D. Tex. 2024). To read ABI's reports, click here and here. Judge Lane said that the "Objectors rely on several cases outside the Second Circuit that are distinguishable from the facts here."

Judge Lane considered the objectors' reliance "on the thoughtful discussion of releases" by Bankruptcy Judge Goldblatt in *Smallhold*. There, he said that parties who "did not have the opportunity to vote on the plan could not be found to consent to the third-party release, notwithstanding the ability to opt out." *Smallhold*, he said, could not be reconciled with authorities in the Fifth Circuit, where nonconsensual third-party releases have never been permitted. Courts in that circuit, he said, "have routinely allowed consensual releases using an opt-out mechanism before *Purdue Pharma*."

Analogy to Contract Law

Judge Lane ended his 47-page opinion by addressing the U.S. Trustee's contention that the releases were not permissible as a matter of contract law, similar to the analysis by Judge Goldblatt

in *Smallhold*. He said that the Restatement (Second) of Contracts "clearly recognizes that silence and/or inaction may constitute consent" in three circumstances.

Prominently, Judge Lane said that "silence and inaction will constitute acceptance of an offer when 'the offeror has stated or given the offeree reason to understand that assent may be manifested by silence or inaction, and the offeree in remaining silent and inactive intends to accept the offer.' Restatement (Second) of Contracts § 69(1)(b)." The exception, he said, was "tricky" when applied to nonvoting creditors.

However, Judge Lane found no reason to decide the question as a matter of contract law "given the Court's conclusions above that consent exists as to these creditors under applicable federal bankruptcy law."

Approving the releases "and the opt-out mechanism in the Plan," Judge Lane directed the parties to submit an order consistent with the confirmation order.

Observations

Judge Lane's opinion is an excellent survey of pre- and post-*Purdue* caselaw on opt-in versus opt-out. The opinion, however, may have limited precedential value because no one with an economic interest opposed the releases. Moreover, noteholders with an economic interest had given virtually unanimous written consents to the releases.

Keeping in mind that general unsecured creditors were unimpaired, Judge Lane's decision might be seen as standing for the principle that nondebtor releases are permissible when impaired creditors are overwhelmingly in favor of the releases and everyone else is paid in full.

The opinion is *In re Spirit Airlines Inc.*, 24-11988 (Bankr. S.D.N.Y. March 7, 2025).

Another bankruptcy court in New York holds that the ability to opt out of nondebtor releases represents consent after Purdue.

Opting Out Is Consent for Nondebtor Chapter 11 Releases, New York Judge Says

Confirming a chapter 11 plan, Chief Bankruptcy Judge Martin Glenn of New York explained why, in his view, state law rules about contract formation don't control when deciding whether the opportunity to opt out represents consent making nondebtor releases permissible after *Harrington v. Purdue Pharma L.P.*, 602 U.S. 204 (2024). The decision by Judge Glenn is being appealed by the U.S. Trustee.

The debtor was a large Latin American airline with about $4 billion in funded debt, more than half of which was secured. The result of numerous compromises, the debtor proposed a plan that extinguished about $2.5 billion of debt, some in exchange for new equity.

The plan included nondebtor releases in favor of the creditors' committee and its members, along with creditors and groups of creditors who were engaged in financing and negotiating the plan. The releases covered claims "based on or relating to, or in any manner arising from, in whole or in part," the chapter 11 case, in the broadest sense.

The plan also included an exculpation for the released parties and a broadly worded injunction barring creditors and "parties in interest" from taking action to interfere with implementation of the plan.

Creditors were given the option of opting out of releases by checking a box on the ballot. The nondebtor releases were binding on creditors — whether they voted for or against the plan or abstained from voting — as long as they did not check the opt-out box.

As Judge Glenn said in his May 22 opinion, the releases were not binding on those "who could not vote because they are impaired under the Plan and were deemed to have rejected the Plan."

Creditor classes accepted the plan by wide majorities. There were several hundred opt-outs, mostly from holders of funded debt.

The debtor resolved all objections to confirmation apart from two objections by the U.S. Trustee.

The government watchdog contended that the releases were not consensual and that the plan-support injunction was too broad. More specifically, Judge Glenn described the U.S. Trustee as contending "that there is no federal bankruptcy law to determine what consent is, [that] state law must apply, and that under state law, opt-outs are impermissible and do not manifest consent." In addition, the U.S. Trustee argued "that there is no authority in the Code for an injunction barring claims between nondebtors."

What Governs Consent: State or Federal Law?

Whether state or federal law governs consent, Judge Glenn said, "ultimately decides whether opt-outs are appropriate in these circumstances."

For Judge Glenn, the first question was whether nondebtor releases can be part of a chapter 11 plan or whether they must be "separate contracts." He said it was "necessary to look first at *Purdue's* analysis of 1123(b) to determine whether the Court narrowed subsection (b) to such an extent that it cannot encompass consensual third-party releases." He concluded that the "Court did not so narrow the statute."

Judge Glenn said it would be "too cramped a reading of *Purdue*" if one were to conclude that Section 1123(b)(6) permits "only those plan provisions which concern relationships between the debtor and another entity (not between two third parties)." He reached his conclusion in large part based on *U.S. v. Energy Resources Co.*, 495 U.S. 545 (1990), a Supreme Court decision relied upon by both the majority and the dissent in *Purdue*.

Judge Glenn read *Energy Resources* "as permitting chapter 11 plans to affect creditor-non-debtor relationships." He added that the majority in *Purdue* "was careful to state that it did not wish its ruling to affect the propriety of *consensual* releases," and that *Purdue* "should not be read to significantly curtail the scope of bankruptcy courts' powers under section 1123(b)(6)." [Emphasis in original.]

Citing the Fifth Circuit's prohibition of nonconsensual, nondebtor releases even before *Purdue*, Judge Glenn said, "Courts in the Fifth Circuit have long allowed releases via opt-outs, and they continue to do so post-*Purdue*. *See, e.g., In re Robertshaw US Holding Corp.*, 662 BR 300, 323 (Bankr. S.D. Tex. 2024)." He added, "None of these Fifth Circuit cases have focused on *state law* in deciding whether opt-outs are permissible." [Emphasis in original.] To read ABI's report on *Robertshaw*, click here.

"In short," Judge Glenn said,

> [T]he caselaw strongly indicates that courts in the Fifth Circuit find that bankruptcy courts have authority under federal law, most likely section 1123(b)(6), to grant consensual third-party releases, as they assess the validity of

> those releases under a federal, not state, law rubric. This logic existed prior to *Purdue* and survives it.

Closer to home, Judge Glenn cited a recent decision by New York's Bankruptcy Judge Sean Lane, who "recently recognized in his *Spirit Airlines* decision [that] the weight of the caselaw in this district has found that federal bankruptcy law applies. *In re Spirit Airlines, Inc.*, 24-11988, 2025 WL 737068, at *9 (Bankr. S.D.N.Y. Mar. 7, 2025)." To read ABI's report on *Spirit Airlines*, click here.

Judge Glenn also found a practical reason for concluding that federal law, not state contract law, governs consent to nondebtor releases: "The potential need to engage in untold numbers of individualized choice-of-law analyses cuts in favor of applying federal law, for the sake of both judicial efficiency and the Code's goal of creating a centralized bankruptcy law."

Courts that Employ State Law

Judge Glenn cited decisions from Delaware, New York and the Ninth Circuit that "found that third-party releases must be standalone contracts, separate from the chapter 11 plans, and thus draw their power from state contract law, not federal law." Prominently, he cited *In re Smallhold, Inc.*, 665 B.R. 704 (Bankr. D. Del. 2024), and *In re Tonawanda Coke Corp.*, 662 B.R. 220 Bankr. W.D.N.Y. 2024). To read ABI's reports, click here and here.

Judge Glenn said that each opinion looking to state law "misses that (1) section 1123(b)(6) provides bankruptcy courts with such authority and (2) federal waiver doctrines also provide the background and applicable federal law."

Jurisdiction

The U.S. Trustee argued that the bankruptcy court had no jurisdiction to impose waivers or releases between nondebtors. "If the creditor has consented to the bankruptcy court's jurisdiction over non-core claims," Judge Glenn said, "the court can issue a final order and thereby release the claim."

Judge Glenn cited *Wellness Int'l Network, Ltd. v. Sharif*, 575 U.S. 665, 684-5 (2015), for the proposition that consent need not be express but may be implied, as long as it is knowing and voluntary. In the case before him, he found consent because the creditors had been served and did not raise a constitutional objection. In terms of adequacy of notice, he said that the fact that a "significant number of creditors both voted and chose to opt out of releases here indicates that there has been adequate service of process."

Judge Glenn overruled the objections and confirmed the plan.

Update

The U.S. Trustee has appealed. As counsel for the regional U.S. Trustee, the notice of appeal lists, among others, the General Counsel from the Executive Office for U.S. Trustees from Washington, D.C.

Observations

Prof. Ralph Brubaker provided ABI with the following commentary:

> The *GOL* opinion gets one thing right: It is impossible to determine what constitutes sufficient consent to release a third-party, nondebtor's claim included in a plan without first determining what authorizes inclusion of such a release in the plan.
>
> The conclusion that § 1123(b)(6) provides such authority, however, simply cannot be squared with *Purdue Pharma*'s interpretation of § 1123(b)(6) as only authorizing plan provisions "which concern *the debtor* — its rights and responsibilities, and its relationship with its creditors," *not* those of a nondebtor.
>
> The bankruptcy courts simply do not have the power (under the Bankruptcy Code or otherwise) to create, at their own behest, a settlement-only class-action process for creditors' direct claims against nondebtors.

For further analysis, *see* Ralph Brubaker, *Taking the* Purdue Pharma *Decision Seriously: Not Even* Consensual *Nondebtor Plan Releases Are Permissible (Part I)*, 45 Bankr. L. Letter No. 3 (Mar. 2025).

Prof. Brubaker is the James H.M. Sprayregen Professor of Law at the University of Illinois College of Law.

The opinion is *In re GOL Linhas Aéreas Inteligentes SA*, 24-10118 (Bankr. S.D.N.Y. May 22, 2025).

Bankruptcy Judge Paul Baisier of Atlanta disagreed with Bankruptcy Judge Craig Goldblatt of Delaware about requiring creditors to vote before they are saddled with nondebtor releases in chapter 11 plans.

Bankruptcy Courts Don't Agree on What's a 'Consensual' Nondebtor Release

Since the Supreme Court handed down *Purdue*, bankruptcy courts in reported decisions have different answers for an unanswered question: What constitutes a "consensual" release given to nondebtors in a chapter 11 plan?

In an opinion on December 5, Bankruptcy Judge Paul Baisier of Atlanta decided that creditors who were given notice have conferred consensual releases in favor of nondebtors if they neither vote nor opt out.

Judge Baisier's holding is at odds with a decision in late September by Delaware Bankruptcy Judge Craig T. Goldblatt, who held that a creditor would be bound by a nondebtor release if the creditor voted on the plan but did not opt out. A creditor who did not vote would not be bound. *In re Smallhold Inc.*, 24-10267, 2024 BL 337399, 2024 WL 4296938 (Bankr. D. Del. Sept. 25, 2024). To read ABI's report, click here.

Judge Baisier aligned himself with Bankruptcy Judge Christopher M. Lopez of Houston, who imposed nondebtor releases on anyone who did not opt out, including creditors who did not vote on the plan. *In re Robertshaw US Holdings Corp.*, 24-90052, 2024 BL 292649, 2024 Bankr. Lexis 1958 (Bankr. S.D. Tex. Aug. 16, 2024). To read ABI's report, click here.

The Atlanta Debtors

The 282 debtors before Judge Baisier had been operators of 140 nursing homes. Mediation resulted in agreement on a chapter 11 plan.

Judge Baisier said that the plan "provides for a full release of claims against various third parties who made substantial contributions to this case and their affiliates by any creditor who does not affirmatively opt out of the release." He added that "the Plan would not be possible, and unsecured creditors (and even certain of the secured creditors) would most likely get nothing from any other possible resolution of these cases."

The debtor sent the plan, disclosure statement and ballots to some 6,400 creditors, but only 850 votes were cast. In other words, only 13% of creditors voted.

The ballots contained a box that a creditor could check to opt out. The plan did not permit creditors to vote for the plan but opt out, and creditors who did not vote would be bound by the releases. In substance, any creditor who did not check the opt-out box would be giving a release.

Among those who voted, Judge Baisier said that "well over" 500 opted out. He added that "the vast majority of the 'opt out' ballots were submitted by those who voted against the Plan." One class of creditors did not approve the plan, requiring Judge Baisier to confirm the plan via cramdown.

What's 'Consensual'?

The U.S. Trustee lodged the only objection to confirmation, contending that an opt-out release is not consensual. Judge Baisier said that *Purdue* did not question the efficacy of consensual releases, nor did the Court say what a consensual release is. *See Harrington v. Purdue Pharma L.P.*, 144 S. Ct. 2071 (2024). To read ABI's report, click here.

Having found no "circuit level decisions addressing the issue of whether an opt-out mechanism renders a third-party release consensual," Judge Baisier said that "an overwhelming majority of [decisions by bankruptcy courts] find that a creditor's vote to accept a plan containing a third-party release (like the Plan) makes the release consensual, and this Court agrees."

"A somewhat harder question," Judge Baisier said, "is whether a party that votes to reject the Plan or sends a ballot abstaining from voting has consented to the Release if they do not choose to opt out."

The "hardest question," he said, "is what to do with creditors that take no action." On that question, he said that courts "are markedly split on the issue, with some categorically finding that a release cannot be consensual absent an affirmative act to opt in, and others finding that opt-out mechanisms that (as is the case here) provide adequate notice and a simple opt-out process can result in a consensual release."

In *Smallhold*, Judge Baisier said that "Judge Goldblatt transitioned away from a default model of determining consent to a third-party release to another model for making that determination — a contract model." He went on to say that "the basis for the enforcement of consensual releases has not as far as this Court has been able to determine been described anywhere as a 'contract' for them."

For himself, Judge Baisier said "evidence of consent . . . appears to be the touchstone for determining whether a creditor can be bound to a release."

Employing the evidence-of-consent standard, Judge Baisier held that creditors who voted for the plan have consented. Similarly, he held that creditors who voted against the plan would be giving releases if they did not check the opt-out box.

Judge Baisier then dealt with the 5,550 creditors who did not vote. If someone received a ballot, he said, "You cannot simply ignore it." That is to say, someone who did not vote would be giving releases.

"However, that is not the end of the story," Judge Baisier said. He created a rebuttable presumption that silence is acceptance.

"As to any individual creditor there may be some set of facts . . . that would make it unreasonable to assume that their failure to respond constitutes their consent to the result," Judge Baisier said. As examples, he mentioned someone in the hospital or not residing where the plan was sent.

To allow for rebutting the presumption, Judge Baisier held that the confirmation order must provide "an opportunity for those people and entities to make a case to this Court sometime after confirmation that they should not be bound, [and] that they should not be 'deemed' to have consented." Furthermore, he said that the "opportunity cannot be time-bounded but should include some provision that requires the party seeking relief to identify the claims or types of claims they seek to pursue and the identities or types of defendants they intend to seek them against."

Observations

The decision by Judge Baisier does not scribe a bright line regarding creditors who did not vote. Let's see whether debtors and releasees will be satisfied with the possibility of having thousands of creditors entitled to opt out after confirmation.

Regarding creditors who do not vote, this writer believes that the definitive opinion ultimately will be based on due process concepts. By analogy, notice by publication has been sufficient for discharging claims held by unknown creditors. But will the same concept hold for barring creditors from suing nondebtors?

And what about acceptance of a distribution by a creditor who did not vote? If voting is required to impose releases (as Judge Goldblatt held), does accepting a distribution, no matter how small, effect a release of nondebtors? And what's the result when nondebtors contribute no cash or property toward creditors' distributions?

And what if the distribution is small, as it was in *In re Tonawanda Coke Corp.*, 662 B.R. 220 (Bankr. W.D.N.Y. Aug. 27, 2024). There, Chief Bankruptcy Judge Carl L. Bucki of Buffalo, N.Y.,

decided that state contract law does not permit a plan to confer releases on nondebtors when creditors are only entitled to opt out. The plan had $300,000 for distribution among creditors with more than $282 million in unsecured claims. He held that creditors "have not given consent as required by the Supreme Court" in *Purdue* "[a]bsent a writing expressly agreeing to a release of nondebtors." To read ABI's report, click here.

The opinion is *In re Lavie Care Centers LLC*, 24-55507 (Bankr. N.D. Ga. Dec. 5, 2024).

Stays & Injunctions

A receiver was tagged $45,000 for failing to turn over estate property by demanding payment of administrative fees.

Fifth Circuit Arguably Expands the *Barton* Doctrine's *Ultra Vires* Exception

Reversing the district court, The Fifth Circuit arguably expanded the *ultra vires* exception to the *Barton* doctrine in a nonprecedential opinion, which means that receivers, without demanding payment, must immediately turn over property when the owner files a bankruptcy petition.

A plaintiff obtained a default judgment for more than $170,000. The state court appointed a receiver to collect the judgment on behalf of the plaintiff. Later, the state court entered an order specifically directing the receiver to seize the property of a third-party, nondefendant corporation.

The receiver seized the third party's property. Two weeks later, the third party filed a chapter 11 petition and demanded that the receiver turn over its property. The receiver agreed to return the property, but only after payment of administrative expenses.

According to the Fifth Circuit's *per curiam* opinion on December 31, the debtor paid the fees, and the receiver turned over the property 10 days later.

In bankruptcy court, the debtor brought an adversary proceeding against the receiver, asserting claims including turnover and stay violation. Finding that the receiver had held estate property hostage, Bankruptcy Judge Jeffrey P. Norman found a stay violation and ordered the receiver to pay the debtor $45,000.

The receiver appealed and won a reversal in district court based on the *Barton* doctrine. *See Berleth v. Preferred Ready-Mix LLC (In re Preferred Ready-Mix LLC)*, 660 B.R. 214 (S.D. Tex. March 31, 2024). To read ABI's report, click here.

The district court narrowly interpreted the *ultra vires* exception to the *Barton* doctrine. Unwilling to "stretch the *ultra vires* exception to a place where it has not gone before" (*Id*. at 221), the district court decided that the bankruptcy court had no subject matter jurisdiction, vacated the bankruptcy court order and remanded with instructions to dismiss the suit in bankruptcy court without prejudice.

The debtor appealed to the Fifth Circuit and won, based on the appeals court's more expansive understanding of the *ultra vires* exception.

The *Ultra Vires* Exception to the *Barton* Doctrine

Citing *Barton v. Barbour*, 104 U.S. 126, 128 (1881), the Fifth Circuit said that the "doctrine generally requires that a party seeking to sue a receiver must obtain leave from the court that appointed the receiver." When the doctrine applies, the court lacks subject matter jurisdiction.

After adoption of the Bankruptcy Act of 1898, the doctrine was extended to cover bankruptcy trustees and was subsequently broadened by many circuits to protect court-appointed officials and fiduciaries, such as trustees' and debtors' counsel, real estate brokers, accountants, and counsel for creditors' committees.

"Importantly," the Fifth Circuit said, the *Barton* doctrine is subject to the *ultra vires* exception, which applies to "actions taken by a receiver without appointing court authority." Specifically, *Barton* said that the *ultra vires* exception applies "if, by mistake or wrongfully, the receiver takes possession of property belonging to another." *Id.* at 134.

Focusing on the case on appeal, the appeals court decided that "the *ultra vires* exception to the *Barton* doctrine applies because [the receiver] only had appointing court authority to seize and maintain [the debtor's] property, not property of the bankruptcy estate." The circuit court held that the receiver "was without authority — and acted *ultra vires* — when he continued to seize and maintain possession of property of the bankruptcy estate despite receiving notice of the bankruptcy petition and a demand for turnover."

The exception applicable, the appeals court ruled that the debtor "therefore did not need leave from the appointing court to sue [the receiver] in bankruptcy court for his belated return of property of the bankruptcy estate post-demand for turnover." The court reversed and remanded "for further proceedings not inconsistent with this opinion."

Observations

Take it as a given that the *ultra vires* exception did apply. Would the Supreme Court's decisions in *Fulton* and *Taggart* alter the result?

Fulton tells us that maintaining the *status quo* does not violate the automatic stay. Standing alone, simply holding estate property was not a stay violation if there was no turnover order from the bankruptcy court. By demanding fees, however, the receiver did more than maintain the *status quo*. Thus, *Fulton* might not help the receiver.

Taggart could be more helpful for the receiver in terms of sanctions. The Supreme Court taught us in *Taggart* that the bankruptcy court "may impose civil contempt sanctions when there is no objectively reasonable basis for concluding that the creditor's conduct might be lawful under the discharge order." *Taggart v. Lorenzen*, 139 S. Ct. 1795, 1799 (2019).

Under *Taggart*, was it "objectively reasonable" for the receiver to demand fees? That's a close question.

The opinion is *Berleth v. Preferred Ready-Mix LLC (In re Preferred Ready-Mix LLC)*, 24-20158 (5th Cir. Dec. 31, 2024).

The same district judge who correctly predicted that Purdue's nonconsensual releases were prohibited has nonetheless upheld a preliminary injunction barring suits against nondebtors.

Purdue Preliminary Injunction Protecting Nondebtors Upheld on Appeal

For the first time in an Article III court after the Supreme Court banned nonconsensual, nondebtor releases in *Harrington v. Purdue*, a district judge in New York has upheld a preliminary injunction barring suits against nondebtors.

District Judge Colleen McMahon warned the parties in the *Purdue* case that they must agree on a new chapter 11 plan "pretty soon," or she would no longer permit preliminary injunctions.

The 40 Preliminary Injunctions

In her November 26 opinion, Judge McMahon recounted the history of the *Purdue* case and how the bankruptcy court had issued a preliminary injunction soon after the chapter 11 filing in 2019. The preliminary injunction barred everyone from suing nondebtors and even prevented the enforcement of governments' police and regulatory powers. In 2020, not long after the chapter 11 filing, Judge McMahon said that she had upheld the preliminary injunction.

Judge McMahon recited how she had written the opinion that overturned Purdue's confirmation. *In re Purdue Pharma, L.P.*, 635 B.R. 26 (S.D.N.Y. 2021). To read ABI's report, click here. She was reversed when the Second Circuit reinstated confirmation. *Purdue Pharma, LP v. City of Grande Prairie (In re Purdue Pharma, LP)*, 69 F.4th 45 (2d Cir. 2023). To read ABI's report, click here. The Supreme Court granted *certiorari* and reversed the Second Circuit at the end of the last term in late June, nixing nonconsensual, nondebtor third-party releases. *Harrington v. Purdue Pharma L.P.*, 144 S. Ct. 2071 (2024). To read ABI's report, click here.

When the *Purdue* case returned to the bankruptcy court, Bankruptcy Judge Sean H. Lane of New York entered preliminary injunctions several more times to facilitate mediation designed for cobbling together a new plan with contributions from the Sackler family. Since the outset of the case, Judge McMahon said that the preliminary injunction has been extended about 40 times.

When Bankruptcy Judge Lane entered a preliminary injunction after the Supreme Court set aside the nonconsensual releases in the *Purdue* plan, the State of Maryland filed an appeal,

professing a desire to pursue unfair and deceptive trade practice claims against nondebtors that had been frozen since the chapter 11 filing in 2019.

On appeal, the state argued that *Harrington v. Purdue* deprived the bankruptcy court of power to enjoin litigation against nondebtors.

The Standards Are Met for a 'P.I.'

Before turning to the merits, Judge McMahon considered whether the bankruptcy court had jurisdiction after *Harrington v. Purdue* to issue preliminary injunctions of the sort.

Judge McMahon said that the Supreme Court's holding was "narrow" and only banned nonconsensual releases protecting nondebtors, but "otherwise left unchanged the Bankruptcy Court's power." In the Second Circuit, she said that a preliminary injunction "would fall within the 'related to' jurisdiction of the Bankruptcy Court."

Judge McMahon cited bankruptcy courts that have recently decided that *Harrington v. Purdue* does not prohibit the issuance of preliminary injunctions. *See, e.g.*, *In re Parlement Techs., Inc.,* 661 B.R. 722, 724 (Bankr. D. Del. 2024); and *In re Diocese of Buffalo, N.Y.,* 663 B.R. 197, 200 (Bankr. W.D.N.Y.). To read ABI's reports, click here and here.

Having found jurisdiction and power, Judge McMahon analyzed whether the debtors had satisfied the usual four requirements for issuance of a preliminary injunction.

With regard to the likelihood of a successful reorganization, Judge McMahon said that the mediators and "most of the major stakeholders" were "confident" that "a successful reorganization plan is imminent." Concerning imminent irreparable harm, she deferred to the bankruptcy court's finding that "mediation efforts would cease" if war "were to break out."

In terms of the balance of harm and the public interest, Judge McMahon decided that the "public interest in securing a significant voluntary contribution from the [nondebtors] far outweighs Maryland's interest in advancing its administrative proceeding today."

"In light of the progress of mediation to date," Judge McMahon upheld the latest preliminary injunction," because "the balance of the hardships and the public interest both favor leaving the injunction in place in order to facilitate the ongoing mediation."

The 'Elephant in the Room'

In the last two pages of her opinion, Judge McMahon said, "The 'elephant in the room' is that the Preliminary Injunction has been in effect for a very, very long time." If there is no agreement on a plan over the 2024 holidays, she said "there will no doubt be another 'modest' request — and

quite possibly another — and yet another . . . . [E]very single time, the parties will tell Judge Lane that they are inching ever closer to an agreement and only need a little more time."

"But there must be an end to this mediation process," Judge McMahon said. When there are more extensions, "it becomes less and less convincing that the parties really are on the cusp of a deal, or that the public interest would be better served by prolonging the stay, rather than by ramping up litigation against the (perhaps recalcitrant) Sacklers."

Judge McMahon said that agreement on a "plan needs to come pretty 'soon,' or the preliminary injunction factors will cease to favor further postponement of the ability of parties who have every right to sue the Sacklers to start the war of all against all."

Observation

Ordinarily, opening the floodgates to litigation is an empty threat. This writer believes the threat is real this time, because it was Judge McMahon who overturned Purdue's original plan against the weight of Second Circuit authority.

The opinion is *State of Maryland v. Purdue Pharma LP (In re Purdue Pharma LP)*, 24-7042 (S.D.N.Y. Nov. 26, 2024).

A magistrate judge decided that a bankruptcy court's order from another district halting suits against nondebtors was unenforceable because it was not an 'injunction' made under Section 105(a).

A Magistrate Judge Refuses to Enforce an Order Staying Actions Against Nondebtors

A decision by a magistrate judge in Michigan counsels attorneys for chapter 11 debtors to take care in drafting orders intended to expand the automatic stay to halt lawsuits against nondebtors.

Not to keep you in suspense, the Michigan magistrate judge declined to enforce an order entered by the bankruptcy court in Houston purporting to stay all lawsuits against nondebtors "in their entirety . . . on an interim basis pursuant to section 362 of the Bankruptcy Code."

The plaintiff was a prisoner who filed a lawsuit *pro se* in federal district court in Michigan claiming that the defendants committed "deliberate indifference to his serious medical needs in violation of the Eighth Amendment."

One of the defendants was an individual employed by Wellpath Holdings Inc., which filed a chapter 11 petition in Houston on November 11. The prisoner did not name Wellpath as a defendant.

In the chapter 11 case, Wellpath obtained as series of orders from the bankruptcy court that purported to stay lawsuits against nondebtors, like the employee, "on an interim basis pursuant to section 362 of the Bankruptcy Code." Wellpath filed a suggestion of bankruptcy with the court in Michigan and attached a copy of the bankruptcy court's orders purporting to halt the prisoner's lawsuit, among all others.

In an opinion and order on December 4, Magistrate Judge Kimberly G. Altman of Detroit declined Wellpath's invitation to put the prisoner's suit on ice.

Citing a 1993 decision by the Sixth Circuit, Judge Altman said that a bankruptcy court cannot "stay proceedings against non-debtor defendants under 11 U.S.C. § 362." *See Patton v. Beardon*, 8 F.3d 343 (6th Cir. 1993). She quoted a bankruptcy court in Ohio that said, "[T]he only entity to which the § 362 stay applies is the debtor. As such, it may not be extended to third parties such as the [d]ebtor's co guarantors. *In re Nat'l Staffing Servs. LLC*, 338 B.R. 35, 36-37 (Bankr. N.D. Ohio 2005)."

On the other side of the fence, Judge Altman quoted the Sixth Circuit for having said, "Some courts have held that the debtor's stay may be extended to non-bankrupt parties in unusual circumstances." *Patton v. Beardon*, 8 F.3d 343, 349 (6th Cir. 1993). However, she went on to quote the Sixth Circuit for having also said that extensions of the automatic stay "were in fact injunctions issued by the bankruptcy court after hearing and the establishment of unusual need to take this action to protect the administration of the bankruptcy estate." *Id*.

Even if there were "unusual circumstances," the circuit court in *Patton* said that "the bankruptcy court would first need to extend the automatic stay under its equity jurisdiction pursuant to 11 U.S.C. § 105." *Id*.

"The order from Wellpath's bankruptcy proceeding," Judge Altman said, "does not cite 11 U.S.C. § 105(a) and does not set forth the preliminary-injunction factors or contain any analysis on the subject." Indeed, she said, "The phrase 'preliminary injunction' is in fact nowhere to be found."

Given that "no preliminary injunction has been issued," Judge Altman held that "neither this Court nor the bankruptcy court can otherwise 'extend' the automatic stay to non-debtor defendants."

Judge Altman ruled that "the case [brought by the prisoner] will not be stayed and will proceed against [the Wellpath employee] and all the other defendants," because "Wellpath is not a party to this case, and its bankruptcy stay has not properly been extended to non-debtor parties, like [the employee]."

Observations

The federal district court in Michigan was not sitting as an appellate court in review of the order entered by the bankruptcy court in Houston.

This writer invites readers to explain the basis on which the Michigan court could decline to enforce the order of the bankruptcy court in another district.

The opinion is *Levitan v. Maclean*, 23-12439 (E.D. Mich. Dec. 4, 2024).

A district judge in Ohio declined to sit as an appellate court by deciding whether a bankruptcy court in another state had properly 'spread' the automatic stay.

District Courts Disagree on Enforcing an 'Automatic Stay' Protecting Nondebtors

Last month, we reported one of several decisions where district courts in the Eastern District of Michigan refused to enforce an order by the bankruptcy court in Houston that "spread" the Section 362 automatic stay to stop lawsuits against nondebtors. *See Levitan v. Maclean*, 23-12439 (E.D. Mich. Dec. 4, 2024). To read ABI's report, click here.

Declining to rule as though she was on an appellate court reviewing the decision from Houston, the Chief District Judge for the Northern District of Ohio has decided to enforce the injunction aimed at halting lawsuits against nondebtors.

You decide who has the better argument: Chief District Judge Sara Lioi of Akron, Ohio, or the district judges who found fault with "spreading" the automatic stay.

To Stay or Not to Stay, That Is the Question

In the case before Judge Lioi, the plaintiff brought a Section 1983 action against Wellpath LLC and several individual defendants. Wellpath provides medical services for prisons and jails throughout the country. The individual defendants were often employees of Wellpath.

After Wellpath began a chapter 11 reorganization in Houston, Judge Lioi said that the bankruptcy court entered an order that "stays 'any lawsuits' in which Wellpath is a defendant, including 'claims against the Non-Debtor Defendants . . . pursuant to section 362 of the Bankruptcy Code.'" As debtor in possession, Wellpath filed a suggestion of bankruptcy and argued that "this entire case must be stayed," Judge Lioi said.

Quoting Section 362(a)(1), Judge Lioi said it was "clear" that the suit must be stayed against Wellpath. However, she went on to cite the Sixth Circuit for the idea that a "bankruptcy stay may also be extended to encompass non-debtors."

"It appears the bankruptcy court intended to do so here," Judge Lioi said, "as its interim order stayed any case in which Wellpath is a defendant, including 'claims against the Non-Debtor Defendants[.]'" She went on to say that "several courts have stayed actions in which Wellpath is a defendant in their entirety."

"Several decisions in the Eastern District of Michigan," Judge Lioi said, "have come to a different conclusion as to the scope of the stay." She described them as relying on the principle "that district courts have 'jurisdiction concurrent with the originating bankruptcy court to determine the applicability of the bankruptcy court's automatic stay.'"

Exercising jurisdiction to define the scope of the automatic stay, Judge Lioi said that "those decisions conclude that the bankruptcy court's interim order 'does not cite 11 U.S.C. § 105(a) and does not set forth the preliminary-injunction factors or contain any analysis on the subject' and therefore 'does not require a stay of proceedings against' the non-debtor defendants."

"To allow this matter to proceed as to the non-debtor defendants strikes the Court as more akin to granting relief from the bankruptcy court's stay order, a power vested in the bankruptcy court," Judge Lioi said. "[T]hat issue," she said, "is best resolved by the bankruptcy court itself or appealed to the appropriate district court in Texas.

"[A]ny potential deficiencies in the interim order may well be resolved by the bankruptcy court's final order, which is currently set for a hearing in January 2025," Judge Lioi said. She therefore "defer[s] to the bankruptcy court on this issue and does not consider the lack of § 105 analysis to overcome the bankruptcy court's stated intention to extend the stay to include 'Non-Debtor Defendants[.]'"

Calling for a status report by January 31, Judge Lioi stayed the case, "subject to the lifting of the stay as to some or all defendants."

The opinion is *McLemore v. County of Mahoning*, 23-1144 (N.D. Ohio Dec. 30, 2024).

An opinion by Bankruptcy Judge Carl L. Bucki might be read, incorrectly, to mean that Purdue precludes preliminary injunctions stopping suits against nondebtors.

No More Injunctions Barring Suits Against Nondebtors in a Diocese Sexual Abuse Case

Bankruptcy Judge Craig T. Goldblatt of Delaware wrote an opinion in July explaining how a chapter 11 debtor, after *Purdue*, can obtain a preliminary injunction halting lawsuits against nondebtors. *Parlement Technologies Inc.*, 661 B.R. 722 (Bankr. D. Del. July 15, 2024). To read ABI's report, click here.

Chief Bankruptcy Judge Carl L. Bucki of Buffalo, N.Y., wrote an opinion that might be read to mean that preliminary injunctions protecting nondebtors are no longer available after *Harrington v. Purdue Pharma L.P.*, 144 S. Ct. 2071 (2024). To read ABI's report on *Purdue*, click here.

This writer understands Judge Bucki's September 30 opinion more properly to mean that the bankruptcy court will not issue a preliminary injunction protecting nondebtors when the chapter 11 case is almost five years old; there is no plan, and the creditors' committee and the debtor are at an impasse, despite years of mediation.

Seven Prior Injunctions

The Diocese of Buffalo, N.Y., filed a chapter 11 petition in February 2020, looking to resolve some 800 lawsuits asserting sexual abuse claims against the diocese and nondebtor affiliates like schools and parishes.

Promptly after the chapter 11 filing, the debtor commenced an adversary proceeding to halt lawsuits against nondebtor, affiliated entities. Seven times, Judge Bucki granted preliminary injunctions stopping lawsuits against affiliates that were not covered by the automatic stay.

Most recently, Judge Bucki granted a preliminary injunction in January 2024. At the time, the Second Circuit's decision in *Purdue* meant that the diocese might be able to confirm a plan with nonconsensual releases for nondebtors. However, argument in *Purdue* had been held in the Supreme Court one month before.

Recognizing that the Supreme Court might ban nonconsensual releases, Judge Bucki structured the injunction he issued in January to expire after the decision in *Purdue*. When the Supreme Court reversed the Second Circuit in *Purdue* and barred nonconsensual releases of nondebtors, the diocese filed a new motion seeking a preliminary injunction covering all of the diocese's affiliates.

Grounds for Preliminary Injunctions

Judge Bucki recited Second Circuit standards in nonbankruptcy cases for preliminary injunctions. Basically, there must be a likelihood of success on the merits, or serious questions with the balance of hardship tipping "decidedly" in favor of the plaintiff. In addition, the plaintiff must show the likelihood of irreparable harm.

In the case before him, Judge Bucki found "neither a likelihood of success nor serious questions for litigation." However, the debtor argued that Section 105(a) provides the basis for an injunction covering affiliates not protected by the Section 362 automatic stay.

Judge Bucki responded by pointing to language in Section 105(a), which provides that the "court may issue any order . . . that is necessary or appropriate to carry out the provisions of" the Bankruptcy Code. Among the applicable provisions of the Code, he identified Section 1106(a)(5), which says that a debtor "shall" file a plan "as soon as practicable."

"Recognizing this need to develop a plan," Judge Bucki said that he had "relied on section 105(a) in [his] four most recent decisions granting a temporary stay of all litigation against parishes and affiliates." After *Purdue*, though, he said that the debtor could no longer propose a plan with nonconsensual releases.

Judge Bucki recognized that nothing in *Purdue* "expressly prohibits a temporary stay of litigation against parishes and affiliates." However, he went on to say that "the outcome in *Purdue Pharma* strikes the rationale for any further such injunction."

According to Judge Bucki, three years of mediation failed to produce a plan, and the debtor reported a "breakdown in negotiations" with the official creditors' committee. Although the debtor might succeed with a plan having consensual releases, the judge said he could not "foresee the likely development of a fully consensual plan."

Judge Bucki denied the motion for a preliminary injunction, finding "insufficient justification to use section 105 for the purpose of granting a stay of all lawsuits against parishes and affiliates."

Observations

Out of context, some language in Judge Bucki's opinion could be taken to mean that preliminary injunctions stopping lawsuits against nondebtors are no longer available after *Purdue*.

After almost five years in chapter 11, Judge Bucki could not see the likelihood of a consensual plan conferring releases on nondebtors. This writer therefore interprets the opinion to mean that injunctions might issue earlier in cases where the possibility of a plan is alive and well. In *Parlement*, Judge Goldblatt saw no *per se* bar to preliminary injunctions stopping suits against nondebtors.

Presumably, a debtor at the outset of a chapter 11 case could demonstrate the four factors required by Judge Goldblatt for issuance of a preliminary injunction stopping lawsuits against nondebtors. Judge Goldblatt did not interpret "success on the merits" to require the likelihood of confirming a plan with nonconsensual releases.

The opinion is *Diocese of Buffalo, N.Y. v. JMH 100 Doe (In re Diocese of Buffalo, N.Y.)*, 20-01016 (Bankr. W.D.N.Y. Sept. 30, 2024).

A Delaware bankruptcy judge says there could be circumstances when automatic stays will not be enforced after the court has denied a motion to compel arbitration.

Bankruptcy Has No General Exception to an Automatic Stay After Denial of Arbitration

After confirmation of chapter 11 plan, a bankruptcy judge in Delaware held that the Supreme Court's *Coinbase* decision requires staying prosecution of an adversary proceeding when the defendant is appealing the bankruptcy court's denial of an arbitration motion.

Bankruptcy Judge Mary F. Walrath was careful to say that her December 13 opinion should not be understood to mean "that the holding in *Coinbase* is applicable to all adversary proceedings in bankruptcy cases."

In *Coinbase*, the Supreme Court held 5/4 that denial of a motion to compel arbitration automatically imposes a stay on the entire action in the trial court, pending appeal from the order denying arbitration. *Coinbase Inc. v. Bielski*, 143 S. Ct. 1915, 216 L. Ed. 2d 671 (Sup. Ct. June 23, 2023). To read ABI's report, click here.

The Lawsuit After Confirmation

The corporate debtors had sold all of its physical assets and confirmed a chapter 11 plan vesting causes of action in the reorganized debtor. At the outset of the chapter 11 case, the debtors had sued a third party on claims including breach of contract and fraud. The debtors alleged that the defendants all along intended "to acquire the [debtors'] most valuable asset, their manufacturing plant, for themselves without fulfilling" their obligations under a contract with the debtors.

The defendants had filed a motion to compel arbitration. Previously in the adversary proceeding, Judge Walrath decided that some of the claims were arbitrable and others were not. The defendants filed an appeal from that portion of the decision where Judge Walrath ruled that the claims were not subject to arbitration.

Citing *Coinbase*, the defendants filed a motion to enjoin the adversary proceeding in bankruptcy court pending outcome of the appeal. Naturally, the reorganized debtor objected.

What Does *Coinbase* Mean?

Judge Walrath interpreted *Coinbase* to mean "that a district court must stay its proceedings pending an interlocutory appeal of the arbitrability of the case." The debtor argued that the Supreme Court made an exception for bankruptcy appeals, noting that footnote 6 in the Court's majority opinion refers to 28 U.S.C. § 158(d)(2)(D) as a circumstance in which there should not be an automatic stay.

Judge Walrath disagreed with the debtor. She said "that footnote 6 of *Coinbase* cannot be read to create an exception for all bankruptcy appeals. That footnote does not reference bankruptcy appeals generally; it cites as a statutory exception only subsection 158(d)(2)(D), which is limited to direct appeals from the bankruptcy court to the court of appeal."

Judge Walrath held that "footnote 6 of *Coinbase* does not indicate an intention by the Supreme Court to exclude all bankruptcy appeals from its holding that an appeal of denial of arbitration creates an automatic stay of the proceeding pending appeal."

Coinbase Covered Bankruptcy Courts

Next, the debtor contended that *Coinbase* did not apply because the Supreme Court only referred to district courts and did not mention bankruptcy courts.

Again, Judge Walrath disagreed. She said that bankruptcy courts are "units" of the district courts. She concluded that "a reference to district courts in *Coinbase* can logically be interpreted to include the bankruptcy courts."

Bankruptcy Isn't Always Unique

Judge Walrath characterized the debtor as contending that *Coinbase* should not apply because "the Supreme Court and the Third Circuit have acknowledged [that] the unique nature of bankruptcy cases . . . mandates a different practice for bankruptcy appeals."

Citing academics who foresaw problems in applying *Coinbase* to bankruptcy appeals, Judge Walrath noted that an automatic stay "could cause disruptive — and clearly unintended — delays in bankruptcy cases 'where time is often of the essence.'" She agreed that bankruptcy cases "are different" because "they involve numerous (sometimes thousands) of different parties and many issues that may affect directly or indirectly some or all of those parties."

"The difference," Judge Walrath said, "requires different appellate practices and procedures." "However," she "agree[d] with the Defendant[s] that the policy behind these different practices and procedures in bankruptcy cases is not applicable to the instant adversary proceeding" because "there are essentially only two parties," not thousands.

Furthermore, Judge Walrath said "there are no significant other issues that depend on the outcome of this adversary proceeding. The Debtors' Plan has been confirmed and there are few administrative matters pending." As a result, she said, "[T]his adversary proceeding is more akin to a civil action in district court than to a typical bankruptcy matter."

Holding that the appeal was not frivolous, Judge Walrath decided to "stay this entire adversary proceeding, pending final resolution of the Defendants' appeal of this Court's order denying their Motion to Dismiss the adversary in favor of arbitration."

Observations

In ABI's report on *Coinbase*, we made the following observation:

> The Supreme Court has yet to decide where or to what extent arbitration clauses are enforceable in bankruptcy. Is arbitration always prohibited, or only when the dispute falls within the bankruptcy court's "core" jurisdiction?
>
> The majority opinion does not limit the automatic stay rule to particular sorts of cases. Presumably, it also applies in bankruptcy.
>
> Suppose a creditor's agreement with the debtor contains a broadly worded arbitration clause. What if the debtor objects to the creditor's claim, the creditor invokes the arbitration agreement, and the bankruptcy court denies the motion to compel arbitration? Is the objection to claim automatically stayed pending appeal to the district court, the circuit court and the Supreme Court?
>
> Or, what about the question of whether a creditor with an arbitration agreement is impaired by a chapter 11 plan? Or, what if the creditor claims that the plan is not fair and equitable? Are the proceedings in bankruptcy court automatically enjoined until there is a final order declining to compel arbitration?
>
> Compelling arbitration in bankruptcy cases could stall chapter 11 cases. Depending on the nature of the issue, a *Coinbase* automatic stay pending appeal could delay, disrupt or torpedo a reorganization.

The opinion is *Lordstown Motors Corp. v. Hon Hai Precision Industry Co. (In re Nu Ride Inc.)*, 23-50414 (Bankr. D. Del. Dec. 13, 2024).

Retention & Compensation

The district judge who excoriated Jackson Walker in a decision last year will now decide whether the firm must disgorge what it was paid in dozens of large chapter 11 cases.

Fate of Jackson Walker Is Now in the Hands of a District Judge from Another District

By withdrawing the reference, the mishegoss resulting from the bankruptcy judge in Houston cohabiting with a lawyer in his court has now been consolidated into the courtroom of District Judge Alia Moses, the Chief District Judge for the Western District of Texas.

Technically speaking, the matter remains in the Southern District of Texas because Judge Moses is sitting by designation in the Southern District of Texas to review matters involving former Bankruptcy Judge David Jones and the Houston-based law firm of Jackson Walker, or JW.

Withdrawing the reference to herself in an opinion on April 9, Judge Moses was already steeped in the alleged misdoings involving Jones, JW and former JW partner Elizabeth Freeman, who was Jones's paramour. In an opinion on August 16, Moses reluctantly dismissed a lawsuit against Jones, Freeman, JW and a nationwide firm for which JW had served as local counsel in large chapter 11 cases in Houston.

In her opinion last year, Judge Moses dealt with a lawsuit filed by a shareholder of a large chapter 11 debtor whose case was pending before Jones. The defendants included Jones, Freeman, JW and the debtor's general bankruptcy counsel. Judge Moses said she was dismissing the suit last year "with consternation."

Withdrawal of the reference primarily means that Judge Moses will preside over 34 actions in which the U.S. Trustee is seeking to revoke JW's retention and force JW to disgorge millions in fees paid while the relationship between Jones and Freeman was a secret. Before we describe the decision on withdrawal of the reference, we'll hit some of the high points in Judge Moses's opinion last year where she took "no pleasure" in dismissing.

The Reluctant Dismissal

After the relationship between Jones and Freeman became public, a former shareholder in a large case in Jones's court sued him, Freeman and the debtor's general counsel. The complaint stated claims based on RICO and *Bivens*, a theory based on a Supreme Court opinion recognizing an implied cause of action resulting from an unreasonable search and seizure.

Judge Moses recited the "serious" allegations in the complaint, saying "they remain only allegations." She accepted them as true in deciding whether the suit could survive a dismissal motion. Granting dismissal in her 38-page opinion last year, she decided that the former shareholder lacked standing to pursue the RICO claims and that the *Bivens* allegations failed to state a claim. *Van Deelen v. Jones*, 2024 BL 289434, 2024 U.S. Dist. LEXIS 148920, 2024 WL 3852349 (S.D. Tex. Aug. 16, 2024). To read the opinion, click here.

Although dismissing, Judge Moses said that "nothing . . . redeems Jones's misconduct" and that the relationship between Jones and Freeman was "a glaring appearance of impropriety." She added, "Whether through hubris, greed, or profound dereliction of duty, Jones flouted these statutory and ethical requirements by presiding over dozens of cases from which he was obviously disqualified."

Although obliged to dismiss the suit, Judge Moses said that the former shareholder's "allegations, if true, show that he suffered injustice in Jones's courtroom."

Dismissing, Judge Moses said she "takes no pleasure in this result" and that the allegations, "if true, cast doubt on the integrity of numerous high-profile bankruptcy cases."

The Bankruptcy Court Report and Recommendation

Withdrawal of the references was long in process. Having commenced 34 proceedings aimed at revoking JW's retention and forcing the firm to disgorge fees it was paid, the U.S. Trustee filed motions to withdraw the references in November 2023. The following month, the Chief Bankruptcy Judge in the Southern District of Texas, Eduardo V. Rodriguez, issued a report recommending that the references remain with the bankruptcy judges.

If the district court were to withdraw the references, the Chief Bankruptcy Judge recommended that the matter remain in bankruptcy court until ready for trial. After trial in district court, the Chief Bankruptcy Judge recommended that the distribution of disgorged funds, if any, be determined in the "sound discretion" of the bankruptcy judges presiding over those cases.

Emphatic Withdrawal of the References

Ruling on the recommendation, Judge Moses noted that the U.S. Trustee did not contend that reference withdrawal was mandatory. Rather, Judge Moses was deciding whether withdrawal was for "cause" under 28 U.S.C. § 157(d). In the Fifth Circuit, the governing authority is *Holland Am. Ins. Co. v. Succession of Roy*, 777 F.2d 992 (5th Cir. 1985).

On the merits, Judge Moses decided to withdraw the references in two pages. She said that *Holland* calls for the court to consider whether the matter is core or noncore, along with

consideration of the promotion of uniformity in administration, the reduction of forum-shopping, the fostering of economical use of debtors' and creditors' resources, and the expedition of the bankruptcy process.

Turning to the case at hand, Judge Moses said that many of the issues were not those that could only arise in bankruptcy, even though Jones was a judge. Already being "thoroughly acquainted with the facts," she said that "uniformity, economy, and expediency all weight in favor of withdrawal."

But Judge Moses was not through. The *Holland* factors, she said, "are not exhaustive. Beyond the *Holland* factors, the Court considers the fact that judicial proceedings must both be and appear impartial . . . . [T]he appearance of bias provides 'cause' to appropriately adapt judicial assignment processes to cure such concerns."

Terminating references to the bankruptcy courts and calling for a status conference, Judge Moses added:

> This unique case nevertheless requires stiff measures. The need to reestablish public trust and confidence in the court system alone impels withdrawal in this highly unusual case.

Observations

This writer reads the opinion by Judges Moses to mean that bankruptcy judges in Houston shouldn't touch matters involving JW. No matter how Houston bankruptcy judges might rule, their decisions could be questioned.

If Houston judges were tough on JW, Jones and Freeman, some could say they were too tough because they felt betrayed by Jones. Or, if Houston judges were easy on Jones, some could say they were partial to someone who had been a friend and colleague.

It is well that the Chief District Judge in Houston selected the Chief District Judge from another district to preside.

The opinion is *In re Professional Fee Matters Concerning the Jackson Walker Law Firm*, 23-4787 (S.D. Tex. April 9, 2025).

Hammons Fall dictated denial of a Tucker Act class action for recovery of overpayment of U.S. Trustee fees in chapter 11 cases.

It's Really Over. No Refunds for Overpayment of Nonuniform U.S. Trustee Fees

The Supreme Court decided in June 2022 that the 2018 increase in U.S. Trustee fees paid by most chapter 11 debtors was unconstitutional because it was not immediately applicable in the two states with Bankruptcy Administrators rather than U.S. Trustees. *Siegel v. Fitzgerald*, 142 S. Ct. 1770 (Sup. Ct. June 6, 2022). *Siegel* left open the question of whether debtors who had paid too much were entitled to refunds. To read ABI's report, click here.

Differing with all four circuits that had held to the contrary, the Supreme Court ruled 6/3 in June 2024 that chapter 11 debtors in 48 states who paid $326 million in unconstitutionally higher U.S. Trustee fees were not entitled to refunds as a remedy for the constitutional violation. *Office of the U.S. Trustee v. John Q. Hammons Fall 2006 LLC*, 602 U.S. 487 (June 14, 2024). To read ABI's report, click here.

For chapter 11 debtors who overpaid U.S. Trustee fees, the last hope for a refund lay in a class action pending in the U.S. Court of Federal Claims under the Tucker Act, 28 U.S.C. §§ 1346(a).

We regret to report there will be no refunds. The Court of Claims granted the government's motion to dismiss in an opinion on June 30 by Court of Claims Judge Stephen S. Schwartz.

The Constitutional Violation

Judge Schwartz's decision was an extension of his reading of *Hammons Fall*. He cited the Court for saying that the constitutional violation was in nonuniformity, not in higher fees paid by some chapter 11 debtors. "That meant," he said, "that the disparity itself was the constitutional violation to be corrected." Like the Supreme Court, he "identified several reasons Congress would prefer prospective parity rather than monetary refunds."

"The Court," Judge Schwartz said, "concluded that prospective parity 'cures the constitutional violation, and due process does not require another result.' *Id*. at 504."

Prospective Remedy Was Enough

Judge Schwartz examined whether the result would be different because the class plaintiffs were suing under the Tucker Act, not based on a naked constitutional violation.

Judge Schwartz said that the Tucker Act covers "illegal extractions." The Court of Claims has jurisdiction if the complaint makes a nonfrivolous allegation that the government obtained money through a violation of the Constitution, a statute or a regulation. The complaint, he said, established the jurisdiction of the Court of Claims.

Jurisdiction shown, Judge Schwartz turned to the question of whether the complaint stated a claim. In the case before him, the "most important" of the three relevant factors was whether the statute meant expressly or impliedly that the violation entails a return of money unlawfully extracted.

On the question of remedy, Judge Schartz said that the "obvious problem for Plaintiffs is the Supreme Court's holding in *Hammons* that the constitutional wrong of nonuniformity was fully remedied by prospective equality." Although *Hammons Fall* did not mention illegal extractions or the Tucker Act, he said that the opinion "covers Plaintiffs' exaction claim by negating one of its elements," the lack of a refund as an implied remedy.

Since the Supreme Court decided that prospective equality was the proper remedy, Judge Schwartz held that "the additional remedy of a refund cannot have been implied as well." In other words, he said, "the debtors did not suffer the injury of being charged too much — only of unequal treatment, which Congress addressed with prospective equality."

Judge Schwartz granted the government's motion to dismiss the complaint.

This writer does not expect an appeal.

The opinion is *Acadiana Management Group LLC v. U.S.*, 19-496C (Ct. Claims June 30, 2025).

Preferences, Fraudulent Transfers & Claims

The Fifth Circuit declines to adopt a securities industry guidebook for what's a permissible financing.

Fifth Circuit Bans Uptier Financings for Violating the Principle of Ratable Treatment

In a remarkable opinion, the Fifth Circuit banned so-called uptier financings. The decision by Circuit Judge Andrew S. Oldham included an equally remarkable discussion of equitable mootness where the Fifth Circuit had no hesitation in reversing confirmation of a consummated chapter 11 plan that may mean millions of dollars in losses for some creditors.

Given the gravity of the December 31 opinion, we will deal with uptier financing today. Tomorrow, we will cover equitable mootness and issues related to relief that an appeals court can grant on reversing plan confirmation.

The Norm of Ratable Treatment

Judge Oldham began his opinion by saying, "Ratable treatment is an important background norm of corporate finance." It is, he said, "a lender's 'sacred right' under syndicated loan agreements."

"The norm of ratable treatment," Judge Oldham said, "provides that the borrower may not choose to repay only one of its lenders. Rather, it must proportionally allocate [the repayment] among the relevant lenders according to their share of the outstanding debt."

"Uptiers," Judge Oldham said, "are a relatively new and controversial exception to the ratable treatment norm . . . . They are controversial because, according to critics, uptiers create a zero-sum game of 'lender-on-lender violence.'"

Judge Oldham said that an uptier financing works by amending

> the terms of a credit facility to allow the issuance of new super-priority debt. Because a majority of lenders in the existing facility must typically consent to such an amendment, the borrower purchases consent by allowing these lenders to exchange their existing debt for new super-priority debt, often at an above-market price . . . . Since not all of the lenders participate in the uptier, the uptier is a non-*pro rata* transaction that violates the norm of ratable treatment.

Judge Oldham said that the advantages of an uptier include "play[ing] lender groups off of each other and avoid[ing] the expense of dealing with holdouts." Furthermore, "[t]he costs of an uptier transaction are borne entirely by the minority lenders, who end up with subordinated debt worth less than before."

The Serta Simmons Uptier Financing

Having extolled the virtues of ratable treatment, Judge Oldham described the uptier financing by bedding-maker Serta Simmons Bedding LLC.

In 2016, the company had sold a series of syndicated loans yielding $1.95 billion in first lien debt and $450 million in second lien loans.

To protect "the sacred right of *pro rata* sharing," Judge Oldham described the 2016 loan agreement as having a provision preventing the company from "pay[ing] its obligations to one lender while offering nothing to the rest." As further protection, he said that the agreement included another provision that "generally requires [the] unanimous consent of any affected lender to waive, amend, or modify" the *pro rata* sharing requirement. Other provisions in the agreement could be modified by a simple majority vote of lenders.

There were two exceptions to the *pro rata* repayment requirement. One was a "Dutch option," and the second was an "open market purchase." The loan agreement, Judge Oldham said, did not define "open market purchase." The "patent ambiguity in the undefined term," he said, "forms the foundation of this case."

With the company facing financial difficulty, Judge Oldham described how the company cobbled together an uptier financing in 2020 with some but not all of its first and second lien lenders. The parties and Judge Oldham called them the "Prevailing Lenders."

The Prevailing Lenders provided new $200 million financing in the form of first-out, super-priority debt. They traded $1.2 billion in existing financing for $875 million in second-out, super-priority debt. Overall, the deal gave the company more cash and less debt. However, Judge Oldham said that the deal allowed the Prevailing Lenders "to jump the creditor line and get paid before their erstwhile first and second lien comrades."

Anticipating litigation in the future, the Prevailing Lenders voted by a bare majority to amend the 2016 loan agreement to allow the uptier financing. They also labeled the uptier financing an "open market purchase."

There was more. The company agreed to indemnify the Prevailing Lenders for any losses or liabilities they might incur as a consequence of the uptier financing.

The Serta Simmons Chapter 11 Case

The company filed a chapter 11 petition in early 2023 in Houston. The case was assigned to Bankruptcy Judge David R. Jones, who resigned several months later.

Immediately, the debtor filed an adversary proceeding seeking a declaration that the uptier financing did not violate the 2016 loan agreement. Opposition came from lenders in the 2016 financing who were not among the Prevailing Lenders. The parties and Judge Oldham referred to the opponents as the "Excluded Lenders."

The bankruptcy court granted summary judgment to the Prevailing Lenders and held that the uptier financing was a permitted "open market purchase." The bankruptcy court certified a direct appeal, which the Fifth Circuit accepted.

After dismissing counterclaims for breach of contract asserted by the Excluded Lenders in the adversary proceeding, the bankruptcy court entered final judgment in favor of the debtor and the Prevailing Lenders. Again, the Fifth Circuit accepted a direct appeal.

The Chapter 11 Plan

Because the prepetition indemnification of the Prevailing Lenders would not survive confirmation of the debtor's chapter 11 plan, the plan gave the Prevailing Lenders a new indemnification. The bankruptcy court confirmed the plan and approved "the settlement indemnity [as] a fair and equitable component of a § 1123(b)(3) settlement," Judge Oldham said.

The Fifth Circuit accepted a direct appeal of the confirmation order.

Appellate Jurisdiction

Having consolidated four appeals, Judge Oldham first addressed the Fifth Circuit's appellate jurisdiction and the jurisdiction of the bankruptcy court. Meticulously but quickly, he decided that the bankruptcy court had jurisdiction and power to enter final judgments, with one exception.

The exception was state law breach-of-contract claims by the Excluded Lenders against the Prevailing Lenders, where the bankruptcy court did not have constitutional power to enter a final judgment under *Stern v. Marshall*, 564 U.S. 462, 482 (2011). However, Judge Oldham held that the lack of objection by the debtor and the Prevailing Lenders was implied consent under *Wellness International Network, Ltd. v. Sharif*, 575 U.S. 665 (2015), allowing the bankruptcy court to enter final judgment dismissing the Excluded Lenders' counterclaims.

Judge Oldham also held that the Fifth Circuit had appellate jurisdiction under 28 U.S.C. § 158(d).

It Wasn't an Open Market Purchase

On the merits, Judge Oldham first undertook *de novo* review of the bankruptcy court's decision on summary judgment holding that the uptier financing was a permissible open market purchase. Under New York law governing the 2016 financing, he explained why the uptier financing was not an open market transaction.

By referencing dictionaries and by analogy to the Federal Reserve's open market activities, Judge Oldham concluded that "an open market purchase is a purchase of corporate debt that occurs on the secondary market for syndicated loans."

Judge Oldham added that "the words 'open market' point to a specific 'market,' not merely a general context where private parties engage in non-coercive transactions with each other." He rejected the idea "that there is an open market wherever there is competition." Properly, he said, "an open market is one tied to a specific market, like the stock market or the commodities market or the securities market."

Applied to the case at hand, Judge Oldham said that "an open market purchase occurs on the specific market for the product that is being purchased . . . , and the market for that product is the 'secondary market' for syndicated loans."

If the company had wanted to effect an "open market purchase and thereby circumvent the sacred right of ratable treatment," Judge Oldham said, "it should have purchased its loans on the secondary market. Having chosen to privately engage individual lenders outside of this market," he said that the debtor "lost the protection of" the provision in the 2016 loan agreement that gave an exception for open market purchases.

For the same reason that the uptier financing was not an open market transaction, Judge Oldham decided that it also was not subject to the exception for Dutch auctions.

Other Rejected Arguments

Of significance in future cases dealing with syndicated loans, Judge Oldham rejected the Prevailing Lenders' reliance on "a guide published by the Loan Syndications and Trading Association" (LSTA) to show "that industry usage supports their expansive definitions of 'open market purchase.'"

While the "LSTA guide carries some weight," Judge Oldham said, "it is not binding authority." Even if it were dispositive, he said that "its discussion of open market purchases does not support the 2020 Uptier."

Holding "that the 2020 Uptier was not a permissible open market purchase within the meaning of the 2016 Agreement," Judge Oldham reversed "the bankruptcy court's contrary ruling."

In one paragraph, Judge Oldham ruled in favor of the Excluded Lenders in their appeal from the bankruptcy court's denial of their counterclaims for breach of contract. He said that the counterclaims were "largely based" on the issue of open market purchases.

Judge Oldham reversed and remanded for reconsideration of the Excluded Lenders' breach of contract claims. In words the bankruptcy court likely will not ignore on remand, he added that "the Excluded Lenders have a strong case that [the debtor] and the Prevailing Lender plaintiffs breached the 2016 Agreement."

Observations

Prof. Stephen J. Lubben provided ABI with the following commentary:

> The Court's ruling on "open market purchases" was refreshingly sensible, compared to the typical hyper-literalism we normally see in corporate finance decisions. Too often courts say [that] "while the parties might not have intended this result, it was not technically prohibited, and the parties are sophisticated, so too bad for you."
>
> That just encourages even more outrageous abuse in the next case. I am hopeful that the *Serta* decision will reset the situation with regard to aggressive "liabilitymanagement transactions," which are often little more than a flagrant attempt to favor one group over another in the forthcoming chapter 11 case.

Among the commentators cited in his opinion, Judge Oldham included Prof. Lubben's "Holdout Panic," 96 AM. BANKR. L.J. 1 (2022). Prof. Lubben occupies the Harvey Washington Wiley Chair in Corporate Governance & Business Ethics at Seton Hall University School of Law.

The opinion is *Excluded Lenders v. Serta Simmons Bedding LLC (In re Serta Simmons Bedding LLC)*, 23-20181 (5th Cir. Dec. 31, 2024).

On direct appeal, the Third Circuit said that the PBGC's new rules dealing with the American Rescue Plan Act of 2021 did not violate the major questions doctrine.

Third Circuit Upholds PBGC's Rulemaking Authority in Calculating Withdrawal Claims

Affirming Bankruptcy Judge Craig T. Goldblatt on direct appeal, the Third Circuit decided that bankrupt trucker Yellow Corp. could not reduce its liability for withdrawing from multiemployer pension plans by drawing on some of the billions of dollars that Congress appropriated during the pandemic to save pension funds.

In his September 16 opinion, Circuit Judge Thomas L. Ambro decided that two regulations promulgated by the Pension Benefit Guaranty Corp. were "reasonable conditions" and were neither arbitrary nor capricious.

Of perhaps greater significance in terms of a possible petition for *certiorari*, Judge Ambro held that the PBGC's rulemaking did not violate the major questions doctrine.

The American Rescue Plan Act of 2021

Judge Ambro began his opinion by tracing the history of the Employee Retirement Income Security Act of 1974 and the Multiemployer Pension Plan Amendments Act of 1980. Created under ERISA, the PBGC collects insurance premiums to provide benefits when underfunded pension plans terminate.

Judge Ambro explained that ERISA gave the PBGC "wide regulatory authority" to issue regulations. The appeal dealt with two regulations adopted by the PBGC after Congress passed the American Rescue Plan Act of 2021 during the pandemic "to shore up the nation's struggling pension system" with billions of dollars.

One regulation required pension plans to phase in financial assistance from the ARPA over several years rather than add the funds to plan assets all at once. Judge Ambro said that the regulation would "affect[] withdrawal liability, as an employer that withdrew later would calculate its liability against a bigger base of plan assets, offsetting the amount owed."

The second regulation prohibited pension plans from recognizing funds received from the ARPA before the funds were paid into the plan. Judge Ambro explained how the rule meant that

a pension plan's withdrawal liability would not be reduced by funds that were awarded but not received before withdrawal.

Yellow's Withdrawal Date

Yellow filed a chapter 11 petition in August 2023 and liquidated, terminating pension plans in the process. Pension plans filed $6.5 billion in claims for withdrawal liability, which was calculated as of December 31, 2022, but the pension plans did not receive funds from the ARPA until January 2023. For Yellow, its pension plans had smaller assets in view of the date of withdrawal, giving the debtor larger withdrawal liability. For other pension plans, debtors had larger withdrawal liability as a result of the phase-in regulation limiting the size of the plans' assets.

After the debtor lodged objections to the plans' claims, both sides filed motions for summary judgment, with the debtor challenging the validity of the two regulations. Bankruptcy Judge Goldblatt upheld the regulations and certified a direct appeal, which the Third Circuit accepted.

PBGC Had 'Gap-Filling' Regulatory Authority

On the merits, Judge Ambro began by saying that the debtor "lob[bed] a slew of challenges at the regulations" by arguing "that the regulations violate the PBGC's statutory authority and are arbitrary, capricious, or otherwise invalid." However, he said that the debtor's "strongest argument is that ARPA did not grant the PBGC the *regulatory* authority to change the *statutory* formula for withdrawal-liability calculation." [Emphasis in original.]

Judge Ambro was "not convinced" by the argument. He quoted Judge Goldblatt for correctly holding that "'Congress has expressly granted the PBGC the type of gap-filling authority that [*Loper Bright Enters. v. Raimondo*, 603 U.S. 369 (2024)] described, both in ERISA as originally enacted in 1974 and again in the provisions of [ARPA] that are directly at issue here.'" He held that "the more specific provisions of ARPA control over the general provisions of" earlier legislation.

Judge Ambro ruled that "the two regulations are 'reasonable conditions' on the grant of funds to the plans, promulgated according to Congress's grant of authority to the PBGC in ARPA."

Reasonable Regulations

Next, Judge Ambro turned to the question of whether the two regulations were arbitrary or capricious. He did not review the regulations *de novo*. Rather, he asked whether the PBGC gave a "satisfactory explanation" for its actions.

"As [Bankruptcy Judge Goldblatt] aptly explained," Judge Ambro said, "the notice-and-comment process for the regulations was comprehensive.'[I]ndustry stakeholders, including

employers, pension plans, actuarial firms, law firms, individuals, and members of Congress,' weighed in."

"We are convinced," he said, "that the administrative record reflects 'reasonable' rulemaking, 'reasonably explained,' given the "'appropriate deference' . . . owed to 'agency decisionmaking.'""

Major Questions Doctrine

The debtor contended that the regulations violated the major questions doctrine pronounced by the Supreme Court in *West Virginia v. EPA*, 597 U.S. 697, 716, 724 (2022). Judge Ambro said that the doctrine means that "[a]n agency cannot take action that results in a 'transformative expansion' of its authority — especially over issues of 'vast economic and political significance' — without express permission from Congress."

It was "not an extraordinary case," Judge Ambro said. "Far from a 'transformative expansion,'" he said, it was "PBGC business as usual, transacted per 'clear congressional authorization.'"

Affirming the bankruptcy court, Judge Ambro held that the two regulations "were valid exercises of its delegated authority under ARPA, and [that the debtor] must pay the higher withdrawal liability contracted for with the" pension plans.

The opinion is *In re Yellow Corp*., 25-1421 (3d Cir. Sept. 16, 2025).

Fancy drafting by 'brilliant financiers and lawyers,' the judge said, didn't validate an uptier transaction when the 'effect' was to release collateral without a two-thirds vote.

In Lender-on-Lender Violence, an 'Uptier' Financing Bites the Dust, this Time in Houston

As a sequel to the Fifth Circuit's remarkable *Serta Simmons* opinion at the end of December, Bankruptcy Judge Marvin Isgur of Houston overturned a different "uptier" transaction that emerged from a tussle among sophisticated lenders in what's being called lender-on-lender violence.

Judge Isgur distilled the practical effect of a series of simultaneous transactions to conclude that the top dogs had violated the terms of the governing bond indenture when they provided $250 million in new funding designed to put their larger, existing debt above everyone else's.

Among other things, the Fifth Circuit decided in *Serta Simmons* that the debtor's uptier financing before bankruptcy was not a permissible "open market purchase" and thereby violated the rights to ratable treatment that belonged to lenders who were not permitted to put their debt on top of the pile. *Excluded Lenders v. Serta Simmons Bedding LLC (In re Serta Simmons Bedding LLC)*, 23-20181 (5th Cir. Dec. 31, 2024). To read ABI's report, click here.

The January 17 opinion by Judge Isgur didn't turn on the open market purchase. He identified other grounds in finding that a breach of contract occurred in implementing the uptier financing.

The Existing Debt

Judge Isgur conducted a 35-day trial over six months with 21 witnesses and hundreds of exhibits. His explication of the facts reads like the detail in a doctoral dissertation. To understand the gravity of the holdings in his report and recommendations, a cursory summary of the uptier transaction is sufficient.

The debtor had two series of senior secured notes, one for $650 million due in 2024 and another for $900 million due in 2026. In addition, there was $525 million in unsecured notes. The indentures for both secured issues required a two-thirds vote to authorize a non-*pro rata* transaction, including the release of collateral.

Facing a liquidity crisis, the debtor received proposals from existing noteholders. The superior proposal came from a group called the Majority, which held more than two-thirds of the 2024 notes. As Judge Isgur said, their proposal was not "actionable" because they "did not control two-thirds of the 2026 Notes."

To skirt the problem, Judge Isgur said that the majority "decided to proceed by sleight of hand."

The indenture for the pivotal 2026 notes only required a majority vote to issue new notes. By issuing another $250 million in 2026 secured notes to themselves, the Majority would then claim to control more than two-thirds of the enlarged issue, thus allowing them to vote to allow the release of collateral. That's what they did.

The Uptier Transaction

In automatic, simultaneous transactions, the Majority authorized the issuance to themselves of $250 million in new 2026 secured notes. Then holding more than two-thirds of the 2026 notes, the majority modified the indenture to allow the release of collateral. Next, the majority exchanged their outstanding secured and unsecured notes for, as Judge Isgur put it, "new, super-senior first-lien and second-lien notes."

In other words, the Majority invested $250 million and moved their existing secured and unsecured notes into a super-priority category ahead of everyone else.

Before bankruptcy, an investor group called the Minority had sued in state court, alleging that they had been stripped of their liens. They wanted the state court to declare the transaction null and void and unenforceable. They also wanted the state court to unwind the transaction.

The debtor filed a chapter 11 petition, stopping the suit in state court. On the day of filing, the debtor filed an adversary proceeding asking Judge Isgur to declare that the uptier transaction was valid and enforceable. The Minority answered with counterclaims asking Judge Isgur to declare breach of contract.

In his January 17 opinion, Judge Isgur ruled on the breach of contract claims, leaving remedies for later determination. Because the Majority held more than two-thirds of the 2024 notes, there was no breach of contract. The opinion therefore focused on the question of whether the uptier financing breached the indenture for the 2026 notes.

Good Faith Wasn't an Issue

The contract claims were governed by New York law, where "the good faith of a breaching party to a contract does not insulate the breaching party from liability," Judge Isgur said. Facing a "severe liquidity crisis," he said that the debtor "acted in what it sincerely believed was its best

interest." However, he went on to say, "Not all actions taken in the best interest of a party are done in good faith."

Nonetheless, Judge Isgur made no findings about the debtor's good faith. Rather, he ruled on whether the transaction complied with the indenture, adding that the debtor's and the Majority's "mental states have no effect on any contract-based claims."

The outcome turned on the provision in the 2026 indenture, which said that "no amendment, supplement or waiver may (1) have the effect of releasing all or substantially all of the Collateral from the Liens . . . or altering the priority of the security interests of the Holders of the 2026 Secured Notes in the Collateral . . . ."

The critical words were "have the effect of." That is to say, did the issuance of the $250 million in additional notes "have the effect of" releasing collateral? Judge Isgur determined that he was obliged to look "beyond the contract to the resulting effect."

As a fact, Judge Isgur found that the Majority would not have bought the additional $250 million in notes without the uptier, and that the completion of the uptier occurred automatically upon the purchase of the $250 million in notes. In other words, the uptier was the "inevitable result" of the sale of the new notes.

Judge Isgur ruled that the transaction "failed" at the issuance of the new notes and "did not release the liens securing the 2026 Notes." As a result, he held that the "2026 Notes remain secured by first liens."

Judge Isgur declared "that the rights, liens, and interests that were for the benefit of all of the holders of 2026 Notes . . . remained in full force and effect . . . ."

The opinion is *Wesco Aircraft Holdings Inc. v. SSD Investments Ltd. (In re Wesco Aircraft Holdings Inc.)*, 23-3091 (Bankr. S.D. Tex. Jan. 17, 2025).

Following the Supreme Court's Morgan v. Sundance, the appeals court interpreted an arbitration agreement like any other contract, with no policy favoring arbitration over litigation.

Second Circuit Doesn't Compel a Liquidating Trustee to Arbitrate with an Insurer

Strictly construing the arbitration clause in an insurance policy, the Second Circuit upheld the bankruptcy court by holding that the trustee of a liquidating trust was not compelled to arbitrate a claim against the insurer.

The corporate debtor confirmed a chapter 11 plan creating a liquidating trust. The trustee of the liquidating trust sued the debtor's officers and directors. A settlement ensued in which the officers and directors assigned to the trustee their rights to pursue insurance coverage.

The liquidating trustee then sued the insurer for the officers' and directors' defense costs and indemnification rights. The insurer moved to compel arbitration.

The insurance policy called for arbitration of any "dispute between the insurer and the policyholder regarding any aspect of this policy." As the Second Circuit said in its nonprecedential opinion on April 15, "policyholder" was defined to mean the debtor.

In bankruptcy court and on appeal, the insurer argued that the dispute was arbitrable based on the idea that the liquidating trustee was seeking relief in his capacity as the policyholder. The insurer also contended that the officers and directors were subject to the arbitration clause because they were asserting rights given them by the insurance policy.

Chief Bankruptcy Judge Alan S. Trust of Central Islip, N.Y., denied the arbitration motion. After affirmance in district court, the insurer appealed to the Second Circuit. The appeal was heard by a panel composed of José A. Cabranes, Gerard E. Lynch and Raymond J. Lohier, Jr.

Citing Second Circuit authority, the panel said that the "threshold question" was whether the parties agreed to arbitrate and whether the disputes were within the scope of the arbitration agreement.

Parsing the complaint, the panel said that the "allegations and claims for relief . . . relate entirely to [the insurer's] duty to defend and indemnify the directors and officers in connection with the earlier adversary proceedings." It was, the appeals court said, "a dispute between insureds

and the insurer, not a dispute between the policyholder and the insurer" and "thus falls outside the scope of the Arbitration Provision."

Contrary to the insurer's idea that the trustee was acting in the shoes of the debtor-insured, the panel said that "the Trustee here is acting only as the assignee of the insureds, not as the policyholder." The court added, "the directors and officers cannot be compelled to arbitrate their disputes with [the insurer] as third-party beneficiaries." The policy, the panel said, was only an agreement to arbitrate between the insurer and the debtor, "not any disputes between [the insurer] and the directors and officers."

The Second Circuit upheld the judgment of the district court affirming Bankruptcy Judge Trust's denial of the arbitration motion.

Observation

The Second Circuit interpreted the arbitration agreement like any other contract.

The opinion doesn't say a word about a federal policy favoring arbitration, an idea extinguished by the Supreme Court in *Morgan v. Sundance, Inc.*, 596 U.S. 411 (May 23, 2022). For the unanimous Court, Justice Elena Kagan said, the "policy is to make 'arbitration agreements as enforceable as other contracts, but not more so.' *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 404, n. 12 (1967)." *Id*. at 418.

Justice Kagan added, "a court must hold a party to its arbitration contract just as the court would to any other kind. But a court may not devise novel rules to favor arbitration over litigation." *Id*. To read ABI's report, click here.

The opinion is *Ehrenberg v. Allied World National Assurance Co. (In re Orion Healthcorp Inc.)*, 24-2511 (2d Cir. April 15, 2025).

What needs to be proven before a guarantee for an investment is so speculative that it's a fraudulent transfer? Is good faith by both the borrower and the lender enough to defeat a fraudulent transfer claim?

Circuit Judges Disagree: Can an Investment Be So Risky that It's a Fraudulent Transfer?

Over a dissent, the Tenth Circuit decided that an investment was not so speculative that it gave rise to a constructively fraudulent transfer.

As demonstrated by the dissent, the case raises the question of whether an investment made in good faith can be so speculative that issuing a personal guarantee becomes a fraudulent transfer because the guarantor received no reasonably equivalent value in return for the guarantee.

Enough Skin in the Game?

Years before he became a debtor, a man had an idea but lacked capital to get the business off the ground. An acquaintance would supply capital, but not as an equity investor. The two agreed to form an LLC.

The lender made loans to the LLC in return for 82% ownership. The debtor received 15% ownership and a salary, with the opportunity to increase the debtor's percentage ownership if the business were a success. The parties understood that the debtor's salary would come from the lender's loans.

The debtor gave his personal guarantee to repay the full amount of the lender's loans up to $750,000. As security for the personal guarantee, the debtor gave the lender a security interest in a judgment in favor of the debtor.

Later, the debtor collected the judgment and gave $750,000 to the lender in full satisfaction of the lender's personal guarantee, because the lender had already advanced more than $750,000.

Not long after, the lender stopped making advances. By that time, the lender had advanced almost $900,000 to the LLC under the loan agreement. From the loan, the debtor had received salary totaling $235,000. Without additional funding, the business halted.

With the two-year statute of limitations about to run after the debtor filed a chapter 7 petition, the trustee sued the lender in bankruptcy court, alleging that the lender's receipt of the $750,000 was a constructively fraudulent transfer recoverable under Sections 544 and 550 and the Utah Uniform Fraudulent Transfer Act.

Decisions Below

The trustee and the lender filed cross motions for summary judgment. Chief Bankruptcy Judge Kevin R. Anderson of Salt Lake City granted summary judgment in favor of the lender and dismissed the adversary proceeding.

Based on undisputed facts, Judge Anderson concluded that the debtor's $750,000 guarantee was not a fraudulent transfer because the debtor received reasonably equivalent value. Having found the guarantee valid and enforceable, Judge Anderson also ruled that paying off the guarantee was not a fraudulent transfer.

The trustee appealed to the Tenth Circuit Bankruptcy Appellate Panel, which affirmed in an opinion by Bankruptcy Judge Terrence L. Michael. *Bird v. Wardley (In re White)*, 22-008, 2024 BL 56199, 2024 Bankr Lexis 424, 2024 WL 698232 (B.A.P. 10th Cir. Feb. 21, 2024). To read ABI's report, click here.

Judge Michael found "nothing remarkable or nefarious" in the loans or the repayment of the loans and decided that the bankruptcy court had correctly determined that the debtor had received reasonably equivalent value for the $750,000. *White*, *id.*, 2024 BL 56199 *6.

The trustee appealed to the circuit.

Was There Value for the Guarantee?

The crux of the appeal was whether the debtor had received reasonably equivalent value for the $750,000 personal guarantee. For the majority, Circuit Judge Veronica S. Rossman noted that neither the Utah statute, the Utah Supreme Court "nor the Bankruptcy Code defines the phrase 'reasonably equivalent value.'"

Although the Tenth Circuit had not ruled on the issue, Judge Rossman said that the parties, the bankruptcy court and the BAP "all relied on the Third Circuit's framework for 'how to determine whether an investment that failed to generate a positive return nevertheless conferred value on the debtor.' *Mellon Bank, N.A. v. Off. Comm. of Unsecured Creditors of R.M.L., Inc. (In re R.M.L., Inc.)*, 92 F.3d 139, 152 (3d Cir. 1996)." She added that the assessment of value is made as of the date of the transfer, without benefit of hindsight.

In *RML*, Judge Rossman said that the Third Circuit decided that there was no value to an investment when there was a "zero probability of success" and that there could be reasonably equivalent value if there was "any chance" of a positive return.

Among other relevant factors, Judge Rossman said, is whether the transaction was negotiated at arm's length. She then applied the factors to the case on appeal, concluding first that the debtor's employment gave value "beyond debate." Likewise, the 15% ownership also gave value for the guarantee. The possibility of increasing the ownership percentage also provided value.

Agreeing with the lower courts that the debtor received value, Judge Rossman analyzed whether the value was reasonably equivalent in view of what the debtor gave up, namely the $750,000 guarantee.

The bankruptcy court said that the trustee never alleged that the deal had a zero probability of success. Judge Rossman found no error in that regard, because there was at least "*some* evidence" of the possibility of success "and *no* evidence suggests otherwise." [Emphasis in original.] She said that "facts point in only one direction: suggesting [that the business] was reasonably likely to succeed" and that there was "no evidence" that the business was "doomed from the start."

Judge Rossman therefore held that a "rational factfinder could not conclude [that the business] was essentially doomed . . . on its *very first day*." [Emphasis in original.] She also agreed with the two lower courts that the debtor "gained about as much as — perhaps even more than — the guaranty liability was worth," because the debtor "gained substantial benefits" while he was "likely to be on the hook for well less than the full $750,000."

Summing up, Judge Rossman concluded that "the summary judgment record compels the conclusion that [the business] had at least some reasonable chance of success at the time of the guaranty [and that the debtor] gained benefits that are at least 'approximately equivalent,' or 'roughly equivalent' to the value of the debt he took on." She therefore found that "no genuine issue of material fact exists over whether [the debtor] received reasonably equivalent value for the guaranty."

Everything else was downhill. Since the $750,000 was a valid obligation, the payment was reasonably equivalent value because the guarantee was "irrevocable and unconditional." Judge Rossman therefore affirmed the grant of summary judgment in favor of the lender.

The Dissent

Circuit Judge Harris L. Hartz "respectfully" dissented. In his view, "a reasonable factfinder . . . could properly find that [the lender] did not provide [the debtor] with reasonably equivalent value in return for the $750,000 guarantee."

Like the majority, Judge Hartz said that value is determined from the creditors' point of view, because "[c]reditors do not necessarily share the same perspective as the debtor on the value of an expenditure (investment) by the debtor." From the point of view of creditors, he said that "whether the investment in [the business] is reasonably equivalent in value to the $750,000 guarantee depends on whether, at the time of the investment, the investment looks like a good idea."

Judge Hartz went on to say,

> If every reasonable creditor would think the investment is a good idea, then summary judgment should be granted in favor of [the lender] on the ground that [the debtor] received reasonably equivalent value for the guarantee. If every reasonable creditor would think the investment is a bad idea, then summary judgment should be granted against [the lender]. If reasonable creditors could differ on the issue, the reasonably-equivalent-value issue is left for a fact-finder.

Pointing to several bits of evidence indicating that the investment was an "iffy proposition," Judge Hartz disagreed with the majority because he believed that a "general creditor could have serious doubts about the opinion's analysis of value."

Judge Hartz would have denied the lender's motion for summary judgment and remanded for trial.

Observation

Imagine this: An investor makes a loan to a startup. Before the business fails, the startup repays some interest or principal on the loan. Suppose the trier of fact decides there was little chance the business would succeed.

Should repayment of a loan made in good faith be deemed a fraudulent transfer? Who would make loans to risky businesses, especially if secured loans could be set aside as fraudulent transfers? Why would anyone, in good faith, make a loan to a business that was doomed to fail?

On motion for summary judgment, should it be enough to establish that the loan was made in good faith following arm's length negotiation?

The opinion is *Bird v. Wardley (In re White)*, 24-4033 (10th Cir. July 22, 2025).

The 'ordinary course' defense only applies to credit terms with healthy customers, not to debtors in financial distress, even if pressure is ordinary in the industry.

Applying Pressure on the Debtor Obviates the 'Ordinary Course' Defense to a Preference

Following Third Circuit precedent where there may be a circuit split, Bankruptcy Judge Craig T. Goldblatt of Delaware held that the "ordinary course" defense to a preference is not available when the creditor "was imposing credit pressure on the debtor to extract payment and thus reduce its own exposure."

Early in his January 15 opinion, Judge Goldblatt foreshadowed the outcome when he said that "the ordinary course defense is intended to capture circumstances in which the debtor's decision to make the payment was simply business as usual, . . . not terms that are imposed when a debtor runs into financial trouble."

Tightened Credit Terms

The debtor was a retailer. The creditor was a "logistics provider" that arranged for shipments of goods to the debtor's locations.

Originally, the debtor had a $3 million credit limit, with payments due in 30 days. When the debtor was encountering "financial distress," Judge Goldblatt said that the creditor responded by tightening credit terms." Specifically, the creditor first lowered the credit limit to $1.75 million and later to $1 million. In addition, email correspondence showed that the creditor was imposing "credit pressure." At one point, the creditor imposed a "credit hold" and refused to make shipments without a $300,000 wire transfer.

The debtor confirmed a chapter 11 plan creating a liquidating trust. The trust filed a preference complaint against the debtor for about $3.1 million.

When the trustee filed a motion for summary judgment, the creditor raised the ordinary course defense but conceded that all of the elements of a preference were present under Section 547(b). Judge Goldblatt characterized the creditor as contending that the ordinary course defense "ought to be available so long as the credit pressure it applied to the debtor was commonplace within the relevant industry."

Credit Pressure Isn't 'Ordinary'

Judge Goldblatt was charged with ruling on the applicability of the ordinary course defense contained in Section 547(c)(2). The subsection provides that a trustee may not avoid a preferential transfer "to the extent that 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."

Judge Goldblatt explained that the defense "is intended to encourage vendors to continue to deal with distressed companies on ordinary terms." He said it is an "objective test [that] looks to the general norms of the creditor's industry."

The creditor, Judge Goldblatt said, was primarily relying on its credit manager, who testified that "it is common in the transportation and logistics industry for a supplier to tighten the credit terms once it becomes clear that a customer is facing financial difficulty."

Judge Goldblatt said that the case was calling on him to decide

> whether "ordinary course" means terms that are ordinary when dealing with a healthy company, or whether the defense is still available when the defendant was imposing credit pressure on the debtor, so long as the defendant can show that it was customary in the relevant industry to impose such credit pressure on customers in financial distress.

Judge Goldblatt cited the Third Circuit for having "expressly rejected the claim . . . that conduct of the defendant . . . should be treated as ordinary because it was similar to the treatment the defendant afforded to two other vendors." *In re Molded Acoustical Prods. Inc.*, 18 F.3d 217, 227 (3d Cir. 1994).

Again citing the Third Circuit, Judge Goldblatt went on to say,

> One's dealings with companies facing financial distress is not the measure of ordinariness. Rather, "ordinary terms are those which prevail in healthy, not moribund, creditor-debtor relationships."

Id.

Drawing from the Third Circuit, Judge Goldblatt said that the purpose of the ordinary course defense "is to 'deter[] the failing debtor from treating preferentially its most obstreperous or demanding creditors" and to "discourag[e] … creditors from racing to dismember the debtor.'" *Id.* at 219.

As further support for his conclusion, Judge Goldblatt cited other authority where the Third Circuit "found that the debtor's payments were not made in the ordinary course when the defendant . . . 'tightened its credit terms [and] imposed a credit limit.'" *In re Hechinger Inv. of Delaware, Inc.*, 489 F.3d 568, 578 (3d Cir. 2007).

Judge Goldblatt said that his decision was in accord with a recent opinion by Delaware's Bankruptcy Judge Mary F. Walrath in *In re Center City Healthcare LLC*, 664 B.R. 208 (Bankr. D. Del. Aug. 27, 2024). He described Judge Walrath as having said that the ordinary course standard "is based on the terms that prevail when the debtor is healthy, not in financial distress." To read ABI's report on *Center City*, click here.

Judge Goldblatt granted partial summary judgment in favor of the trustee by striking the creditor's ordinary course defense. Disputed issues of fact regarding "new value" precluded entry of final judgment.

The opinion is *FI Liquidating Trust v. C.H. Robinson Co. Inc. (In re Fred's Inc.)*, 21-51065 (Bankr. D. Del. Jan. 15, 2025).

Just because an avoidance action is prepetition property under Section 541(a)(1) doesn't mean that a lender can have a lien on the avoidance action as a general intangible, district judge says in affirming Bankruptcy Judge Thad Collins.

A Lender Can't Have a Lien on Avoidance Actions, District Judge Says

The Fifth and Eighth Circuits did debtors and trustees a favor by holding that avoidance actions are estate property under Sections 541(a)(1) and (a)(7) that may be sold under Section 363(b)(1).

However, both circuits created a problem for debtors and trustees because they held that avoidance actions were estate property under Section 541(a)(1) as well as Section 541(a)(7). Under Section 541(a)(1), they reasoned that avoidance actions were either "inchoate property" or "conditional, future [and] speculative" property.

By saying that avoidance actions were property that had some form of existence before filing under Section 541(a)(1), the circuits opened the door for a secured lender to claim a lien on avoidance actions.

Chief Bankruptcy Judge Thad J. Collins of Cedar Rapids, Iowa, confronted precisely that issue when a lender with a security interest in general intangibles and proceeds cited the two circuits in contending that the lender had a valid security interest in the estate's avoidance actions and any proceeds from them. Judge Collins denied the lender's motion for summary judgment, effectively ruling that the lender had no security interest in avoidance actions. *In re BDC Group, Inc.*, 23-00484, 2024 WL 4137984 (Bankr. N.D. Iowa Sept. 10, 2024). To read ABI's report, click here.

The lender appealed. We are pleased to report that Judge Collins was affirmed on July 17 in an opinion by District Judge Leonard T. Strand of Cedar Rapids.

The two circuit decisions are *Pitman Farms v. ARKK Food Co. (In re Simply Essentials)*, 78 F.4th 1006 (8th Cir. 2023); and *Briar Cap. Working Fund Cap. v. Remmert (Matter of S. Coast Supply Co.)*, 91 F.4th 376, 382 (5th Cir. 2024), *cert. denied sub nom. Remmert v. Briar Cap. Working Fund Cap., LLC.*, 144 S. Ct. 2631 (2024). To read ABI's reports, click here and here.

The circuit decisions would have been sufficient had they both only held that avoidance actions are estate property under Section 541(a)(7) as an "interest in property that the estate acquires after the commencement of the case."

Judge Collins Got It Right

In the case on appeal, Judge Strand said that the "sole issue" was whether the lender had "a lien on Chapter 5 avoidance actions by debtor." He described the lender as arguing "that the Eighth Circuit's statement in *Simple Essentials* that 'the debtor has an inchoate interest in the avoidance actions prior to the commencement of the bankruptcy proceedings' means that secured creditors can receive a debtor's interest in avoidance actions as collateral."

After *de novo* review, Judge Strand said he "agree[d] with the entirety of the Bankruptcy Court's opinion," including Judge Collins' rejection of the lender's "argument that *Simply Essentials* changed longstanding law regarding liens on avoidance actions." Judge Strand noted how Judge Collins had begun by "summarizing cases holding that pre-petition liens do not attach to avoidance actions" and "then discussed case law holding that avoidance actions arise post-petition, and thus qualify as after-acquired property that cannot be encumbered by pre-petition liens."

Judge Strand described how Judge Collins "discuss[ed] the myriad ways in which *Simply Essentials* failed to change anything about long-standing case law surrounding the effect of pre-petition liens on avoidance actions" and "determined that [the lender's] arguments fundamentally undermine the holding of *Simply Essentials*."

Affirming the bankruptcy court's denial of the lender's motion for summary judgment, Judge Strand noted how the lender's theory would have "allow[ed] a single creditor to diminish the estate at the expense of all other creditors.

Observations

If there be an appeal, let's hope the Eighth Circuit affirms.

If there's a reversal, every security agreement will be written to give liens to lenders on bankruptcy avoidance actions. Primary assets will disappear, and lenders could extinguish claims against themselves by snatching ownership away from trustees, debtors in possession, creditors' committees and liquidating trustees.

The foregoing are opinions of the writer, not ABI.

The opinion is *Keystone Savings Bank v. Hanrahan*, 24-104 (N.D. Iowa July 17, 2025).

The circuits are split on whether a bankruptcy court can compel marshalling by the IRS.

A District Court Decision Implies that Marshaling Is Impermissible in Bankruptcy

Based on statutory language and the Supreme Court's *Jevic* decision, District Judge Matthew J. Kacsmaryk of Amarillo, Texas, took sides on a circuit split in holding that "a bankruptcy court may not, as a *per se* matter, invoke the equitable remedy of marshaling against the United States in a tax collection case."

Although the case involved marshaling when the Internal Revenue Service had a priority claim, Judge Kacsmaryk's February 10 opinion could be read to mean that marshaling is never permissible in bankruptcy.

The IRS Priority Claim and Lien

The individual chapter 7 debtors owned real property allegedly worth $1.1 million that was exempt under Texas law. The IRS had recorded a tax lien against the property, but the tax lien was not subject to the state exemption.

The IRS also had a valid, unsecured $255,000 priority claim for the same debt covered by the tax lien. The chapter 7 trustee was holding almost $470,000 for distribution for creditors.

The trustee filed a motion asking the bankruptcy court to require marshaling by compelling the IRS to collect its priority claim by foreclosing the lien on the exempt real estate. To the extent that foreclosing came up short, the bankruptcy court would have allowed the IRS to be paid any deficiency through the priority claim.

Without marshaling, the IRS presumably would recover the $255,000 tax claim in full by recovery on the priority claim. Without marshaling, the distribution to other creditors would be cut in half. Moreover, the debtors would retain all of the $1.1 million in exempt property.

With marshaling, the IRS still would be paid in full by foreclosing the tax lien, but other creditors would have a larger recovery. With marshaling, the debtors would be paying the IRS, not creditors.

The trustee and the IRS cross moved for summary judgment. The bankruptcy court granted the trustee's motion to require marshaling and denied the cross motion by the IRS. Judge Kacsmaryk granted a motion by the IRS for an interlocutory appeal.

The Split

Judge Kacsmaryk described marshaling as "an equitable doctrine that allows courts to require a creditor who can resort to two or more funds for payment to seek payment from a fund other than the only one that another creditor may access." Quoting the Supreme Court, he said it was designed "'to prevent the arbitrary action of a senior lienor from destroying the rights of a junior lienor or a creditor having less security.'" *Meyer v. U.S.*, 375 U.S. 233, 237 (1963).

As courts of equity, Judge Kacsmaryk said that bankruptcy courts "can order marshaling even without explicit statutory authority," given that marshaling traces its origin to English common law.

With regard to bankruptcy and governmental claims, Judge Kacsmaryk said that the circuits are split. Among other courts, he listed the Ninth and Second Circuits and the Ninth Circuit Bankruptcy Appellate Panel for having held that marshaling "may not be invoked against the government."

On the other side of the fence, Judge Kacsmaryk said that "some circuit and district courts have applied it against the government."

Although the Fifth Circuit has not addressed the question, Judge Kacsmaryk cited a district court in Texas for holding that it "may not be invoked against the United States."

The Statutory Answer

Judge Kacsmaryk found the answer in Sections 507 and 726.

Section 726 says that property of the estate "shall" be paid "first" toward priority claims in Section 507, where the IRS has an eighth priority claim. Citing *Jevic*, he said, "This order is not negotiable." *Czyzewski v. Jevic Holding Corp.*, 580 U.S. 451, 457 (2017). Quoting the Court, he said that "'priority is an absolute command'" in chapter 7 liquidations. *Id*. at 464.

Judge Kacsmaryk rejected the trustee's idea that marshaling only obliged the IRS to pursue its lien first. "But when Congress prescribes an order of claim disbursement with mandatory language," he said, "it removes the bankruptcy court's discretion to deviate for mere equitable reasons."

Judge Kacsmaryk cited a bankruptcy court in Texas in 1990 and scholarly commentators from 1985 and 1990 for having called the "doctrine of marshaling in bankruptcy . . . into question."

Based on Sections 507 and 726, Judge Kacsmaryk held that "a Trustee representing unsecured creditors may not seek to marshal against a government agency like the IRS with a valid, priority, unsecured tax claim in a bankruptcy estate."

The Anti-Injunction Act

Judge Kacsmaryk had another statutory basis for his holding: the Anti-Injunction Act, 26 U.S.C. § 7421(a). He quoted the Supreme Court as saying that the "manifest purpose" of the Act "'is to permit the United States to assess and collect taxes alleged to be due without judicial intervention.'" *Enoch v. Williams Packing & Navigation Co.*, 370 U.S. 1, 7 (1962).

"The Anti-Injunction Act," Judge Kacsmaryk said, "allows no exceptions for a bankruptcy court to raise hurdles to tax collection." He cited the Second Circuit for holding that a junior lienholder cannot invoke marshaling against the government.

Judge Kacsmaryk found a violation of "the Anti-Injunction Act's plain text" by demanding "that the IRS seek its revenue outside the bankruptcy estate." He reversed the bankruptcy court and granted the IRS's motion for summary judgment on marshaling.

The opinion is *U.S. v. Ries*, 24-146 (N.D. Tex. Feb. 10, 2025).

To defeat motions to dismiss, preference and fraudulent transfer complaints need not contain all the information to be learned in discovery, Bankruptcy Judge Craig Goldblatt says.

Sufficiency of Preference and Fraudulent Transfer Complaints Described by Judge Goldblatt

Bankruptcy Judge Craig T. Goldblatt of Delaware wrote an opinion describing how much detail a preference and fraudulent transfer complaint must have to survive a motion to dismiss for failure to state a claim.

Having been given derivative standing to pursue avoidance actions, the creditors' committee in a chapter 11 case filed a complaint to recover preferences or constructively fraudulent transfers. The defendant filed a motion to dismiss for failure to state a claim under Rules 12(b)(3) and (b)(6), which Judge Goldblatt denied in his October 30 opinion.

Pleading Standards

Following the Supreme Court's *Iqbal* and *Twombly* decisions, Judge Goldblatt said that a "pleading that simply recites the elements is improperly conclusory." These days, he said, a "complaint must 'contain plausible facts which state a claim.'"

In the Third Circuit, courts apply a three-step test, Judge Goldblatt said. First, courts note the elements that a plaintiff must plead. Second, the courts accept well-pleaded facts as true and disregard legal conclusions. Third, the courts must decide whether the factual allegations are sufficient to state a plausible claim for relief.

On a motion to dismiss, "the court must draw 'all reasonable inferences' from the properly alleged facts 'in favor of the non-moving party,'" Judge Goldblatt said.

"Usually," Judge Goldblatt said, "a reviewing court should consider only the allegations within the four corners of a complaint, which includes materials attached to the complaint." Therefore, he said, "plaintiffs are not required to provide actual "copies of the invoices, bills, canceled checks or other tangible evidence to substantiate" their complaint."

Sufficiency of the Preference Claims

To state a preference claim, Judge Goldblatt said that the plaintiff must (a) identify the nature and amount of each antecedent debt, (b) identify each alleged preference, and (c) allege that it conducted reasonable due diligence into the "defendant's known or reasonably knowable affirmative defenses."

To allege the nature and amount of the antecedent debt, Judge Goldblatt said that the complaint "must identify the amounts owed, describe the relationship between the parties, and link the allegedly preferential transfers to that relationship." The defendant argued that the complaint was deficient because the complaint did not identify which of the three agreements between the parties gave rise to the preferential transfers.

Judge Goldblatt said that the complaint stated that there were "agreements" between the parties for the provision of goods and/or services, which gave rise to "$195,699.29" in preferences. He said that the committee was "not required to identify the specific agreements in its complaint." The complaint, he said, "only needs to give enough detail to allow the defendant to identify the payment in question," not "everything [the defendant] might wish to know about the plaintiff's claims."

Judge Goldblatt ruled that the committee had "sufficiently alleged the nature and amount of each antecedent debt and ha[d] provided enough detail to allow [the defendant] to identify the payments at issue." To the extent that the defendant wants more information, he said that "it will be entitled to discovery in accordance with the rules."

Identification of the Preference

To identify the preference, Judge Goldblatt said that the plaintiff must identify the date of the transfer, the name of the transferor, the name of the transferee, and the amount of the transfers.

The defendant contended that the complaint was insufficient because it did not identify the specific contract that gave rise to the transfer. Judge Goldblatt dismissed the argument, saying that the committee had sufficiently identified the transfers, for the reasons previously given.

The Conduct of Due Diligence

The defendant argued that the committee had not sufficiently pleaded due diligence as required by Section 547(b) because the complaint did not specify the agreements that gave rise to the preferences.

Judge Goldblatt retorted by saying that because "the diligence element is a condition precedent governed by Rule 9(c) of the Federal Rules of Civil Procedure, it is not subject to the *Iqbal* and *Twombly* standard." To plead diligence adequately, he said, "the plaintiff need only advance a 'general allegation' that 'all conditions precedent have occurred.'"

In the complaint, Judge Goldblatt recited how the committee stated that "it conducted its 'own due diligence' into [the defendant's] reasonably knowable affirmative defenses by reviewing 'the books and records' in its possession."

Judge Goldblatt said that the committee satisfied Section 547(b) because it "only needs to allege that it conducted reasonable due diligence into the defendant's known or reasonably knowable affirmative defenses."

Sufficiency of the Fraudulent Transfer Claims

The defendant argued that the constructively fraudulent transfer claims were inadequately pleaded because the complaint did not meet the heightened pleading standard in Rule 9(b), which requires that "a party must state with particularity the circumstances constituting fraud or mistake."

"Constructively fraudulent transfers are not subject to the heightened pleading standard that applies in cases of actual fraud," Judge Goldblatt said. For an adequate pleading, he said, "the plaintiff need only allege that 'there was a transfer for less than reasonably equivalent value at a time when the [debtor was] insolvent.'"

Judge Goldblatt denied the motion to dismiss, because the committee had adequately pleaded both preferential and constructively fraudulent transfers.

The opinion is *In re Pack Liquidating LLC*, 22-10797 (Bankr. D. Del. Oct. 30, 2024).

Good faith and attention to detail should enable a failing business to avoid WARN Act liability.

Delaware Judge Writes a Treatise for Avoiding WARN Act Liability

Facing the possibility of bankruptcy, managers of the business face a dilemma created by the federal Worker Adjustment Retraining Notification Act, known as the WARN Act. To avoid liability for back pay, the WARN Act requires giving workers 60 days' written notice of plant closings or mass layoffs.

However, giving a WARN Act notice to avoid liability could quickly turn the possibility of bankruptcy into reality, by driving away customers and workers.

On December 19, Bankruptcy Judge Craig T. Goldblatt of Delaware surveyed the law nationwide and wrote a 67-page opinion telling company executives how to behave and what to write to workers to avoid WARN Act liability.

The Precipitous Liquidation

The business in question was Yellow Corp., once one of the country's largest truckers. In precarious financial condition, the company had hired an investment banker to hunt down new investment or modify existing loan agreements. Facing a liquidity crunch, the company asked the union pension fund for a deferral of a contribution. The pension fund refused.

When the company didn't make the payment, the union gave notice of a strike in 72 hours. Both sides saw the strike notice as a bluff, but customers reacted otherwise. Daily shipments fell from about 45,000 to almost nothing in a matter of days. New financing or modification of loan agreements no longer feasible, the company filed a chapter 11 petition to liquidate.

In chapter 11, individuals, unions and pension funds filed proofs of claim under the WARN Act. In addition, the debtor was named as a defendant into two adversary proceedings professing WARN Act liability. Following discovery, both sides filed motions for summary judgment.

Ruling on summary judgment, Judge Goldblatt dealt with statutory exceptions to WARN Act liability.

The First Two Exceptions

Judge Goldblatt first dealt with the so-called faltering company exception in 29 U.S.C. § 2102(b)(1). As the judge said, it provides an exception to the notice requirement if "as of the time that notice would have been required," the employer (a) "was actively seeking capital or business which, if obtained would have enabled the employer to avoid or postpone the shutdown" and (b) "the employer reasonably and in good faith believed that giving the notice required would have precluded the employer from obtaining the needed capital or business."

When notice ultimately is given, Judge Goldblatt said that it "must contain a brief statement explaining why one or more of the exceptions applies."

With regard to the first exception, Judge Goldblatt said that "the summary judgment record clearly indicates that the debtors' efforts, through [the company's investment banker], to explore options either to refinance existing indebtedness or to attract new capital was sufficient to fall within the faltering company exception." He added, "Retaining an investment banker that is actively engaged in exploring the market for sources of new liquidity is precisely the kind of activity that qualifies under the faltering company exception."

The second exception is in 29 U.S.C. § 2102(b)(2). As Judge Goldblatt said, it provides an exception to the requirement of 60 days' notice "if the layoff is 'caused by business circumstances that were not reasonably foreseeable as of the time' notice would have been required."

To determine whether the event was not reasonably foreseeable, Judge Goldblatt quoted the Third Circuit, which said that "the court must ask, applying an objective standard, 'whether a similarly situated employer' using its 'commercially reasonable business judgment would have foreseen' the businesses' closure as of the date notice would have been required."

On summary judgement, Judge Goldblatt said that the "record makes clear that the debtors' shut down was caused by an unforeseeable business event," namely, the "history of brinksmanship." The debtor, he said, "had every reason to believe . . . that the [the union] would come to the table before the clock ran out." He added that the business failure was caused, "at least in substantial part, by the [union's] miscalculation about the effect of sending a strike notice."

Judge Goldblatt ruled that "the summary judgment record makes clear that the layoffs were 'caused by business circumstances that were not reasonably foreseeable at the time,' within the meaning of the WARN Act."

The Notices Fall Short

For either exception to apply, Judge Goldblatt said that the accompanying regulations require the that the debtor "must 'give as much notice as is practicable and at that time shall give a brief statement of the basis for reducing the notification period.'"

When the company eventually gave the notices, Judge Goldblatt said they "did not contain enough facts adequately to justify the reduced notice." The first notice was "devoid of actual facts," and the second notice was "a closer question" but did not contain "language specific to the company's circumstances."

Judge Goldblatt therefore held that the debtor "may not validly invoke the WARN Act's faltering company exception."

The Liquidating Fiduciary Exception

The company had another escape hatch, the liquidating fiduciary exception that arises under the WARN Act's definition of an "employer" as a "business enterprise" with more than 100 employees. Judge Goldblatt cited the federal Department of Labor's commentary in saying that "a fiduciary 'whose sole function in the bankruptcy process is to liquidate a failed business … does not succeed to the notice obligations.'"

The question, Judge Goldblatt said, "is whether, at the time of the layoffs, the debtors were still engaged in their usual business activity." Applying caselaw, he concluded that "the debtors were no longer 'employers' within the meaning of the WARN Act after they had both stopped picking up new shipments and delivered the final shipment."

On the earlier date when nonunion employees were fired, Judge Goldblatt found "no dispute" that the debtors were employers. A few days later, when union workers were fired, the record was unclear, and he was unable to grant summary judgment one way or the other, given "a genuine dispute of material fact."

Waivers of WARN Act Liability

Initially, the debtor agreed to pay severance to employees who signed waivers of WARN Act liability. Later, but still before bankruptcy, the debtor decided to pay severance to everyone. The question arose as to whether the waivers were enforceable.

As a matter of contract law, Judge Goldblatt said that the record did not support summary judgment for either side, because it "boils down to whether the debtors made a knowingly false statement when they represented to employees that they were required to sign the release in order to obtain the severance payment."

'Good Faith' Could Preclude Liability

Judge Goldblatt said that Section 2104(a)(4) "allows courts to, in their discretion, reduce a company's liability under the Act if the employer shows that the violative 'act or omission' was

'in good faith and that the employer had reasonable grounds for believing that the act or omission was not a violation' of the WARN Act."

While the record could not justify granting summary judgment, Judge Goldblatt told the parties that he "views the debtors' violation of the WARN Act in this case to be something of a technical one." Therefore, he said, "the parties should appreciate that if the evidence at trial is broadly consistent with the existing record, there is a substantial prospect that the Court will exercise the discretion afforded to it by § 2104(a)(4)."

Judge Goldblatt granted and denied summary judgment in part.

The opinion is *Moore v. Yellow Corp. (In re Yellow Corp.)*, 23-50457 (Bankr. D. Del. Dec. 19, 2024).

Because a trustee suing to recover a fraudulent transfer is acting in the interest of creditors, not the debtor, the in pari delicto defense does not apply, says Bankruptcy Judge Scott Clarkson.

In Pari Delicto Defense Doesn't Apply to a Trustee Exercising Avoidance Powers

When a trustee uses avoiding power to recover fraudulent transfers under Section 548 or state law, there is no *in pari delicto* defense, according to Bankruptcy Judge Scott C. Clarkson of Santa Ana, Calif.

In his March 27 opinion, Judge Clarkson explained that *in pari delicto* did not apply because the trustee was not suing on behalf of the debtor. Rather, the trustee was "assert[ing] [the defense] for the benefit of [the] Debtor's creditors, whose rights [the] Trustee enforces."

If the debtor in possession had been suing under Section 544, Judge Clarkson said there also would have been no *in pari delicto* defense because "the debtor-in-possession would also be stepping into the shoes of the unsecured creditors."

The Criminal Enterprise

The chapter 11 debtor was a law firm where management was soon replaced by a chapter 11 trustee. In the third paragraph of his opinion, Judge Clarkson said he had "previously found that [the] Debtor, since its pre-petition inception (and through the time of the appointment of the Chapter 11 Trustee), was, in this Court's opinion, operating a significant criminal enterprise."

Judge Clarkson described the debtor as "a law firm that allegedly provided consumer debt resolution services on a nationwide basis, with client files numbering in the several tens of thousands, if not more." To land clients, the debtor used marketing agents who brought in clients in return for "a percentage of monthly payments collected from the clients."

Judge Clarkson said it was an "unethical and most likely illegal enterprise." Among other things, he said that retainers paid by clients were not held in trust until earned but "were most likely looted by the principal or principals controlling [the] Debtor pre-petition and post-petition, before the appointment of the Chapter 11 Trustee."

The trustee sued one of the marketing agents to recover fraudulent transfers of about $620,000 plus preferences of some $420,000. The defendant raised an *in pari delicto* defense.

The Illegal 'Capping' Agreement

The trustee responded by saying that the marketing arrangement was an illegal "capping agreement" barred under California law that "conferred no reasonably equivalent value to Debtor." Specifically, Judge Clarkson said that the arrangement violated California Business and Professional Code § 6154(a), which states that "[a]ny contract for professional services secured by any attorney at law or law firm in this state through the services of a runner or capper is void."

A "capper" is defined in the statute as someone "acting for consideration . . . as an agent for an attorney . . . in the solicitation or procurement of business for the attorney at law or law firm as provided in this article." Judge Clarkson said that the defendant fit "squarely" into the definition of a "capper."

Judge Clarkson said that the debtor "engaged in actually fraudulent transfers by engaging in illegal activity with Defendant . . . in furtherance of Debtor's criminal enterprise."

Analyzing the undisputed facts, Judge Clarkson concluded that the trustee had shown the elements of both fraudulent transfers and preferences. He was left to decide whether the defendant could raise the *in pari delicto* defense, because the debtor was the primary motivator in the illegal activity.

The Scope of *In Pari Delicto*

Citing the Ninth Circuit, Judge Clarkson said that the "*in pari delicto* doctrine bars recovery by a plaintiff who bears 'at least substantially equal responsibility for his injury,' and also has been applied to bar recovery 'where the plaintiff has participated in some of the same sort of wrongdoing as the defendant.'"

The trustee countered by saying that he was not on behalf of the debtor but on behalf of creditors under the trustee's powers given by Sections 544 and 548, alongside similar California law.

Judge Clarkson said it's "generally" true that a trustee stands in the shoes of the debtor, making *in pari delicto* available when the defense could be raised against the debtor. "In this adversary proceeding, however," he said, the "Trustee is not standing in the shoes of Debtor but rather the unsecured creditors, making the *in pari delicto* defense inapplicable."

Judge Clarkson explained that a trustee has two sources for mounting avoidance actions. Under Section 541(a)(1), the trustee succeeds to the debtor's interests. On the other hand, a trustee may sue under Section 544 by asserting the rights of creditors. He cited a handful of cases for the proposition "that the doctrine of *in pari delicto* is inapplicable for claims brought under § 544"

because the trustee "is not attempting to bring a claim for the benefit of a debtor but in favor of unsecured creditors."

Just like "*in pari delicto* is not applicable as a defense to Trustee's claims under § 548," Judge Clarkson said "it is likewise not applicable to Trustee's claims under" California fraudulent transfer law.

Judge Clarkson held that "the *in pari delcito* defense is not available to Defendant" because "a defendant cannot raise the *in pari delicto* defense against a trustee when the causes of action asserted rely on avoidance powers."

Dispensing with other defenses raised by the defendant, Judge Clarkson granted summary judgment to the trustee on the preference and fraudulent transfer claims.

Observations

A creature of common law predating the U.S. constitution, *in pari delicto* came into vogue under the former Bankruptcy Act given the understanding that a bankruptcy trustee steps into the shoes of the debtor.

The same concept does not exist under the Bankruptcy Code. Rather, the Code creates an estate under Section 541 that the trustee administers under Section 704. There are no transfers of estate property to the trustee. The bankruptcy trustee no longer steps into the debtor's shoes.

The *in pari delicto* defense does not infect federal receivers, because a receiver represents creditors, not the debtor. As Judge Clarkson has held, it's about time that federal courts came to realize that bankruptcy trustees are in the same position as receivers and that *in pari delicto* should not apply to trustees any more than it applies to federal receivers.

There is a choice-of-law question, however. If a trustee is suing under Section 548, it would seem to this writer that a federal court would be in a position to decide whether *in pari delicto* exists as a matter of federal law. In some circuits, though, reconsideration of *in pari delicto* might require presentation to a circuit court sitting *en banc*.

What if the trustee is suing under state law and state law promotes *in pari delicto*? Is a federal court sitting in bankruptcy entitled to declare that *in pari delicto* does not apply to trustees suing under state law? What if state courts have held that *in pari delicto* applies to bankruptcy trustees? Must a federal court certify a question to the state supreme court?

The opinion is *Marshack v. JGW Solutions LLC (In re Litigation Practice Group PC)*, 23-01148 (Bankr. C.D. Cal. March 27, 2025).

ROCHELLE'S DAILY WIRE

Sales

For a sale 'free and clear,' nondebtors can be enjoined from suing.

In '363' Sales, Three Courts Say *Purdue* Doesn't Bar Injunctions Protecting Buyers

Following the *Purdue* decision from the Supreme Court last year, three bankruptcy courts have permitted sales of estate property to bar suits against nondebtor purchasers of estate assets.

The third decision came on January 24 from Bankruptcy Judge Keith L. Phillips of Richmond, Va., in a case involving insurance policies covering asbestos claims.

The debtor was a shipyard that went out of business in the 1980s but was saddled with 126,000 lawsuits for exposure to asbestos. By the time the debtor filed a chapter 11 petition last year, only 2,700 claims remained.

The debtor had several insurance policies that had not been exhausted. Apparently, there were disputed coverage questions. The debtor and the insurers entered into a settlement agreement where the insurers bought back the policies with effect as though "the policies had never been issued," Judge Phillips said.

The settlement agreement contained an injunction that would bar anyone with a claim against the debtor from suing the settling insurers. Over objection from the U.S. Trustee and another shipyard that was a co-defendant alongside the debtor in some lawsuits, Judge Phillips had approved the settlement providing for a sale of the policies under Section 363.

The other shipyard filed a notice of appeal together with a motion for a stay pending appeal, which Judge Phillips denied in his January 24 opinion.

Purdue Doesn't Apply to 363 Sales

In the Fourth Circuit on a motion for a stay pending appeal, Judge Phillips said that the appellant must show (1) a likelihood of success on the merits, (2) irreparable harm if the stay is denied, (3) that the other party will not be substantially harmed by the stay, and (4) that the public interest will be served by a stay.

First, Judge Phillips addressed the likelihood of success on appeal. He characterized the other shipyard as contending that *Purdue's* limitation on nondebtor injunctions also applies to Section 363 sales. *See Harrington v. Purdue Pharma L.P.*, 144 S. Ct. 2071 (2024). To read ABI's report, click here.

Judge Phillips began by citing authorities for the principle that bankruptcy courts may sell estate property "free and clear" by enjoining creditors from suing the purchaser. In bankruptcy cases, he said that "[i]nsurers and their insureds who have filed chapter 11 cases because of mass tort claims often enter into settlement agreements characterized as 'buyback' transactions to obtain funds to pay claimants." Buybacks, he said, are "entered into to facilitate an orderly distribution of funds to asbestos-related claimants while avoiding extensive litigation costs associated with resolving disputes over coverage issues."

Judge Phillips cited a decision by Bankruptcy Judge Corali Lopez-Castro of Miami, who, he said, "acknowledged that *Purdue* did not call into question negotiated settlements governed by Bankruptcy Rule 9019 or the sale of the Debtors' insurance policies under § 363." *In re Bird Global, Inc.*, 23-20514 (Bankr. S.D. Fla.).

Judge Phillips sided with Judge Lopez-Castro. He said that allowing "a creditor to independently pursue its claim against property of the debtor after it been sold in bankruptcy would have a chilling effect on the sale of assets in bankruptcy. *Purdue* was not intended to thwart that process."

Judge Phillips found "noting" in *Purdue* to suggest "that the protections afforded a buyer pursuant to § 363, including the ability of the purchaser to obtain the asset free of the claims of the debtor's creditors, were intended to be abrogated."

Next, Judge Phillips cited a decision by Bankruptcy Judge Martin Glenn of New York who, he said, approved "a settlement agreement containing releases and injunctions." Judge Glenn "was not persuaded by the argument urged by the United States Trustee that *Purdue* is applicable in the context of a § 363 sale in addition to the context of plan confirmation."

Finding no likelihood of success on appeal, Judge Phillips went on to find no irreparable harm besetting the other shipyard while finding "substantial" harm to the debtor were there a stay pending appeal. In terms of public policy, he decided that "public policy is best served by preserving the finality of sales in bankruptcy."

Judge Phillips denied the motion for a stay pending appeal.

The opinion is *In re Hopeman Brothers Inc*., 24-32428 (Bankr. E.D. Va. Jan. 24, 2025)

New York's Judge Philip Bentley interpreted Section 363(f)(5) to permit a sale free and clear whenever a creditor could conduct a foreclosure or a UCC sale.

Bankruptcy Judge Rejects a District Court's Narrow View of Sales Free and Clear

A district judge in New York wrote an opinion in 2014 espousing a narrow reading of Section 363(f)(5) that would allow the sale of property free and clear of liens only when the debtor or the trustee, not a creditor, "could compel the interest holder to accept a money satisfaction for its interest." *Dishi & Sons v. Bay Condos LLC*, 510 B.R. 696, 710 (S.D.N.Y. 2014).

Because a trustee or an owner would seldom have the right to compel a lienholder "to accept a money satisfaction of such interest" in "a legal or equitable proceeding," *Dishi* would typically bar selling liened property free and clear in bankruptcy cases.

Since district court opinions are not binding authority even in the same district, bankruptcy courts in New York typically do not follow *Dishi.* New York's Bankruptcy Judge Philip Bentley wrote an opinion on March 4 politely explaining why *Dishi* is not the best or proper reading of Section 363(f)(5). Because the underlying order by Judge Bentley is already final, there will not be an appeal.

Selling a Hotel Free and Clear

The debtor operated a leased hotel in Manhattan that fell on hard times during the pandemic. With $114 million in first-lien debt and no financing to operate, Judge Bentley said that the debtor's "only viable option" was to sell the assets.

After 13 months of mediation, the parties negotiated a global settlement calling for a sale to the holder of the first lien on a $78 million credit bid. To permit the hotel to reopen, the buyer was willing to pony up $20 million in cash to cure defaults on leases and contracts.

The only objection to the sale and confirmation of the plan came from the holder of a $189,000 mechanic's lien, who wrapped itself in the *Dishi* flag. The mechanic's lien was deeply underwater and would be treated as a general unsecured debt under the plan.

Sustaining the *Dishi* objection, Judge Bentley said, "would effectively elevate this lien holder's rights from those of an unsecured to a secured creditor, enabling it to demand to be paid as the price of dropping its objection to the sale."

The Best Reading of Section 363(f)(5)

The outcome turned on the interpretation of Section 363(f), which provides that a "trustee may sell property . . . free and clear of any interest in such property of an entity other than the estate, only if . . . (5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest."

Judge Bentley explained why Section 363(f)(5) "is often the only available basis for a free-and-clear sale." Subsection (1), he said, is construed "narrowly, to apply only to a limited number of non-bankruptcy laws that permit non-judicial sales free and clear of liens." If "the holder of a lien that is not in *bona fide* dispute refuses to consent," he said that "subsections (2), (3) and (4) by their terms do not apply."

"For decades" before *Dishi*, Judge Bentley said that "many courts and commentators considered it settled that section 363(f)(5) made free-and-clear sales widely available because foreclosure sales and UCC sales satisfied that subsection." If *Dishi* were to govern, he said that "Section 363(f)(5) would rarely be satisfied."

Judge Bentley said that *Dishi* "was right" in rejecting a "sweepingly broad construction" that would permit a sale free and clear if it were theoretically possible for a governmental condemnation to extinguish interests in property. Instead, he favored "a middle-ground construction" that would not "encompass . . . any conceivable hypothetical proceeding . . . but only proceedings that might realistically be brought in the case before the court if the automatic stay were lifted or did not apply." In most cases, he said, "this would include either foreclosure proceedings or UCC sales."

Employing a "realistic possibility" standard, Judge Bentley said, "does not render sections 363(f)(1) through (4) superfluous." Unlike eminent domain takings, he said that foreclosure sales "do not extinguish all interests in the property," such as "easements and covenants running with the land" and nondisturbance agreements.

"Most important," Judge Bentley said, his interpretation "conforms more closely" with "the text, statutory context and purposes of this subsection." He pointed out that "section 363(f)(5) is written in the passive voice." By comparison, he said that "*Dishi's* interpretation drastically narrows this language."

Judge Bentley said that the propriety of his interpretation was "even clearer" when considering "the Bankruptcy Code's other provisions concerning the treatment of secured debt." Among other sections, he mentioned Section 506(a), where a secured creditor's claim can be bifurcated into a secured and unsecured claim when the lien is partially underwater.

Pragmatically speaking, Judge Bentley said that *Dishi* “would depress the price any potential buyer would be willing to pay” or “enable holders of out-of-the-money liens to extract payment of hold-up value in exchange for waiving their liens.”

Judge Bentley overruled the objection and allowed the debtor to sell the lease “free and clear of all liens, claims and encumbrances.”

The opinion is *In re Urban Commons 2 West LLC*, 22-11509 (Bankr. S.D.N.Y. March 4, 2025).

Affirming Bankruptcy Judge Michael Romero, the district court holds that an exemption remains valid even though the exempt property remains subject to a nondischargeable domestic support obligation.

Trustee May Not Liquidate Estate Property Solely to Benefit a DSO Creditor

Affirming Bankruptcy Judge Michael E. Romero, a district judge in Denver wrote an opinion standing for the proposition that a trustee may not liquidate estate property solely for the benefit of the holder of a nondischargeable domestic support obligation.

The chapter 7 debtor scheduled assets with a total value of about $13,000. The debtor claimed exemptions under Colorado law covering all the assets.

The debtor's schedules also listed a priority unsecured claim arising from a domestic support obligation of almost $20,000. We shall refer to a domestic support obligation as a DSO.

The Objection to the Exemption Claim

The chapter 7 trustee objected to the debtor's exemption claim. According to the March 27 opinion by District Judge Charlotte N. Sweeney, the trustee reasoned that the debtor was not entitled to the exemption under state law given the existence of the DSO claim that covered all of the debtor's property.

Bankruptcy Judge Romero overruled the trustee's objection to the exemption while declaring that the exempt assets would remain subject to the nondischargeable DSO claim. The trustee appealed.

The appeal dealt with the trustee's efforts to deny the exemption, take the assets into the estate, and then distribute the assets to the former wife, less, however, the trustee's commissions and expenses of administration. In other words, denying the exemption would have meant a smaller recovery by the former wife. The former wife would have been paying the trustee for administering the estate.

State Law

As he had done unsuccessfully in bankruptcy court, the trustee rested the appeal on Colo. Rev. Stat. § 13-54-106, which provides that state exemptions do not apply to "arrearages for child support or for child support debt."

In bankruptcy cases, District Judge Sweeney noted how the former wife's DSO was "further protected" by Section 522(c). The subsection provides that exempt property

> is not liable during or after the case for any debt of the debtor that arose, or that is determined under section 502 of this title as if such debt had arisen, before the commencement of the case, except — (1) a debt of a kind specified in paragraph (1) or (5) of section 523(a) (in which case, notwithstanding any provision of applicable nonbankruptcy law to the contrary, such property shall be liable for a debt of a kind specified in such paragraph).

Section 523(a)(5) refers to DSOs, which are defined in Section 101(14A) and encompassed the former wife's DSO claim.

Synthesizing the Code, Judge Sweeney said that "exempt property remains liable during or after the case for any DSO debt." The case at hand, however, involved a state exemption. She said that the "Tenth Circuit has not addressed if a debtor with a DSO can claim Colorado exemptions pursuant to § 13-54-106."

Examining sparse Colorado appellate authority on Section 13-54-106, Judge Sweeney identified a state Court of Appeals decision which held that a personal injury award, exempt under state law, is not protected from garnishment by the holder of a DSO. She interpreted the decision to mean that "otherwise exempt property does not lose its exempt status but is nonetheless available to DSO creditors."

Affirming Judge Romero, Judge Sweeney therefore held "that the plain language of § 13-54-106 . . . unambiguously permits the garnishment of otherwise exempt property for collection of child support arrearages."

Section 522(a)(2)

Alternatively, the trustee relied on Section 544(a)(2), which gives a trustee the avoiding power of a hypothetical judicial lien creditor. Specifically, the trustee relied on a decision from the Tenth Circuit Bankruptcy Appellate Panel holding that the powers given to a trustee under Section 544(a) are not limited to avoidance of transfers but subsume broader rights including objecting to exemptions.

In other words, the trustee seemed to be saying that the trustee could step into the shoes of a DSO creditor, to whom the state exemption was not applicable.

Synthesizing Tenth Circuit authority, Judge Sweeney came to the conclusion that a trustee can use Section 544(a)(2) to defeat an improperly-claimed exemption but may not use Section 544(a)(2) to reach exempt assets that are not estate property.

Having already held that the assets were exempt, Section 544(a)(2) was therefore not available to the trustee.

Policy

Judge Sweeney reached the same result based on policy. Since the DSO was larger than all of the assets, she observed that "the administration of the Assets would be for the benefit of only a single creditor — the DSO creditor — rather than unsecured creditors."

Judge Sweeney paraphrased Bankruptcy Judge Romero for having "concluded that it would be 'improper' (as it would be where a chapter 7 trustee seeks to liquidate fully-encumbered property for the benefit of a single secured creditor) to permit the Trustee to liquidate the Assets where the sole benefit to the estate would be the recoupment of administrative costs."

The trustee, Judge Sweeney said, "fails to address whether there is a true benefit to the estate under the facts here." She decided that Judge Romero "did not err in determining that allowing the Trustee to administer the Assets would run afoul of the [Trustee's] Handbook's directive prohibiting trustees from administering an asset where the proceeds of liquidating will primarily benefit the trustees."

Judge Sweeney affirmed Judge Romero's decision, finding no error in the interpretation of state law.

The opinion is *Rodriguez v. Tucker (In re Tucker)*, 24-304 (D. Colo. March 27, 2025).

Small Biz. Reorg. Act

Judge Meredith Grabill of New Orleans agreed with New York's Judge Mastando that a Subchapter V plan can enjoin lawsuits against nondebtors for the life of a three-year plan.

Two Courts Hold: Injunctions Are Ok to Protect Nondebtors for the Life of a Plan

Bankruptcy Judge Meredith S. Grabill of New Orleans agrees with New York's Bankruptcy Judge John P. Mastando, III: A Subchapter V plan may contain a preliminary injunction barring suits against a nondebtor for the life of the plan, whether it be three or five years.

The corporate debtor in Judge Grabill's court was an operator of fast-food restaurants. The debtor closed some locations, sold some assets, renegotiated several leases and filed a plan to continue operating nine locations. (No, this is not a story about how a franchisor can kill a reorganization by objecting to assumption of franchise agreements.)

The debtor satisfied all objections to the plan except for an objection from the holder of an unsecured note for about $800,000. The plan called for amortization of the note on a seven-year schedule at 5% interest, with a balloon payment of some $500,000 at the end of the three-year plan.

Neither the balloon payment nor the 5% interest rate rubbed the noteholder the wrong way. Rather, the noteholder objected to a three-year injunction in the plan barring the noteholder from suing the debtor's principal, who had guaranteed the note.

In her May 13 opinion, Judge Grabill described the plan this way:

> [I]f a creditor's claim is treated through the Plan, that creditor is prohibited from pursuing satisfaction of that claim from any other person, but only for the three-year term of the Plan or the date the Debtor defaults on Plan payments and fails to cure the default timely, whichever is first.

As Judge Grabill said, the U.S. Trustee and the noteholder objected to confirmation "solely on the assertion that [*Harrington v. Purdue Pharma L.P. (In re Purdue Pharma)*, 603 U.S. 204, 227 (2024)] and [*Highland Capital Management Fund Advisors, L.P. v. Highland Capital Management, L.P. (In re Highland Capital Management, L.P.)*, 132 F.4th 353 (5th Cir. 2025)] prohibit the inclusion of temporary, non-consensual, non-debtor injunctions in a confirmed plan of reorganization." To read ABI's reports on *Purdue* and *Highland Capital*, click here and here.

Not leaving the reader in doubt, Judge Grabill said that she "agrees with [the decision by Judge Mastando in *In re Hal Luftig Co.*, 667 B.R. 638 (Bankr. S.D.N.Y. 2025)] that an 'argument that *Purdue Pharma* prohibits bankruptcy courts from, as part of a plan, temporarily enjoining creditors' collection efforts against non-debtors is without merit.' *Id*. at 663." To read ABI's report on *Hal Luftig*, click here.

Distinguishing *Highland Capital*

Sitting in the Fifth Circuit, Judge Grabill was bound by *Highland Capital*. She explained how the *Highland Capital* "court went to lengths to clarify why its holding in [the prior decision, *NexPoint Advisors, L.P. v. Highland Capital Mgmt., L.P. (In re Highland Capital Mgmt., L.P.)*, 48 F.4th 419 (5th Cir. 2022)] narrowed both the exculpation clause in the plan as well the gatekeeper provision of the plan in the same manner."

Highland Capital, Judge Grabill said, "was not asked to and did not address temporary, non-consensual, non-debtor injunctions entered at confirmation to facilitate successful implementation of a plan."

Zale Still Obtains

Judge Grabill said that "nothing in [*Highland Capital*] appears to have disturbed the Fifth Circuit's recognition of the use of temporary, non-consensual, non-debtor injunctions found in *Feld v. Zale Corp. (In re Zale Corp.)*, 62 F.3d 746 (5th Cir. 1995), a seminal case in the Fifth Circuit relied upon by numerous panels to date to foreclose non-consensual, non-debtor releases and permanent injunctions."

At greater length, Judge Grabill explained:

> Thus, although *dicta*, the *Zale Corp*. court clearly recognized that circumstances may arise in a bankruptcy case justifying the issuance of a temporary injunction of non-debtor actions through the plan confirmation process. This Court finds that *Zale Corp.* continues to be a valid legal proposition.

Judge Grabill overruled objections to the plan by the U.S. Trustee and the noteholder "to the extent they assert that the holdings in *Purdue Pharma* or [*Highland Capital*] ban outright temporary, non-consensual, non-debtor injunctions entered at confirmation to facilitate the successful implementation of a plan."

Unusual Circumstances Exist

Judge Grabill then turned to the question of whether the debtor had shown the facts required by *Zale*, which held that temporary injunctions are permissible when there are "unusual circumstances." *Zale, supra*, at 62 F.3d 761.

Judge Grabill found that the debtor and its principal had an "identity of interest" in that a suit against the principal was "essentially a suit against the Debtor." In addition, she said that the services of the debtor's principal were "vital to the Debtor's successful reorganization" and that a lawsuit on the guaranty "would divert the time, attention, and resources of the Debtor's executive and manager from effecting the Debtor's reorganization efforts."

Therefore, Judge Grabill found that "the Debtor has satisfied the *Zale Corp*. 'unusual circumstances' test warranting the issuance of a temporary, non-debtor injunction to facilitate the successful implementation of the Plan."

To close the loop, Judge Grabill found that the debtor also had satisfied the four-factor test for issuance of a preliminary injunction. Among other things, she said that the harm to the noteholders was "minimal" when compared to the debtor, who might "forfeit[] its ability to reorganize" if there were no injunction barring suit on the guaranty.

Judge Grabill overruled the objections and held that the injunction in the plan was "properly issued pursuant to 11 U.S.C. §§ 105(a) and 1123(b)(6)."

The opinion is *In re Miracle Restaurant Group LLC*, 24-11158 (Bankr. E.D. La. May 13, 2025).

Bankruptcy Judge Jason Burgess agrees with Bankruptcy Judges John Mastando and Meredith Grabill that Purdue doesn't preclude a five-year injunction as part of a Subchapter V plan.

Another Court Approves a Nondebtor Injunction for the Five-Year Life of a Sub V Plan

A bankruptcy court has approved another Subchapter V plan enjoining lawsuits against a nondebtor for the five-year life of the plan.

Bankruptcy Judge Jason A. Burgess of Jacksonville, Fla., said that *Harrington v. Purdue Pharma L.P.*, 603 U.S. 204 (2024), "targeted non-consensual third-party permanent releases, not temporary injunctions that are at issue here." In a September 2 opinion, he said that the U.S. Trustee was seeking "to stretch [the] implications [of *Purdue*] beyond their intended reach."

The corporate debtor recruited engineers. The owner was the only employee and the only person who brought in new clients. An employer would pay the debtor a percentage of the salary of someone placed by the debtor.

Evidently, the owner had guaranteed some of the debtor's debts. The plan included an injunction barring suits against the owner for the five-year life of the plan. The injunction would dissolve on discharge, dismissal, plan default or the owner's termination of employment by the debtor.

The only objection to confirmation came from the U.S. Trustee, who argued that the injunction was barred by *Purdue*. To read ABI's report on *Purdue*, click here.

Judge Burgess said that courts have "narrowly construed" *Purdue* and that the Supreme Court was dealing with "non-consensual third-party permanent releases rather than temporary injunctions."

Purdue, Judge Burgess said, "found that § 1123(b)(6), in conjunction with § 105, does not permit bankruptcy courts to issue non-consensual third-party releases." He added, "The Supreme Court did not consider § 1123(a)(5), which the Court finds distinguishable from § 1123(b)(6)."

Judge Burgess pointed out how Section 1123(a)(5) contains a nonexhaustive list of means for implementing a plan, not a catchall phrase like Section 1123(b)(6). In the case at hand, he said that

"the Plan Injunction is necessary for implementation of the plan and thus is authorized by § 1123(a)(5) in conjunction with § 105."

"Other courts," Judge Burgess said, "have also found a temporary injunction like the one here to be necessary 'to facilitate the successful implementation of the Plan.'" He cited *In re Hal Luftig Co.*, 667 B.R. 638 (Bankr. S.D.N.Y. Feb. 24, 2025), by Bankruptcy Judge John P. Mastando, III, and *In re Miracle Restaurant Group LLC*, 24-11158, 2025 BL 163588, 2025 Bankr Lexis 1188 (Bankr. E.D. La. May 13, 2025), by Bankruptcy Judge Meredith S. Grabill. To read ABI's reports, click here and here.

Having decided that temporary injunctions are not categorically prohibited in Subchapter V plans, Judge Burgess addressed the Fifth Circuit's two *Zale* factors and the four-factor test for temporary injunctions to determine whether a temporary injunction was appropriate in the case at hand. *See Feld v. Zale Corp. (In re Zale Corp.)*, 62 F.3d 746 (5th Cir. 1995).

Judge Burgess decided that *Zale* was satisfied, in part because the debtor's ability to perform the plan was entirely dependent on the owner. Regarding the test for temporary injunctions, he said that the plan injunction "will merely delay the enjoined creditors from collecting," because the plan would toll statutes of limitations. In fact, he said that the owner "may be better situated to pay a meaningful distribution towards his debts" five years from now when the plan is over.

Having found compliance with *Zale* and the requirements for a temporary injunction, Judge Burgess overruled the objection to the five-year injunction and confirmed the plan.

The opinion is *In re Engineering Recruiting Experts LLC*, 24-03292 (Bankr. M.D. Fla. Sept. 2, 2025).

New York's Judge John Mastando saw no reason a Subchapter V plan couldn't enjoin lawsuits against nondebtors for the life of a five-year plan.

Purdue Doesn't Preclude Injunctions from Protecting Nondebtors for the Life of a Plan

Although nondebtor, third-party releases are no longer permissible in chapter 11 plans after *Purdue*, Bankruptcy Judge John P. Mastando, III, of New York decided that a Subchapter V plan may contain a preliminary injunction barring suits against a nondebtor for the five-year life of the plan.

The corporate debtor was a notable Broadway producer. An individual was the sole owner and president of the corporate debtor.

Claiming it had not received its share of the income from a pair of productions, an investor initiated an arbitration against the corporate debtor and the owner. The arbitrator gave the investor an award of $2.6 million against the debtor and the owner, jointly and severally. The district confirmed the award, which was automatically stayed for 30 days.

On the 29th day, the debtor corporation filed a chapter 11 petition under Subchapter V. The debtor filed an adversary proceeding and persuaded Judge Mastando to enter a preliminary injunction preventing the investor from enforcing the arbitration award against the owner.

The debtor filed a chapter 11 plan that would have given the owner a release from liability on the arbitration award. In return, the plan required the owner to supply $600,000 toward payments under the plan.

In an opinion in November 2023, Judge Mastando found authority to confirm the plan over objections by the investor and the U.S. Trustee. However, he read the Second Circuit's decision in *In re Purdue Pharma LP*, 69 F.4th 45 (2d Cir. May 30, 2023), *cert. granted sub nom. Harrington v. Purdue Pharma L.P.*, No. (23A87), 2023 WL 5116031 (U.S. Aug. 10, 2023), as requiring him to issue a report and recommendation to the district court regarding confirmation of the plan. *See In re Hal Luftig Co.*, 655 B.R. 508 (Bankr. S.D.N.Y. Nov. 22, 2023). To read about the bankruptcy court's rationale for imposing a nonconsensual, nondebtor release, click here.

The Rejected R&R

The U.S. Trustee and the investor objected to the report and recommendation. District Judge Denise Cote sustained their objections in an 11-page opinion in March 2024. *See In re Hal Luftig Co.*, 657 B.R. 704 (S.D.N.Y. March 19, 2024). To read ABI's report, click here.

Having issued her decision before the Supreme Court decided *Purdue*, Judge Cote stopped short of precluding nonconsensual, nondebtor releases in all Subchapter V cases. However, she found that the case failed one of the Second Circuit's *Purdue* factors, which required that the impacted class must have voted "overwhelmingly." *Purdue*, *supra*, 69 F.4th at 78-79. In the case before her, the affected class had rejected the plan.

Judge Cote remanded for "further proceedings consistent with this Opinion." She held, "Resolving these issues through a nonconsensual release within the Debtor's bankruptcy is not permissible." *Hal Luftig*, *supra*, 657 B.R. at 709.

On Remand

On return to bankruptcy court, the debtor dropped the idea of a nondebtor release, naturally. Instead, the revised plan extended the preliminary injunction protecting the owner until the closure of the chapter 11 case, dismissal, or the grant or denial of discharge. The injunction applied only to the investor's claims against the owner.

Both unsecured classes voted against the plan, including the class with the investor and its claim, which by that time had risen to $2.9 million.

Conceding that the plan satisfied the other confirmation requirements for a nonconsensual plan under Section 1129(a) as incorporated by Section 1191, the investor argued that the plan was not "fair and equitable" and thus failed to comply with Section 1191. More particularly, the investor contended that the plan was "untenable" under the Supreme Court's decision in *Harrington v. Purdue Pharma L.P.*, 602 U.S. 204 (2024). To read ABI's report, click here.

Dealing with the investor's confirmation objection in his February 24 opinion, Judge Mastando cited Second Circuit authority for the notion that a preliminary injunction may cover nondebtors under Sections 362(a) and 105(a). *Queenie, Ltd. v. Nygard Int'l.*, 321 F.3d 282 (2d Cir. 2003). Furthermore, he said that the "Supreme Court did not address the bankruptcy courts' authority to grant non-consensual third party automatic stay extensions in *Purdue Pharma*."

Judge Mastando said it was an issue of first impression as to whether a nondebtor preliminary injunction could be extended for the life of a chapter 11 plan. In part, he found the answer in Section 362(c)(4), where the Code provides that the automatic stay continues in a chapter 11 case until a discharge is granted or denied.

Given that the plan's stay extension was consistent with Section 362(c)(4), Judge Mastando held that the longer "duration [of the stay] does not render the relief facially impermissible." Next, he ruled that the extended stay satisfied the four requirements for a preliminary injunction.

Judge Mastando closed his opinion by examining whether the longer stay duration made the plan unfair and inequitable. As to the investor's idea "that *Purdue Pharma* prohibits bankruptcy courts from, as part of a plan, temporarily enjoining creditors' collection efforts against non-debtors," he said that the argument was "without merit." He also rejected the idea that the stay extension "'amounts to a discharge' over the life of the Third Amended Plan."

Judge Mastando explained that the investor was not left without recourse. The claim remains valid, he said, and the investor could pursue the claim after the debtor's discharge. He similarly "reject[ed] the argument that such relief 'goes against all concepts of fairness and equity.'"

Overruling the objection and awaiting submission of an order confirming the plan, Judge Mastando said it was "inappropriate to impose any requirement that would effectively allow an objecting unsecured creditor to derail an otherwise confirmable plan . . . solely because that creditor holds the largest unsecured claim against the estate."

The opinion is *In re Hal Luftig Co. Inc.*, 22-11617 (Bankr. S.D.N.Y. Feb. 24, 2025).

Sub V committees are appropriate when issues cannot be addressed by expanding the powers of the trustee or removing the debtor in possession.

Judge Isicoff Describes Limited Times When Committees Are Appointed in Subchapter V

Almost writing on a clean slate, Bankruptcy Judge Laurel M. Isicoff of Miami described the limited circumstances under which a court can or should appoint an official creditors' committee in a Subchapter V case.

Basically, there should be an official committee only when problems in the case cannot be addressed by either expanding the powers of the Subchapter V trustee or removing the debtor in possession.

The debtor was an operator of 28 movie theaters in eight states. Other than a $50 million secured claim held by the debtor's parent, the noncontingent liquidated claims amounted to $1.9 million. The debtor was planning on conducting a traditional restructuring by rejecting or renegotiating executory contracts and leases.

One creditor filed a motion for the appointment of an official committee of unsecured creditors. The creditor believed that a committee was needed because there was a question about the debtor's eligibility for Subchapter V, unsecured creditors had no unified voice, and the $50 million claim owing to the parent should be investigated.

The motion for a committee was controlled by Sections 1102(a)(3) and 1181(b). "Unless the court for cause orders otherwise," the former says, "a committee of creditors may not be appointed in a small business case or a case under subchapter V of this chapter." Section 1181(b) provides that Section 1102(a) does not apply in a Subchapter V case "[u]nless the court for cause orders otherwise . . . ."

In short, there is an official committee in Subchapter V only for "cause."

The Paucity of Authority

In her August 28 opinion, Judge Isicoff said that a "benefit" of Subchapter V "is that there is 'no mandatory appointment of a creditors' committee.'" In place of a committee, she said that "Subchapter V provides for the automatic appointment of a Subchapter V trustee, whose

mandatory duties include examining proofs of claim, furnishing information to parties in interest, and facilitating the development of a consensual plan."

Although the Bankruptcy Code does not define "cause," Judge Isicoff said that a decision on the motion was committed to her discretion. In terms of precedent, she said "there is very little case law addressing what a court should consider in determining whether there is 'cause' necessary to appoint a creditors' committee."

In terms of applying caselaw by analogy, Judge Isicoff said that authorities on "appointment of additional committees in traditional chapter 11 cases" were "inapplicable . . . and unpersuasive" because "the statutory framework for appointing a committee in a Subchapter V case arises in a different context."

Judge Isicoff cited *dicta* from a decision handed down shortly after the adoption of Subchapter V where a bankruptcy court in California said that appointment of a committee "requires a showing that its 'existence will improve recoveries to creditors, will assist in the prompt resolution of this case, and is necessary to provide effective oversight of the debtors.'"

Following the adoption of Subchapter V, Judge Isicoff found only one case where a committee was appointed. *In re Sharity Ministries Inc.*, Case No. 21-11001 (JTD), Tr. of Aug. 9, 2021 Hr'g. ECF #130 at 61-63 (Bankr. D. Del. Aug. 10, 2021). In *Sharity*, however, the debtor had 10,000 "members." In addition, there was "evidence that the debtor had misled its members, was an insurance company operating without licensure and regulation, and that a substantial amount of the members' contributions were used to pay a third party rather than the members' medical expenses."

In addition to appointing a committee in *Sharity*, the court expanded the powers of the Subchapter V trustee to investigate the debtor's financial affairs.

Guidance from the Trustee's Duties and Removal of a DIP

Having identified no authority except from *Sharity* on the elements of "cause," Judge Isicoff found that "guidance comes from the provisions relating to the expansion of a Subchapter V trustee's duties pursuant to section 1183(b)(2) and the provisions addressing the extreme circumstances of removal of a Subchapter V debtor in possession pursuant to 11 U.S.C. § 1185."

Regarding the appointment of a committee under Section 1102(a)(3), Judge Isicoff quoted the *Collier* treatise:

> The duties of the subchapter V trustee under section 1183(b)(1), together with the trustee's additional duties under section 1183(b)(2) that the court can order for

> cause, will enable the subchapter V trustee to protect the interests of unsecured creditors in most small business debtor cases without the need for a committee.
>
> The provisions authorizing the court to appoint a committee for cause allows the court to take into account all of the relevant facts and circumstances. The court will balance the potential cost of a committee against the need to protect the interests of creditors in the reorganization process, taking into account the enhanced role of the United States trustee or the appointment of a subchapter V trustee.

7 *Collier on Bankruptcy* ¶ 1102.04[1] (Richard Levin & Henry J. Sommer eds., 16th ed.).

In deciding whether to appoint a committee in Subchapter V, Judge Isicoff decided that "a court should take into consideration factors that cannot, or logically should not, be addressed by the remedies provided by section 1183(b)(2) or factors which rise to the level of cause for removal of a debtor in possession under section 1185." She listed seven factors to consider:

> (a) the size and complexity of the case (whether the case is one which more closely resembles a traditional chapter 11 case);
> (b) the number of creditors involved in the case and the nature of their debt;
> (c) the nature of the debtor's assets;
> (d) the nature of the debtor's business and how it is regulated;
> (e) the amount of secured debt, the number of secured creditors, and the nature of the collateral in which such creditors assert a lien;
> (f) whether and to what extent any other creditor or other party in interest supports the relief requested; [and]
> (g) whether there are any other factors present in the case which, notwithstanding section 1183(b)(2), would interfere with the ability of the Subchapter V trustee to perform his or her normal statutory duties effectively.

Applying the factors to the case at hand, Judge Isicoff said it was "not a complex case." Even if the debt was near the cap, she said that factor was "not persuasive." The need for a "unified voice," she said, "is not supported by the number of creditors in these cases or the nature of their debt."

Denying the motion for a committee, Judge Isicoff noted that no other creditor had joined the motion said that the Subchapter V trustee could investigate the parent's secured claim.

The opinion is *In re Cinemex Holdings USA Inc.*, 25-17559 (Bankr. N.D. Fla. Aug. 28, 2025).

A bankruptcy judge in San Antonio disagreed with two bankruptcy judges in Houston by holding that a nonvoting class is equivalent to rejecting a plan in Subchapter V of chapter 11.

Texas Courts Are Split on Ignoring Nonvoting Classes in Confirming a Sub V Plan

Two bankruptcy courts in Houston decided in 2023 that a plan under Subchapter V of chapter 11 can be confirmed as a consensual plan even if there are no votes in a class. *See In re Franco's Paving LLC*, 654 B.R. 107 (Bankr. S.D. Tex. 2023); and *In re Hot'z Power Wash, Inc.*, 655 B.R. 107 (Bankr. S.D. Tex. 2023). To read ABI's reports on the two Texas cases, click here and here.

Now, we have a split among the districts in Texas.

Houston is in the Southern District of Texas. Bankruptcy Judge Michael M. Parker of San Antonio, in the Western District of Texas, split with his Houston colleagues by holding in a March 28 opinion that a nonvoting class is equivalent to a class that rejects the plan, precluding confirmation as a consensual plan.

In the case before him, Judge Parker was able to confirm as a nonconsensual plan under Section 1191(b).

Consensual and nonconsensual plans differ in one significant regard: Many courts are holding that a corporation in Subchapter V can have nondischargeable claims if confirmation is nonconsensual, whereas no claims are nondischargeable if the plan is consensual.

One Class Doesn't Vote

The debtor in the case before Judge Parker operated a restaurant. The plan had three impaired, voting classes. Two classes of unsecured creditors voted unanimously in favor of the plan.

The third class had one creditor, a secured lender with liens on most of the assets. The secured creditor did not vote, meaning there were no votes in the class. Counsel for the secured creditor told Judge Parker at a hearing that the lender did not oppose the plan but declined to vote.

Citing the two Houston cases, the debtor implored Judge Parker to confirm as a consensual plan by ignoring the nonvoting class. He declined the invitation.

The Two Governing Statutes

To decide whether a nonvoting class is the same as a rejecting class, Judge Parker cited the two governing statutes. For each class of claims or interests, Section 1129(a)(8) says that "such class has accepted the plan" or is unimpaired for the plan to be confirmed.

Section 1126(c) says that a "class of claims has accepted a plan if such plan has been accepted by creditors . . . that hold at least two-thirds in amount and more than one-half in number of the allowed claims of such class . . . that have accepted or rejected such plan."

Judge Parker described the two Houston judges as having "found that a non-voting class is ignored when determining whether a plan has satisfied § 1129(a)(8)." Judge Parker gave reasons why he was "unpersuaded":

> Congressional preference for consensual plans does not require a court to interpret all statutory language in subchapter V in favor of confirmation of consensual plans any more than the Code's goal of a "fresh start" means that a court should interpret statutory language to grant a debtor and its associates a broad, unrestricted discharge regardless of (i) debtor misbehavior, (ii) notice to creditors and (iii) specific exceptions to discharge.
>
> It's true that Congress would prefer that a debtor would propose a plan which would encourage creditors to affirmatively vote for it, but nothing in the Code converts a creditor's pacificity or affirmative decision not to vote (as in this case) into an affirmative vote in favor of the plan.

Unlike the two Houston courts, Judge Parker did not see the statute as creating an "unsolvable mathematical problem" when the denominator in a fraction is zero because no creditor voted. He said, "The Court does not, however, believe the statute requires that sort of mathematical calculation."

Judge Parker disagreed with the "notion that Congress did not contemplate a non-voting class of creditors." The idea, he said, "is contravened by § 1126 itself, which provides in subsection (a) that creditors may accept or reject a plan."

By using the word "may" rather than "shall," Judge Parker said that "Congress left open a third option — the possibility that creditors could choose not to vote on a plan. Impaired creditors are not confined to a binary 'accept/reject' but instead may abstain."

Where a court must find that a class accepts or rejects a plan, Judge Parker read the two Houston decisions as creating "a third course — the bankruptcy court can merely 'ignore' or 'not count' the non-voting class." He disagreed with the idea of ignoring a class, saying that a "class

either accepts the plan under § 1129(a)(8), or it does not." He saw "[n]othing in the Code [that] allows the Court to equate abstention of a class with acceptance."

Disregarding nonvoting classes "itself invites an absurd scenario," Judge Parker said. He asked, "could a debtor confirm a plan consensually where no creditors vote at all?"

If non-voting classes are disregarded, Judge Parker said that "a debtor could theoretically confirm a 'consensual' plan . . . without a single accepting vote if no creditors vote at all, as all of the non-voting classes are 'ignored.'" He could not "endorse a reading which could result in this logical conclusion."

Judge Parker approvingly cited cases with his point of view where the judge saw nonvoting classes as having rejected the plan. *See, e.g.*, *In re M.V.J. Auto World, Inc.*, 661 B.R. 186 (Bankr. S.D. Fla. 2024); and *In re Florist Atlanta*, 24-51980, 2024 Bankr. LEXIS 1842 (Bankr. N.D. Ga. Aug. 6, 2024). To read ABI's reports, click here and here.

Because a class had not voted, Judge Parker held that the plan "cannot be confirmed under § 1191(a)" as a consensual plan. However, he went on the find that "the plan can be confirmed non-consensually under § 1191(b)."

The opinion is *In re Sushi Zushi of Texas LLC*, 24-51147 (Bankr. W.D. Tex. March 28, 2025).

Over a dissent, the Eleventh Circuit aligned with the Fourth and Fifth Circuits by holding that corporate Subchapter V debtors can have nondischargeable debts, unlike corporations in 'regular' chapter 11.

No Circuit Split: Sub V Corporate Debtors Can Have Nondischargeable Debts

There is no circuit split on the question of whether corporate debtors with nonconsensual Subchapter V plans can have nondischargeable debts.

Over a dissent, the Eleventh Circuit agreed with the Fourth and Fifth Circuits by holding on July 9 that corporate debtors in Subchapter V with nonconsensual plans can have nondischargeable debts "of the kind" specified in Section 523(a).

In her opinion for the majority, Circuit Judge Barbara Lagoa said that the "difficult statutory interpretation question" was a "close call."

Judge Lagoa's decision fell in line with the Fourth and Fifth Circuits in *Avion Funding v. GFS Indus., LLC (In re GFS Indus. LLC)*, 99 F.4th 223 (5th Cir. 2024); and *Cantwell Cleary Co. Inc. v. Cleary Packaging, LLC (In re Cleary Packaging LLC)*, 36 F.4th 509, 517 (4th Cir. 2022). To read ABI's reports, click here and here.

The Debtor Wins in Bankruptcy Court

Before bankruptcy, the corporate debtor was slammed with punitive damages for violating the Lanham Act. Answering a question, the jury found that the debtor acted "maliciously."

Soon after the judgment, the debtor filed a petition under Subchapter V of chapter 11. The judgment creditor filed a complaint, alleging that the debt was nondischargeable under Sections 523(a)(6) and 1192(2) as a willful and malicious injury.

Of the opinion that Section 523(a)(6) only applied to individuals, the bankruptcy court granted the debtor's motion to dismiss.

The Eleventh Circuit accepted the judgment creditor's direct appeal.

Two Sections Point Different Ways

When the Subchapter V debtor has a nonconsensual plan, Judge Lagoa explained that dischargeability is governed by Section 1192. It provides that "the court shall grant the debtor a discharge of all debts provided in section 1141(d)(1)(A) of this title . . . *except any debt* — . . . (2) *of the kind* specified in section 523(a) of this title." [Emphasis added.]

The problem arises from the interplay with the preamble in Section 523(a), which provides that a "discharge under section . . . 1141 . . . does not discharge an *individual debtor*" from 19 types of debt. [Emphasis added.]

Parsing the statute, Judge Lagoa decided that Section 1192 applies to both individual and corporate debtors in Subchapter V. She went on to say that the word "debt" is "agnostic to who the holder is." Next, she held that "of the kind" modifies "debt."

Taken "all together," Judge Lagoa held that the court will grant an individual or corporate debtor "a discharge of its debts except for the twenty-one kinds of debt found in § 523(a)." She devoted the remainder of her opinion to rebutting the debtor's arguments.

Regarding the "individual debtor" preamble in Section 523(a), Judge Lagoa said that the debtor's argument was "unconvincing." Quoting the Fourth Circuit, she first said that "'§ 1192(2)'s cross-reference to § 523(a) does not refer to *any kind of debtor* addressed by § 523(a) but rather to a *kind of debt* listed in § 523(a).'" [Emphasis in original.] She said that her conclusion was "further informed" by the broader context of the statute as a whole.

Looking elsewhere in the Bankruptcy Code, Judge Lagoa said "that when Congress wanted to specify which kinds of debtors cannot discharge debts under § 523(a), it has done so through express language in their respective sections."

The debtor argued that Section 523(a) was more specific than Section 1192. Judge Lagoa rejected the contention, saying,

> Like the canon against surplusage, where the text of the statute is unambiguous, as is the case here, there is no need to rely on the general/specific canon.

Reversing, Judge Lagoa held "that under § 1192, both individual and corporate debtors cannot discharge any debts of the kind listed in § 523(a)."

The Dissent

Circuit Judge Robert J. Luck filed a one-page dissent. Most of the space was devoted to citations for the 11 opinions by bankruptcy judges holding "that the nondischargeability

provisions of 11 U.S.C. section 523(a) are not applicable to corporate debtors who confirm nonconsensual plans (cramdowns) under subchapter V."

Saying that "these courts have the best reading of the bankruptcy code," Judge Luck respectfully dissented.

Observation

Politics plays little to no role when it comes to bankruptcy. The majority opinion and the dissent were both written by circuit judges appointed by President Trump.

Any hope for a circuit split may lie in the Ninth Circuit, where the bankruptcy appellate panel has been the only appellate court to ban nondischargeability for corporate Subchapter V debtors. *Lafferty v. Off-Spec Sols. LLC (In re Off-Spec Sols. LLC)*, 651 B.R. 862 (B.A.P. 9th Cir. 2023). In *Off-Spec*, the case evidently settled while an appeal was pending in the Ninth Circuit. To read ABI's report on *Off-Spec*, click here.

The opinion is *Benshot LLC v. 2 Monkey Trading LLC (In re 2 Monkey Trading LLC)*, 23-12342 (11th Cir. July 9, 2025).

The bankruptcy judge in Pensacola, Fla., is giving the Eleventh Circuit an opening to split with the Fourth and Fifth Circuits.

Judge Oldshue Splits with Two Circuits: No Nondischargeability for Sub V Corporations

Although the Fourth and Fifth Circuits have held that corporations in Subchapter V of chapter 11 can be saddled with nondischargeable debts in nonconsensual plans, Bankruptcy Judge Jerry C. Oldshue, Jr., sitting in Pensacola, Fla., swam against the tide by following the Ninth Circuit Bankruptcy Appellate Panel (BAP).

In his February 14 opinion, Judge Oldshue concluded that banning nondischargeability in Subchapter V for corporations "provide[s] the best statutory interpretation of §1192's incorporation of 523(a) by giving effect to all the statutory language, recognizing the long-standing application of §523(a) to only individual debtors, and comporting with the overall purpose of the [Small Business Reorganization Act]."

Companion Suits in State Court and Bankruptcy Court

Several creditors had sued a corporation in state court. Three years later, the corporation filed a petition under Subchapter V of chapter 11. The debtor removed the suit from state court, but Judge Oldshue had abstained because the lawsuit was far advanced, state law issues predominated, the claims were noncore, and a jury trial had been demanded.

In chapter 11, the creditors who had sued in state court filed a complaint seeking a declaration that the debt was nondischargeable under Section 523(a)(2), (4) and (6). The debtor responded with a motion to dismiss.

Sections 1192 and 523(a)

The outcome was controlled by Sections 1192 and 523(a). Applicable to nonconsensual plans, Section 1192 provides that "the court shall grant the debtor a discharge of all debts provided in section 1141(d)(1)(A) of this title . . . *except any debt* — . . . (2) *of the kind* specified in section 523(a) of this title." [Emphasis added.]

Section 523(a) provides that a "discharge under section . . . 1141 . . . does not discharge an *individual debtor*" from 19 types of debt. [Emphasis added.]

Judge Oldshue observed that the "juxtaposition of §1192(2) and the reference to 'individual debtor' in §523(a)'s preamble has resulted in differing opinions on the issue of whether the §523 exceptions to discharge apply to corporate debtors." He cited the Fourth and Fifth Circuits and a district court in Illinois for holding "that both individual and corporate debtors covered by §1192 are subject to the discharge exceptions of §523(a)." *Cantwell-Cleary Co. v. Cleary Packaging LLC (In re Cleary Packaging LLC)*, 36 F.4th 509 (4th Cir. June 7, 2022). To read ABI's report, click here. *Avion Funding LLC v. GFS Industries LLC (In re GFS Industries LLC)*, 99 F.4th 223 (5th Cir. April 17, 2024). To read ABI's report, click here. *Chi. & Vicinity Laborers' Dist. Council Pension Plan, et al. v. R & W Clark Constr., Inc.*, 24 CV 1463, 2024 WL 4789403 (N.D. Ill. Nov. 14, 2024). To read ABI's report, click here.

"[T]he Fourth and the Fifth Circuits," Judge Oldshue said, "have disregarded the reference to 'individual debtor' in §523's preamble and construed the discharge exceptions to apply to both individual and corporate debtors under §1192(2)." The issue, he said, "is not well-settled as other courts have construed the same statutory provisions differently."

Judge Oldshue cited the Ninth Circuit BAP and "other bankruptcy courts, including those in the Eleventh Circuit, [that] have held that the §523 non-dischargeability provisions apply only to individual Subchapter V debtors." *See, e.g.*, *In re Off-Spec Sols., LLC*, 651 B.R. 862 (B.A.P. 9th Cir. 2023); *In re Hall*, 651 B.R. 62 (Bankr. M.D. Fla. 2023). To read ABI's reports, click here and here.

"These courts," Judge Oldshue said, "have found that the better interpretation of §1192 is that it incorporates §523(a)'s limited applicability to individuals." For instance, he said that the Ninth Circuit BAP decided that "adding §1192 to the list of discharge provisions to which [Section 523] applies, extracting only the list of nondischargeable debts from §523(a) without its limitation to individuals, would render the amendment surplusage."

Judge Oldshue found "the reasoning of the Ninth Circuit BAP and the bankruptcy courts in the Eleventh Circuit, holding the exceptions to discharge under §523(a) apply only to individual debtors under §1192(2), convincing. Such decisions provide the best statutory interpretation of §1192's incorporation of 523(a) by giving effect to all the statutory language, recognizing the long-standing application of §523(a) to only individual debtors, and comporting with the overall purpose of the SBRA."

Concluding that the exceptions to discharge in Section 523(a) "only apply to individuals in Subchapter V," Judge Oldshue dismissed the creditors' nondischargeability complaint for failure to state a claim.

Observations

The question is a classic case for application of rules of statutory interpretation, worthy of review by the Supreme Court. Perhaps Judge Oldshue's case will go up on appeal, giving the Eleventh Circuit an opportunity to create a circuit split.

The opinion is *Spring v. Davidson (In re Davidson)*, 23-3005 (Bankr. N.D. Fla. Feb. 14, 2025).

Bankruptcy judges continue to disagree on whether debts of corporations with cramdown plans in Subchapter V can have nondischargeable debts.

Denver Judge Sides with the Circuits: Nondischargeability Infects Subchapter V

Less than a month after Bankruptcy Judge Jerry C. Oldshue, Jr., decided that nondischargeability isn't a "thing" for corporations in Subchapter V of chapter 11, Bankruptcy Judge Thomas B. McNamara of Denver took the opposite tack, sided with the Fourth and Fifth Circuits, and held that corporate debtors in Subchapter V can have nondischargeable debts when they confirm cramdown plans under Section 1191(b).

The corporate debtor filed a petition under Subchapter V and was preparing to confirm a cramdown plan under Section 1191(b) because a class of creditors had rejected the plan. Adding to the debtor's problems, a creditor with a $5.5 million claim filed a complaint alleging that the debt was nondischargeable under Section 523(a)(6) as arising from willful and malicious injury.

Judge McNamara denied the debtor's motion to dismiss the complaint for failure to state a claim under Rule 12(b)(6). His March 17 opinion is a meticulous survey of all authorities coming down both ways on nondischargeability in Subchapter V.

The Split

Judge McNamara recognized the "split of legal authority regarding whether the Section 523(a) nondischargeability provisions (such as Section 523(a)(6)) apply to corporate debtors, including limited liability companies, in Subchapter V cases where the proposed reorganization is nonconsensual."

Disposition of the debtor's motion to dismiss the nondischargeability complaint was controlled by Sections 1192 and 523(a). Applicable to nonconsensual plans, Section 1192 provides that "the court shall grant the debtor a discharge of all debts provided in section 1141(d)(1)(A) of this title . . . *except any debt* — . . . (2) *of the kind* specified in section 523(a) of this title." [Emphasis added.]

As Judge McNamara put it, the "rub" arises from Section 523(a), which provides that a "discharge under section . . . 1141 . . . does not discharge an *individual debtor*" from 19 types of debt. [Emphasis added.]

For most courts, the question is whether the words "individual debtor" in the introductory phrase in Section 523(a) carry over onto Section 1192, which imposes nondischargeability for debtors "of the kind" specified in Section 523(a).

Citing the decision by Judge Oldshue as an example, Judge McNamara said that "most bankruptcy courts construing Sections 1192(2) and 523(a) have concluded — based mainly on the preamble to Section 523(a) as well as policy considerations — that the 20 categories (and subparts) of nondischargeable debt under Section 523(a) apply only to individual Subchapter V debtors." He also cited *Lafferty v. Off-Spec Sols. LLC (In re Off-Spec Sols. LLC)*, 651 B.R. 862 (B.A.P. 9th Cir. 2023), which, so far, is the only appellate court to ban nondischargeability for corporate Subchapter V debtors. To read ABI's report on *Off-Spec*, click here. To read Judge Oldshue's decision, *Spring v. Davidson (In re Davidson)*, 2025 WL 511226 (Bankr. N.D. Fla. Feb. 14, 2025), click here.

Apart from *Off-Spec*, Judge McNamara said that "the analysis used by most bankruptcy courts has not fared well on appeal." Citing the Fourth and Fifth Circuits as the only courts of appeals to confront the question, he said that both held, "as a matter of statutory interpretation, that the discharge of both individual and corporate Subchapter V debtors under Section 1192(2) is subject to the discharge limitations contained in the Section 523(a) categories." *See Avion Funding v. GFS Indus., LLC (In re GFS Indus. LLC)*, 99 F.4th 223 (5th Cir. 2024); and *Cantwell Cleary Co. Inc. v. Cleary Packaging, LLC (In re Cleary Packaging LLC)*, 36 F.4th 509, 517 (4th Cir. 2022). To read ABI's reports, click here and here.

Judge McNamara also cited a district judge in Chicago who upheld the bankruptcy court by deciding that corporate debtors in Subchapter V of chapter 11 can be saddled with nondischargeable debts. *Chicago & Vicinity Laborers' Dist. Council Pension Plan v. R&W Clark Constr. Inc. (In re R&W Clark Constr. Inc.)*, 2024 WL 4789403 (N.D. Ill. Nov. 14, 2024). To read ABI's report, click here.

The Circuit's Logic Is 'Persuasive'

"With due respect to the various Bankruptcy Courts who have ruled otherwise," Judge McNamara found "the traditional statutory analysis employed by the Fourth Circuit Court of Appeals . . . and the Fifth Circuit Court of Appeals . . . far more compelling and persuasive.

"[W]hile the *Off-Spec Solutions* decision is well-written and makes some important points," Judge McNamara "reviewed the arguments of the parties and the case law [and found] the analysis and determination of the *Cleary Packaging* and *GFS Industries* courts to be far more compelling and persuasive than that of the *Off-Spec Solutions* court."

Arriving "at the exact same place as the Fourth and Fifth Circuits," Judge McNamara "endorse[d] those decisions" and denied the debtor's motion to dismiss.

The opinion is *Marmic Fire & Safety Co. Inc. v. ETG Fire LLC (In re ETG Fire LLC)*, 24-1225 (Bankr. D. Colo. March 17, 2025).

Reversing the bankruptcy court, the Chicago district judge follows the Fourth and Fifth Circuits and rejects a contrary holding by the Ninth Circuit BAP.

Chicago District Judge Decides that Sub V Debtors Can Have Nondischargeable Debts

Reversing the bankruptcy court, a district judge in Chicago decided that corporate debtors in Subchapter V of chapter 11 can be saddled with nondischargeable debts.

In his November 14 opinion, District Judge Manish S. Shah followed the Fourth and Fifth Circuits and agreed with a different bankruptcy judge in Chicago, while disagreeing with the Ninth Circuit Bankruptcy Appellate Panel and eight bankruptcy courts.

A creditor held a judgment for more than $3 million against a corporation and its owner. The corporation filed a petition under Subchapter V of chapter 11. The judgment creditor responded with an adversary proceeding seeking a declaration that the debts owing to it were nondischargeable under Section 523(a)(2)(A), (a)(2)(B) and (a)(6).

Believing that nondischargeability does not apply to corporate debtors in Subchapter V just like in "regular" chapter 11, the bankruptcy court granted the debtor's motion to dismiss the complaint for failure to state a claim. *See Chicago & Vicinity Laborers' District Council Pension Plan v. R&W Clark Construction Inc. (In re R&W Clark Construction Inc.)*, 656 B.R. 628 (Bankr. N.D. Ill. Feb. 8, 2024). To read ABI's report on *R&W*, click here.

The creditor appealed to the district court and won a reversal.

Sections 1192 and 523(a)

Apart from a court's concept of policy, the outcome turns on the interpretation of Sections 1192 and 523(a). Applicable to nonconsensual plans, Section 1192 provides that "the court shall grant the debtor a discharge of all debts provided in section 1141(d)(1)(A) of this title . . . *except any debt* — . . . (2) *of the kind* specified in section 523(a) of this title." [Emphasis added.]

Section 523(a) provides that a "discharge under section . . . 1141 . . . does not discharge an *individual debtor*" from 19 types of debt. [Emphasis added.]

Believing there is no nondischargeability for corporations in Subchapter V, the bankruptcy court was persuaded by the Ninth Circuit Bankruptcy Appellate Panel's decision in *Lafferty v. Off-*

Spec Sols., LLC (In re Off-Spec Sols., LLC), 651 B.R. 862 (B.A.P. 9th Cir. 2023), *appeal dismissed per stipulation*, 23-60034, 2023 WL 9291577 (9th Cir. Nov. 12, 2023). To read ABI's report on the BAP opinion, click here.

Concluding that nondischargeability did not apply to corporate debtors in Subchapter V, the BAP saw Section 523(a) and its limitation to individual debtors as being more specific and therefore controlling.

The bankruptcy court declined to follow *Cantwell-Cleary Co. v. Cleary Packaging LLC (In re Cleary Packaging LLC)*, 36 F.4th 509 (4th Cir. June 7, 2022), where the Fourth Circuit held that corporate debtors in Subchapter V may not discharge debts "of the kind" specified in Section 523(a). To read ABI's report, click here. Subsequently, the Fifth Circuit came down the same way in *Avion Funding LLC v. GFS Industries LLC (In re GFS Industries LLC)*, 99 F.4th 223 (5th Cir. April 17, 2024). To read ABI's report, click here.

Notably, Chicago Bankruptcy Judge Deborah L. Thorne of Chicago decided in July that the Fourth and Fifth Circuits had the right idea. She ruled that corporate debtors in Subchapter V are subject to complaints for nondischargeability. *See Christopher Glass & Aluminum Inc. v. Premier Glass Services LLC (In re Premier Glass Services LLC)*, 661 B.R. 939 (Bankr. N.D. Ill. July 31, 2014). To read ABI's report, click here.

Section 1192 Controls

Ruling on the appeal, District Judge Shah decided that Section 1192(2) was "unambiguous" in that it "grants a debtor, either individual or corporate, discharge of all debts except for debts 'of the kind specified in section 523(a).'" On the other hand, he found "trouble" in the preamble to Section 523(a), which says, "A discharge under section . . . 1192 . . . of this title does not discharge *an individual debtor* from" 19 types of debt. [Emphasis added.] Judge Shah devoted 10 pages to explaining why the preamble to Section 523(a) is not controlling.

"When § 1192 refers to the kinds of debt specified in § 523(a)," Judge Shah said, "it is referring to the enumerated debts, not the preamble's reference to types of debtors." The judge said that his conclusion was "bolstered" by bankruptcy courts in Texas and Georgia that had decided in 1995 and 2009 that "virtually identical" language in chapter 12 opens the door to nondischargeability for corporations, not only individual debtors.

Judge Shah saw Congress as having "made a choice to change bankruptcy proceedings for small business debtors and chose to treat individual and corporate debtors the same. To hold that § 523(a) only applies to individuals discharging debt under § 1192 ignores the purposeful change Congress made to the statutory language."

Reversing the bankruptcy court, Judge Shah held that the "'most natural reading' of § 1192(2) applies the exceptions to discharge in the paragraphs of § 523(a) to both corporate and individual debtors."

The opinion is *Chicago & Vicinity Laborers' District Council Pension Plan v. R&W Clark Construction Inc. (In re R&W Clark Construction Inc.)*, 24-1463 (N.D. Ill. Nov. 14, 2024).

A creditor must control a class before its debt can become nondischargeable in Subchapter V.

Nondischargeability in Sub V Only Applies When It's a Nonconsensual, Cramdown Plan

If a corporate debtor under Subchapter V of chapter 11 confirms a *consensual* plan under Section 1191(a), there is no such thing as a nondischargeable debt under Section 523(a), for statutory reasons explained by Bankruptcy Judge Robert M. Matson of Albany, Ga.

In adopting the Bankruptcy Reform Act in 1978, Congress did away with nondischargeable debts for "ordinary" corporations in chapter 11. Why? Because a creditor with a nondischargeable debt in "old" Chapter XI under the former Bankruptcy Act could kill a plan, to the disadvantage of the larger creditor body that would benefit from reorganization.

Taking Judge Matson's January 31 opinion as gospel, a creditor with a nondischargeable debt can kill a Subchapter V plan only if the creditor controls a class that votes against the plan, thereby forcing the debtor to confirm a nonconsensual, cramdown plan under Section 1191(b).

The Consensual Plan

The debtor leased its employees. The lessor paid the employees' wages and could draw funds from the debtor's bank account to cover payroll. Eventually, the lessor's attempt to draw funds from the debtor's bank account failed.

According to the lessor, the debtor made intentionally false representations about the existence of funds in the account to cover the withdrawals. The representations proved false, because the lessor was stuck with $100,000 in bad debt. After the lessor filed suit in state court, the debtor filed a petition under Subchapter V.

However, the debtor did not schedule the lessor as a creditor. Unaware of the bankruptcy, the lessor obtained a default judgment in state court.

The lessor became aware of the bankruptcy when the debtor filed a suggestion of bankruptcy in state court. Because the lessor was unaware of the bankruptcy, the lessor had not filed a proof of claim before the bar date.

The lessor filed a complaint to except the debt from discharge under several subsections in Section

523(a). The debtor objected to confirmation of the debtor's plan, but the objection was resolved in a stipulation with the debtor.

The debtor confirmed a consensual plan under Section 1191(a), evidently because the class including the lessor had voted in favor of the plan. Just after confirmation, the debtor filed a motion to dismiss the nondischargeability complaint.

Although courts are not in agreement, most courts have decided recently that a corporate debtor in Subchapter V can be saddled with a nondischargeable debt. Those cases, though, involved cramdown plans. To read some of the ABI reports on nondischargeability in Subchapter V, click here and here.

When Section 1141(d) Does and Does Not Apply

Addressing the merits of the motion to dismiss, Judge Matson didn't leave the reader in suspense. He stated this holding: "[T]he discharge provisions of § 1192 (and thus the discharge exceptions on which [the lessor] relies) do not apply to a debtor whose plan was confirmed [as a consensual plan] under § 1191(a)."

Judge Matson then rummaged through several statutory provisions to explain how he arrived at his conclusion. He began by saying that a Subchapter V plan can be confirmed in two ways: (1) If the plan is consensual, it's confirmed under Section 1191(a); and (2) if it's nonconsensual or cramdown, it's confirmed under Section 1191(b).

Generally speaking, the breadth of discharge is controlled by Section 1141(d). Broadly, it says that confirmation "discharges the debtor from any debt that arose before such confirmation." The words "any debt," Judge Matson said, mean that "confirmation of a Chapter 11 plan generally results in discharge of debts of the sort identified in § 523(a)."

However, there are exceptions in Section 1141(d). For example, Section 523(a) nondischargeability applies to individuals in chapter 11, and corporations that liquidate don't receive a discharge. In addition, some types of debts owed to a governmental unit are not discharged. *See* Section 1141(d)(2), (3) and (6).

"[M]ost relevant to this case," Judge Matson said, "§ 1141(d) does not apply when the debtor confirms a plan under § 1191(b), but rather § 1192 does." He drew his conclusion from Section 1181(c), which says, "If a plan is confirmed under section 1191(b) of this title, section 1141(d) of this title shall not apply, except as provided in section 1192 of this title."

Judge Matson translated the statutes into intelligible English as follows:

> [T]he discharge provisions of § 1141(d) apply when the debtor confirms [a] consensual plan under § 1191(a) but do not apply when the debtor confirms a nonconsensual plan under § 1191(b). In those cases, § 1192 governs the debtor's discharge instead of § 1141(d).

As authority for his conclusion, Judge Matson cited the Fifth Circuit and a decision by Bankruptcy Judge Joseph G. Rosania, Jr., of Denver. *See In re GFS Indus., LLC*, 99 F.4th 223, 227 (5th Cir. 2024); and *In re Palmer Drives Controls & Sys., Inc.*, 657 B.R. 650, 654 (Bankr. D. Colo. 2024).

For failure "to state a claim upon which relief may be granted," Judge Matson granted the debtor's motion to dismiss the lessor's dischargeability complaint, "[b]ecause § 1192, and by extension the exceptions to discharge, do not apply to the Debtor."

Observations

Judge Matson's decision inferentially explains why it makes sense to have nondischargeability in some Subchapter V cases.

Compared to "regular" chapter 11, corporate debtors in Subchapter V are relatively small. A corporate debtor cannot file in Subchapter V to discharge a nondischargeable debt if that's the primary reason for chapter 11. In those circumstances, a creditor with a comparatively large nondischargeable debt likely would control a class, requiring confirmation of a cramdown plan where nondischargeability is a "thing."

On the other hand, if the nondischargeable debt is small and does not control the class, the creditor with a nondischargeable debt should not be able to kill a chapter 11 case to the disadvantage of other creditors who are in favor of confirmation.

The opinion is *Halo Human Resources LLC v. American Dental of LaGrange LLC (In re American Dental of LaGrange LLC)*, 24-1485 (Bankr. M.D. Ga. Jan. 31, 2025).

The definition of 'small business' uses the word 'activities,' not 'operations,' making nonoperating small business eligible for Subchapter V.

A Business that Never Generated Income Is Eligible for Subchapter V, Judge Norman Says

Because the statutory definition of "small business" refers to "business activities" not "business operations," Bankruptcy Judge Jeffrey Norman of Houston held that the corporate debtor was eligible for Subchapter V of chapter 11 even though the debtor had never generated income.

The LLC debtor was a holding company that owned patented piping technology. As Judge Norman said in his November 20 opinion, the debtor had raised $4 million from bridge loans and by selling secured notes. However, the debtor had not landed a contract to sell pipe.

Three creditors filed an involuntary petition. The debtor consented to entry of an order for relief in chapter 11 and elected to proceed under Subchapter V. The petitioning creditors objected to Subchapter V designation, contending that the debtor was never a "business," never generated income and was never engaged in commercial or business activities.

Judge Norman explained that the creditors were aiming to file a plan of their own, an impossibility unless the case was under "regular" chapter 11.

Defined in Section 101(51D)(A), a "small business debtor"

> means a person engaged in *commercial or business activities* . . . that has aggregate noncontingent liquidated secured and unsecured debts as of the date of the filing of the petition or the date of the order for relief in an amount not more than" $7.5 million. [Emphasis added.]

Judge Norman said that the Bankruptcy Code "does not provide a definition for 'commercial or business activity.'" To decide whether the debtor qualified, he looked at the totality of the circumstances.

From testimony by the debtor's chief operating officer, Judge Norman found that the debtor had a lease, maintained a bank account, continually attempted to generate business, provided marketing materials to potential investors and retained attorneys to protect intellectual property.

For caselaw precedent, both sides relied on *In re Port Arthur Steam Energy LP*, 629 B.R. 233 (Bankr. S.D. Tex. July 1, 2021), where Bankruptcy Judge Christopher M. Lopez of Houston held that collecting accounts receivable and maintaining the physical assets qualified as being engaged in commercial activities, even though the historical business was no longer operating. To read ABI's report, click here.

Judge Norman also took counsel from *In re Offer Space LLC*, 629 B.R. 299 (Bankr. D. Utah April 22, 2021), where Bankruptcy Judge William T. Thurman held that a nonoperating business qualified for Subchapter V if it had a bank account and was managing its few remaining assets. To read ABI's report, click here.

If Section 101(51D)(A) had used the word "operations" in the definition rather than "activities," Judge Norman said he would have found the debtor ineligible for Subchapter V, because the business was no longer functional or operational on the filing date.

Judge Norman held that the debtor "was engaged in 'commercial or business activities'" and qualified for Subchapter V because there was a lease, a bank account and marketing materials for investors, plus "attempts to generate business" and attorneys to protect intellectual property.

The opinion is *In re GCPS Holdings LLC*, 24-32646 (Bankr. S.D. Tex. Nov. 20, 2024).

Losses before filing or during prior aborted reorganizations do not control dismissal of a new reorganization for 'continuing loss or diminution,' First Circuit BAP says.

To Dismiss for 'Loss or Diminution,' the Focus Is on Losses After Filing, BAP Says

When considering a motion to dismiss a chapter 12 case based on "continuing loss to or diminution of the estate and absence of a reasonable likelihood of rehabilitation," the First Circuit Bankruptcy Appellate Panel tells us that "the relevant facts and circumstances are those existing after the petition date."

In its March 5 opinion, the BAP decided that the bankruptcy court erred in dismissing under Section 1208(c)(9) by focusing on the debtor's declining financial condition in two prior stabs at chapter 12.

The Prior Filings

The corporate debtor operated a dairy farm. Filed in 2012, the first case was dismissed following defaults on the confirmed plan. The court dismissed the second chapter 12 case in 2021 for failure to confirm a plan in a timely manner.

After the debtor filed a third chapter 12 case in 2022, the secured lender quickly filed a motion to dismiss under Section 1208(c)(9), based largely, as the BAP said, on the idea that "the debtor's situation had not changed since the dismissal of the prior case, during which the debtor's assets had declined in value," and that revenue had been declining for six years.

The BAP characterized the bankruptcy court as having "described the assets, liabilities, and gross income reported in, and select [operating reports] filed in, the debtor's first, second, and third bankruptcy cases at considerable length" and "concluded that the debtor's financial situation had deteriorated since the first and second cases."

As the BAP said, the bankruptcy court granted the motion to dismiss "under § 1208(c)(9) due to continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation." The debtor appealed to the BAP.

Losses Before Filing Don't Matter

On appeal, the debtor contended that the "bankruptcy court committed reversible error by comparing the condition of the estates in the first and second cases with the condition of the estate in the third case when testing for loss or diminution under § 1208(c)(9)."

The outcome of the appeal turned on the BAP's interpretation of Section 1208(c)(9), which provides that grounds for dismissal include "continuing loss to or diminution of the estate and absence of a reasonable likelihood of rehabilitation." In his opinion for the BAP, Bankruptcy Judge Michael A. Fagone said that the language in Section 1208(c)(9) "was imported verbatim from chapter 11 as a cause that could prompt the dismissal of a chapter 12 case."

On *de novo* review, Judge Fagone said that the BAP was tasked with identifying "the relevant time frame for measuring loss or diminution."

First, Judge Fagone said that the "statute refers to an estate, a singular estate." Second, he said that "the estate is a basket of interests in property that springs into existence upon the filing of the petition." He cited the *Collier* treatise for saying "that loss to or diminution of the estate is a measurement taken during the post-petition period."

To decide whether there was a "loss or diminution under § 1208(c)(9)," Judge Fagone held that "the relevant facts and circumstances are those existing after the petition date." He said that the factual analysis by the bankruptcy court was "predominantly retrospective" and that the "heart of the court's analysis consisted of a comparison of the financial condition of the estate in this case with the financial condition of the debtor in its prior cases."

In particular, Judge Fagone noted how the bankruptcy court observed that the estate had "continued to diminish" for almost five years. At the time of the third filing, he said that the new estate "had only been in existence for about one year and therefore could not have been diminishing for close to five years."

Properly, Judge Fagone said that the bankruptcy court "should have compared the size of the estate at some point after the petition date with the size of the estate at some later point after the petition date."

Focusing on the bankruptcy court's findings about financial condition after the third filing, Judge Fagone said that the "pertinent findings would not be sufficient to support a determination that the estate in this case was diminishing for purposes of § 1208(c)(9)." Rather, he said there was "evidence in the record tending to support the contrary view — *i.e.*, that the estate was enhanced post-petition."

The BAP vacated the dismissal order and remanded for further proceedings.

The opinion is *Las Martas Inc. v. Condado 5 LLC (In re Las Martas Inc.)*, 23-026 (B.A.P. 1st Cir. March 5, 2025).

Consumer Bankruptcy

Discharge/Dischargeability

The Ninth Circuit gives state legislatures the ability to decide whether costs of attorneys' disciplinary proceedings are dischargeable, or not.

Disciplinary Costs Are Nondischargeable in California But Dischargeable in Nevada

Affirming the Bankruptcy Appellate Panel, the Ninth Circuit explained why the costs of an attorney's disciplinary proceeding *are not dischargeable* in California. Paradoxically, similar costs from disciplinary proceedings *are dischargeable* in Nevada.

The circuit's July 31 opinion explains how state legislatures could draft attorney disciplinary legislation so costs will be excepted from discharge under Section 523(a)(7). In other words, the Ninth Circuit's decisions allows state legislatures to skirt the language in Section 523(a)(7), which provides that a debt is not discharged if it is "compensation for actual pecuniary loss. . . ."

Suspensions

An attorney in Nevada was twice disciplined for mishandling client funds. Ultimately, the Nevada Supreme Court suspended the lawyer and directed him to pay more than $21,000 in fees and costs arising from the disciplinary proceedings.

Ten days after the suspension ended, the lawyer filed a chapter 7 petition, listing $25,000 owing to the Nevada Bar Association as a nonpriority unsecured debt. The state bar did not participate in the proceedings. The lawyer received a general discharge.

While the bankruptcy was pending, the lawyer applied for reinstatement. Eventually, the Nevada Supreme Court decided that the lawyer could be provisionally reinstated on the condition that he pay the disciplinary costs. The state high court reasoned that the costs were part of disciplinary proceedings to protect the public and deter misconduct.

A year later, the lawyer reopened his chapter 7 case and moved for sanctions against the bar. The lawyer reasoned that the bar was discriminating against him in violation of Section 525(a), which provides that "a governmental unit may not deny . . . a license . . . to . . . a person that is or has been a debtor under this title. . . , solely because such bankrupt or debtor is or has been a debtor under this title. . . ."

The bankruptcy court denied the motion for sanctions and held that the disciplinary costs were not discharged. The debtor appealed to the Ninth Circuit Bankruptcy Appellate Panel, which

reversed and remanded. *Wike v. State Bar of Nevada (In re Wike)*, 660 B.R. 683 (B.A.P. 9th Cir. July 3, 2024). To read ABI's report, click here.

The bar appealed to the Circuit but lost again in an opinion by Circuit Judge M. Margaret McKeown.

Jurisdiction

Judge McKeown first decided that the *Rooker-Feldman* doctrine did not deprive the appeals court of subject matter jurisdiction. Named for two Supreme Court cases, the doctrine applies when someone calls on federal jurisdiction to appeal a state court judgment. *Rooker-Feldman* is based on the constitutional principle that only the Supreme Court has jurisdiction to review state court judgments.

For Judge McKeown, the inapplicability of *Rooker-Feldman* was evident under Ninth Circuit precedent, *Gruntz v. County of Los Angeles (In re Gruntz)*, 202 F.3d 1074 (9th Cir. 2000). There, the Ninth Circuit held *en banc* that a state court judgment modifying the automatic stay is not binding on federal courts. The appeals court reasoned that "Congress has expressed its intent that bankruptcy matters be handled exclusively in a federal forum." *Id*. at 1077-78.

Judge McKeown held that *Rooker-Feldman* did not deprive the court of appellate jurisdiction, explaining,

> Therefore, the Nevada Supreme Court's order conditionally reinstating [the debtor] to the Bar is not preclusive under *Rooker Feldman*, because otherwise it "would constitute an unauthorized infringement upon the bankruptcy court's jurisdiction." *Gruntz*, 202 F.3d at 1082.

The Evolution of Disciplinary Nondischargeability in the Ninth Circuit

On *de novo* review of the merits regarding dischargeability of disciplinary costs, Judge McKeown turned to Section 523(a)(7), which provides that a debt is not discharged if it is "a fine, penalty, or forfeiture payable to and for the benefit of a governmental unit, and is not compensation for actual pecuniary loss. . . ." She said that the dispositive question was "whether the fees and costs [that the debtor] owes to the Nevada State Bar comprise 'a fine, penalty, or forfeiture' and not 'compensation for actual pecuniary loss.'"

Judge McKeown traced the history of Ninth Circuit authority on Section 523(a)(7) primarily dealing with California law, beginning in 2001 with *State Bar of Cal. v. Taggart (In re Taggart)*, 249 F.3d 987 (9th Cir. 2001). There, the appeals court held that disciplinary costs were discharged. Reading the California statute, the circuit concluded that costs were not fines or penalties but were compensation for actual pecuniary costs.

Responding to *Taggart* two years later, the California legislature amended the California Business and Professions Code by adding Section 6086.10(e). The amendment says that disciplinary costs are "penalties . . . to promote rehabilitation and protect the public." The amendment was a "gamechanger," Judge McKeown said.

In 2010, the next case on point was *State Bar of Cal. v. Findley (In re Findley)*, 593 F.3d 1048 (9th Cir. 2010), where the Ninth Circuit held that California disciplinary costs had become nondischargeable, because the amendment classified costs as "penalties."

Judge McKeown distinguished other Ninth Circuit authorities holding monetary impositions in connection with disciplinary proceedings by concluding that they were discharged because they were not penalties but were for recovery of pecuniary losses.

Nevada Isn't California

Applying Ninth Circuit precedent, Judge McKeown pointed out the differences between California law and Nevada law, because the case on appeal came from Nevada. She noted that fees and costs under Nevada Supreme Court Rules "do not constitute fines or penalties under § 523(a)(7)" because the Nevada rules do "not sufficiently" establish that the payments serve penal and rehabilitative costs and do not qualify as fines.

Judge McKeown held "that the fees and costs assessed against [the debtor] under [Nevada's] Rule 120 are not exempt from discharge." She remanded "with instructions for the bankruptcy court to grant [the debtor's] motion for sanctions against the State Bar of Nevada."

The opinion is *Wike v. State Bar of Nevada (In re Wike)*, 24-4402 (9th Cir. July 31, 2025).

Bartenwerfer held to make a debt nondischargeable as to someone who was neither a partner nor an agent.

Debt Held Nondischargeable as to Someone Who Didn't Commit a Defalcation

Building on *Bartenwerfer*, Bankruptcy Judge Robert J. Faris of Honolulu held that a husband owed a nondischargeable debt because he was the beneficiary of funds that his wife had misappropriated from a trust for which she was the trustee.

Why was the debt nondischargeable as to the husband when he was not responsible for the misappropriation? *Bartenwerfer* made the debt nondischargeable because the trust held a claim against the husband for unjust enrichment.

The Wife's Misappropriation

The wife had been the trustee for her mother's trust. While serving as trustee before her own bankruptcy, the wife misappropriated almost all of the $850,000 that had been in the mother's trust. In the wife's previous bankruptcy, Judge Faris had held that virtually all of the misappropriated $850,000 was nondischargeable under Section 523(a)(4) as a debt for "defalcation while acting in a fiduciary capacity."

The Ninth Circuit Bankruptcy Appellate Panel upheld the nondischargeability judgment in a 37-page nonprecedential opinion. The wife's second appeal to the Ninth Circuit is pending.

The husband filed his own chapter 13 petition. In the husband's case, the trust's successor trustee filed an adversary proceeding against the husband seeking a declaration that some of the $850,000 was a nondischargeable debt owing by the husband to the trust.

The trustee for the trust filed a motion for partial summary judgment but did not contend that the judgment against the wife had preclusive effect. Instead, Judge Faris relied on undisputed facts in his December 17 opinion.

From the $850,000 that the wife had misappropriated from the trust, Judge Faris found that about $565,000 benefited the husband. Among other things, the wife used misappropriated funds to settle a lawsuit that had been pending against both the husband and wife. She also used misappropriated funds to enlarge the couple's home. In addition, she used misappropriated funds to buy a car in the husband's name.

Bartenwerfer Expands Section 523(a)(4)

The outcome turned on the interpretation of Section 523(a)(4), which provides that a "debt" is nondischargeable "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny." Focusing on the word "debt" in Section 523(a)(4), Judge Faris first analyzed whether the husband owed a debt to the trust.

For guidance, Judge Faris looked to *Bartenwerfer v. Buckley*, 598 U.S. 69 (2023), where the high court held a debt to be nondischargeable under Section 523(a)(2)(A) when the debtor was not the person who committed the fraud. The Supreme Court focused "on how the money was obtained, not who committed fraud to obtain it." *Id*. at 72. To read ABI's report on *Bartenwerfer*, click here.

In *Bartenwerfer*, the Supreme Court found the wife liable under state law for the debt because she was a partner with her husband. Similarly, Judge Faris examined Hawaii law and decided that the husband was liable to the trust for unjust enrichment in the amount of some $565,000. Indeed, he said that the husband had not denied "that he benefited from [his wife's] misappropriation of the trust's money."

The Passive Voice Wins the Day

Judge Faris turned to the ultimate question of whether the husband's $565,000 debt to the trust was nondischargeable under Section 523(a)(4).

Judge Faris characterized the husband as having argued "that § 523(a)(4) does not apply because he did not commit any of the types of wrongdoing described in that subsection and [the wife's] wrongdoing cannot be attributed to him."

In *Bartenwerfer*, Judge Faris said that the Supreme Court rejected the same argument because "Congress wrote § 523(a)(2) in the passive voice." In other words, he said, "[T]he identity of the actor is irrelevant. What matters is the nature of the debt."

"The same reasoning applies to subsection (4)," Judge Faris said, because "Congress wrote subsection (4) entirely in the passive voice." Continuing, he said,

> Nothing in subsection (4) specifies that the debtor must be the person who committed the wrong. If the debtor is legally responsible for the damages flowing from such wrongdoing, the debtor's liability is not dischargeable.

Judge Faris pointed to Section 523(a)(6) to buttress his conclusion. He noted how that subsection applies to a "willful and malicious injury *by the debtor* to another entity . . . ." [Emphasis

added.] The words "by the debtor," he said, show that "when Congress wanted to limit nondischargeability to the wrongdoer, it said so."

Granting partial summary judgment for the trust, Judge Faris held that the $565,000 debt for unjust enrichment was nondischargeable as to the husband under Section 523(a)(4). He distinguished cases where "nonbankruptcy law did not hold the debtor liable for the wrongdoing."

Observations

In *Bartenwerfer*, Justices Sonia Sotomayor and Ketanji Brown Jackson concurred, based on the "understanding" that nondischargeability will only be foisted on "agents" or "partners within the scope of the partnership." *Id*. at 84.

In the case before Judge Faris, the husband was neither a partner nor an agent of the wife. Not unexpectedly, the decision by Judge Faris shows that *Bartenwerfer* is being interpreted more broadly than Justices Sotomayor and Jackson would have wished.

The opinion is *Ponce v. Csigi (In re Csigi)*, 23-90019 (Bankr. D. Haw. Dec. 17, 2024).

A decision from a state or federal court before bankruptcy finding a securities law violation isn't required for nondischargeability under Section 523(a)(19).

For Nondischargeability, a Bankruptcy Court Can Find a Securities Law Violation

On a question where the lower courts are divided, the Ninth Circuit Bankruptcy Appellate Panel has decided that a prior decision by a state or federal court finding a violation of securities laws is not required for the bankruptcy court to declare that a debt is nondischargeable under Section 523(a)(19).

As Bankruptcy Judge Robert J. Faris said for the BAP in his November 25 opinion, "An order of the bankruptcy court deciding [the debtors'] liability for a securities violation under Utah law could satisfy § 523(a)(19)."

The Dischargeability Complaint

A creditor loaned $100,000 to a couple for the couple to invest. When the investment turned sour, the creditor sued the couple in state court for violation of state securities laws. Before trial, the couple filed chapter 7 petitions.

In bankruptcy court, the creditor filed a complaint alleging that the debt was nondischargeable under Sections 523(a)(2), (4), (6) and (19). Before trial, the bankruptcy judge acknowledged that courts go both ways but ruled that a finding of a securities law violation must have been made before bankruptcy by a state or federal court before the bankruptcy court can find the debt nondischargeable under Section 523(a)(19).

At trial, the creditor did not present evidence under Section 523(a)(19). After trial, the bankruptcy court found that the creditor had failed to prove a case under Sections 523(a)(2), (4) and (6). Having previously decided that Section 523(a)(19) was not available, the bankruptcy court dismissed the dischargeability complaint.

The creditor appealed to the BAP, alleging error under Sections 523(a)(2), (4), (6) and (19).

Section 523(a)(19) Is Unambiguous

In pertinent part, Section 523(a)(19) provides that a debt is not dischargeable if it

(A) is for — (i) the violation of any of the Federal securities laws . . . , any of the State securities laws, or any regulation or order issued under such Federal or State securities laws . . . ; and
(B) results, before, on, or after the date on which the petition was filed, from — (i) any judgment, order, consent order, or decree *entered in any Federal or State judicial or administrative proceeding* . . . .

[Emphasis added.]

Citing the *Collier* treatise and decisions by bankruptcy courts on both sides, Judge Faris recognized that there "is a split of authority both inside and outside of this circuit over whether the bankruptcy court may enter the judgment or order required by subparagraph (B)." He was also "unaware of any appellate decision directly confronting this question."

There being no controlling authority, Judge Faris began his examination "with the language of the statute itself," focusing on the words "any Federal or State judicial or administrative proceeding." He concluded,

> Nothing in the text or context of § 523(a)(19) suggests that we should deviate from the ordinary, broad meaning of the term "any." Thus, a bankruptcy judgment is "any order or judgment," and "any" federal or state proceeding includes a proceeding before a federal bankruptcy court.

Judge Faris identified reasons supporting the conclusion. "Generally," he said, "bankruptcy courts may determine both the liability on and amount of nondischargeable debts," unless "the Bankruptcy Code explicitly states otherwise." Furthermore, "civil claims against the debtor for securities law violations are within the bankruptcy court's subject matter jurisdiction."

Judge Faris ruled that the bankruptcy court committed no error in finding that the creditor had failed to prove a case under Sections 523(a)(2), (4) and (6). Finding the language in Section 523(a)(19) to be "unambiguous," he held, "An order of the bankruptcy court deciding [the debtors'] liability for a securities violation under Utah law could satisfy § 523(a)(19)."

Because the creditor had been effectively precluded at trial from introducing evidence to show a securities law violation, Judge Faris remanded "this issue to the bankruptcy court for further proceedings on [the creditor's] § 523(a)(19) claim."

The opinion is *Stehrenberger v. Stehrenberger (In re Stehrenberger)*, 23-1207 (B.A.P. 9th Cir. Nov. 25, 2024).

The Ninth Circuit didn't completely close the door to a finding in another case that student loans for a professional degree could be business debts making the debtor eligible for Subchapter V of chapter 11.

Student Loans for a Professional Degree Weren't Business Debts to Qualify for Sub V

Affirming the district court and the late Bankruptcy Judge Joseph M. Meier of Boise, Idaho, the Ninth Circuit held in a nonprecedential opinion that student loans to obtain a professional degree are not "business" debts making a debtor eligible for Subchapter V of chapter 11 when the debtor didn't have plans to own her own business after graduation.

The individual debtor had taken down $325,000 in loans to attend medical school. By the time she filed a petition under Subchapter V, the debt had grown to $650,000 with interest. The student loans amounted to almost 60% of her secured and unsecured debt.

Deciding that the debtor was not eligible for Subchapter V, Bankruptcy Judge Meier held that the loans had not arisen from commercial or business activities. *In re Reis*, 22-00517, 2023 BL 148604 (Bankr. D. Idaho May 02, 2023). To read ABI's report, click here. The district court affirmed. *Reis v. Garvin (In re Reis)*, 23-00279, 2024 BL 313941 (D. Idaho June 20, 2024). To read ABI's report, click here.

The debtor appealed, to no avail.

In a *per curiam* opinion on February 26, the Ninth Circuit explained that debtors are eligible for Subchapter V only if they then had not more than $7.5 million in secured and unsecured debt, "not less than 50 percent of which arose from the commercial or business activities of the debtor." Section 1182(1)(A) (2022).

The panel explained that the appeal only concerned whether the student loans were classified as arising "from the commercial or business activities of the debtor." The panel characterized the debtor as contending that the loans were business debts "because her medical degree was a required step in order to own and operate a medical practice."

Although today's Section 101(51)(D) does not define "business or commercial activities," the panel said it "is exceptionally broad." However, the panel said that the debtor's argument was "particularly unconvincing looking at the totality of the circumstances."

The panel pointed out that the debtor did not own her own medical practice until 10 years after graduating and incurring the debt. The opinion goes on to cite the record as "not indicat[ing] that [the debtor] had a concrete plan to open her own medical practice either at the time she took out the student loans or in the years immediately following her graduation from medical school."

"Under these circumstances," the panel upheld the lower courts, saying, "we cannot conclude that the record below was such that it demanded the bankruptcy court find that her student loan debt did indeed arise from commercial or business activity."

Observations

The panel did not close the door entirely to characterizing student loans for professional degrees as business debts. In a footnote, the panel said, "We assume without deciding that debts incurred before opening a business, including student loan debt, could qualify as debt arising from commercial or business activities."

This writer reads the opinion as concluding that the bankruptcy court had found that the loans, as a fact, were not business debts. The panel quoted the Supreme Court: "[W]here there are two permissible views of the evidence, the factfinder's choice between them cannot be clearly erroneous." *Anderson v. City of Bessemer City*, 470 U.S. 564, 574 (1985).

As this writer reads the record, there were no disputed issues of fact in bankruptcy court. Rather, the bankruptcy court arguably reached a legal conclusion based on undisputed facts.

If there were mixed questions of law and fact, *U.S. Bank NA v. Village at Lakeridge LLC*, 583 U.S. 387 (March 5, 2018), comes into play. For the unanimous Court, Justice Elena Kagan said that drawing the line between legal or factual conclusions "all depends" on whether the work of the appellate court is "primarily legal or factual." *Id*. at 396. To read ABI's report on *Lakeridge*, click here.

Assuming that the bankruptcy court's work was "primarily" legal in drawing legal conclusions based on undisputed facts, the appellate court could have undertaken *de novo* review of the bankruptcy court's legal conclusions based on undisputed facts.

Even applying *de novo* review, the Ninth Circuit panel could have agreed with the legal conclusion and upheld the lower courts.

The opinion is *Reis v. Garvin (In re Reis)*, 24-4201 (9th Cir. Feb. 26, 2025).

A district court in Minnesota left the door open for sometimes compelling debtors to arbitrate claims arising in a bankruptcy case.

Debtor Not Compelled to Arbitrate Automatic Stay or Discharge Violations

A district court in Minnesota ruled that a debtor is not required to arbitrate when the debtor sues the creditor for violating the automatic stay and discharge injunction. However, the January 13 opinion does not completely close the door to arbitration when the debtor sues for something other than a stay or discharge violation.

The debtor was in payment breach of a contract with a provider of services. The contract called for arbitration of disputes.

The creditor received notice of the chapter 7 filing and, later, a separate notice of discharge. In multiple phone calls and written communications, the creditor demanded payment both before and after discharge. In writing and with calls and messages, the debtor and the debtor's counsel on several occasions informed the creditor about the automatic stay and the discharge.

For violating the injunctions, the debtor sued the creditor in district court, seeking actual and punitive damages, plus attorneys' fees.

The creditor responded to the complaint with a motion to compel arbitration. District Judge Katherine Menendez of Minneapolis denied the arbitration motion.

Judge Menendez began analysis of the merits by reciting the usual mantra that "[f]ederal law has a general policy favoring arbitration." However, "arbitration is fundamentally a matter of contract law, and parties cannot be forced to arbitrate 'unless they have contractually agreed to be bound by arbitration,'" Judge Menendez said, quoting the Eighth Circuit.

To compel arbitration, Judge Menendez said there must be an agreement to arbitrate, and the dispute must be within the scope of the arbitration agreement.

Quoting the Eighth Circuit Bankruptcy Appellate Panel, Judge Menendez said that "'a discharge in a Chapter 7 case discharges the debtor from all debts that arose before the date of filing of the bankruptcy petition, except those that are excepted from discharge.'" A reaffirmation agreement, she said, is the only vehicle for a debt to survive discharge.

"Several courts," Judge Menendez said, "have held that, absent a reaffirmation agreement between the debtor and the creditor, an arbitration agreement embedded in a contract terminated by a bankruptcy discharge is unenforceable."

Judge Menendez said that the debtor had agreed "to arbitrate disputes arising out of the parties' contracts, but the bankruptcy discharge terminated [the debtor's] obligations under the contracts by eliminating his debt to [the creditor]."

In the complaint, Judge Menendez said that the debtor was not seeking "to use that agreement as a weapon to obtain anything from [the creditor] while simultaneously trying to avoid the effect of an arbitration clause."

"Instead," Judge Menendez said, the debtor "seeks compensation based on [the creditor's] allegedly unlawful attempts to collect on a debt after it was discharged."

Before denying the arbitration motion, Judge Menendez said it was "true" that "a bankruptcy discharge does not render an arbitration agreement unenforceable, but most have done so in other contexts, where the debtor's claims did not arise out of the creditor's attempts to collect on a discharged debt." She cited three cases where a debtor was required to arbitrate suits against a creditor alleging violations of the federal Fair Credit Reporting Act.

Observation

The opinion does not deal with whether, as some courts have held, the bankruptcy court in which the case was filed has exclusive jurisdiction regarding claims for violation of the automatic stay or discharge injunction.

The opinion is *Rogne v. Digital Forensics Corp.*, 24-2612 (D. Minn. Jan. 13, 2025).

Automatic Stay

The Fifth Circuit undertook a legal analysis of a complex loan agreement to decide there was no 'fair ground of doubt' under Taggart that the lender was violating the discharge injunction.

A Disguised Loan Agreement Didn't Create a 'Fair Ground of Doubt' Under *Taggart*

After a chapter 7 discharge, suing on an unsecured loan agreement that had been dressed up to look like a sale of the debtor's homestead didn't let the lender off the hook under *Taggart*. In a nonprecedential opinion, the Fifth Circuit upheld the bankruptcy court's decision holding the lender in willful contempt of the discharge injunction and granting the debtor an award of damages and attorneys' fees.

The opinion is significant because the Fifth Circuit undertook a thorough legal analysis of a complex document to decide that the loan was unsecured, not secured. *The opinion could be understood to mean that advancing a plausible (but incorrect) legal argument does not avoid contempt liability by giving rise to a "fair ground of doubt" under* Taggart.

The Disguised Loans

Although the language in the documents was complex, a series of three loan agreements boiled down to this: In return for borrowing money, the debtor "sold" his homestead to the lender. At the end of the term of the loan, the debtor could repurchase the home by paying back the loan with interest. Meanwhile, the debtor could remain living in the home.

Only the first of three agreements was filed in the county land records. The three checks from the lender all had notations about a "loan."

When the debtor did not repay the loan, the lender sued in state court, aiming to obtain title to the property. The debtor filed a chapter 7 petition, listing the home as his exempt homestead. The debtor listed the lender as an unsecured creditor.

Through the lender's attorney, the lender received notice of the debtor's discharge. Despite the notice of discharge, the lender returned to state court with a motion seeking a declaration that the lender owned the home. Although the debtor told the creditor that the suit was barred by the discharge order, the lender proceeded to obtain a default judgment stating that the lender owned the home. The lender changed the locks on the home.

The debtor then filed an adversary proceeding in bankruptcy court alleging that the lender committed a willful violation of the discharge injunction.

The bankruptcy judge found the three agreements to be loans, not sales of the home. The bankruptcy court also ruled that the lender had no perfected lien and that the loans were unsecured claims. Finding a willful violation of the discharge injunction, the bankruptcy court awarded the debtor title to the property along with actual damages and attorneys' fees.

On appeal, the district court affirmed, prompting the lender's appeal to the Fifth Circuit.

No 'Fair Ground of Doubt' that the Lender Was Unsecured

The lender was evidently aware of *Taggart*, because the Fifth Circuit's *per curiam* opinion on January 28 characterized the lender as arguing that the "discharge order did not contain clear and specific language prohibiting the [lender] from seeking a declaratory judgment in [state court] that [the lender] had title to the property in question." *See Taggart v. Lorenzen*, 139 S. Ct. 1795 (2019). To read ABI's report, click here.

More particularly, the appeals court described the lender as claiming to have "an objectively reasonable basis for believing they owned the property, such that their conduct did not support a contempt holding."

To hold someone in contempt for violating the bankruptcy discharge, the Fifth Circuit quoted *Taggart* for saying "there must be no objectively reasonable basis for concluding that the creditor's conduct might be lawful under the discharge order" and that there may be no "'fair ground of doubt' as to whether the creditor's conduct might be lawful under the discharge order." *Id*. at 560, 565.

After quoting some of the language in the standard form discharge notice, the appeals court concluded that "the discharge order plainly" precluded the lender from trying to collect an unsecured loan. If it were a lien, the circuit said the lender might have had a right to foreclose.

The appeals court therefore described the question as being "whether the [lender] had an objectively reasonable basis to believe that the discharge order did not bar [the lender's] conduct."

Examining the record, the appeals court identified probative evidence to support the bankruptcy court's finding that the lender was willfully pursuing collection of an unsecured, discharged debt. The circuit court then ruled as follows:

> The [lender] thus had no objectively reasonable basis to believe [its] conduct was lawful under the discharge order, and the bankruptcy court was within its bounds to hold [the lender] in contempt and order the relief it did.

There was more. The Fifth Circuit held that the purchase and sale agreement was void under Texas law and the Texas Constitution. From the legal conclusion, the appeals court went on to say that the lender's belief that it was buying the debtor's property "was not objectively reasonable because the agreements manifestly did not comply with either the Texas Constitution or Texas property law."

Finding that the bankruptcy court's findings were "well supported by the record," the Fifth Circuit affirmed, holding that the lender had made unsecured personal loans and "thereafter willfully violated the discharge order in attempting to collect that debt without a reasonable basis to believe they could properly do so."

The opinion is *Wyly v. Eichor (In re Eichor)*, 24-20238 (5th Cir. Jan. 28, 2025).

The inability to modify a Section 524(a) discharge put the Ninth Circuit BAP in a bind.

A Promise Not to Enforce a Judgment Meant There Was No Discharge Violation

The Ninth Circuit Bankruptcy Appellate Panel painted itself into a corner in 2002 when it held that a bankruptcy court has no discretion to modify a discharge injunction under Section 524(a).

To avoid perceived injustice, two judges on a Ninth Circuit BAP panel decided there was no discharge violation when a plaintiff was suing the debtor on a wrongful death claim but said it would not attempt to collect a judgment from the debtor. To preserve joint and several liability against nondebtors, the plaintiff could not and did not sign any legally enforceable document waiving enforcement against the debtor.

The BAP's June 13 opinion is the result of an unfortunate coincidence between bankruptcy law and Washington State tort law.

The Wrongful Death Action

Through alleged negligence in driving an automobile, the debtor caused a death. Two years after the accident, the debtor filed a chapter 7 petition and received a discharge three months later, there being no assets.

The debtor listed the decedent as a creditor at his former address, but the debtor did not schedule the decedent's personal representative as a creditor. Claiming she was unaware of the bankruptcy, the personal representative sued the debtor and nondebtor third parties in state court three months after discharge.

The debtor's insurance carrier tendered the policy limit of $50,000 in settlement, but the personal representative-plaintiff declined the offer and continued the suit.

After learning of the bankruptcy, the plaintiff believed she was constrained by state law to continue the suit against the debtor personally. As the plaintiff and the BAP read state law, the debtor needed a judgment against the debtor personally to win a joint and several judgment against the debtor and the nondebtor defendants. Had the plaintiff signed a legally enforceable document agreeing to collect nothing from a judgment against the debtor, the possibility of joint and several liability against the other defendants would be lost under the peculiarities of state tort law.

Truncating the procedural history, here's what happened.

The debtor brought an action in bankruptcy court and a motion for summary judgment to enforce discharge.

The plaintiff did not contend in bankruptcy court that the wrongful death suit was not discharged. However, the plaintiff cross moved for summary judgment, contending that the discharge injunction did not preclude her from obtaining a judgment against the debtor as a vehicle for the nondebtors' joint and several liability.

The bankruptcy court granted summary judgment in favor of the debtor, believing that the debtor's discharge barred the plaintiff from pursuing the lawsuit in state court against the debtor and the nondebtor defendants. The plaintiff appealed to the BAP.

A Promise Was Enough

All would have been well if the bankruptcy court could have modified the discharge injunction to allow the suit to continue nominally against the debtor, but Ninth Circuit BAP precedent said otherwise. In his June 13 opinion for the majority, Bankruptcy Judge Gary Spraker cited *Ruvacalba v. Munoz (In re Munoz)*, 287 B.R. 546 (B.A.P. 9th Cir. 2002)., for the principle that "that bankruptcy courts cannot modify the statutory discharge injunction imposed by § 524(a)(2)."

However, Judge Spraker went on to say that "our precedent also establishes that not every post-discharge action against a debtor violates this injunction." He identified a "nuance" based on the idea that "§ 524(e)'s directive that a debtor's discharge does not impact the liability of third parties even if it is premised on a debt that has been discharged as to the debtor."

Judge Spraker explained that "§ 524(a) does not eliminate the debtor's discharged debt as if it never existed; it only enjoins creditors' efforts to recover that debt from the debtor personally." He said that the "question under § 524(a) therefore becomes not simply whether the creditor seeks a judgment against the discharged debtor, but whether she seeks that judgment as part of an effort to recover against the debtor personally."

Sections 524(a)(1) and (2), Judge Spraker said, only preclude seeking a judgment "as part of an effort to recover against the debtor personally." The plaintiff took the position that she was not violating the discharge because she would not seek to recover from the debtor.

Although *Munoz* precluded the bankruptcy court from modifying the discharge injunction to permit joining the debtor as a nominal defendant, Judge Spraker said that *Munoz* opened the door for the idea that a lawsuit against a debtor does not always violate the discharge injunction.

Judge Spraker said that the lawsuit in *Munoz* "did not violate the discharge injunction because the creditors did not seek to collect or recover the resulting judgment from the discharged debtor." *Id*. at 554-55. He explained what *Munoz* means:

> *Munoz* shows that § 524(a)(2) does not enjoin every action against a discharged debtor. Nor does § 524(a)(1) void a judgment against a discharged debtor to the extent that it is not directed at collecting that debt personally from the debtor.

Applying the *Munoz* principles to the case on appeal, "Section 524(a) simply does not enjoin a post-discharge action or void a resulting judgment against a debtor used as a pass-through to impose liability on nondebtors."

Finding "no meaningful difference between" *Munoz* and the case on appeal, Judge Spraker reversed the bankruptcy court and remanded for the entry of summary judgment in favor of the wrongful death plaintiff.

The Dissent

Bankruptcy Judge H. Gan dissented. He said that the plaintiff "has not filed a binding covenant not to enforce the judgment against Debtor, and she cannot do so if she intends to establish joint and several liability," given the peculiarities of Washington State tort law.

Judge Gan believes that the plaintiff's "lawsuit is clearly enjoined by § 524(a)," because the plaintiff "requires a personal judgment against Debtor, and she cannot effectively release Debtor from that personal liability." He was unwilling "to take [the plaintiff] at her word that she will not seek to enforce the judgment against Debtor."

Judge Gan said he would have affirmed, believing that "the bankruptcy court correctly held the lawsuit violates the discharge injunction."

Observation

The difference between the majority and the dissent boils down to this: The majority would accepted the plaintiff's promise that she would not enforce a judgment against the debtor personally, while the dissenter needed an iron-clad, legally enforceable concession that would have barred the plaintiff from enforcing a judgment for joint and several liability.

In this particular case, the plaintiff would be certifiably stupid if she were to attempt to enforce a judgment against the debtor. To avoid manifest injustice, was the majority justified in taking the plaintiff at her word?

The opinion is *Porcel v. Blackwell (In re Blackwell)*, 24-1087 (B.A.P. 9th Cir. June 13, 2025).

In the Tenth Circuit, there's a workaround for courts that believe it's not possible to modify the statutory discharge injunction.

A Suit Nominally Against a Debtor Does/Doesn't Violate the Discharge Injunction

To obtain a "bad faith" judgment against an insurer for the plaintiff's damages in excess of policy limits, the plaintiff must continue the suit nominally against the defendant. When the defendant is in bankruptcy, the Ninth Circuit Bankruptcy Appellate Panel and Bankruptcy Judge Mitchell L. Herren of Wichita, Kan., reached the same result, but on different theories.

To allow the plaintiff-creditor to proceed, the BAP was in a pickle because its own precedent said that a bankruptcy court cannot modify the statutory discharge injunction. *See Ruvacalba v. Munoz (In re Munoz)*, 287 B.R. 546 (B.A.P. 9th Cir. 2002). So, the BAP majority decided in *Porcel v. Blackwell (In re Blackwell)*, 24-1087 (B.A.P. 9th Cir. June 13, 2025), that proceeding nominally against the debtor did not violate the discharge injunction. To read ABI's report on *Blackwell*, click here.

Sitting in the Tenth Circuit and not encumbered by *Munoz*, Judge Herren simply modified the discharge injunction so the plaintiff-creditor could proceed nominally against the debtor.

The Bad Faith Claim

Injured in an auto accident, the creditor made a demand against the defendant's insurer for the $50,000 policy limits. Although the insurer's adjuster said it appeared to be a "limits case," the defendant's insurer only made an offer of $27,500, which the plaintiff-creditor turned down.

After the creditor-plaintiff sued in state court, the defendant's insurer offered the $50,000 policy limit. The creditor-plaintiff rejected the offer. Days before trial, the defendant filed a chapter 7 petition.

The plaintiff-creditor moved in bankruptcy court to modify the automatic stay so the suit could proceed in state court to determine the debtor's liability and collect a judgment in excess of the policy limits from the debtor's insurer.

Before the motion could be heard, the debtor received a general discharge. So, the creditor asked Judge Herren to modify the discharge injunction, because the creditor was only aiming to recover from the insurer, not personally from the debtor. The debtor opposed.

Discharges and Third-Party Liability

On the merits, Judge Herren cited Section 524(a)(2) for saying that discharge "operates as an injunction against the commencement or continuation of an action . . . to . . . recover . . . any such debt as a personal liability of the debtor . . . ." He went on to reference Section 524(e) in saying that "a discharge does not extend to a third party; it provides [that] the discharge 'does not affect the liability of any other entity on . . . such debt.'"

Judge Herren quoted Tenth Circuit precedent, *Walker v. Wilde (In re Walker)*, 927 F.2d 1138, 1142 (10th Cir. 1991), when he said "it is 'established that [§ 524(e)] permits a creditor to bring or continue an action directly against the debtor for the purpose of establishing the debtor's liability when . . . the establishment of that liability is a *prerequisite* to recovery from another entity.'" [Emphasis in original.] Next, he quoted the Tenth Circuit's reference to Eleventh Circuit authority for the idea that the "§ 524(e) exception 'hinges "upon the condition that the debtor not be personally liable in a way that would interfere with the debtor's fresh start in economic life."'"

When an insurer fails to act in good faith, Judge Herren described Kansas law as meaning that "the insurer may be liable for damages in excess of the insured's policy limits, *i.e.*, the excess judgment." However, he said, "the cause of action against the insurer does not arise *until* the at-fault party's liability has been determined and a judgment in excess of the policy limits has been entered in the underlying tort action arising from the accident." [Emphasis added.]

Although the debtor's personal liability had been discharged, Judge Herren said that "§ 524(e) makes it clear [that the insurer's] is unaffected." He therefore held that "§ 524(e) permits Creditor to return to state court to adjudicate his personal injury claims against Debtor without violating the discharge injunction of § 524(a)," because the "Creditor expressly stated in its motion that no effort would be made to collect from Debtor personally."

Since proceeding against the debtor was "a necessary prerequisite to the creditor's ability to attempt to collect from [the insurer]," Judge Herren modified "the discharge injunction for the limited purpose of returning to state court to adjudicate Debtor's liability and, if appropriate, obtain a judgment against her." He added, "Creditor must continue to comply with § 524(a)(2) and make no effort to collect any judgment against Debtor personally."

Observations

There was a dissent in the Ninth Circuit BAP's *Blackwell* opinion. The dissenter believed there would be a discharge violation without an ironclad, legally enforceable commitment by the creditor not to pursue the debtor. In *Blackwell*, state law would have eradicated the creditor's cause of action against the insurer were there a legally enforceable promise not to sue the debtor.

Perhaps there's a workaround for courts like *Blackwell* who believe there is no authority to modify the statutory discharge injunction. The opinion by Judge Herren and the Tenth Circuit's *Walker* decision both hold that an action nominally against the debtor does not violate the discharge injunction when the debtor is not required to use personal assets to defend the suit. If there is no discharge violation, there is no cause to modify the discharge injunction.

The opinion is *In re Collins*, 24-11235 (Bankr. D. Kan. July 18, 2025).

Bankruptcy Judge Michelle Harner decided that a mortgage servicer must allow a chapter 13 debtor's continued use of an online payment platform.

Barring Use of an Online Payment Platform Was an Automatic Stay Violation

Bankruptcy Judge Michelle M. Harner of Baltimore decided that a mortgage servicer who barred the chapter 13 debtor from using the servicer's online payment platform had violated the automatic stay *ab initio*.

For the stay violation, Judge Harner imposed no monetary damages under Section 362(k), because the debtor had sought none.

In her October 30 opinion, Judge Harner conjectured whether "the system might benefit from a *per se* rule that mandates" use of online payment portals, but she said that "any such change must be implemented by Congress or an appropriate regulatory agency."

Online Mortgage Payments

The debtor confirmed her chapter 13 plan. Before bankruptcy, the debtor had been using the servicer's online platform to pay her mortgage. Under the plan, the debtor was paying mortgage arrears through the trustee but was paying the servicer directly for postpetition obligations.

After bankruptcy, the servicer barred the debtor from using the online payment platform, claiming that it was a convenience, not a right.

In testimony, a witness for the servicer said it was "policy" to prevent debtors from using the platform because it was "impossible" for the platform to be used by debtors and nondebtors. Perhaps the servicer was concerned that communications sent automatically by the platform might violate the automatic stay.

The debtor filed a motion to hold the servicer in contempt of the automatic stay. The debtor testified that the servicer had no office nearby, that she no longer had a car and that payments by telephone often took hours, because some customer service representatives believed she could not make payments since she was bankrupt. She also testified that mail was unreliable.

The difficulties occasioned by the loss of the platform caused the debtor to default on the mortgage. The servicer moved for a modification of the automatic stay, but the dispute was resolved by stipulation.

There was a separate agreement between the servicer and the debtor governing use of the online payment platform. The agreement said that the servicer could terminate the customer's use of the platform for violation of any agreement with the servicer or the lender. The agreement also allowed the servicer to terminate a customer's use of the platform "without notice."

Judge Harner said that barring use of the online platform made "it more difficult and time-consuming for the debtor to make her payments and removes a commonly used payment method from the debtor's toolkit."

Estate Property?

Judge Harner marched through several steps to decide whether taking away the payment platform violated the automatic stay. She began with Section 362(a)(3), which provides that the filing of the petition gives effect to an automatic stay 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*." [Emphasis added.]

Before delving into whether there was a stay violation, Judge Harner was obliged to decide whether removal of the platform was done to "exercise control over property of the estate." In other words, was use of the platform an estate asset, given the broad definition of estate property in Section 541(a)(1)?

"It is a well-established principle," Judge Harner said, "that a debtor's prepetition agreements (as well as her rights under those agreements) generally become property of the bankruptcy estate under section 541 of the Code." Citing Section 541(c), she went on to say, "Those interests became property of the estate notwithstanding any provision in the agreement 'that is conditioned on the insolvency or financial condition of the debtor, on the commencement of a case under this title.'"

Even if use of the portal were seen as a property interest of the servicer or a privilege, Judge Harner said, "Many courts have recognized such a contractual right to use as property of the bankruptcy estate under section 541(a) of the Code." Based on the evidence, she concluded that "the Debtor had a prepetition contractual right to use the online portal" and that the "Debtor's right to use the online portal and her interests in the Online Access Agreement came into the bankruptcy estate."

The Stay Was Violated

Having established that there was deprivation of the use of estate property, Judge Harner turned to the question of whether the servicer had violated Section 362(a)(3). She quoted the Supreme Court for having recently said that "§ 362(a)(3) halts any affirmative acts that would alter the *status quo* [of estate property] as of the time of the filing of a bankruptcy petition." *City of Chicago, Illinois v. Fulton*, 592 U.S. 154, 158 (2021).

Having concluded from the facts that the servicer had altered the *status quo*, Judge Harner next raised the question of whether the servicer's action was an "exercise of control." She decided that the action was "akin to a contract termination, which did in fact remove the value of the contract from the bankruptcy estate."

Although every breach of contract is not a stay violation, Judge Harner found "more than a mere breach." The action, she said, "effectively terminated the operative purpose of the Online Access Agreement; it was 'tantamount to a termination.'" She therefore held that the servicer had "changed the status quo and [that the violation of] the automatic stay is void *ab initio*."

Relief and Damages

In her motion, the debtor sought only injunctive relief, not monetary damages under Section 362(k). Furthermore, the record had no "discernable monetary damages to the Debtor," Judge Harner said. In addition, she said that the debtor had not "establish[ed] that she was foreclosed from making her monthly mortgage payments, including through an ACH (Automated Clearing House) or other electronic transfer from her primary bank account to the Servicer."

On the record, Judge Harner said that she could not make a finding of monetary damages under Section 362(k). However, she did "not foreclose the possibility that in a matter with a different factual record, an award of monetary damages under section 362(k), if requested, might be warranted." Furthermore, the debtor's failure "to establish monetary damages under section 362(k) of the Code does not excuse the Servicer's violation of the stay."

"The primary way to abate this violation," Judge Harner said, "is for the Servicer to restore the *status quo* and the Debtor's rights under the Online Access Agreement." On the record, though, she could not "determine whether any such remedy is appropriate or warranted." Therefore, Judge Harner called for more briefing and another hearing.

Judge Harner found herself unable to "address the underlying policy issue, namely whether and when borrowers in financial distress should lose access to online accounts and portals that they have become accustomed to using."

"To the extent that electronic payment methods (such as the online portal) facilitate greater access to credit or success in bankruptcy," Judge Harner said, "the system might benefit from a

per se rule that mandates such access. But any such change must be implemented by Congress or an appropriate regulatory agency."

The opinion is *Klemkowski v. CitiMortgage Inc. (In re Klemkowski)*, 22-10257 (Bankr. D. Md. Oct. 30, 2024).

Rochelle's Daily Wire

The Eleventh Circuit rejected the idea that a Supreme Court decision could nullify a provision in the Bankruptcy Code.

The Supreme Court's *Acevedo* Doesn't Preclude Annulling the Stay, Eleventh Circuit Says

On an issue where the lower courts are split, the Eleventh Circuit held that the Supreme Court's decision in *Roman Catholic Archdiocese of San Juan, Puerto Rico v. Acevedo Feliciano*, 589 U.S. 57 (2020), does not prevent bankruptcy courts from annulling the automatic stay under Section 362(d)(1). In *Acevedo*, the Supreme Court strictly limited the ability of federal courts to enter orders *nunc pro tunc*.

In his July 8 opinion, Chief Circuit Judge William H. Pryor, Jr., adopted the position taken by the Ninth Circuit Bankruptcy Appellate Panel in a 2020 opinion by Bankruptcy Judge William J. Lafferty, III. *In re Merriman,* 616 B.R. 381 (B.A.P. 9th Cir. 2020). To read ABI's reports on *Acevedo* and *Merriman*, click here and here.

Gamesmanship with the Automatic Stay

The appeal in the Eleventh Circuit resulted from the debtor's gamesmanship that the bankruptcy court didn't countenance.

In disputes with his brother, the previously wealthy individual filed a chapter 7 petition. After filing, the brother commenced an arbitration against members of the debtor's family. The debtor intervened in the arbitration without disclosing his bankruptcy to the arbitrator.

In the arbitration, the debtor made claims of more than $800,000 against his brother. In the bankruptcy case, the debtor either did not schedule the claims among his assets or stated that the value was unknown. The debtor took the position in the arbitration that the claims against his family were really claims against him.

Judge Pryor said that the debtor and his attorney "made the strategic choice not to assert that the stay barred" the arbitration. He went on to say that the debtor intended to use the automatic stay "as a 'poison pill' to deploy if the arbitration went against them."

That's what happened. After the arbitrator made an award against him, Judge Pryor said that the debtor "delopy[ed] his poison pill" by claiming that the arbitration was void in view of the automatic stay. The debtor also threatened sanctions against his adversaries unless they were to agree that the arbitration was entirely void.

The poison pill failed to persuade the arbitrator and also failed when the debtor moved in state court to vacate the award. The debtor then tried out the poison pill by asking the bankruptcy court to stay enforcement of the arbitration award against other members of his family, based on the idea that their assets really were his.

Eventually, Bankruptcy Judge Lisa Ritchey Craig annulled the automatic stay under Section 362(d)(1), allowing the arbitration award to stand with regard the debtor's family. Although the arbitration violated the automatic stay, Judge Craig concluded that the debtor was responsible for the violation, not the debtor's adversaries.

Judge Craig surmised that the debtor intended to retain the fruits of victory were he to prevail in arbitration and void the arbitration if he were to lose. Judge Craig also dismissed the debtor's contention that *Acevedo* prevented her from annulling the automatic stay.

On appeal, the district court recognized there were lower court opinions going both ways on whether *Acevedo* meant the end of annulments. The district court affirmed, following the Ninth Circuit BAP's *Merriman* opinion and ruling that *Acevedo* did not bar annulments. While there was a bankruptcy court in New York that saw annulments as having ended, the district court cited the BAP and five other bankruptcy courts that held to the contrary. *See In re Telles*, 20-70325, 2020 WL 2121254, (Bankr. E.D.N.Y. Apr. 30, 2020). To read ABI's report on *Telles*, click here.

Raising *Acevedo* once again, the debtor then took the poison pill to the Eleventh Circuit, without success.

Annulment Doesn't Involve Jurisdiction

In substance, the appeal raised the question of whether the Supreme Court can invalidate a statute like Section 362(d)(1), which provides that the bankruptcy court "shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay," once "cause" has been shown.

Judge Pryor described the subsection as giving the bankruptcy court power to grant retroactive relief from the automatic stay. Launching into an analysis of *Acevedo*, he said that the opinion "did not address the authority to annul automatic stays." He described *Acevedo* as a case where a commonwealth court in Puerto Rico had entered an order after the case had been removed to federal court.

Attempting to validate the commonwealth court's order that had been made after removal, the district court remanded the case *nunc pro tunc* to a date before entry of the commonwealth court's order.

Judge Pryor said that *Acevedo* was based on 28 U.S.C. § 1446(d), which means that a court loses all jurisdiction after removal. He characterized *Acevedo* as holding "that the *nunc pro tunc* order could not retroactively confer jurisdiction on the Puerto Rico trial court and validate" orders made after removal.

Judge Pryor said that the appeal before him "concerns section 362(d) of the Bankruptcy Code, which grants bankruptcy courts the power to modify or annul a stay." In contrast, he said that Section 1446 "grants district courts no such power in actions removed from state court." Furthermore, he said, "jurisdictional concerns that underscored *Acevedo* play no role here."

Mentioning that state and federal courts have concurrent jurisdiction over civil proceedings "related to" bankruptcy, Judge Pryor said that "annulment did not retroactively grant jurisdiction where there was none."

Affirming annulment of the automatic stay, Judge Pryor said that the debtor's "arguments, 'taken to [their] logical end,' would effectively nullify section 362(d). *Merriman*, 616 B.R. at 394."

The opinion is *Patel v. Patel (In re Patel)*, 23-12847 (11th Cir. July 8, 2025).

Jurisdiction

A post-confirmation lawsuit to generate funds to pay a chapter 13 plan establishes 'related to' jurisdiction for noncore claims.

Third Circuit Has a Broad View of 'Related To' Jurisdiction After Plan Confirmation

The Third Circuit pronounced an expansive view of "related to" jurisdiction by allowing chapter 13 debtors to mount a lawsuit in bankruptcy court against a contractor for breach of a contract that occurred after confirmation of the couple's chapter 13 plan.

After a couple confirmed their chapter 13 plan, a fire made their home uninhabitable. They hired a contractor to repair the damage. Following the fire, the debtors fell behind on their plan payments.

After disputes arose between the contractor and the debtors, the contractor walked off the job. Based on "related to" jurisdiction, the debtors sued the contractor in bankruptcy court for breach of contract, among other claims. After trial, Bankruptcy Judge Gregory L. Taddonio issued a 137-page report and recommendation in favor of the debtors.

The district court accepted the bankruptcy court's R&R and entered judgment against the contractor. The contract appealed to the circuit, contending that the bankruptcy court had no subject matter jurisdiction.

In a nonprecedential opinion on October 1, the Third Circuit affirmed.

Under Section 157(a), district courts may refer matters to bankruptcy courts that are "arising under title 11 or arising in or related to a case under title 11 . . . ." The debtors' complaint was not "core," but a bankruptcy court, under Section 157(c)(1), "may hear a proceeding that is not a core proceeding but that is otherwise related to a case under title 11."

In defining the breadth of "related to" jurisdiction, the panel was bound by Third Circuit precedent in *Binder v. Price Waterhouse & Co.* (*In re Resorts Int'l, Inc.*), 372 F.3d 154 (3d Cir. 2004). There, the Third Circuit held that a noncore matter relates to a bankruptcy case "if the outcome could alter the debtor's rights, liabilities, options, or freedom of action . . . [or] in any way impact[] . . . the handling and administration of the bankrupt estate." *Id*. at 164.

Where there has been confirmation of a plan, the Third Circuit went on to say that the existence of "related to" jurisdiction turns on "whether there is a close nexus to the bankruptcy plan or proceeding[s] sufficient to uphold bankruptcy court jurisdiction over the matter." *Id.* at 166–67.

The Third Circuit said that a close nexus exists when the proceeding "affect[s] an integral aspect of the bankruptcy process." *Id.* at 167.

Applying the law to the facts, the panel said there was a "close nexus" to the chapter 13 plan, "an integral aspect of the bankruptcy process," because the debtors had fallen behind on plan payments. There was "related to" jurisdiction given that the debtors "could put any proceeds from the adversary proceeding towards finishing repairs on their home . . . and paying accrued arrearages on their chapter 13 plan."

"Because payment on a confirmed chapter 13 plan qualifies as an 'integral aspect' of the bankruptcy process," the panel held that "the Bankruptcy Court had related-to jurisdiction to hear the [debtors'] adversary proceeding."

Overruling other aspects of the contractor's appeal, the panel affirmed the district court's entry of judgment against the contractor.

The panel consisted of Circuit Judges Cheryl Ann Krause, Stephanos Bibas and Thomas L. Ambro.

The opinion is *Kincaid v. Gruver (In re Gruver)*, 23-1769 (3d Cir. Oct. 1, 2024).

A final judgment on an issue in state court doesn't by itself deprive federal courts of subject matter jurisdiction under the Rooker-Feldman doctrine, the Third Circuit explains.

Circuit Judge Ambro Scribes the Boundaries Between *Rooker-Feldman* and Preclusion

Circuit Judge Thomas L. Ambro has written another gem.

For the Third Circuit in an opinion on September 3, Judge Ambro drew the boundaries between the rules of preclusion and the *Rooker-Feldman* doctrine, a jurisdictional principle. He held:

> The *Rooker-Feldman* doctrine is narrow, and it applies only when a federal plaintiff improperly invokes the jurisdiction of a district court to appeal — in fact or in effect — a state-court judgment.

In the case on appeal, preclusion based on a final state court judgment barred the debtor from asserting a claim in bankruptcy court. However, *Rooker-Feldman* did not deprive the bankruptcy court of subject matter jurisdiction.

Multiple Bankruptcies

As Judge Ambro put it, a couple filed "bankruptcy again and again" to forestall home foreclosure.

Before their first bankruptcy, the couple defaulted on their home mortgage. In foreclosure, they contended that the plaintiff wasn't the holder of the mortgage and had no standing to foreclose. The state court overruled the objection and entered a judgment of foreclosure. The same day, the couple filed a chapter 7 petition and later received a discharge.

A year later, the wife filed a chapter 13 petition and obtained permission from the bankruptcy court to challenge the foreclosure judgment. The state trial court denied rehearing and was affirmed by the state appellate court. The state supreme court denied review, meaning that the foreclosure judgment was final and that the lender had standing to foreclose.

The wife withdrew her chapter 13 petition, but the husband filed one of his own. The wife filed another chapter 13 petition, in which the lender sought relief from the automatic stay.

The wife resisted the lift-stay motion by contending that the lender didn't hold the mortgage, the same issue that had been litigated unsuccessfully in state court. After the bankruptcy court lifted the stay, the wife appealed, but the district court affirmed the lift-stay motion and also ruled that there was no jurisdiction in view of *Rooker-Feldman*.

The wife appealed to the circuit. Judge Ambro agreed that the wife loses, but not on account of *Rooker-Feldman*. Rather, he found jurisdiction and said, "[W]e exercise it to hold that her claims are precluded."

The Evolution of *Rooker-Feldman*

Judge Ambro traced the history of *Rooker-Feldman* from Supreme Court opinions in 1923 and 1983. The doctrine is based on the constitutional principle that only the Supreme Court has jurisdiction over final judgments of state supreme courts.

Quoting *Exxon Mobil Corp. v. Saudi Basic Indus.*, 544 U.S. 280, 283 (2005), Judge Ambro said that "mischief ensued" over the years "as 'the lower courts' '[v]ariously interpreted' the *Rooker-Feldman* doctrine 'to extend far beyond the contours of the *Rooker* and *Feldman* cases, overriding Congress' conferral of federal-court jurisdiction concurrent with jurisdiction exercised by state court.'" Again quoting *Exxon Mobil*, he said that "'federal jurisdiction over an action does not terminate automatically on the entry of judgment in the state court.' *Id.* at 293."

"*Rooker-Feldman* captures only a simple, if not elusive, rule of federal jurisdiction," Judge Ambro said. The narrow rule "does not 'supersed[e] the ordinary application of preclusion law' when a plaintiff relitigates a matter decided in another forum."

Preclusion

Judge Ambro explained how rules governing issue and claim preclusion arise from the Constitution's Full Faith and Credit Clause. Quoting the Supreme Court, he said that claim preclusion means that "a prior final judgment forecloses 'successive litigation of the very same claim.'" In contrast, he said that issue preclusion "bars 'successive litigation of an issue of fact or law'" that was "'actually litigated[,] resolved in a valid court determination[, and] essential to th[at] prior judgment,' even if the issue recurs in the context of a different claim."

Judge Ambro said "it is easy to imagine how a matter barred by preclusion — a suit in district court, for example, that attempts to relitigate a prior state-court claim — looks a lot like something that might offend *Rooker-Feldman*." Quoting the Supreme Court, he said, "*Rooker-Feldman* does not 'stop a district court from exercising subject-matter jurisdiction simply because a party attempts to litigate in federal court a matter [precluded because it was] previously litigated in state court.'"

Rooker-Feldman in Bankruptcy

Although courts unanimously hold that *Rooker-Feldman* applies in bankruptcy cases, Judge Ambro quoted the Third Circuit in saying that "'bankruptcy courts are empowered to avoid state judgments'" under Sections such as 544, 547 and 548, "in an 'apparent contradiction to *Rooker-Feldman*.'"

Judge Ambro went on to explain that "those bankruptcy-court powers over state-court judgments are not based on separate invocations of jurisdiction that violate *Rooker-Feldman*." Rather, he held:

> *Rooker-Feldman* applies only when two additional conditions are met: (a) procedurally, the claim is alleged as part of an adversary proceeding . . . ; and (b) the federal bankruptcy plaintiff's claim, even if 'one that denies a legal conclusion that a state court has reached in a case to which [the plaintiff] was a party,' is not otherwise 'independent' of her state-court claims.

For a proper application of the principles, Judge Ambro pointed to *Philadelphia Entertainment & Development Partners*, 879 F.3d 492 (3d Cir. 2018), where a state court had terminated a gaming license that had been purchased for $50 million. In bankruptcy, the debtor sought to avoid the termination as a fraudulent transfer, but not because the termination had been improper as a matter of state law. To read ABI's report on *Philadelphia Entertainment*, click here.

Judge Ambro explained that there was no violation of *Rooker-Feldman* in *Philadelphia Entertainment* because the avoidance action did not challenge the "bona fides" of the state court judgment. Instead, the issue in bankruptcy court was whether license revocation was avoidable under the Bankruptcy Code as a fraudulent transfer.

Holding

In the case on appeal, the debtor was not the plaintiff on the lift-stay motion in bankruptcy court. Judge Ambro therefore held that *Rooker-Feldman* did not apply. However, the debtor's defense to stay modification was based on the lender's lack of standing. The standing defense was precluded, given the state court's final judgment confirming the lender's right to foreclose.

"Even though [the debtor's] claims are not barred by *Rooker-Feldman*," Judge Ambro affirmed "the District Court's order insofar as it affirmed the Bankruptcy Court's granting of [the lender's] motion to lift the automatic stay" because "they are precluded under New Jersey law."

The opinion is *In re Adams*, 24-1212 (3d Cir. Sept. 3, 2025).

Ninth Circuit questions continuing validity of BAP opinions on finality handed down before Ritzen.

Reimposing the Stay Is a Final Order to Be Appealed Immediately, Ninth Circuit Says

The U.S. Supreme Court held in *Ritzen* that an order granting or denying relief from the automatic stay is a final, appealable order under 28 U.S.C. § 158(a)(1). *Ritzen Group Inc. v. Jackson Masonry LLC*, 589 U.S. 35 (2020). Reversing the district court, the Ninth Circuit held that revocation of a prior order modifying the automatic stay is also a final order requiring an immediate appeal.

In murky areas where it's unclear whether a bankruptcy court's order is final or not, the Ninth Circuit's Sept. 15 opinion means that counsel should take a cautious approach by filing a notice of appeal. An appellate court down the road might decide that the order was final and that an immediate appeal was necessary to preserve appellate jurisdiction.

Stay Modification Revoked

A mother created an irrevocable trust in 2011 and named her daughter as trustee. In 2017, the mother sued her daughter in state court, alleging misuse of trust property. In 2019, the daughter filed a chapter 13 petition, imposing an automatic stay on the suit in state court.

Three months after filing, the mother filed a motion to modify the automatic stay. The bankruptcy court granted the motion, modifying the stay and permissively abstaining in favor of the suit in state court.

During the COVID-19 pandemic, the state court announced that a trial could not be held for almost two years. On motion by the daughter under Rule 60(b)(6), the bankruptcy court revoked the prior order abstaining and modifying the stay.

The mother had filed a complaint in bankruptcy court raising the same claims that were pending in state court. A year after reimposing the stay, the bankruptcy court held a trial and entered judgment in favor of the daughter.

The mother appealed but only challenged the bankruptcy court's order reimposing the stay and vacating abstention. The notice of appeal came one year after the bankruptcy court's order, but the mother took the position that reimposing the stay and revoking abstention was an interlocutory order that could be appealed only after judgment in the underlying adversary proceeding.

The district court concluded that stay reimposition indeed was an interlocutory order, giving appellate jurisdiction. On the merits, the district affirmed the bankruptcy court's order, concluding that revocation was proper under Rule 60(b)(6) rather than Rule 60(b)(1). The mother appealed to the circuit.

In the circuit, neither party questioned appellate jurisdiction, but Circuit Judge Bridget S. Bade did, because a court must assure itself of jurisdiction.

Reimposing the Stay Was Final

Judge Bade began her analysis of appellate jurisdiction by citing *Ritzen* and its predecessor on finality in the bankruptcy context, *Bullard v. Blue Hills Bank*, 575 U.S. 496 (2015). She described *Ritzen* as holding "that an order granting or denying relief from the automatic stay is a 'final, appealable order' under 28 U.S.C. § 158(a)(1) because it 'forms a discrete procedural unit within the embracive bankruptcy case' and 'occurs before and apart from proceedings on the merits of creditors' claims.'" To read ABI's report on *Ritzen*, click here.

Judge Bade quickly disposed the notion that *Ritzen* did not control because *Ritzen* dealt with imposition of a stay, not reimposition of a stay. She said, "Although the [order reimposing the stay] did not, strictly speaking, grant or deny a party relief from the automatic stay, but instead *reimposed* the automatic stay, that is a distinction without a difference for purposes of finality." [Emphasis in original.]

Quoting *Bullard*, Judge Bade said that the order vacating "stay relief and abstention … and reimposing the automatic stay definitively disposed of a discrete dispute because it 'alter[ed] the status quo and fixe[d] the rights and obligations of the parties.' *Bullard*, 575 U.S. at 502." Her conclusion that the order reimposing the stay "disposed of a discrete dispute within the bankruptcy case, and thus was final, necessarily follows from *Ritzen*'s holding that orders granting or denying relief from the automatic stay are final, 589 U.S. at 42."

Abstention Was Also Final

To counter the conclusion that reimposition of the stay was a final order, the mother argued that the circuit should characterize the order as two orders, not one. In other words, the mother argued that revocation of abstention was a not final order, even if reimposition of the stay was final.

In response, Judge Bade said, "we do not think that the March 2021 order can be severed in this way." She explained,

> Both aspects of the order — addressing abstention and stay relief — are based on the same decision: whether it would be "in the interest of justice, or in the interest of comity with State courts or respect for State law," to have the Massachusetts state court resolve the state-law claims. 28 U.S.C. § 1334(c)(1). The two parts of the order rise and fall together.

Moreover, abstention revocation by itself was final. "[E]ven if considered separately from the adjudication of stay relief, the order rescinding abstention," she said, "'dispose[d] of a procedural unit anterior to, and separate from, claim-resolution proceedings' and is thus final in its own right."

Judge Bade vacated the district court's order affirming the bankruptcy court's revocation order and remanded with instructions to dismiss the appeal for lack of jurisdiction.

Footnote

Late in the opinion, Judge Bade suggested that a pair of decisions on finality by the Ninth Circuit Bankruptcy Appellate Panel may no longer be valid because they were decided before *Ritzen*. *See Krasnoff v. Marshack* (*In re Gen. Carriers Corp.*), 258 B.R. 181 (B.A.P. 9th Cir. 2001), and *Certain Underwriters at Lloyds, Syndicates 2623/623 v. GACN Inc.* (*In re GACN Inc.*), 555 B.R. 684 (B.A.P. 9th Cir. 2016).

The opinion is *Fantasia v. Diodato*, 23-3742 (9th Cir. Sept. 15, 2025).

In a nonprecedential opinion, the Eleventh Circuit holds that 28 U.S.C. § 1927 may not be used to impose monetary sanctions on pro se litigants.

Courts Must Use Inherent Powers for Sanctions on *Pro Se* Litigants, Eleventh Circuit Says

Aligning itself with the Fifth Circuit plus *dicta* from the Second Circuit and the Supreme Court, the Eleventh Circuit held in a nonprecedential opinion that a bankruptcy court, and by extension a district court, may not impose sanctions on a *pro se* litigant under 28 U.S.C. § 1927.

The subject of the Eleventh Circuit's *per curiam* opinion on August 26 was an individual we shall call the owner. She was the founder and controlling shareholder of a corporation in Subchapter V of chapter 11.

The bankruptcy court removed the debtor as a debtor in possession and expanded the powers of the Subchapter V trustee. The bankruptcy court later approved a settlement negotiated between the trustee and a creditor. After approval, the trustee filed a motion to impose sanctions on the owner. The creditor joined the motion.

The bankruptcy court granted the sanctions motion. As described by the circuit panel, the owner "made thirteen filings that 'were frivolous, untimely, asserted facts not before the [c]ourt, attempted to relitigate issues already decided, and/or improperly sought relief on behalf of third parties.'" The panel added that the "bankruptcy court determined that [the owner] had acted in bad faith."

Under Section 1927, the bankruptcy court imposed almost $10,000 in monetary sanctions on the owner for what the bankruptcy court characterized as "'excess costs, expenses, and attorney['s] fees reasonably incurred' because of [the owner's] conduct." The bankruptcy court also imposed filing restrictions.

After the district court affirmed, the debtor appealed to the circuit, which handed down its decision without oral argument. In the circuit, the owner only challenged the sanctions under Section 1927.

Not 'Admitted,' then No 1927 Sanctions

In its present form since 1980, Section 1927 provides:

> Any attorney or other person admitted to conduct cases in any court of the United States . . . who so multiplies the proceedings in any case unreasonably and vexatiously may be required by the court to satisfy personally the excess costs, expenses, and attorneys' fees reasonably incurred because of such conduct.

Reviewing for abuse of discretion, the panel quoted the Second Circuit for having said in 1992 that the word "admitted" "'suggests application' of section 1927 only 'to those who, like attorneys, gain approval to appear in a lawyerlike capacity.'"

The panel said that the Second Circuit's "reading is consistent with the Supreme Court's decision in *Chambers v. NASCO, Inc.*, 501 U.S. 32 (1991)," the Eleventh Circuit said. Similarly, the Fifth Circuit said in 1996 that sanctions may be awarded under Section 1927 only against attorneys or those admitted to practice in the court.

The circuit panel said that the Supreme Court in *Chambers* "referenced the district court's conclusion that section 1927 'applies only to attorneys' while discussing the applicability of section 1927." The panel added that the Supreme Court "did not dispute the district court's conclusion."

Although the Supreme Court's statement may have been *dicta*, the circuit said that "the fact that the Supreme Court did not correct the district court's statement of the law suggests that it viewed section 1927 as exclusively applicable to attorneys — 'admitted' to practice law."

While the owner had the right to represent herself in court, the panel said that she was not admitted to conduct cases in any court.

The creditor, in whose favor sanctions had been imposed, argued that the circuit need not reach a conclusion on Section 1927 because the bankruptcy court could have imposed sanctions under its inherent powers. The panel responded by saying that "the bankruptcy court's order makes clear that it did not rely on its inherent authority to impose the monetary sanctions."

The circuit held that the bankruptcy court had abused its discretion "[b]ecause section 1927 cannot support sanctions against a non-attorney *pro se* litigant." The circuit vacated the monetary sanctions and remanded for further proceedings.

The owner may not be out of the woods. In closing, the panel said that "nothing prevents the bankruptcy court from imposing monetary sanctions based on its inherent authority on remand."

The opinion is *Perryman v. Kien (In re Micron Devices Inc.)*, 24-11215 (11th Cir. Aug. 26, 2025).

Rochelle's Daily Wire

In a chapter 7 case, a disappointed bidder wasn't required to show Article III standing but was still required to demonstrate prudential standing as falling within the class of persons protected by Section 363.

A Disappointed Bidder Didn't Have Prudential Standing in a Chapter 7 Case

The Supreme Court's *Truck Insurance* decision upset what we thought we knew about bankruptcy standing. It gives broadly defined parties in interest the right to appear and be heard in chapter 11 cases under Section 1109(b). *Truck Insurance Exchange v. Kaiser Gypsum Company, Inc.*, 602 U.S. 268 (June 6, 2024). To read ABI's report, click here.

But what about chapter 7 cases? Who has the right to object to an action proposed by a trustee? Is it the same in chapter 7 as in chapter 11?

In an eloquent opinion on August 15, Bankruptcy Judge Robert H. Jacobvitz of Albuquerque, N.M., scribed the outlines of who has the right to be heard in a chapter 7 case.

Selling a Malpractice Claim

Having been slapped with a judgment in state court for more than $1.7 million, the individual debtor filed a chapter 7 petition. The debtor's scheduled assets included a legal malpractice claim against the law firm that unsuccessfully defended him in state court. Apart from the judgment, the debtor had less than $28,000 in unsecured nonpriority claims.

The chapter 7 trustee agreed to sell the legal malpractice claim to the judgment creditor for $25,000. The sale would be made without warranties or representations and would be free and clear of liens. The judgment creditor's claim would remain subordinate to all other allowed claims.

The law firm that was the target of the malpractice claim filed the only objection to the sale. In addition, the firm offered $27,500 to buy the claim. The firm argued that the claim should be sold at auction and that the malpractice claim was not assignable under state law.

The trustee contended there was no need to rule on the merits because the firm had no Article III standing. Before addressing the merits, Judge Jacobvitz dealt with standing, a jurisdictional threshold.

Article III Standing

Citing the Tenth Circuit Bankruptcy Appellate Panel, Judge Jacobvitz began by saying that the "requirement for Article III standing applies in bankruptcy court, even though the bankruptcy court is not an Article III court." However, he mentioned in a footnote that the Fourth Circuit held two years ago that bankruptcy courts are not constrained by the strictures of Article III jurisdiction. *Kiviti v. Bhatt*, 80 F.4th 520 (4th Cir. 2023), *cert. denied*, 144 S. Ct. 2519 (2024). To read ABI's report on *Kiviti*, click here.

Because the "Trustee has Article III standing to prosecute the Motion to Sell," Judge Jacobvitz said, "[i]t is unnecessary to determine whether [the law firm] independently satisf[ies] the requirements of Article III standing." Since the trustee has Article III standing, he said that "objecting parties need not themselves have Article III standing to prosecute their objections."

As a result, Judge Jacobvitz decided that "the Trustee's argument [about the law firm's lack of standing] is misplaced."

Prudential Standing

The law firm's prudential standing was another matter.

Quoting the Tenth Circuit, Judge Jacobvitz said,

> "Prudential standing represents judicially self-imposed limits on the exercise of federal jurisdiction that [generally] are founded in concern about the proper — and properly limited — role of the courts in a democratic society." In bankruptcy court, "[p]rudential standing consists of 'a judicially-created set of principles that, like constitutional standing, places limits on the class of persons who may invoke the court's decisional and remedial powers.'"

Judge Jacobvitz interpreted *Lexmark Int'l Inc. v. Static Control Components, Inc.*, 572 U.S. 118 (2014), as taking "a narrower view of the traditional prudential standing doctrines, clarifying that 'zone of interests' and 'general grievances' that were previously treated as aspects of prudential standing are not properly classified as prudential standing limitations at all." Instead, he read the Supreme Court as saying that "the 'generalized grievance' test is properly part of the Article III standing inquiry."

While the "zone of interests" test is no longer a part of prudential standing, Judge Jacobvitz said that "it remains relevant." He interpreted the "zone of interests" test as asking the court "to determine 'whether a legislatively conferred cause of action encompasses a particular plaintiff's claim,'" quoting the Tenth Circuit.

After *Lexmark*, Judge Jacobvitz understood the Tenth Circuit as referring to non-Article III limits on the right to assert a claim as "merely ask[ing] whether a particular federal cause of action 'encompasses a particular plaintiff's claim.'"

In a bankruptcy case, Judge Jacobvitz said he would "refer to that standing concept as the 'Right to be Heard.'" He then turned to the question of whether the law firm had the right to be heard.

The Right to Be Heard

To assert a claim under a federal statute, Judge Jacobvitz quoted the Supreme Court for saying that the right to be heard "'belong[s] to the class of persons to whom the statute grants a right to sue;' that is, 'a plaintiff must be within the "zone of interests" that the statute protects.'"

When someone files a motion in a bankruptcy case, Judge Jacobvitz said that "the relief often is not sought against only a named party. Such is the case with the Motion to Sell, where the Trustee seeks approval of the sale of the Legal Malpractice Claims under § 363." Deciding who has the right to object "requires a limiting principle."

To decide whether someone has the right to be heard depends, Judge Jacobvitz said, "on whether the objecting party belongs to the class of persons entitled to participate in the contested matter; that is, whether the interests of the objecting party fall within the 'zone of interests' the statute protects."

If it were a case under chapter 11, Judge Jacobvitz said that the law firm would have a right to be heard under Section 1109(b), because "party in interest" is a "broad term" and "contemplates that the broadest category of potential litigants will have the Right to be Heard."

"But § 1109(b) does not apply in chapter 7 cases," Judge Jacobvitz said. Furthermore, "most" sections applicable to chapter 7 cases, including Section 363(b) governing sales, "do not identify who may object to a motion and instead simply allow the Court to grant relief requested in a motion 'after notice and a hearing.'"

The law firm contended it had a right to be heard because state law prohibits assignment of the malpractice claim.

With a limited exception, Judge Jacobvitz said that "the interests of a disappointed bidder for a bankruptcy estate asset who otherwise is a stranger to the bankruptcy case are not the type of interests protected under the Bankruptcy Code to challenge a § 363 sale." The exception arises when "there are allegations of fraud, collusion, bad faith, or other fundamental unfairness that taints the sale."

Judge Jacobvitz said that the right to assign a malpractice claim "should be decided by the state court." Furthermore, he observed that the lawyers "have not alleged that fraud, collusion, bad faith, or other fundamental unfairness taints the Trustee's sale."

As "disappointed bidders" who "do not fall within the class of persons protected by § 363 even though they have offered to pay more for the Legal Malpractice Claims," Judge Jacobvitz held that the firm "do[es] not have a Right to be Heard on their Objection to the Motion to Sell."

Since the firm lacks standing to assert the objection to the sale, Judge Jacobvitz granted the sale motion because there were no other objections.

Observations

Typically, creditors and parties in interest have the right to appear and be heard. In the case before Judge Jacobvitz, the law firm was not a creditor. Was it a party in interest since it was bidding for the asset?

In *Truck Insurance*, the test for party in interest is whether that party will be affected by the case. As a bidder, it could be said that the law firm was affected and therefore was a party in interest. This writer agrees with Judge Jacobvitz that the law firm could be heard were it a chapter 11 case.

Is the rule different in chapter 7? Did *Truck Insurance* change the rule in chapter 7?

The opinion is *In re Riddle*, 23-10827 (Bankr. D.N.M. Aug. 15, 2025).

Second Circuit barred offensive use of claim preclusion based on 'fairness' but hinted that offensive claim preclusion might never be permitted.

Allowed Claim Can't Be Used Offensively, Second Circuit Says

In an important decision, the Second Circuit held that a creditor may not use an uncontested claim allowance in an offensive use of claim preclusion if it would be "unfair."

In her August 8 opinion, Circuit Judge Beth Robinson stopped short of deciding whether offensive claim preclusion is never permissible. If offensive claim preclusion were squarely present, she hinted that it might never be allowed.

Uncontested Claim Allowance

The debtor had been a sales representative for his employer. After taking a job with a competitor, the former employer sued the debtor in federal district court for misappropriation of trade secrets and violation of a noncompetition agreement. The lawsuit was stayed automatically when the debtor filed a chapter 7 petition.

In bankruptcy court, the employer filed a claim for $315,000. When neither the trustee nor the debtor objected, the bankruptcy court entered an order allowing the claim for $315,000. After the trustee filed a final report to which no one objected, the employer received a distribution of almost $13,000.

Meanwhile, the debtor waived his discharge. When the automatic stay terminated, the employer moved for summary judgment in district court. Initially, the district judge denied the summary judgment motion. As Judge Robinson said, the district court "emphasized" that the employer was "attempting to use claim preclusion offensively as opposed to defensively and concluded that allowing that in this case would be unfair."

Deciding on reconsideration that claim preclusion could be used offensively, the district court reversed position, granted summary judgment for the employer and entered judgment against the debtor for some $312,000.

The debtor appealed and won in the circuit.

Authority Wasn't Controlling

Citing the Second Circuit, Judge Robinson said,

> Claim preclusion applies in a later litigation "if an earlier decision was (1) a final judgment on the merits, (2) by a court of competent jurisdiction, (3) in a case involving the same parties or their privies, and (4) involving the same cause of action."

Also citing the Second Circuit, Judge Robinson said that claim preclusion "applies 'with full force' to matters that a bankruptcy court decides."

Urging the Second Circuit to affirm, the employer relied primarily on *EDP Medical Computer Systems, Inc. v. U.S.*, 480 F.3d 621, 624 (2d Cir. 2007). Judge Robinson explained why *EDP* was not controlling.

The Internal Revenue Service had filed a claim against the corporate chapter 7 debtor in *EDP*. Neither the trustee nor the debtor objected to the IRS's claim, and it was allowed. Eventually, the trustee paid the IRS's claim in full.

After bankruptcy, the debtor sued the IRS in federal court, seeking a full refund. (The circuit's opinion does not explain how a corporate debtor could sue after the bankruptcy was over.) The district court granted summary judgment dismissing the suit, holding that the bankruptcy court's claim allowance had preclusive effect.

The Second Circuit affirmed, agreeing that the bankruptcy court's order allowing the claim was a final judgment entitled to preclusive effect. Judge Robinson said that the Second Circuit "rejected the argument that claim preclusion is not available because the amended proof of claim wasn't actually litigated on the merits."

Observing that the IRS was invoking claim preclusion defensively, Judge Robinson said that *EDP* "doesn't answer the pivotal question here: whether [the employer] can invoke claim preclusion *offensively* to compel a money judgment against [the debtor] based on the allowed claim." [Emphasis in original.]

Offensive Use of Claim Preclusion?

Judge Robinson examined claim preclusion and said that the employer's "position is at odds with our general understanding of claim preclusion as a defensive tool." She found "no decision" among sister circuits "blessing the use of claim preclusion to bar defense of a claim rather than to preclude an affirmative claim." Drawing from Supreme Court authority, she explained why:

> [A]pplication of claim preclusion to bar a party from *defending* against a claim rather than barring a party from *advancing* a claim raises fairness concerns because claim preclusion applies to claims that *could have been litigated* even if they weren't, and a party defending against a claim may have good reasons separate from the merits to forego asserting a defense in a particular circumstance. [Emphasis in original.]

See Lucky Brand Dungarees, Inc. v. Marcel Fashions Group, Inc., 590 U.S. 405, 413 n.2 (2020).

To the same effect, Judge Robinson cited the Eleventh Circuit for the idea that a claim in bankruptcy is not an attempt to recover a judgment against the debtor but is an endeavor to obtain a distribution from the bankrupt estate. The Atlanta-based court said that a proof of claim is an attempt at participating in the distribution but is not a judgment that the creditor can execute against the debtor.

Judge Robinson said that the employer was not attempting to enforce a judgment that had already been entered, but rather was "seeking to secure a money judgment based on the bankruptcy court's allowance of its claim."

Based on the authorities she had cited, Judge Robinson "reiterate[d] the Supreme Court's doubts about whether claim preclusion can ever apply offensively in this way — to preclude a party from defending against a claim based on a prior judgment, rather than to preclude a party from advancing a claim."

Fairness

Judge Robinson saw no need to decide the "broad question" of whether claim preclusion can ever be used offensively. Even if a court could apply claim preclusion offensively in "some circumstances," she said that a court "cannot do so when it would be unfair, and applying claim preclusion to support a judgment for [the employer] here would be unfair."

Judge Robinson adopted the fairness approach "from the Supreme Court's application of the related doctrine of issue preclusion," where the doctrine precludes relitigating an issue that was actually and necessarily decided.

Compared to claim preclusion, Judge Robinson said that "issue preclusion applies only if an issue has been 'actually litigated.'" The Supreme Court, she said, "has recognized that offensive use of issue preclusion implicates different considerations than defensive application."

Not disallowing the use of offensive issue preclusion altogether, Judge Robinson said that the Supreme Court "gave trial courts discretion to decide whether to apply offensive issue preclusion

and cautioned that they should not allow the use of offensive issue preclusion where it 'would be unfair to a defendant.'" *Parklane Hosiery Co., Inc. v. Shore*, 439 U.S. 322, 331 (1979).

The Supreme Court, Judge Robinson said, "recognized that *offensive* use of issue preclusion implicates different considerations than *defensive* application." [Emphasis in original.] Factors bearing on fairness include whether the defendant had an incentive to litigate the prior action vigorously.

On the facts of the case on appeal, applying claim preclusion would be unfair, Judge Robinson said, because the debtor's "incentives to litigate [the employer's] claims in the bankruptcy proceeding were quite different from his incentives in the district court." An allowed claim in bankruptcy is not an enforceable judgment entailing the attachment of a debtor's property. It only permits participating in a distribution from the estate.

When claims exceed the bankruptcy estate, Judge Robinson said that "a debtor may have little incentive to contest individual claims." Furthermore, defending against the employer's lawsuit in district court "would not amount to a collateral attack" on the claim allowance. The debtor "merely seeks to defend against additional liability beyond the sums distributed to [the employer] in the bankruptcy proceeding."

"Some future case," Judge Robinson said, "may require us to consider whether claim preclusion can ever be used as a sword rather than as a shield, or at least whether that is true with respect to the effect of a bankruptcy court's allowance of a claim."

Having no need to "decide that question categorically in order to resolve this case," Judge Robinson held that claim preclusion did not apply. She reversed the district court's award of summary judgment to the employer and remanded for further proceedings.

The opinion is *Brown v. Thermal Surgical LLC*, 24-127 (2d Cir. Aug. 8, 2025).

In a split decision, the Ninth Circuit majority held that a chapter 13 debtor has the right to dismiss under Section 1307(b) before the bankruptcy court decides whether the filing was in good faith.

Even if Ineligible for Chapter 13, Ninth Circuit Says the Debtor Can Still Dismiss

Over a dissent, the majority on a Ninth Circuit panel affirmed the Bankruptcy Appellate Panel by holding that a debtor retains an "absolute right" to dismiss a chapter 13 case under Section 1307(b) even when an objecting creditor contends that the debtor filed the chapter 13 petition in bad faith and was never eligible for chapter 13.

A former employer sued the debtor before bankruptcy for breach of a noncompetition and nondisclosure agreement, together with misappropriation of trade secrets. The former employer won a judgment for about $215,000 and recorded the judgment to obtain a lien on the debtor's real property.

The debtor filed a chapter 13 petition, listing about $87,000 in unsecured debt plus $950,000 in secured debt, including $364,000 owing to the former employer. At the time, the debt limit in Section 109(e) was about $1.25 million for secured debts and about $420,000 for noncontingent, liquidated, unsecured debts.

Alleging that the debt resulted from a willful and malicious injury to property or a fraud while acting in a fiduciary capacity, the employer filed an adversary proceeding in bankruptcy court to declare that the judgment was nondischargeable. In addition, the employer alleged that the debtor had concealed assets. The employer also objected to the debtor's homestead exemption.

Rather than fight on all fronts, the debtor filed a motion to dismiss the chapter 13 case under Section 1307(b), which provides, "On request of the debtor at any time, . . . the court *shall dismiss* a case under this chapter." [Emphasis added.]

Arguing that dismissal would further the debtor's wrongdoing and that the debtor had too much unsecured debt for chapter 13, the former employer opposed dismissal and moved for conversion to chapter 7. The former employer contended that the bankruptcy judge could not dismiss the case without first holding a hearing and deciding whether the debtor was eligible for chapter 13.

Bankruptcy Judge Natalie M. Cox of Las Vegas overruled the objection and permitted dismissal. The former employer appealed, losing a second time in an opinion for the BAP by

Bankruptcy Judge Robert J. Faris. *Tico Construction Co. v. Van Meter (In re Powell)*, 644 B.R 181 (B.A.P. 9th Cir. Oct. 21, 2022). To read ABI's report, click here.

Interpreting Section 1307(b), the BAP cited the Second, Sixth and Ninth Circuits for giving a chapter 13 debtor a seemingly absolute right to dismiss a chapter 13 case that has not been previously converted from chapters 7, 11 or 12. The Ninth Circuit opinion is *Nichols v. Marana Stockyard & Livestock Market Inc. (In re Nichols)*, 10 F.4th 956 (9th Cir. Sept. 1, 2021). To read ABI's report on *Nichols*, click here. However, the BAP cited the Fifth and Eighth Circuits for holding that dismissal under Section 1307(b) may be conditioned on the debtor's good faith.

Nichols Controls

In the circuit, the former employer conceded that *Nichols* gave the debtor an "absolute right to dismiss," even if the filing were in bad faith. However, the debtor argued that the word "debtor" in Section 1107(b) must be interpreted to mean a debtor who is eligible for chapter 13.

[Note: To this writer, it appears that the former employer was asking the Ninth Circuit panel to overrule *Nichols*, without asking the circuit to sit *en banc*.]

In her majority opinion on October 1, Circuit Judge Jennifer Sung declined to decide whether "debtor" means someone eligible for chapter 13. Even if the former employer was correct, she held that "the debtor is presumptively a debtor under Chapter 13 — and the petition filing is enough to commence a Chapter 13 case under § 301(a)."

"And once a Chapter 13 case has been commenced under § 301(a)," Judge Sung held that "the debtor has an absolute right to voluntarily dismiss that case under § 1307(b), and the bankruptcy court is not required to conclusively resolve any disputes about the debtor's Chapter 13 eligibility before granting a dismissal request."

Judge Sung based her conclusion on the notion "that a case is commenced [under Section 301(a)] by the filing of a petition — not an eligibility determination by the bankruptcy court." She said that the former employer did "not identify any statutory text that requires or even suggests that the court must verify the debtor's eligibility before a dismissal can be granted under § 1307(b)."

Even if the debtor had filed under chapter 13 in bad faith, Judge Sung cited *Nichols* in holding that the filing of the petition "caused a case to be commenced under chapter 13," requiring the bankruptcy court "to dismiss [the debtor's] Chapter 13 case without further inquiry." She affirmed the BAP.

The Dissent

Circuit Judge Daniel P. Collins "respectfully" dissented. To him, it was "implicit in the language of § 103(j) and § 1307(b) that the various rights and procedures specified in Chapter 13, including the absolute right of voluntary dismissal under § 1307(b), apply only in a case that is *properly* 'under such chapter.'" [Emphasis in original.]

To Judge Collins, it made "no sense" to say that "the Code nonetheless allows the various rights contained within a given chapter to be invoked by an entity that is ineligible to proceed under that chapter." It "cannot be correct," he said, that a debtor could "brazenly falsify his schedules" and "later invoke Chapter 13's absolute right of dismissal when a creditor calls out his false statements and seeks to convert the proceedings to another chapter."

Judge Collins would have reversed.

Note: Circuit Judge Daniel P. Collins is not to be confused with Bankruptcy Judge Daniel P. Collins, who sits in Phoenix.

Observations

Allowing dismissal despite possible bad faith, the BAP alluded to the statement in *Nichols* that the bankruptcy court has "other tools" to deal with abuse. An example, the BAP said, would be imposing a bar to refiling or other conditions under Section 105(a). Another tool might be sanctions under Bankruptcy Rule 9011(c)(1)(A).

In *Caldwell v. Unified Capital Corp. (In re Rainbow Magazine, Inc.)*, 77 F.3d 278, 284 (9th Cir. 1996), the Ninth Circuit said there was "little doubt" that a bankruptcy court has "inherent power" under Section 105(a) to issue sanctions for abuse of process and vexatious conduct.

In the case on appeal, dismissal of the chapter 13 case wasn't necessarily the end of the story. After dismissal, the bankruptcy court retained the power to impose sanctions if the debtor had misbehaved.

The opinion is *Tico Construction Co. v. Van Meter (In re Powell)*, 22-60052 (9th Cir. Oct. 1, 2024).

At least with regard to standing for objections to claims, Delaware's Judge Craig Goldblatt believes that the Truck Insurance standard for chapter 11 also applies in chapter 7.

Judge Goldblatt Engrafts the Standing Rules from *Truck Insurance* onto Chapter 7

Regarding the ability of a creditor to object to claims in a chapter 7 case, the times are changing after the decision last term from the Supreme Court in *Truck Insurance Exchange v. Kaiser Gypsum Company, Inc.*, 602 U.S. 268 (2024). To read ABI's report, click here.

In 2011, a district judge in New York described the "majority rule" as holding that a creditor lacks standing to object to the claim of another creditor unless given authority from the bankruptcy court. *Pascazi v. Fiber Consultants, Inc.*, 445 B.R. 124, 129 (S.D.N.Y. 2011).

Bankruptcy Judge Craig T. Goldblatt of Delaware saw *Truck Insurance* as having overruled the majority. In a decision on October 21, he said that "§ 502(a) must be read to permit not only the chapter 7 trustee, but all parties with a direct financial stake in the outcome of a claims allowance dispute, to object to the allowance of claims." He went on to cite the *Collier* treatise for having said that creditors are parties in interest with standing to object to other creditors' claims.

Truck Insurance and Section 502(a)

Truck Insurance involved a chapter 11 case and the interpretation of Section 1109(b), which is not applicable in chapter 7 cases. For chapter 11 cases, the subsection says 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." [Emphasis added.]

Interpreting Section 1109(b) in *Truck Insurance*, Justice Sonia Sotomayor said for the unanimous Court that the "text is capacious." She concluded that "parties in interest" refers "to entities that are potentially concerned with or affected by a proceeding." *Truck Insurance*, *supra*, 602 U.S. at 271, 276.

As long as a creditor is "potentially" affected by the chapter 11 case, the Supreme Court interpreted Section 1109(b) broadly to mean that a creditor may object to any action taken in a chapter 11 case, even if the action does not affect the objecting creditor.

However, the breadth of standing defined by the Supreme Court in *Truck Insurance* does not apply to chapter 7 cases.

The New York Case

In 2011, District Judge William H. Pauley, III, affirmed a bankruptcy court that had ruled that a creditor lacked standing to object to the claim of another creditor. *See Pascazi, supra.* Citing a decision from an Ohio bankruptcy court in 1988, he said there is "no clear consensus" on whether a creditor can object to another creditor's claim in a chapter 7 case. *Id*., 445 B.R. at 128. In chapter 7 cases, the statutory guidance for creditors' objections to claims is contained in Section 502(a), which says that a filed claim is allowed "unless a party in interest, including a creditor of a general partner in a partnership that is a debtor in a case under chapter 7 of this title, objects."

Judge Pauley conceded that a "creditor is a 'party in interest' under § 502(a) and thus, at least in theory, has standing to object to the claim of another creditor." *Id*. Contrary to the general principle, he cited a Seventh Circuit opinion from 1996 when he said there is a "significant — though not universally adopted — judicial limitation." *Id*. at 129. He proceeded to say that the "majority of courts hold that '[a]s a general rule, absent leave of court, the chapter 7 trustee alone may interpose objections to individual proofs of claim," again citing the Seventh Circuit. *Id*.

At the time, Judge Pauley saw the majority of courts as believing that a creditor may not object to a claim unless the trustee has refused to lodge an objection. Judge Pauley said he was persuaded and adopted "the majority approach," affirming the bankruptcy court's ruling that one creditor lacked standing to object to the claim of another.

Judge Goldblatt's Cut on Standing After *Truck Insurance*

In the case before Judge Goldblatt, one creditor in a chapter 7 case had objected to the allowance of the claim of another creditor. The creditor whose claim was under objection argued that the objector lacked standing. Naturally, Judge Goldblatt said that "11 U.S.C. § 502(a) states that any 'party in interest' has standing to object to the allowance of a claim in a chapter 7 case."

Regardless of the language in Section 502(a), the creditor whose claim was under objection argued that "only the chapter 7 trustee may object to proofs of claim." Citing Judge Pauley's decision, Judge Goldblatt said, "It is true that there are cases that have so held."

However, Judge Goldblatt read *Truck Insurance* to say that "'party in interest' is meant to be interpreted broadly and should include any party who is 'potentially concerned with, or affected by, a proceeding.'"

In view of *Truck Insurance*, Judge Goldblatt decided that Section 502(a) "must be read to permit not only the chapter 7 trustee, but all parties with a direct financial stake in the outcome of a claims allowance dispute, to object to the allowance of claims."

The decision by Judge Goldblatt represents his preliminary thoughts on a dispute that is boiling to the surface. Ultimately, he is likely to hold that a creditor may object to another's claim.

The opinion is *In re Team Systems International LLC*, 22-10066 (Bankr. D. Del. Oct. 21, 2024).

Wife who contributed nothing toward household expenses is still counted as part of the 'household,' Chicago's Judge Slade says.

Married Immediately Before Bankruptcy, the 'Household' Is Two, Not One

Even though a couple were married only one month before the husband filed a chapter 13 petition, Chicago's Bankruptcy Judge Michael B. Slade decided that the husband was entitled to claim a house of "2" even though the wife contributed nothing to household expenses.

The income of the debtor-husband was above the median. The number in his household therefore would affect how much he would be required to pay creditors under a chapter 13 plan. *See* Section 707(b)(2)(A).

The couple were married only one month before the debtor filed his chapter 13 petition. The non-debtor wife testified that she used her income to pay her personal expenses and paid none of the household expenses.

The chapter 13 trustee filed an objection to confirmation of the debtor's plan, contending that the payments should be larger because the household should consist of only one person, not two. The trustee argued that the debtor's "financial circumstances are unchanged by his marriage" because he was paying the same amounts for housing before and after marriage.

Judge Slade responded by saying "that married couples who live together — even those who try to keep their finances separate — are intertwined in numerous ways" and "that marriage has consequences, legal and economic." The debtor's payment of all of the household expenses, he said, "demonstrates, beyond doubt, interdependence, as [the debtor's] income is also used to pay some of her expenses."

The outcome depended on the meaning of "household," a term not defined in the Bankruptcy Code. "All dictionary definitions of the term that I have located, however, would include two spouses living together," Judge Slade said.

In terms of authorities on how to count the number in a household, Judge Slade identified three "competing approaches."

The "heads on beds" approach simply counts the number of people living in the housing unit. The "IRS dependent" approach includes only those whom the debtor may claim as a dependent.

The "economic unit" approach rests on the financial interdependency between the debtor and others. The Seventh Circuit has not taken a position, Judge Slade said.

Judge Slade said he was "persuaded that Congress most likely intended bankruptcy courts to apply something like the 'economic unit' test, looking to the details of the debtor's factual situation and determining, in the court's best judgment, how many other persons' finances are intertwined at least to some degree with the debtor's."

But "regardless of what test is applied," Judge Slade said it was "hard to see how [the debtor's] wife would not be part of his 'household,'" for several reasons. First, he said, "none of the parties has cited a single case in which a debtor's cohabitating spouse was not counted in a debtor's household size."

Second, he said that the Bankruptcy Code does in other places, "explicitly address situations where a debtor is married but has finances separate from his or her spouse. 11 U.S.C. § 707(b)(7)(B)." Third, "the Official Forms strongly suggest that debtors should count in these calculations their cohabitating spouse."

Refusing to be the first judge who "excluded a cohabitating spouse from the 'household,'" Judge Slade said it was "highly relevant that the Debtor pays housing costs for he and his wife." He overruled the trustee's objection, holding "that the Debtor's cohabitating spouse is part of his 'household' for purposes of the relevant calculations under the Bankruptcy Code."

The opinion is *In re Hardy*, 24-10769 (Bankr. N.D. Ill. March 18, 2025).

The Ninth Circuit holds that claim preclusion doesn't prevent a debtor from claiming federal exemptions after the bankruptcy court has denied state exemption.

Claim Preclusion Didn't Preclude Making Successive Exemption Claims, Circuit Says

Reversing the district court and upholding a decision by Bankruptcy Judge Scott H. Gan of Tucson, Ariz., the Ninth Circuit held that issue preclusion does not prevent a debtor from successfully claiming a federal exemption after the bankruptcy court has previously denied exemptions under state law.

Of potentially greater significance, the circuit court recognized the bankruptcy court's discretion to grant an exemption that the debtor has not correctly claimed.

Three Shots at Exemptions

The individual chapter 7 debtor originally claimed an Arizona state exemption for real property and a recreational vehicle, or RV. When the trustee objected, the debtor amended his schedules to claim exemptions for the same property using Washington State law. When the debtor failed to oppose the trustee's objection to the Washington exemption claims, the bankruptcy court sustained both objections.

One month later, the debtor amended his schedules a third time, on this occasion claiming federal homestead exemptions for both the real property and the RV, utilizing the hanging paragraph in Section 522(b)(3). "If the effect of the domiciliary requirement under subparagraph (A) is to render the debtor ineligible for any exemption," the hanging paragraph provides that "the debtor may elect to exempt property that is specified under subsection (d)."

Under Section 522(d), the exemptions applicable to the case on appeal were the federal homestead exemption in Section 522(d)(1) and the so-called wildcard exemption in Section 522(d)(5).

At the hearing on the debtor's third exemption claim, Bankruptcy Judge Gan ruled that the debtor was entitled to the federal homestead exemption for the real property. Because the debtor had the right under Bankruptcy Rule 1009(a) to amend his schedules at any time, Bankruptcy Judge Gan dismissed the idea that the prior denial of the homestead exemption precluded an exemption under federal law.

Although the debtor had incorrectly claimed a federal homestead exemption for the RV, Bankruptcy Judge Gan granted the wildcard exemption for the RV, even though the debtor had not claimed a wildcard exemption.

Reversal in District Court

On appeal, the district court reversed, believing that claim preclusion prevented the debtor from claiming any federal exemptions after state exemptions had been denied.

The district court also ruled that the bankruptcy court should not have allowed the wildcard exemption when the debtor had not claimed that exemption.

The debtor appealed to the circuit and won in an October 14 opinion by District Judge Joan H. Lefkow of Chicago, sitting by designation.

Claim Preclusion

Addressing claim preclusion, Judge Lefkow began by paraphrasing the Ninth Circuit for holding that "unappealed orders denying exemptions are entitled to preclusive effect in later bankruptcy court proceedings." Moreover, claim preclusion bars subsequent litigation of claims that were raised or could have been raised. For claim preclusion, the Ninth Circuit requires an identity of claims, a final judgment on the merits and identity or privity between the parties.

In the case on appeal, the only issue was identity of claims. Among the four tests in the Ninth Circuit for identity of claims, the only question was whether the two suits arose from the same nucleus of facts.

More particularly in the Ninth Circuit, whether claims arose from the "same transactional nucleus of facts" turns on "'whether they are related to the same set of facts and *whether they could conveniently be tried together*.' *ProShipLine Inc. v. Aspen Infrastructures Ltd.*, 609 F.3d 960, 968 (9th Cir. 2010) (emphasis in original) (quoting *W. Sys., Inc. v. Ulloa*, 958 F.2d 864, 871 (9th Cir. 1992))."

While the Ninth Circuit had no authority regarding successive exemption claims, the Eighth Circuit had dealt with the question in *In re Ladd*, 450 F.3d 751 (8th Cir. 2006). There, the circuit reversed the lower courts for having ruled that claim preclusion barred a new exemption claim.

In *Ladd*, the Eighth Circuit noted that the debtor could not have raised a state exemption as an alternate theory to the federal exemption claim, because Schedule C does not allow pleading state and federal homestead exemptions in the alternative.

"We agree with *Ladd*," Judge Lefkow said, "that § 522(b)(1) and Schedule C prohibit raising state and federal homestead exemptions on a single schedule." She explained,

> Part 1 of Schedule C, which a debtor must use to claim exemptions, allows a debtor to claim *either* "state and federal nonbankruptcy exemptions" or "federal exemptions," but not both. [Emphasis in original.]

Judge Lefkow found "no claim preclusion here" given "the preclusion in bankruptcy of simultaneous state and federal claims of exemption." In other words, "the *availability* of a claim in an earlier proceeding is a necessary condition to claim preclusion." [Emphasis in original.]

In the case on appeal, Judge Lefkow said that "the federal claim could not have been tried with the Washington (or Arizona) claim, so no degree of similarity between the state and federal exemption statutes could result in claim preclusion."

The trustee contended that denial of the state exemption in a final order required claim preclusion. Judge Lefkow responded by saying that "a final judgment on the merits is only one element of claim preclusion."

Judge Lefkow said that her "determination is further supported by significant policy interests." She cited the House Report on Section 522 for saying that debtors are entitled to make full use of exemptions and that exemptions are to be interpreted liberally in favor of debtors. She also found "explicit support" in Bankruptcy Rule 1009(a), which allows a debtor to amend a schedule "at any time before the case is closed."

Reversing the district court for believing that claim preclusion barred the debtor from claiming federal exemptions, Judge Lefkow held "that, because the federal bankruptcy exemption could not have been raised or tried simultaneously with the exemption brought under Washington law, there is no identity of claims here and so no claim preclusion."

The Wildcard Exemption

The debtor claimed a federal homestead exemption for his RV, but Bankruptcy Judge Gan decided that the facts gave the debtor a valid wildcard exemption, even though the debtor never claimed a wildcard exemption for the RV. On appeal, the trustee argued it was error to grant an exemption that the debtor had not claimed.

Quoting the Ninth Circuit, Judge Lefkow said, "'we have the authority to identify and apply the correct legal standard, whether argued by the parties or not,'" and to consider as dispositive "'even an issue the parties fail to identify and brief.'" She therefore held that "[g]ranting the [wildcard] exemption . . . was an appropriate exercise of discretion."

Judge Lefkow nonetheless conceded that courts have declined to grant unclaimed exemptions *sua sponte*, but the matter before the bankruptcy court was a contested matter, not an adversary proceeding. In contested matters, she said, "bankruptcy courts have more discretion." Furthermore, Section 105(a) gives bankruptcy courts the right to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title."

Judge Lefkow decided that the failure to claim a wildcard exemption was "a technical pleading error, not a failure to make an entirely discrete claim." Therefore, the "bankruptcy court appropriately identified the wildcard exemption within the governing federal scheme."

Reversing the district court's judgment about claim preclusion and applicability of the wildcard exemption, Judge Lefkow remanded to the district court with instructions to vacate its decision and remand to the bankruptcy court for proceedings consistent with the opinion.

Note

On behalf of the National Consumer Bankruptcy Rights Center and National Association of Consumer Bankruptcy Attorneys, James J. Haller of Chicago submitted an *amicus* brief on behalf of the debtor.

The opinion is *Nance v. Warfield (In re Nance)*, 24-2745 (9th Cir. Oct. 14, 2025).

Plans & Confirmation

Once a chapter 13 plan is confirmed, a debtor in the Sixth Circuit may not surrender collateral and treat the deficiency as an unsecured claim.

Sixth Circuit Restricts Ability to Surrender Collateral and Modify a Chapter 13 Plan

Unlike the majority of courts, the Sixth Circuit doesn't permit a chapter 13 debtor to surrender collateral, modify a confirmed plan and classify the deficiency as an unsecured claim.

Bound by Sixth Circuit precedent, Bankruptcy Judge Nancy B. King of Nashville, Tenn., devised a partial workaround in her June 24 opinion. She allowed the debtors to surrender the car while paying the remainder of the secured claim without interest. In other words, surrendering the car after confirmation allowed the debtor to avoid paying interest, despite still being required to pay the depreciated value of the car in full.

The Old Car

The debtors filed a chapter 13 plan in 2023 and confirmed a plan. Their ten-year-old car had an agreed value of almost $14,000. The plan treated the car loan as fully secured with interest payable under the plan at 10.5%.

The debtors had acquired the car within 910 days of filing, precluding them from bifurcating the auto loan under the hanging paragraph following Section 1325(a)(9).

After confirmation, the car had mechanical problems, and the debtor had financial difficulties. The debtors moved to modify the confirmed plan by surrendering the car and paying the $10,000 remaining agreed value of the car, but without interest.

The lender objected, contending that the debtor must continue paying interest under authority of two Sixth Circuit decisions, *Chrysler Fin. Corp. v. Nolan (In re Nolan)*, 232 F.3d 528 (6th Cir. 2000), and *Ruskin v. DaimlerChrysler Servs. N. Am. (In re Adkins)*, 425 F.3d 296 (6th Cir. 2005).

Nolan and *Adkins*

Judge King quoted *Nolan* as holding that a chapter 13

> "debtor cannot modify a plan under section 1329(a) by: (1) surrendering the collateral to a creditor; (2) having the creditor sell the collateral and apply the

> proceeds toward the claim, and (3) having any deficiency *classified as an unsecured claim*." 232 F.3d 528, 535 (citation omitted) (emphasis added).

Judge King described the Sixth Circuit in *Nolan* as having focused "on debtors manipulating the system by using the collateral post-confirmation until all the value has been wrung out of it, then surrendering the collateral and modifying the plan to reduce the payment to the secured creditor."

Judge King went on to say that the circuit in *Adkins* "doubled down on the holding in *Nolan*" by "extend[ing] the holding to include not just voluntary surrender, but also the more prevalent circumstance of debtors seeking to modify the treatment of a secured creditor who has obtained relief from the automatic stay and foreclosed."

"The majority of courts outside the Sixth Circuit have found *Nolan* and *Adkins* unduly restrictive," Judge King said. She quoted Bankruptcy Judges David D. Cleary and William R. Sawyer as having said that the decisions were "simply wrong." She quoted Judge Sawyer as saying that "the Sixth Circuit erected several artificial restrictions on post confirmation plan modification." *In re Scarver*, 555 B.R. 822, 833-834 (M.D. Ala. 2016).

Judge King described the "two main criticisms of *Nolan* and *Adkins*" as follows:

> (1) The Sixth Circuit's interpretation of 11 U.S.C. § 1329 is unnecessarily narrow and/or restrictive, and (2) *Nolan* and *Adkins* do not leave room for reconsideration of a claim under 11 U.S.C. § 502(j).

Quoting *In re Disney*, 386 B.R. 292, 304 (Bankr. D. Colo. 2008), Judge King said, "Most courts . . . point out that when 11 U.S.C. § 1329(a) 'is read in context with claim reconsideration under § 502(j), it is apparent that § 1329(a) permits modifications to be made to a plan that reflect the reality of changed circumstances.'"

The Partial Workaround

Judge King said she was bound by Sixth Circuit precedent unless there "is a legitimate distinguishable basis to rule otherwise."

Distinguishing the case before her, Judge King said that "the Debtors are not seeking to 'reclassify' [the lender's] claim, not seeking to foist depreciated collateral values on [the lender], and not seeking to discharge the balance owed to [the lender]."

Instead, Judge King said that the debtors were "proposing to pay [the lender] **the value of the claim determined at confirmation**, albeit without additional post-surrender interest." [Emphasis

in original.] As a result, she said that the lender "bears no greater risk than any other Chapter 13 creditor who no longer has collateral to protect its claim."

Consequently, Judge King said that the "concerns of *Nolan* and *Adkins* are not present under the facts of this case."

Judge King found a "meaningful distinction." Where *Nolan* focused on preventing a debtor from thrusting the economic burden on the lender, she said, "That policy concern does not arise when the debtor is paying the value of the claim as determined at confirmation, albeit without further interest." She went on to say that "modification to surrender collateral is expressly authorized in 11 U.S.C. § 1329(a)(1) and (3)" and "nothing in *Nolan* nor *Adkins* holds to the contrary."

Distinguishing the two circuit decisions, Judge King said that the "Debtors are not attempting to reclassify but are instead seeking only to modify the amount of the payment to take into account the surrender and sale of the collateral" and "are still paying the secured creditor the full value of its allowed claim as was set at confirmation, but without post-surrender interest."

Judge King held that the proposed plan modification "fits squarely within 11 U.S.C. § 1329 and within the boundaries of what is permissible in the Sixth Circuit under *Nolan* and *Adkins*." She overruled the objection and granted the motion to modify the plan.

Observations

A direct appeal would give the Sixth Circuit an opportunity to sit *en banc* and consider aligning the circuit's authority with the majority of courts.

A decision by former Bankruptcy Judge Keith M. Lundin contrary to *Nolan* and *Adkins* is cited in Judge King's decision. She also quotes and cites Judge Ludin's treatise, LundinOnChapter13.com.

Judge Lundin provided the following commentary to ABI:

> If Judge King's decision goes up, it would offer the Sixth Circuit an opportunity to create a small space for chapter 13 debtors around its (mistaken) decisions in *Nolan* and *Adkins.* More than two decades of contrary decisions from other courts amply demonstrates that *Nolan* was misguided. As much as I wish for *en banc* correction of *Nolan*, *Adkins* signals that the Sixth Circuit will stubbornly stick to its lonesome path.

The opinion is *In re Bain*, 23-03205 (Bankr. M.D. Tenn. June 24, 2025).

When a home mortgage matures during the term of a chapter 13 plan, the debtor may bifurcate and cram down the secured claim, the Ninth Circuit holds.

Four Circuits Align: Section 1322(c)(2) Permits Bifurcating a Short-Term Mortgage

Avoiding a split of circuits, the Ninth Circuit affirmed the Bankruptcy Appellate Panel by holding that the exception in Section 1322(c)(2) permits a chapter 13 debtor to bifurcate a home mortgage that matures before the end of the plan.

Adopting the BAP analysis by Bankruptcy Judge Robert J. Faris, the opinion by Circuit Judge William A. Fletcher rejected the idea that the exception only permits modifying the payment, not the claim.

Judge Fletcher's May 22 opinion also upheld the BAP's decision that the court's valuation of collateral after filing can be used in deciding whether the debtor has too much unsecured debt for chapter 13 and that the court is not required to use the valuation contained in the debtor's schedules at filing.

Valuation of the Home

On filing, the chapter 13 debtors scheduled their home with a value of just over $1 million, subject to first and second mortgages totaling about $1.4 million. By itself, the deficiency on the second mortgage meant that the debtors had $400,000 in unsecured debt.

Taking other unsecured debts into consideration, the debtors had more than about $420,000 in unsecured debt, the maximum at the time under Section 109(e) for eligibility in chapter 13. However, the holder of the second mortgage evidently didn't realize that the debtors were over the debt limit.

At the debtors' behest, the bankruptcy court held a valuation trial and decided that the home was actually worth $1,225,000 as of the filing date. The new valuation meant that the debtors had less than $420,000 in total unsecured debt, because the higher valuation reduced the unsecured portion of the junior lender's claim.

Based on the higher valuation of the home and the second mortgage maturing before the end of the five-year plan, the debtors filed an amended plan to bifurcate the secured claim of the junior

lender into a secured claim and an unsecured claim. The amended plan called for paying the secured portion in full over the life of the plan. The unsecured portion would be discharged.

The junior lender objected to confirmation, asking for dismissal by contending that the debtors should be stuck with the lower valuation of the home contained in the debtors' original schedules. The lender also objected to confirmation by arguing that the exception in Section 1322(c)(2) only allows modifying the payment, not the claim itself.

Bankruptcy Judge Mark Houle overruled the objections and confirmed the plan. The BAP affirmed. *Mission Hen LLC v. Lee (In re Lee)*, 655 B.R. 340 (B.A.P. 9th Cir. Nov. 13, 2023). To read ABI's report on the BAP opinion, click here. The junior lender appealed to the circuit.

Chapter 13 Eligibility

On the merits, Circuit Judge Fletcher began with eligibility and cited the Ninth Circuit's own precedent for the proposition that "eligibility should normally be determined by the debtor's originally filed schedules, checking only to see if the schedules were made in good faith." *Scovis v. Henrichsen (In re Scovis)*, 249 F.3d 975, 982 (9th Cir. 2001).

The case was not normal, he said, because the lender had not objected to eligibility until after the bankruptcy court had given the home a higher value and thereby reduced the amount of the debtors' unsecured debt. It "makes sense," he said, "to use the court's valuation as the basis for an eligibility determination under § 109(e)."

Upholding the BAP's affirmance on the question of eligibility, Judge Fletcher said,

> We conclude in the circumstances of this case that strict adherence to the generally applicable *Scovis* rule would result in an inaccurate valuation of the Property and undermine the goals of Chapter 13.

Antimodification and Section 1322(c)(2)

The debtors' ability to bifurcate and cram down the junior mortgage was seemingly precluded by Section 1322(b)(2), which does not permit modifying "a claim secured only by a security interest in real property that is the debtor's principal residence . . . ." Following *Nobelman* in 1993, where the Supreme Court held that Section 1322(b)(2) would not permit bifurcation, Congress adopted Section 1322(c)(2) a year later.

When the last payment on a home mortgage is due before the last payment under the plan, Section 1322(c)(2) allows the plan to "provide for the payment of the claim as modified."

The junior lender argued once more in the circuit that Section 1322(b)(2) only permitted modification of the payment but does not allow bifurcation and stripping down the secured claim.

Judge Fletcher said that the BAP was "in good company," because three circuits and courts "across the country" have "held that § 1322(c)(2) permits bifurcation of a short-term claim like [the junior lender's]." Among others, he cited *Hurlburt v. Black*, 925 F.3d 154 (4th Cir. 2019) (*en banc*). To read ABI's report, click here. [Note: There had been a split of circuits until the Fourth Circuit sat *en banc* and reversed the circuit's prior holding.]

Judge Fletcher found two reasons in the language of the statute that indicate permission for bifurcation. First, the prefatory clause in Section 1322(c)(2), "Notwithstanding subsection (b)(2)," "indicates that the provision is an exception to § 1322(b)(2)," he said.

Second, Judge Fletcher said, "§ 1322(c)(2) specifies that 'the plan may provide for the payment of the claim as modified pursuant to section 1325(a)(5) of this title.'" Citing *Hurlburt*, he said that the "reference to § 1325(a)(5) makes clear that § 1322(c)(2) was intended to allow debtors to bifurcate and cram down such claims that are to be paid off before the final payment of the plan is due."

Judge Fletcher affirmed the BAP's decision affirming confirmation of the chapter 13 plan.

The opinion is *Mission Hen LLC v. Lee*, 23-4220 (9th Cir. May 22, 2025).

A 2/1 decision required chapter 13 debtors to accelerate repayment of nondischargeable student loans.

Fifth Circuit: Repayment of Unsecured Term Loan Sometimes Must Be Accelerated in '13'

In a split decision, the majority on the Fifth Circuit panel are requiring chapter 13 debtors to accelerate the repayment of nondischargeable student loans when there is available disposable income. As Circuit Judge Priscilla Richman said in her dissent, the majority sided with the chapter 13 trustee by requiring "repayment of long-term, non-dischargeable student loan debt . . . before it is due in order for the debtors' respective bankruptcy plans to be confirmed."

When unsecured claims can be paid in full, the opinion appears to mean that chapter 13 debtors in the Fifth Circuit must accelerate repayment of unsecured terms loans if there is available disposable income.

For better cash flow, could a chapter 13 debtor avoid the result required in the Fifth Circuit by reaffirming an unsecured term loan?

Disposable Income Enough to Pay Unsecured Claims in Full

The appeal involved two chapter 13 debtors. Both were above median income with five-year plans, and both had nondischargeable student loans. For one debtor, the student loan was "in deferment." The student loan for the other was "in forbearance."

The debtors' disposable income evidently was sufficient to pay the student loans and other unsecured debt in full over the terms of the plans. However, the plans only provided for full payment of other unsecured claims. As Judge Richman said in her dissent, the student loans would "be fully repaid under the terms of the loans, with interest," after completion of plan payments.

Writing for the majority, Circuit Judge Irma Carillo Ramirez characterized the chapter 13 trustee as having objected to confirmation because the two plans did *not* commit to paying all unsecured claims in full over the course of the plans, "even though Debtors were projected to earn enough disposable income during the applicable commitment period to pay all allowed, unsecured claims."

Taking sides with the debtors and overruling the trustee's objections, the bankruptcy judge confirmed the plans. "[A]lthough Debtors' student-loan obligations would not be paid in full during the Plans," the bankruptcy judge reasoned, "§ 1325(b)(1)(A) was nevertheless satisfied

because those obligations would be paid in full 'according to their contractual terms as permitted under § 1322(b)(5).'"

After the district court affirmed, the chapter 13 trustee appealed to the circuit.

The Statutes

For herself and Circuit Judge Andrew S. Oldman, Judge Ramirez said that chapter 13 gives debtors "a significant amount of flexibility" in their plans, quoting circuit authority. However, the outcome of the appeal turned on the interrelationship between Section 1325(b)(1)(A)-(B) and Section 1322(b)(5).

"If the trustee or the holder of an allowed unsecured claim objects to the confirmation of the plan," Section 1325(b)(1) provides that

> the court may not approve the plan unless, as of the effective date of the plan — (A) the value of the property to be distributed under the plan on account of such claim is not less than the amount of such claim; or (B) the plan provides that all of the debtor's projected disposable income to be received in the applicable commitment period beginning on the date that the first payment is due under the plan will be applied to make payments to unsecured creditors under the plan.

Although the plan was not devoting all disposable income to the payment of unsecured claims, the debtors contended they were entitled to confirmation by Section 1322(b)(5), which provides for "the curing of any default within a reasonable time and maintenance of payments while the case is pending on any unsecured claim or secured claim on which the last payment is due after the date on which the final payment under the plan is due."

Judge Ramirez quoted the *Collier* treatise for saying that "'the plan may not be confirmed unless the debtor proposes to pay into the plan all of the debtor's "disposable income" for a specified period or until all allowed unsecured claims are paid in full, whichever is earlier.'" When all disposable income is not devoted to unsecured creditors, she went on to paraphrase *Collier* for saying "that the trustee's § 1325(b)(1) objection may be overcome if the debtor proposes to pay the full value of the allowed, unsecured claims 'under the plan.'"

In both cases, the debtors were neither paying all unsecured claims in full nor were they using all of their disposable income. The question then became whether Section 1322(b)(5) was a safety valve allowing confirmation.

For Judge Ramirez, the question turned on the meaning of "under the plan," as used in both statutes. "In isolation," she said that the debtors' and the trustee's interpretations were both "reasonable."

‘13’ Means Paying as Much as You Can

Judge Ramirez found the answer in “Chapter 13’s statutory scheme.”

“On more than one occasion,” Judge Ramirez said that the “Supreme Court has made clear that ‘under the plan’ in § 1325(a)(5)(B)(ii) means the debtor must finish paying off the value of the allowed, secured claim by the end of the plan.” Citing the Fifth Circuit, she said that “provisions of Chapter 13 containing ‘under the plan’ show that the phrase means during the life of the plan.”

In terms of policy and quoting the House Report on the amendments that gave rise to chapter 13 as we know it today, Judge Ramirez said that “BAPCPA sought ‘to ensure that debtors repay creditors the maximum they can afford.’” “Section 1325(b) operates harmoniously with this purpose,” she said.

“Given that § 1325(b)(1)(A)’s use of the phrase ‘under the plan’ means by the end date of a Chapter 13 plan,” Judge Ramirez held that “the statute requires Debtors to pay in full all allowed, unsecured claims — including their student-loan obligations — within the life of the Plans.”

‘Shall’ in 1325(b) Beats Out ‘May’ in 1233(b)(5)

Judge Ramirez devoted the remainder of her opinion to rebutting the debtors’ arguments, beginning with the debtors’ idea that the payments on student loans were “under the plans” given that they were “provided for” in the plans. Because the debtors would not be entitled to discharges until having completed all payments under the plans, she said that the debtors’ contention would not allow them to have discharges until many years down the road when the student loans were paid in full, long beyond the five-year limit on chapter 13 plans.

While Section 1322(b)(5) says that the “plan may” cure and continue payments on a debt that finally comes due after the plan is over, Judge Ramirez noted that Section 1325(b) uses the word “shall.” She would not allow “a permissive provision [in § 1322(b)(5) to] trump[] a mandatory one [in § 1325(b)], which runs counter to ordinary meaning and standard interpretive practices.”

Judge Ramirez explained when debtors could employ Section 1322(b)(5): “Debtors may treat their student-loan obligations under § 1322(b)(5) as long as they are contributing 100% of their disposable income to paying off all allowed, unsecured claims (including the student loans).” In other words, a debtor may repay a student loan at the contract or deferral rate only when all disposable income is going to creditors.

Finding that the text in Section 1325(b)(1)(A) was “plain and unambiguous,” Judge Ramierz vacated the confirmation order while allowing the “Debtors to file new plans consistent with this decision.”

The Dissent

Judge Richman "respectfully" dissented, summarizing the facts as follows:

> The plans provide that all unsecured debt other than the student loans will be repaid in full during the sixty-month duration of the bankruptcy plan. The student loans, however, will be fully repaid under the terms of the loans, with interest, beyond that sixty-month period and will be paid directly to the creditors. Each of the debtors has disposable income, after allowing for one hundred-percent payment of debts during the term of the plan, that could be used to repay the full amounts of the student loans during the sixty-month duration of the plan if that debt is accelerated.

The majority's decision, Judge Richman said, meant that the "repayment of long-term, non-dischargeable student loan debt [would] be accelerated and repaid years before it is due in order for the debtors' respective bankruptcy plans to be confirmed."

Judge Richman disagreed about the interpretation of "under the plan." She said,

> The term "under the plan" as used in § 1325(b)(1)(A) is not limited to during the plan. The concept of during the plan is encompassed within, but not as broad as, "under" the plan. In other words, non-dischargeable debts can be provided for "under the plan" even though they will not be repaid during the plan.

Judge Richman went on to say that "§ 1322(b)(5) aids in understanding that bankruptcy plans may recognize that certain long-term debts are not discharged and will be repaid long after other debts are repaid and discharged under 'the plan.'" Although the wording "is admittedly clumsy," she read it to mean that "a 'plan' may recognize that a future payment or payments will continue to be due under long-term, non-dischargeable loans 'after the date on which the final payment under the plan is due.'"

Judge Richman disagreed with the majority's understanding that the debtors would not be entitled to discharges until paying the student loans in full, years after completion of the five-year plan. She explained:

> Under 11 U.S.C. § 1328(a)(1), "as soon as practicable after completion by the debtor of all payments under the plan," the court "shall grant the debtor a discharge of all debts provided for by the plan . . . except any debt . . . provided for under section 1322(b)(5)."

Judge Richman ended her opinion by taking sides with the First Circuit Bankruptcy Appellate Panel's decision in *In re Nieves*, 647 B.R. 809 (B.A.P. 1st Cir. 2023). She read the BAP as holding that "§ 1322(b)(5) permits a plan to maintain contractual payments for the remaining term of the debt even though the final payment of the debt is to be paid after the three- or five-year term of a plan." She read the BAP as saying that "the intent of Congress was clear and that requiring long-term contracts to be accelerated to be paid within a three- to five-year plan limitation would scuttle protections Congress intended to provide to homeowners and other borrowers under long-term contracts."

The opinion is *Bassel v. Durand-Day (In re Durand-Day)*, 23-10956 (5th Cir. April 21, 2025).

Bankruptcy Judge Michelle Harner decided that a mortgage servicer must allow a chapter 13 debtor's continued use of an online payment platform.

Barring Use of an Online Payment Platform Was an Automatic Stay Violation

Bankruptcy Judge Michelle M. Harner of Baltimore decided that a mortgage servicer who barred the chapter 13 debtor from using the servicer's online payment platform had violated the automatic stay *ab initio*.

For the stay violation, Judge Harner imposed no monetary damages under Section 362(k), because the debtor had sought none.

In her October 30 opinion, Judge Harner conjectured whether "the system might benefit from a *per se* rule that mandates" use of online payment portals, but she said that "any such change must be implemented by Congress or an appropriate regulatory agency."

Online Mortgage Payments

The debtor confirmed her chapter 13 plan. Before bankruptcy, the debtor had been using the servicer's online platform to pay her mortgage. Under the plan, the debtor was paying mortgage arrears through the trustee but was paying the servicer directly for postpetition obligations.

After bankruptcy, the servicer barred the debtor from using the online payment platform, claiming that it was a convenience, not a right.

In testimony, a witness for the servicer said it was "policy" to prevent debtors from using the platform because it was "impossible" for the platform to be used by debtors and nondebtors. Perhaps the servicer was concerned that communications sent automatically by the platform might violate the automatic stay.

The debtor filed a motion to hold the servicer in contempt of the automatic stay. The debtor testified that the servicer had no office nearby, that she no longer had a car and that payments by telephone often took hours, because some customer service representatives believed she could not make payments since she was bankrupt. She also testified that mail was unreliable.

The difficulties occasioned by the loss of the platform caused the debtor to default on the mortgage. The servicer moved for a modification of the automatic stay, but the dispute was resolved by stipulation.

There was a separate agreement between the servicer and the debtor governing use of the online payment platform. The agreement said that the servicer could terminate the customer's use of the platform for violation of any agreement with the servicer or the lender. The agreement also allowed the servicer to terminate a customer's use of the platform "without notice."

Judge Harner said that barring use of the online platform made "it more difficult and time-consuming for the debtor to make her payments and removes a commonly used payment method from the debtor's toolkit."

Estate Property?

Judge Harner marched through several steps to decide whether taking away the payment platform violated the automatic stay. She began with Section 362(a)(3), which provides that the filing of the petition gives effect to an automatic stay 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*." [Emphasis added.]

Before delving into whether there was a stay violation, Judge Harner was obliged to decide whether removal of the platform was done to "exercise control over property of the estate." In other words, was use of the platform an estate asset, given the broad definition of estate property in Section 541(a)(1)?

"It is a well-established principle," Judge Harner said, "that a debtor's prepetition agreements (as well as her rights under those agreements) generally become property of the bankruptcy estate under section 541 of the Code." Citing Section 541(c), she went on to say, "Those interests became property of the estate notwithstanding any provision in the agreement 'that is conditioned on the insolvency or financial condition of the debtor, on the commencement of a case under this title.'"

Even if use of the portal were seen as a property interest of the servicer or a privilege, Judge Harner said, "Many courts have recognized such a contractual right to use as property of the bankruptcy estate under section 541(a) of the Code." Based on the evidence, she concluded that "the Debtor had a prepetition contractual right to use the online portal" and that the "Debtor's right to use the online portal and her interests in the Online Access Agreement came into the bankruptcy estate."

The Stay Was Violated

Having established that there was deprivation of the use of estate property, Judge Harner turned to the question of whether the servicer had violated Section 362(a)(3). She quoted the Supreme Court for having recently said that "§ 362(a)(3) halts any affirmative acts that would alter the *status quo* [of estate property] as of the time of the filing of a bankruptcy petition." *City of Chicago, Illinois v. Fulton*, 592 U.S. 154, 158 (2021).

Having concluded from the facts that the servicer had altered the *status quo*, Judge Harner next raised the question of whether the servicer's action was an "exercise of control." She decided that the action was "akin to a contract termination, which did in fact remove the value of the contract from the bankruptcy estate."

Although every breach of contract is not a stay violation, Judge Harner found "more than a mere breach." The action, she said, "effectively terminated the operative purpose of the Online Access Agreement; it was 'tantamount to a termination.'" She therefore held that the servicer had "changed the status quo and [that the violation of] the automatic stay is void *ab initio*."

Relief and Damages

In her motion, the debtor sought only injunctive relief, not monetary damages under Section 362(k). Furthermore, the record had no "discernable monetary damages to the Debtor," Judge Harner said. In addition, she said that the debtor had not "establish[ed] that she was foreclosed from making her monthly mortgage payments, including through an ACH (Automated Clearing House) or other electronic transfer from her primary bank account to the Servicer."

On the record, Judge Harner said that she could not make a finding of monetary damages under Section 362(k). However, she did "not foreclose the possibility that in a matter with a different factual record, an award of monetary damages under section 362(k), if requested, might be warranted." Furthermore, the debtor's failure "to establish monetary damages under section 362(k) of the Code does not excuse the Servicer's violation of the stay."

"The primary way to abate this violation," Judge Harner said, "is for the Servicer to restore the *status quo* and the Debtor's rights under the Online Access Agreement." On the record, though, she could not "determine whether any such remedy is appropriate or warranted." Therefore, Judge Harner called for more briefing and another hearing.

Judge Harner found herself unable to "address the underlying policy issue, namely whether and when borrowers in financial distress should lose access to online accounts and portals that they have become accustomed to using."

"To the extent that electronic payment methods (such as the online portal) facilitate greater access to credit or success in bankruptcy," Judge Harner said, "the system might benefit from a

per se rule that mandates such access. But any such change must be implemented by Congress or an appropriate regulatory agency."

The opinion is *Klemkowski v. CitiMortgage Inc. (In re Klemkowski)*, 22-10257 (Bankr. D. Md. Oct. 30, 2024).

District court equates distribution to creditors in chapter 13 to substantial consummation of a chapter 11 plan.

Debtor's Appeal from Chapter 13 Plan Confirmation Held Equitably Moot

A district judge in Virginia held that a *debtor's* appeal from an order confirming the debtor's chapter 13 plan was equitably moot.

In his December 11 opinion, District Judge Michael S. Nachmanoff of Alexandria, Va., said that the debtor should have sought or obtained a stay pending appeal to prevent the debtor's appeal from becoming equitably moot after the chapter 13 trustee began making distributions. The judge evidently believed that the commencement of distributions in chapter 13 is equivalent to substantial consummation of a chapter 11 plan.

The chapter 13 debtor's original plan called for $7,200 in payments over the three-year life of the plan. Judge Nachmanoff said that the bankruptcy court held a hearing and denied confirmation of the first plan based on the debtor's "failure to meet his burden of proof on the liquidation and good faith tests."

Over the debtor's objection, the bankruptcy court eventually confirmed the debtor's third amended plan, which would pay $20,550 over three years. The debtor appealed confirmation of the third amended plan, but Judge Nachmanoff dismissed the appeal as equitably moot.

Equitable Mootness

Quoting a Fourth Circuit decision from 2017, Judge Nachmanoff said,

> "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." *In re Bate Land & Timber LLC*, 877 F.3d 188, 195 (4th Cir. 2017) (internal quotations and citation omitted).

Citing an earlier decision from the Fourth Circuit, Judge Nachmanoff said that equitable mootness is "often invoked" in bankruptcy cases "because it may become 'impractical and imprudent to upset the plan of reorganization at [a] late[r] date.' *Mac Panel Co. v. Virginia Panel Corp.*, 283 F.3d 622, 625 (4th Cir. 2002)."

A prudential doctrine not based on Article III's requirement of a case or controversy, equitable mootness kills an appeal when (1) the appellant neither sought nor obtained a stay pending appeal; (2) the plan has been substantially consummated; (3) reversal would affect the success of the plan; and (4) third parties would be affected, Judge Nachmanoff said.

Judge Nachmanoff said that "all four factors weigh in favor of finding the appeal equitably moot." The debtor did not seek a stay pending appeal, and the plan had been substantially consummated.

"[U]ndoubtedly," Judge Nachmanoff said, reversal would "in effect nullify that plan . . . . under which claimants have already received payments." He therefore concluded that the interests of creditors "would be substantially affected."

Denying the appeal as equitably moot, Judge Nachmanoff quoted a district judge in Maryland who said in a chapter 11 case, "'It would be inequitable for this Court … to disgorge third parties of funds already dispersed to them in accordance with the Confirmed Plan.'" *Clark v. Council of Unit Owners of 100 Harborview Drive Condo.*, 2019 WL 4673434 at *6 (D. Md. Sept. 25, 2019).

Observations

The decision seems to mean that the commencement of payments in a three- or five-year chapter 13 plan can extinguish an appeal. Presumably, an appeal from a chapter 13 confirmation order would also be equitably moot were a creditor appealing.

In the case on appeal, the debtor would be continuing to make payments for another 18 months. Were there a reversal, the debtor could stop making payments or make payments in a lower amount without seeking disgorgement from creditors. Equitable mootness should not enable creditors to receive more than they would be paid under a properly confirmed plan, at least when reversal would not entail disgorgement.

The decision is an uncomfortable fit with *Bullard v. Blue Hills Bank*, 575 U.S. 496 (2015), where the Supreme Court held that denial of confirmation of a chapter 13 plan is not a final order subject to appeal. The unanimous opinion by Chief Justice John J. Roberts, Jr., said that a debtor, like the one in the case before Judge Nachmanoff, has two options: "to seek or accept dismissal of his case and then appeal, or to propose an amended plan and appeal its confirmation." *Id*. at 507.

For the debtor before Judge Nachmanoff, dismissal was not an option, because the debtor would lose protection from the automatic stay.

When neither the debtor nor creditors would be adversely affected by the pendency of an appeal, it is unclear why seeking a stay pending appeal should be required. Indeed, it is unclear whether a bankruptcy court would even grant a stay. If there were a stay, the bankruptcy court

likely would require the debtor to continue making payments at the rate specified in the confirmed plan, while directing the trustee to withhold distributions from creditors.

A stay pending appeal would neither benefit nor harm either the debtor or the creditors. With a stay having no practical value, it is unclear why a stay or an application for a stay should be required to maintain the vitality of an appeal.

And what if the court were to deny a stay pending appeal? Would the appeal become equitably moot, with the effect of never allowing a debtor or creditors to challenge a possibly defective confirmation order?

As the primary indicia of equitable mootness, substantial consummation of a chapter 11 plan and the commencement of distributions to creditors in chapter 13 are fundamentally inapposite. In chapter 11, most or all of the transactions take place on the effective date. In chapter 13, payments continue for three to five years, and the debtor does not receive a discharge until payments are completed.

The opinions are those of the writer, not ABI.

The opinion is *Cook v. Chapter 13 Trustee*, 24-00288 (E.D. Va. Dec. 11, 2024).

Compensation

The debtors' inequitable conduct didn't relieve counsel of the duty to disclose fees charged for post-petition litigation.

Debtors' Lawyer Has No 7th Amendment Right to Sue for Post-Petition Fees, Circuit Says

Holding that a debtor's lawyer has no Seventh Amendment right for a jury to decide what the debtor owes for fees in connection with a chapter 7 case, the Third Circuit upheld bankruptcy courts' power under Section 329 to rule on the adequacy of disclosures and determine the amount of compensation paid to attorneys by chapter 7 debtors for post-petition services.

The April 24 opinion by Circuit Judge Cheryl Ann Krause permits no exception to the rule that lawyers must disclose what they are charging chapter 7 debtors. She reversed the district court and reinstated the judgment issued by Bankruptcy Judge Jerrold N. Poslusny, Jr.

Judge Krause was also the author of a Third Circuit decision just six day earlier where she held that Section 107 "displaces" common law and more broadly protects trade secrets and confidential information than does common law. *Mesabi Metallics Co. LLC v. Cleveland-Cliffs Inc. (In re ESML Holdings Inc.)*, 23-2954 (3d Cir. April 16, 2025). Before Judge Krause's appointment to the Third Circuit in 2014, she had clerked for both the Ninth Circuit and the Supreme Court. To read ABI's report on *Mesabi*, click here.

Big Fees

The decision shows how hard cases sometimes make good law. Given what Judge Krause called their "misconduct," the debtors were not a sympathetic lot, as the facts reveal.

A couple hired a law firm to file a chapter 7 case that the debtors said "would be a simple, no-asset bankruptcy" in New Jersey. It "was anything but," Judge Krause said.

To file the petition, the debtors paid the firm a $3,500 prepetition retainer. In the disclosure on Official Form 2030, the firm said that the retainer covered "all aspects of the bankruptcy case," including adversary proceedings and contested matters.

Judge Krause characterized the firm as saying that "the Debtors 'withheld and concealed information regarding the existence and/or value of their assets,' requiring it to 'conduct[] its own extensive valuation analysis of the [debtors'] properties several times, correct[] the [debtors'] bankruptcy schedules and other submissions several times, and defend[] the [debtors] in litigation' in the Bankruptcy Court."

Given the extra work, the firm had billed the debtors $151,000 over the first 16 months after filing. The debtor and the firm cut a deal where the firm reduced the fee to $113,000. The debtors agreed to pay $100,000 from the impending sale of a home. The firm did not amend the Form 2030 filing, nor did they file a new one to disclose the billings and promised payments.

As it turned out, the couple sold the home but paid the firm nothing. “Instead,” Judge Krause said, “they kept the money and used it to purchase a new home.” The firm withdrew as counsel and sued the debtors in federal district court in Pennsylvania, requesting a jury trial.

After failing to transfer venue of the Pennsylvania case to New Jersey, the debtors “moved in the Bankruptcy Court in New Jersey for an examination of the reasonableness of [the firm’s] fees under § 329(a) and Bankruptcy Rule 2016(b),” Judge Krause said. The firm responded by claiming to have a Seventh Amendment right to a jury trial in Pennsylvania. According to Judge Krause, the firm argued that it “did not violate § 329(a) or Bankruptcy Rule 2016(b) because it was not required to disclose post-petition legal services, and it was [the firm’s] attorneys’ practice not to do so.”

Bankruptcy Judge Poslusny of Camden, N.J., sided with the debtors and ruled that the firm had violated Section 329(a) and Rule 2016(b) by failing to disclose the agreement to pay $113,000 in fees. He ordered the firm to disgorge whatever it had been paid and barred the firm from collecting for any other work in connection with the case. *In re Aquilino*, 20-15628, 2023 WL 2191494, at *7 (Bankr. D.N.J. Feb. 23, 2023).

The firm appealed. Reversing, the district court in New Jersey decided that the firm had the right to a jury trial because it never filed a proof of claim. *In re Aquilino*, 660 B.R. 197, 205–06 (D.N.J. 2024). To read ABI’s report on the district court opinion, click here.

The debtor appealed to the circuit. The Executive Office for the U.S. Trustee and the U.S. Trustee filed an *amicus* brief contending there was no right to a jury trial and that the bankruptcy court was empowered to enforce Section 329.

The Statute and the Rule

“Given the need for transparency in bankruptcy cases,” Judge Krause said,

> [t]he Code requires attorneys who represent debtors to “file with the court a statement of the compensation paid or agreed to be paid, if such payment or agreement was made after one year before the date of the filing of the petition, for services rendered or to be rendered in contemplation of or in connection with the case by such attorney.” 11 U.S.C. § 329(a).

She added,

> Federal Rule of Bankruptcy Procedure 2016(b) makes this disclosure obligation "a continuing one," *In re Stewart*, 970 F.3d 1255, 1258 (10th Cir. 2020), by requiring attorneys to supplement their statements "within 14 days after any payment or agreement not previously disclosed." Fed. R. Bankr. P. 2016(b).

The two provisions yield a "plain and simple rule," Judge Krause said, quoting the Seventh Circuit:

> "[A]ttorneys must inform the bankruptcy court of their compensation and promptly update the filing if their fees change." *In re Dordevic*, 62 F.4th 340, 342 (7th Cir. 2023).

Seventh Amendment and Jurisdiction

Contrary to the firm's argument, Judge Krause had "little difficulty" deciding that the bankruptcy court had jurisdiction. She held that the dispute "arose under" the Bankruptcy Code because it was a remedy expressly provided by the Code.

Judge Krause added that "the Bankruptcy Code provides both the right and remedy, and proceedings initiated under § 329(a) therefore fall within § 157(b)(2)'s non-exclusive list of 'core' proceedings."

Having found core jurisdiction, Judge Krause turned to the question of whether the firm had a Seventh Amendment right to a jury trial. Of course, she said, "That right only attaches to claims that are 'legal in nature,' not ones that are equitable. *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 53 (1989)."

When the claim is both legal and equitable, Judge Krause cited *SEC v. Jarkesy*, 603 U.S. 109, 123 (2024), where the Supreme Court said that the remedy is the more important consideration. To read ABI's report, click here. Again citing *Jarkesy*, she said there is no jury trial right when the remedy is solely to restore the *status quo*. *Id*.

From *Jarkesy*, Judge Krause held that "violations of § 329(a) give rise to equitable remedies, not legal ones." Citing the Second, Fifth and Ninth Circuits, she went on to hold that "permissible sanctions for violations of § 329(a) include disgorgement of collected fees and cancellation of fee agreements for bankruptcy-related services."

Having found "a § 329(a) proceeding and a claim that is equitable," Judge Krause ruled that "the District Court erred by concluding that [the firm's] right to a jury trial in the Collection Action extended to the § 329(a) proceeding in the Bankruptcy Court."

The Equities

For several reasons, Judge Krause decided that the equities did not favor the firm. First, she said that the firm violated Section 329(a) and Rule 2016(b) "at a minimum because it was required to, and did not, disclose the Letter Agreement," where the debtors agreed to pay $113,000. Even if the firm's original Form 2030 were compliant, she said that the firm's "subsequent failure to update [the] statement and disclose the Letter Agreement unequivocally violated its disclosure obligation."

Similarly, Judge Krause decided that the bankruptcy court had not abused its discretion. Citing four circuits, she said, "Courts of Appeals that have addressed the issue have regularly held that full disgorgement and cancellation of fee agreements can be an appropriate sanction for violating the Code's disclosure requirements."

Because "the Bankruptcy Court was aware of and considered the Debtors' misconduct that necessitated" the firm's extensive services after filing, Judge Krause found no abuse of discretion, because the bankruptcy court had "considered all relevant factors, including the balance of equities."

Even though it was "a fortuitous result for the Debtors," Judge Krause "reverse[d] the District Court's judgment and . . . reinstate[d] that of the Bankruptcy Court."

The opinion is *In re Aquilino*, 24-1781 (3d Cir. April 24, 2025).**s**

Holding that a debtor's lawyer has no Seventh Amendment right for a jury to decide what the debtor owes for fees in connection with a chapter 7 case, the Third Circuit upheld bankruptcy courts' power under Section 329 to rule on the adequacy of disclosures and determine the amount of compensation paid to attorneys by chapter 7 debtors for post-petition services.

The April 24 opinion by Circuit Judge Cheryl Ann Krause permits no exception to the rule that lawyers must disclose what they are charging chapter 7 debtors. She reversed the district court and reinstated the judgment issued by Bankruptcy Judge Jerrold N. Poslusny, Jr.

Judge Krause was also the author of a Third Circuit decision just six day earlier where she held that Section 107 "displaces" common law and more broadly protects trade secrets and confidential information than does common law. *Mesabi Metallics Co. LLC v. Cleveland-Cliffs Inc. (In re ESML Holdings Inc.)*, 23-2954 (3d Cir. April 16, 2025). Before Judge Krause's appointment to the Third Circuit in 2014, she had clerked for both the Ninth Circuit and the Supreme Court. To read ABI's report on *Mesabi*, click here.

Big Fees

The decision shows how hard cases sometimes make good law. Given what Judge Krause called their "misconduct," the debtors were not a sympathetic lot, as the facts reveal.

A couple hired a law firm to file a chapter 7 case that the debtors said "would be a simple, no-asset bankruptcy" in New Jersey. It "was anything but," Judge Krause said.

To file the petition, the debtors paid the firm a $3,500 prepetition retainer. In the disclosure on Official Form 2030, the firm said that the retainer covered "all aspects of the bankruptcy case," including adversary proceedings and contested matters.

Judge Krause characterized the firm as saying that "the Debtors 'withheld and concealed information regarding the existence and/or value of their assets,' requiring it to 'conduct[] its own extensive valuation analysis of the [debtors'] properties several times, correct[] the [debtors'] bankruptcy schedules and other submissions several times, and defend[] the [debtors] in litigation' in the Bankruptcy Court."

Given the extra work, the firm had billed the debtors $151,000 over the first 16 months after filing. The debtor and the firm cut a deal where the firm reduced the fee to $113,000. The debtors agreed to pay $100,000 from the impending sale of a home. The firm did not amend the Form 2030 filing, nor did they file a new one to disclose the billings and promised payments.

As it turned out, the couple sold the home but paid the firm nothing. "Instead," Judge Krause said, "they kept the money and used it to purchase a new home." The firm withdrew as counsel and sued the debtors in federal district court in Pennsylvania, requesting a jury trial.

After failing to transfer venue of the Pennsylvania case to New Jersey, the debtors "moved in the Bankruptcy Court in New Jersey for an examination of the reasonableness of [the firm's] fees under § 329(a) and Bankruptcy Rule 2016(b)," Judge Krause said. The firm responded by claiming to have a Seventh Amendment right to a jury trial in Pennsylvania. According to Judge Krause, the firm argued that it "did not violate § 329(a) or Bankruptcy Rule 2016(b) because it was not required to disclose post-petition legal services, and it was [the firm's] attorneys' practice not to do so."

Bankruptcy Judge Poslusny of Camden, N.J., sided with the debtors and ruled that the firm had violated Section 329(a) and Rule 2016(b) by failing to disclose the agreement to pay $113,000 in fees. He ordered the firm to disgorge whatever it had been paid and barred the firm from collecting for any other work in connection with the case. *In re Aquilino*, 20-15628, 2023 WL 2191494, at *7 (Bankr. D.N.J. Feb. 23, 2023).

The firm appealed. Reversing, the district court in New Jersey decided that the firm had the right to a jury trial because it never filed a proof of claim. *In re Aquilino*, 660 B.R. 197, 205–06 (D.N.J. 2024). To read ABI's report on the district court opinion, click here.

The debtor appealed to the circuit. The Executive Office for the U.S. Trustee and the U.S. Trustee filed an *amicus* brief contending there was no right to a jury trial and that the bankruptcy court was empowered to enforce Section 329.

The Statute and the Rule

"Given the need for transparency in bankruptcy cases," Judge Krause said,

> [t]he Code requires attorneys who represent debtors to "file with the court a statement of the compensation paid or agreed to be paid, if such payment or agreement was made after one year before the date of the filing of the petition, for services rendered or to be rendered in contemplation of or in connection with the case by such attorney." 11 U.S.C. § 329(a).

She added,

> Federal Rule of Bankruptcy Procedure 2016(b) makes this disclosure obligation "a continuing one," *In re Stewart*, 970 F.3d 1255, 1258 (10th Cir. 2020), by requiring attorneys to supplement their statements "within 14 days after any payment or agreement not previously disclosed." Fed. R. Bankr. P. 2016(b).

The two provisions yield a "plain and simple rule," Judge Krause said, quoting the Seventh Circuit:

> "[A]ttorneys must inform the bankruptcy court of their compensation and promptly update the filing if their fees change." *In re Dordevic*, 62 F.4th 340, 342 (7th Cir. 2023).

Seventh Amendment and Jurisdiction

Contrary to the firm's argument, Judge Krause had "little difficulty" deciding that the bankruptcy court had jurisdiction. She held that the dispute "arose under" the Bankruptcy Code because it was a remedy expressly provided by the Code.

Judge Krause added that "the Bankruptcy Code provides both the right and remedy, and proceedings initiated under § 329(a) therefore fall within § 157(b)(2)'s non-exclusive list of 'core' proceedings."

Having found core jurisdiction, Judge Krause turned to the question of whether the firm had a Seventh Amendment right to a jury trial. Of course, she said, "That right only attaches to claims that are 'legal in nature,' not ones that are equitable. *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 53 (1989)."

When the claim is both legal and equitable, Judge Krause cited *SEC v. Jarkesy*, 603 U.S. 109, 123 (2024), where the Supreme Court said that the remedy is the more important consideration. To read ABI's report, click here. Again citing *Jarkesy*, she said there is no jury trial right when the remedy is solely to restore the *status quo*. *Id*.

From *Jarkesy*, Judge Krause held that "violations of § 329(a) give rise to equitable remedies, not legal ones." Citing the Second, Fifth and Ninth Circuits, she went on to hold that "permissible sanctions for violations of § 329(a) include disgorgement of collected fees and cancellation of fee agreements for bankruptcy-related services."

Having found "a § 329(a) proceeding and a claim that is equitable," Judge Krause ruled that "the District Court erred by concluding that [the firm's] right to a jury trial in the Collection Action extended to the § 329(a) proceeding in the Bankruptcy Court."

The Equities

For several reasons, Judge Krause decided that the equities did not favor the firm. First, she said that the firm violated Section 329(a) and Rule 2016(b) "at a minimum because it was required to, and did not, disclose the Letter Agreement," where the debtors agreed to pay $113,000. Even if the firm's original Form 2030 were compliant, she said that the firm's "subsequent failure to update [the] statement and disclose the Letter Agreement unequivocally violated its disclosure obligation."

Similarly, Judge Krause decided that the bankruptcy court had not abused its discretion. Citing four circuits, she said, "Courts of Appeals that have addressed the issue have regularly held that full disgorgement and cancellation of fee agreements can be an appropriate sanction for violating the Code's disclosure requirements."

Because "the Bankruptcy Court was aware of and considered the Debtors' misconduct that necessitated" the firm's extensive services after filing, Judge Krause found no abuse of discretion, because the bankruptcy court had "considered all relevant factors, including the balance of equities."

Even though it was "a fortuitous result for the Debtors," Judge Krause "reverse[d] the District Court's judgment and . . . reinstate[d] that of the Bankruptcy Court."

The opinion is *In re Aquilino*, 24-1781 (3d Cir. April 24, 2025).

Although lower courts have disagreed, the Second Circuit joined three other circuits in holding that a standing trustee may not retain the percentage fee when chapter 13 cases are dismissed before confirmation. Consequently, '13' debtors with confirmed plans pay standing trustees' fees.

No Circuit Split: 4 Circuits Say No '13' Trustee Fees if Dismissal Precedes Confirmation

Twenty-seven months after oral argument, the Second Circuit avoided making a circuit split, sided with three other circuits, and held that a chapter 13 standing trustee "cannot keep any percentage fee he collects from the debtor's pre-confirmation payments if no plan is confirmed."

Twelve Years and No Mortgage Payments

The lender made a first attempt at foreclosing the debtor's home in 2007. Although the bank won a judgment of foreclosure following the debtor's default, the debtor held off a foreclosure sale by filing five chapter 13 petitions between 2009 and 2017.

When the debtor filed her sixth and final chapter 13 petition in mid-2019, she had not paid her home mortgage for 12 years and was more than $450,000 in arrears. As required, the debtor began making plan payments to the chapter 13 trustee designed largely to cure arrears.

By the time the debtor had filed her motion to dismiss the chapter 13 case more than a year after filing, the debtor had paid some $362,000 to the chapter 13 trustee. Of course, the trustee had retained everything because the debtor had not confirmed a plan. After the court granted dismissal, the trustee filed a final report calling for returning about $341,000 to the debtor. The trustee intended to retain approximately $21,000 as the trustee's percentage fee.

The debtor objected, seeking an order from the bankruptcy court directing the trustee to disgorge the $21,000. The bankruptcy court sided with the trustee, allowing the trustee to retain the $21,000. *In re Soussis*, 624 B.R. 559 (Bankr. E.D.N.Y. Nov. 12, 2020). To read ABI's report, click here. The district court affirmed, portending a split of circuits. *Soussis v. Macco*, 20-05673, 2022 BL 22690, 2022 US Dist Lexis 12386, 2022 WL 203751 (E.D.N.Y. Jan. 24, 2022). To read ABI's report, click here.

The debtor appealed, and the case was well-briefed on both sides. As *amicus*, the National Consumer Bankruptcy Rights Center and the National Association of Consumer Bankruptcy Attorneys were on the debtor's side. The National Association of Chapter Thirteen Trustees was on the trustee's side.

In an impressive 47-page opinion on May 9 that merits reading in full text, Circuit Judge Susan L. Carney reversed and remanded with instructions for the trustee to return the $21,000 to the debtor. Judge Carney said she was siding with the Seventh, Ninth and Tenth Circuits. *See Marshall v. Johnson*, 100 F.4th 914 (7th Cir. 2024); *In re Evans*, 69 F.4th 1101 (9th Cir. 2023), *cert. denied sub nom. McCallister v. Evans*, 144 S. Ct. 1004 (2024); and *In re Doll*, 57 F.4th 1129 (10th Cir. 2023), *cert. denied sub nom*. *Goodman v. Doll*, 144 S. Ct. 1001 (2024). To read ABI's reports, click here, here and here.

Statutory Authority

For the benefit of the uninitiated reader, Judge Carney wrote a detailed explanation of the workings and history of chapter 13. Procedures require the debtor to begin making plan payments soon after filing, but the trustee retains the payments until plan confirmation.

The case on appeal was a matter of statutory interpretation for *de novo* review, Judge Carney said. Whether a chapter 13 trustee can retain the percentage fee paid by a debtor if the case were dismissed before confirmation turns principally on Sections 1326(a)(2) and 586(e)(2).

In pertinent part, Section 1326(a)(2) provides:

> If a plan is not confirmed, the trustee shall return any such payments not previously paid and not yet due and owing to creditors pursuant to paragraph (3) to the debtor, after deducting any unpaid claim allowed under section 503(b).

In pertinent part, Section 586(e)(2) provides that a standing chapter 13 trustee "shall collect such percentage fee from all payments received by such individual under plans in the cases under subchapter V of chapter 11 or chapter 12 or 13 of title 11 for which such individual serves as standing trustee."

Judge Carney pointed out how the inability of a chapter 13 trustee to retain collected fees in cases dismissed before confirmation does not affect the trustee's overall compensation. She explained:

> The percentage fee system does not compensate standing trustees based on the time devoted to or any other aspect of the quality or quantity of work done on a particular Chapter 13 case. Rather, the amount of the percentage fee that the trustee is authorized to "collect" turns simply on the amount of a debtor's actual payments

> to creditors. Thus, the trustee will receive less from a debtor making low monthly payments than from one making high monthly payments, whatever the distribution of the related workloads . . . .
>
> It is in the nature of this system that certain cases — those in which a debtor completes all payments and the payment amounts are large — will provide more support to the trustee and the trustee system than will other cases . . . .
>
> [T[he percentage fee protocol ensures that the standing trustee receives reasonable compensation in any given year from all of the many cases that he administers, not from any single case.

Section 1326(a)(2) Predominates

Turning to the merits, Judge Carney described the chapter 13 trustee and the U.S. Trustee as "arguing that because 28 U.S.C. § 586(e)(2) directs the standing trustee to 'collect' the fee out of all 'payments made under the plan,' the standing trustee is entitled to keep the fee, whether or not the plan is confirmed." She framed the question as whether "the percentage fee established by Section 586" that the trustee collects is "a part of the 'payments . . . proposed by the plan' that . . . the trustee must return to the debtor [under Section 1326(a)(2)] when a plan is not confirmed."

Under the "plain text of the statute," Judge Carney decided that the collected percentage fee is part of the "payments . . . proposed by the plan" that the trustee must return to the debtor. She explained,

> [I]n the Chapter 13 context, the term "payments . . . proposed by the plan," 11 U.S.C. § 1326(a)(1), means the debtor's entire schedule of monthly lump sum payments. This aggregation includes an unspecified amount for the percentage fee. Accordingly, the percentage fee — like the amounts allocated to any other line-items in the plan — must be returned to the debtor if no plan is confirmed.

Buttressing her conclusion, Judge Carney noted there were only two exceptions in Section 1326(a)(2) regarding the trustee's duty to return plan payments to the debtor: (1) payments "not previously paid and not yet due and owing to creditors"; and (2) unpaid administrative expenses under Section 503(b). The parties agreed that a chapter 13 trustee's fees are not administrative expenses, and the trustee's fees were not already owing to creditors.

Judge Carney held that "the payments in 'the amount . . . proposed by the plan' in Section 1326(a)(2) refers to the entire sum of the pre-confirmation payment, including the amounts intended to cover the trustee's percentage fees."

"Because the statute does not authorize the trustee to deduct an amount for the percentage fee," Judge Carney concluded that the collected fees "must be returned to the debtor if no plan is confirmed."

Section 586(e)(2)

Having decided that Section 1326(a)(2) pointed to victory for the debtor, Judge Carney turned to the contention by the U.S. Trustee and the chapter 13 trustee that Section 586(e)(2) "authorizes them to collect and keep the percentage fee, rather than to collect and hold it subject to some future event."

Judge Carney saw "two plausible readings" of Section 586(e)(2), one in favor of the trustee and one for the debtor. She decided that the word "collect" as used in Section 586(e)(2) was "ambiguous." Furthermore, she concluded that "Congress likely did not intend [for Section 586(e)(2)] to resolve the question posed in this case." She decided that Section 586(e)(2) "does not alter our interpretation of the text of Section 1326(a)(2), which in our view requires that the percentage fee be returned to the debtor."

In further support for her conclusion, Judge Carney noted that chapter 12 and Subchapter V of chapter 11 both explicitly allow trustees to retain fees if the case is dismissed before confirmation. She found similar support for her conclusion in the legislative histories of chapters 11, 12 and 13.

Judge Carney closed her opinion by saying that public policy evident in chapter 13 points toward returning collected fees to the debtor. She could not say that the "system is unfair to debtors who secure confirmation of a plan and complete all payments; while those debtors will pay a larger fee, they also benefit most from Chapter 13."

Judge Carney admitted that "[r]easonable minds may disagree about the wisdom of Congress's choices as a matter of public policy, [but we] are bound to apply the structure Congress has created as we understand it."

Judge Carney reversed and remanded "with instructions to the District Court to enter judgment granting [the debtor's] disgorgement motion."

Observations

Not requiring chapter 13 debtors to pay trustees' fees coincides with the idea that debtors should not be punished for attempting chapter 13. However, it is not successful chapter 13 debtors who pay trustees' fees. It's the creditors of successful debtors who pay trustees' fees.

Chapter 13 is not free for debtors whose cases are dismissed. The debtor's counsel fees are administrative expenses that are paid in dismissed cases.

Here's the policy issue for Congress: The efforts of a chapter 13 trustee can be the reason for dismissal. Should creditors of successful debtors pay chapter 13 trustees, or should debtors of dismissed cases pay?

The opinion is *Soussis v. Macco (In re Soussis)*, 22-155 (2d Cir. May 9, 2025).

Courts are split on whether chapter 7 trustees can be paid on another theory when the trustee had made no distributions to creditors under Section 326(a).

Bankruptcy Courts Disagree on Paying a '7' Trustee Who Made No Distributions

On an issue where the courts are split, Bankruptcy Judge Guy R. Humphrey of Dayton, Ohio, decided that a chapter 7 trustee was entitled to no compensation because the trustee had made no distributions to creditors, even though the chapter 7 trustee had identified assets prompting the debtor to convert to chapter 13 and file a 100% plan.

However, Judge Humphrey decided in his March 10 opinion that the chapter 7 trustee's counsel was entitled to compensation, although the trustee wasn't.

The individual debtor had filed a chapter 7 petition and claimed an exemption for her interest in a trust created by her parents. The chapter 7 trustee investigated and sought an extension of time to object to the exemption claim. The trustee was taking the approach that it was not a spendthrift trust exempt under Section 541(c)(2).

Claiming that she had received a raise at work and could afford chapter 13, the debtor moved for conversion. Initially objecting to conversion, the chapter 7 trustee later dropped her opposition, and the case converted. In chapter 13, the debtor immediately filed a 100% plan.

The chapter 7 trustee filed an application for an allowance of compensation. Counsel for the chapter 7 trustee also filed a fee application. The debtor objected, contending that the chapter 7 trustee was entitled to no compensation because she had made no distributions to creditors.

In chapter 7, a trustee's compensation is governed by Sections 330(a)(1), 330(a)(7), and 326(a) and (c). Section 330(a)(1) permits "reasonable compensation" plus reimbursement of expenses, but Section 330(a)(7) says that "the court shall treat such compensation as a commission, based on section 326."

'No Soup for You!'

Pivotal for Judge Humphrey, Section 326(a) gives the trustee "reasonable compensation" on a sliding scale based "upon all moneys disbursed or turned over in the case by the trustee to parties in interest, excluding the debtor, but including holders of secured claims."

Judge Humphrey pointed out how the BAPCPA amendments in 2005 changed the landscape for chapter 7 trustees. For the most part, the amendments favored chapter 7 trustees by locking in compensation as "a commission, based on section 326," and thereby removing other considerations under Section 330(a) that might result in reducing a trustee's compensation.

Similarly, the amendments removed chapter 7 trustees from the list of professionals subject to the factors in Section 330(a)(3). Now, the subsection only refers to trustees under chapter 11.

In the case before him, Judge Humphrey framed the question as "whether the Trustee is entitled to a statutory fee when no assets were 'disbursed or turned over' during the Chapter 7 case. 11 U.S.C. § 326(a)."

"Multiple courts," Judge Humphrey said, "have found that a Chapter 7 trustee that has not collected any assets cannot be compensated for a commission under § 326(a)." On the other hand, he acknowledged that "some courts, largely considering pre-BAPCPA law, have allowed § 326 fees to Chapter 7 trustees in this type of situation under various theories."

Judge Humphrey cited courts applying a *quantum meruit* theory, and others using a "composite trustee" approach, to compensate a chapter 7 trustee up to the maximum after first deducting the chapter 13 trustee's fee. He also cited the "lodestar" approach utilized to compensate the chapter 7 trustee in *In re Cummings*, 659 B.R. 895 (Bankr. D.N.M. May 22, 2024). To read ABI's report on *Cummings*, click here.

Judge Humphrey said that he "respectfully" disagreed with *Cummings*, because:

1) [T]he specific statutory exception and directive of § 330(a)(7) prevails over the language in § 330(a)(1); and
2) § 330(a)(3) specifically applies to Chapter 11 trustees, and does not reference a Chapter 7 trustee.

"While there may have been a basis to award such compensation prior to the enactment of BAPCPA," Judge Humphrey ruled that the trustee was not entitled to commissions because the "Chapter 7 Trustee did not distribute any funds to creditors or [turn over] such funds to parties in interest."

Ok to Pay the Chapter 7 Trustee's Counsel

Compensation for the chapter 7 trustee's counsel was a different kettle of fish, Judge Humphrey said, because counsel's fee awards are "an administrative expense under §§ 503(b)(2), 507(a)(2), and 330(a) of the Code," and Section 326(a) "does not apply to counsel to the trustee."

The debtor conceded that counsel's services were actually rendered and that the hourly rates were reasonable.

Judge Humphrey found as a fact that the trustee's investigation "did have a bearing on the Debtor's decision to convert the case to Chapter 13" and the debtor's consequent 100% plan. He also decided that the chapter 7 trustee's responsibilities did not end with the conversion motion because the trustee "was sufficiently within her responsibilities to conduct an analysis of the merits of the Debtor's motion to convert."

Judge Humphrey personally reviewed counsel's time records and allowed the requested compensation after one small deduction, because "the services benefitted the bankruptcy estate by resulting in a Chapter 13 plan providing the unsecured creditors with a 100% dividend."

The opinion is *In re Staker*, 24-30527 (Bankr. S.D. Ohio March 11, 2025).

Estate Property

What's a settlement of a personal injury claim? Is it income earmarked for creditors in chapter 13?

Eleventh Circuit: Chapter 13 Debtor Keeps Settlement of a Personal Injury Claim

A chapter 13 debtor who sustained a personal injury after filing was not required to pay the settlement proceeds to creditors, thanks to a decision by Bankruptcy Judge Henry A. Callaway of Mobile, Ala., who was upheld by the Eleventh Circuit on August 1.

The debtor filed a chapter 13 petition in 2018 and confirmed a plan with an $850 monthly payment giving unsecured creditors a 40% recovery. Fourteen months after filing, the debtor sustained a personal injury and eventually received a $45,000 settlement. After attorneys' fees and subrogation for medical bills, the debtor took home about $20,000.

The chapter 13 trustee filed a motion under Section 1329 to modify the plan and direct all of the net settlement proceeds to the trustee for distribution to creditors. Applying the net settlement proceeds would have raised the unsecured creditors' recovery to 77%.

At trial on the motion, the debtor testified that she was living "hand to mouth," didn't work and was living on Social Security disability payments. She and her husband had a truck that was inoperable after hitting a deer. They didn't have $6,000 to repair the truck. They had been forced to borrow $3,500 from the debtor's parents to pay bills while the husband took time from work to care for the debtor during her convalescence.

As described in the Eleventh Circuit's nonprecedential, *per curiam* opinion, Bankruptcy Judge Callaway decided that the net settlement proceeds were estate property but "determined that the Bankruptcy Code did not require the court to modify the debtors' bankruptcy plans to account for the post-petition personal-injury net settlement proceeds."

Finding that the settlement did not increase the debtor's ability to pay creditors, Judge Callaway denied the trustee's motion to modify the plan. After the district court affirmed, the trustee appealed to the Eleventh Circuit.

Standard of Review

The circuit panel first addressed the standard of review.

Because Section 1329(a) says that a "plan may be modified," the panel decided to "review the bankruptcy court's decision for an abuse of discretion."

Modification Requirements of Section 1329

Quoting Section 1329(b)(1), the panel said that "the proposed modification must conform with '[s]ections 1322(a), 1322(b), and 1323(c) of this title and the requirements of section 1325(a) of this title.'"

Quoting Eleventh Circuit precedent, *In re Guillen*, 972 F.3d 1221, 1229 (11th Cir. 2020), the panel said,

> We have recognized that "[n]othing prevents a bankruptcy court from refusing to confirm a modified plan put before it," even "where modified plans satisfy" the requirements of section 1329.

The panel therefore said that the outcome of the appeal "turns on (1) whether the trustee's proposed modifications met the requirements of section 1329; and (2) if so, whether the bankruptcy court abused its discretion by denying the proposed modifications."

The trustee's proposed plan modification, the panel said, satisfied the liquidation test in Section 1325(a)(4) and the disposable income test under Section 1325(b)(1). Both establish floors for what a debtor must pay.

However, the panel said that the "parties and *amici* dispute several issues about whether and how the liquidation and disposable-income tests apply to modified plans under section 1329." The panel saw no reason to decide the question because the debtor conceded that "the trustee's proposed modified plans met the applicable minimum requirements of those statutes."

The panel therefore assumed "without deciding that the trustee's proposed modified plans met all relevant requirements of section 1329."

Abuse of Discretion

The panel turned to the question of whether the bankruptcy court had abused discretion in denying the motion to modify the plan.

The panel described Bankruptcy Judge Callaway as having "reasoned" that the debtor was "still experiencing pain from [her] injuries . . . [,] was living paycheck-to-paycheck and needed money to pay for car repairs and to repay her parents."

"Accordingly," the panel said, Judge Callaway "found that the settlement proceeds did not increase the debtors' ability to pay their unsecured creditors in a way sufficient to justify approval of the trustee's proposed modifications."

Although the Eleventh Circuit had said in *Guillen* that an unforeseen change in circumstances is "good reason" to modify a plan, the panel went on to quote *Guillen* where it said, "Nothing prevents a bankruptcy court from refusing to confirm a modified plan put before it." *Id*. at 1229.

Finding "ample support" in the record for Judge Callaway's findings, the panel saw no abuse of discretion and affirmed the bankruptcy court's denial of the motion to increase plan payments.

Observations

What's a settlement of a personal injury claim?

What if a debtor had an auto accident, and the car was totaled due to the fault of someone else? Is the settlement "disposable income" that goes to creditors, leaving the debtor with nothing to buy another car? Settlement of a claim for a car accident wouldn't increase the debtor's net worth.

How is a personal injury settlement any different from settling a claim for damage to personal property? The debtor in a personal injury suit lost an asset: her good health. Furthermore, chapter 13 requires debtors to pay "disposable income" to creditors. Is a personal injury settlement income or replacement of an asset?

Debtors are supposed to be no worse off for having filed in chapter 13. If a post-petition personal injury claim goes to creditors, a chapter 13 debtor would be worse off than a similar debtor in chapter 7.

Thanks

We salute Thomas Moers Mayer of Herbert Smith Freehills Kramer (US) LLP, who submitted an *amicus* brief in support of the debtor on behalf of the National Association of Consumer Bankruptcy Attorneys and the National Consumer Bankruptcy Rights Center.

The opinion is *Conte v. Boutwell (In re Boutwell)*, 24-10264 (11th Cir. Aug. 1, 2025).

Declining to create a circuit split, Third Circuit Judge Thomas Ambro held that a retirement plan structured according to ERISA is excluded from estate property even if transactions by the trust violated ERISA or IRS Code regulations.

A Retirement Plan that's Not 'Tax-Qualified' Is Still Excluded from Estate Property

Following the Fifth and Seventh Circuits, Thomas L. Ambro wrote an opinion for the Third Circuit holding that "a retirement plan governed by [the Employee Retirement Income Security Act] that is not tax-qualified is still protected by ERISA's anti-alienation bar" and does not become estate property.

In his October 24 opinion, Judge Ambro declined to make federal common law in derogation of Section 541(c)(2), which says, "A restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title."

The Governing Statutes

Before delving into the facts of the case, Judge Ambro laid out the governing statutes.

ERISA, he said, establishes the standards of conduct for those who administer retirement plans. In addition, retirement plans are given favorable tax treatment for compliance with rules promulgated under the Internal Revenue Code.

Judge Ambro rephrased Section 541(c)(2) to mean "that bankruptcy respects rules protecting trust assets from a beneficiary's creditors. If a creditor cannot access the trust outside bankruptcy, the assets remain out of its reach in bankruptcy." He cited the Supreme Court in *Patterson v. Shumate*, 504 U.S. 753 (1992), for holding that a trust established under ERISA is "a trust that is enforceable under applicable nonbankruptcy law" that takes trust property outside of the bankruptcy estate.

Violations of ERISA and the IRS Code

In his chapter 7 petition, the debtor disclosed ERISA trusts with $1.6 million in assets and claimed them to be excluded from the bankruptcy estate under Section 541(c)(2). The chapter 7

trustee filed a complaint alleging that operations of the trust violated both ERISA and the IRS Code and thus brought the trust assets into the estate.

Judge Ambro characterized Bankruptcy Judge Kathryn C. Ferguson as having "dismissed [the trustee's complaint] because 'a plain meaning reading of § 541(c)(2)' excluded the Retirement Plans from the bankruptcy estate even if they were operated contrary to ERISA and the IRC."

The district court affirmed on the same grounds, prompting the trustee's appeal to the Third Circuit in hopes of creating a circuit split.

The Question on Appeal

The trustee wanted the appeals court to reverse based on *Patterson*. The trustee read *Patterson* to mean that a retirement plan is ERISA-qualified only if it is tax-qualified and follows ERISA's rules.

Judge Ambro conceded there is a split, with two circuit courts on one side and a few bankruptcy courts on the other. He framed the question on appeal as "whether, assuming (as [the trustee] alleges) that the Retirement Plans did not comply with ERISA and the IRC, the former nonetheless provides an 'enforceable' bar to alienation of [the debtor's] interest in the Plans."

Judge Ambro Refuses to Go Beyond the Statutes

Judge Ambro said that the trustee "provides no statutory support for [his] proposition. And we see none in ERISA's text." He agreed with decisions from the Seventh and Fifth Circuits. *See In re Baker*, 114 F.3d 636, 640 (7th Cir. 1997); and *Traina v. Sewell (In re Sewell)*, 180 F.3d 707, 711 (5th Cir. 1999).

Judge Ambro described the Seventh Circuit opinion by Frank H. Easterbrook as having held that "plans governed by ERISA are excluded from the bankruptcy estate under § 541(c)(2) because of the statute's anti-alienation command," and that violations of ERISA did not make ERISA inapplicable, because what matters is the application of ERISA rather than the observation of its rules.

Judge Ambro cited bankruptcy court opinions from Maryland, Michigan and Florida that have held that violations of ERISA or IRS rules would bring trust assets into the bankruptcy estate. The most recent of these contrary opinions was issued in 2000. He said that the three opinions point "to no statute or authority suggesting that ERISA's anti-alienation bar fails to protect from misbehaving plan administrators."

Citing *Law v. Siegel*, 571 U.S. 415 (2014), Judge Ambro said that an appeal to equity must fail, because the Supreme Court held "that equity cannot be used to override bankruptcy's detailed scheme delineating the property of the bankruptcy estate."

Judge Ambro affirmed the lower courts, holding that "interests in trusts are not part of the bankruptcy estate if applicable law prohibits their alienation." There being no language in ERISA or the IRS Code "that disables those protections if a retirement plan violates ERISA's rules or is not tax-qualified," he said that Section 541(c)(2) excludes retirement plans from the bankruptcy estate, "even if their operation did not comply with ERISA and the [IRS Code]."

The opinion is *McDonnell v. Gilbert (In re Gilbert)*, 23-2944 (3d Cir. Oct. 24, 2024).

If there's a constructive trust on property in the debtor's name, the debtor was only the trustee of the constructive trust and had no legal interest in the property.

A Transfer from the Debtor to a Constructive Trust Isn't a Transfer of Debtor's Property

Even when the debtor had legal title to property, the transfer of the property to a constructive trust is not a transfer of the debtor's property, for reasons explained by the Third Circuit.

Several individuals formed a corporation to buy real property. One of the owners of the corporation lent the corporation the funds necessary to purchase the property. The corporation took title to the property.

When the corporation never repaid the loan, the lender sued the corporation in state court, claiming she was the equitable owner. After trial, the state court imposed a constructive trust on the property and recognized the lender as the equitable owner because she had funded the purchase and was not repaid. The state court directed the corporation to convey title to the lender.

The state appellate court affirmed, and the Pennsylvania Supreme Court denied a petition for leave to appeal. The lender then recorded title to the property in her name.

Several months later, a creditor filed an involuntary petition against the corporation. The creditor ultimately purchased causes of action belonging to the corporation's estate. The creditor then filed an adversary proceeding against the lender, claiming that the transfer of the property was a preference or a fraudulent transfer.

Chief Bankruptcy Judge Gregory L. Taddonio of Pittsburgh granted the lender's motion for summary judgment dismissing the complaint. Judge Taddonio reasoned that the imposition of a constructive trust was not a transfer of the debtor's property, negating both a fraudulent transfer and a preference. The district court affirmed.

The Third Circuit affirmed in a *per curiam*, nonprecedential opinion on January 9.

To prevail, the appeals court cited Section 547(b) to say that the plaintiff "must demonstrate that there was a transfer of a property interest from [the debtor corporation] to [the lender]." Generally speaking, state law determines the interest, if any, that the debtor has in property.

In the case on appeal, the circuit court said,

> The beneficiary of a constructive trust is deemed to have held equitable title from the date the original owner conveyed the property, and the trustee is deemed to "have never owned the equitable interest in [the] property in the first place."

Indeed, Pennsylvania courts hold that a constructive trust is in existence at the inception of the transaction, even if a constructive trust is not judicially decreed until years later. In other words, as the Third Circuit previously said, "a constructive trust arises at the time of the relevant transaction."

By imposition of the constructive trust, the state court held that the lender was the beneficial and equitable title holder and that the debtor, as trustee, held only legal title. The "imposition of a constructive trust," the Third Circuit said, "is not a transfer of an interest from the debtor in the property."

Under state law, the Third Circuit held that the debtor "never had any equitable interest in the property to transfer." Consequently, "any transfer of bare legal title for such property is not a transfer of property of the estate."

The appeals court upheld dismissal of the preference and fraudulent transfer claims because "neither the state court's declaration that [the lender] was the property's equitable owner, nor the subsequent transfer of legal title to her, constituted a transfer of property of the estate."

The opinion is *Snyder v. Biros (In re U Lock Inc.)*, 24-1202 (3d Cir. Jan. 9, 2025).

While neither Social Security benefits nor post-petition income are estate property in Subchapter V, they must be included in an individual's monthly operating reports, Bankruptcy Judge Jacobvitz says.

Although Exempt, Social Security Benefits Must Be Reported in Subchapter V

Since Social Security benefits are exempt property, must an individual debtor in Subchapter V of chapter 11 report Social Security income on monthly operating reports?

The answer is "yes," according to Bankruptcy Judge Robert H. Jacobvitz of Albuquerque, N.M.

The Subchapter V debtor was an individual who owned rental properties. She also had about $1,400 a month in Social Security benefits. On her monthly operating reports, the debtor reported her rental income but did not list her Social Security benefits, contending that monthly reporting was not required because the benefits were exempt property.

Judge Jacobvitz disagreed in his January 3 opinion.

Addressing the merits, Judge Jacobvitz cited 42 U.S.C. § 407(a), which provides that "none" of someone's Social Security benefits "shall be subject to execution, levy, attachment, garnishment, or other legal process, or to the operation of any bankruptcy or insolvency law." He went on to say that the benefits do not lose their exempt status when deposited into a bank account.

Despite the exemption, Judge Jacobvitz cited the Ninth Circuit Bankruptcy Appellate Panel for having held that Social Security benefits must be scheduled in a chapter 7 case.

In an individual's Subchapter V case, Judge Jacobvitz said that "earnings from the debtor's services performed post-petition do not become property of the bankruptcy estate." Similarly, he said that "an individual debtor [is not] required to contribute social security income to fund a subchapter V plan, although an individual debtor may choose to make plan payments with social security income."

"Even so," Judge Jacbovitz said, "an individual subchapter V debtor must include in the monthly operating reports exempt post-petition social security income, as well as earnings from the debtor's services performed post-petition, even though neither is property of the estate."

Judge Jacobvitz said that his conclusion about disclosure was "made clear by the plain meaning of § 308," which requires small business debtors to file "periodic financial" reports disclosing "actual cash receipts," with comparisons of projected to actual receipts and disbursements.

Judge Jacobvitz said that "Section 308(b) does not differentiate earnings and cash receipts that are not property of the estate from those that are estate property." He therefore held that "§ 308 requires an individual subchapter V debtor with social security income to report such income in the monthly operating reports and attach copies of supporting bank account statements to document both receipts and disbursements of such income."

At the end of his opinion, Judge Jacobvitz explained why reporting of Social Security income was integral to the Subchapter V process. The reports, he said, "give a complete and accurate picture of a debtor's ongoing post-petition financial situation, which will impact the feasibility of a subchapter V plan of reorganization."

Judge Jacobvitz directed the debtor to report her Social Security income on monthly operating reports and to attach copies of bank account statements into which the benefits were deposited.

The opinion is *In re Ghaffair*, 24-10453 (Bankr. D.N.M. Jan. 3, 2025).

Claims

The Ninth Circuit BAP eased the burden on debtors needing to prove that a lender violated Section 524(i) by failing to credit payments made under a plan.

Ninth Circuit Primed to Decide Whether Emotional Distress Damages Survived *Taggart*

The Ninth Circuit Bankruptcy Appellate Panel wrote a decision teeing up a case where the Ninth Circuit can decide whether a claim for intentional infliction of emotional distress from a violation of the discharge injunction survived the Supreme Court's *Taggart* decision.

The December 20 BAP opinion by Bankruptcy Judge Scott H. Gan also closed the door to loopholes that a secured creditor might use to avoid liability under Section 524(i) for failure to credit payments under a chapter 13 plan.

The Cure Required by the Plan

A couple confirmed a plan one month after filing a chapter 13 petition in 2014. When the secured creditor did not file a claim, the debtors filed a claim asserting that the arrears on their home mortgage were about $19,000. The lender never filed an amended claim.

The plan called for curing the $19,000 in arrears during the life of the chapter 11 plan and paying the mortgage currently.

At the end of the 60-month plan, the debtor had paid some $166,000, more than the $165,500 called for under the plan.

The chapter 13 trustee filed a notice of final cure payment. The lender responded with a statement saying that the debtors had paid the arrears in full and that the debtors were current on postpetition payments.

The trustee filed a final report, and the debtors received their discharges.

After discharge, the lender began rejecting the debtor's monthly mortgage payments and claimed that the mortgage was delinquent by more than $10,000. The debtors filed an adversary proceeding in bankruptcy court. The procedural machinations were complex, but here's essentially what happened.

The debtors' complaint alleged that the lender had violated the discharge injunction under Section 524(a)(2) by failing to credit the mortgage payments they made after discharge. The complaint sought damages for intentional infliction of emotional distress.

The lender responded with a motion to dismiss, which the bankruptcy court granted. *Valdellon v. Wells Fargo Bank N.A. (In re Valdellon)*, 659 B.R. 377 (Bankr. E.D. Cal. April 30, 2024). To read ABI's report, click here.

The bankruptcy court reasoned that the failure to credit post-discharge payments could not be in violation of Section 524(i), which deals with payments under a plan. The bankruptcy court also believed that *Taggart v. Lorenzen*, 139 S. Ct. 1795 (2019), obviated the possibility of having emotional distress damages for a discharge violation. To read ABI's report on *Taggart*, click here.

In discovery during the adversary proceeding, it came out that the lender was claiming the actual arrears were more than the $19,000 to be cured under the confirmed plan.

Section 524(i)

The debtors' appeal required the BAP to interpret Section 524(i), which provides,

> The willful failure of a creditor to credit payments received under a plan confirmed under this title . . . shall constitute a violation of an injunction under subsection (a)(2) if the act of the creditor to collect and failure to credit payments in the manner required by the plan caused material injury to the debtor.

Bankruptcy Rule 3002.1(f) and (g) were adopted to create a procedure where, as occurred in this case, the lender agreed with the trustee's determination that defaults had been cured.

In his opinion for the BAP, Judge Gan said that "the court may grant relief through a civil contempt order" because "§ 524(i) makes a willful failure to credit payments under a plan a violation of the discharge injunction." He analyzed the extent to which *Taggart* changed the rules for contempt of the discharge injunction.

Other than declaring there must be no fair ground of doubt about the wrongfulness of the creditor's actions, Judge Gan quoted the Ninth Circuit for saying that *Taggart* "'did not otherwise alter a movant's threshold burden of going forward.' *Mellem v. Mellem (In re Mellem)*, 625 B.R. 172, 178 (9th Cir. 2021)."

To state a claim for contempt under Section 524(i), Judge Gan said that the debtor must alleged a willful failure to credit payments received under the plan and show material injury. To determine whether the debtor's complaint alleged a plausible claim, he said, "it is not necessary for Debtors

to specify exactly how [the lender] failed to credit the payments, when the allegations are that [the lender] failed to give the arrearage payments their curative effect."

The lender, Judge Gan said, "must apply the payments to the debt in the manner directed by the plan." Requiring the debtor to show how the lender misapplied payments "would obviate the statute's purpose in cases where the creditor refuses reinstate a loan and effectuate a cure of prepetition arrears."

In the complaint, the debtors had asserted that they made all payments required by the plan and had made post-discharge payments until the lender stopped accepting their payments. "These allegations," Judge Gan said, "are plausibly suggestive of a violation of § 524(i)," because the lender "is bound by the terms of the confirmed plan" that fixed the cure at $19,000.

Furthermore, Judge Gan said, the entry of the discharge order "necessarily determined that Debtors made all payments under the plan." He therefore held that the "Debtors are not precluded from seeking relief under § 524(i)."

Did *Taggart* End Emotional Distress Damages?

Having held that the debtors were entitled to assert a discharge violation arising from Section 524(i), Judge Gan turned to the question of whether the court could award damages for emotional distress.

Citing the BAP's decision in *Ocwen Loan Servicing, LLC v. Marino (In re Marino)*, 577 B.R. 772, 788-88 (B.A.P. 9th Cir. 2017), *aff'd in part & appeal dismissed in part*, 949 F.3d 483 (9th Cir. 2020), Judge Gan said, "We have previously held that bankruptcy courts can award compensatory damages for emotional distress caused by willful violations of the discharge injunction."

Judge Gan said that the bankruptcy court had rejected the BAP's analysis in *Marino* by relying on the "old soil" statement by the Supreme Court in *Taggart*. "We do not read *Taggart* so broadly," Judge Gan said.

Taggart, Judge Gan said, "did not address the range of permissible compensatory damages available under civil contempt, nor did it hold that courts should not look to § 362(k) by analogy in deciding compensatory damages for civil contempt." He was "not persuaded that *Taggart* compels us to depart from our precedent in *Marino*."

Citing the Supreme Court precedent, Judge Gan said that the "measure of compensation for civil sanctions is not limited to pecuniary losses." He went on to say, "We expect that violations of the discharge injunction often will involve nonpecuniary damages," because one of the benefits of a discharge is "peace of mind."

Judge Gan set aside dismissal of the adversary proceeding and remanded for further proceedings.

The opinion is *Valdellon v. PHH Mortgage Corp. (In re Valdellon)*, 24-1086 (B.A.P. 9th Cir. Dec. 20, 2024).

Changing the rule under the former Bankruptcy Act, the Code and Federal Rule 24 now allow bankruptcy courts to impose deadlines for creditors to join involuntary petitions.

On a Split, First Circuit Holds that Deadlines to Join Involuntary Petitions Are Permissible

Highlighting a change from the former Bankruptcy Act on a topic where the circuits are split, the First Circuit convincingly held that the bankruptcy court may establish a deadline for creditors to join an involuntary petition.

The district court had recognized a large, offshore judgment against a U.S. company, which we shall refer to as the debtor. In response, the debtor began an assignment in the U.S. for the benefit of creditors, or an ABC.

After the ABC was underway, the judgment creditor alone filed an involuntary chapter 7 petition against the debtor. The assignee in the ABC filed a motion to dismiss, asserting that the debtor had 15 creditors, meaning that there had to be two more petitioning creditors or the petition would be dismissed. For simplicity, we shall refer to the assignee as the debtor.

Alongside the motion to dismiss, the debtor filed an answer to the petition, also asserting the existence of more than 12 creditors and the lack of three petitioning creditors required by Section 303(b). The bankruptcy court then entered an order establishing a deadline for other creditors to join as involuntary petitioners.

A second creditor did join the involuntary petition before the deadline, but a third creditor purportedly joined after the deadline.

At the hearing on the involuntary petition, the judgment creditor wanted Bankruptcy Judge Janet E. Bostwick to include the third involuntary petitioner by relying on a 1936 decision under the former Bankruptcy Act. *Guterman v. C.D. Parker & Co., Inc.*, 86 F.2d 546 (1st Cir. 1936). There, the First Circuit held that a creditor could join an involuntary petition "at any time." *Guterman* notwithstanding, Judge Bostwick dismissed the petition, because there were only two petitioning creditors.

The petitioning creditors appealed, but the First Circuit Bankruptcy Appellate Panel upheld dismissal in an opinion by Bankruptcy Judge Peter G. Cary. *PCC Rokita SA v. HH Technology*

Corp. (In re HH Technology Corp.), 659 B.R. 788 (B.A.P. 1st Cir. June 17, 2024). To read ABI's report, click here.

On the question of a deadline for joining as an involuntary petitioner, Judge Cary said there is a split of circuits. He cited the Third Circuit for holding that a creditor may join at any time while the Sixth Circuit upholds joinder deadlines.

The petitioners appealed to the First Circuit but lost a third time in a July 24 opinion by Circuit Judge Seth R. Aframe.

Section 303(c) and Rule 24

In the circuit, the petitioners once again contended that Section 303(c) permits a creditor to join at any time. The subsection reads,

> After the filing of a petition under this section but before the case is dismissed or relief is ordered, a creditor holding an unsecured claim that is not contingent, other than a creditor filing under subsection (b) of this section, may join in the petition with the same effect as if such joining creditor were a petitioning creditor under subsection (b) of this section.

Although Judge Aframe said it was "clear" that a creditor could join as a petitioner, he cited the Supreme Court and said that "a non-party with a statutory right to intervene in a civil action does not ordinarily possess an ancillary right to intervene at any time." He pointed to Federal Rule 24(a), applicable in proceedings involving involuntary petitions by Bankruptcy Rule 1018. "On *timely motion*," the federal rule provides that "the court must permit anyone to intervene who: (1) is given an unconditional right to intervene by a federal statute . . . ." [Emphasis added.]

Judge Aframe framed the question as "whether, when it comes to creditor joinder, section 303(c) displaces Rule 24's timely intervention requirement and gives creditors the right to join a pending involuntary petition at any time."

When the Bankruptcy Code "intends to give creditors a right to take action at any time during an involuntary petition's pendency," Judge Aframe said that "it uses additional language to make that intention clear." He cited 11 sections of the Code where "at any time" or similar language is used. The lack of "at any time" or similar language in Section 303(c), he said, "strongly suggests that section 303(c) was not intended to give creditors the right to join a pending involuntary petition at any time."

On the other side of the fence, Judge Aframe said that both the First Circuit in *Guterman* and the Supreme Court had held under the former Bankruptcy Act that creditors could join at any time, but Section 59(f) of the Act said that creditors could join an involuntary petition "at any time" or

file an answer in opposition. Since similar words were not included in Section 303, the Code wrought a change in prior law.

Further to the point of imposing deadlines, Judge Aframe said that bankruptcy courts "enjoy substantial case-management authority," and that taking away the ability to erect deadlines "would divest bankruptcy courts of an important case management tool at a critical stage in an involuntary case." He affirmed the bankruptcy court's judgment dismissing the involuntary petition.

The opinion is *PCC Rokita SA v. HH Technology Corp. (In re HH Technology Corp.)*, 24-9002 (1st Cir. July 24, 2025).

n involuntary petitioner whose claim was paid after filing is still counted as an involuntary petitioner, the Ninth Circuit BAP says.

Fully Secured, Nonrecourse Creditors Can Be Involuntary Petitioners, BAP Says

On the same day, the Ninth Circuit Bankruptcy Appellate Panel issued two opinions in the same case laying down important rules for involuntary petitions:

(1) Fully secured creditors with nonrecourse claims are counted in deciding whether there are 12 or more creditors; and
(2) If a creditor has a claim on the filing date, the creditor is counted even if the claim is paid off later.

Initially, the only creditor filing the involuntary chapter 7 petition had a judgment claim for more than $7 million. Later, several other creditors filed joinders in the involuntary petition. Ultimately, the bankruptcy judge decided that there were 12 creditors with claims that were "not contingent as to liability or the subject of a bona fide dispute as to liability or amount," the standard in Section 303(b)(1) for deciding who may be an involuntary petitioner and how many involuntary petitioners there must be. If there were fewer than 12 creditors, one involuntary petitioner is enough under Section 303(b)(2).

One of the 12 creditors had a fully secured, nonrecourse claim. The creditor who first filed the involuntary petition therefore contended that the fully secured creditor should not be counted. Were that correct, there would be only 11 creditors, and one involuntary petitioner would be enough.

The bankruptcy judge decided that the fully secured creditor was counted and dismissed the involuntary petition. The petitioning creditor with the $7 million claim filed an appeal.

Fully Secured Creditors Are Counted

Writing the first of the BAP's two decisions on October 29, Bankruptcy Judge William J. Lafferty, III, found no controlling authority to resolve the first question but said that "a majority of out-of-circuit decisions . . . hold that fully secured, nonrecourse creditors are countable creditors for purposes of § 303(b)."

The outcome turned on the interpretation of Section 303(b)(1). When there are 12 or more creditors, the subsection says that the involuntary petition must be filed

> by three or more entities, each of which is either a holder of a claim against such person that is not contingent as to liability or the subject of a bona fide dispute as to liability or amount, . . . , if such noncontingent, undisputed claims aggregate at least [$18,600] more than the value of any lien on property of the debtor securing such claims held by the holders of such claims.

Judge Lafferty said that the subsection "does not explicitly differentiate between petitioning creditors and countable creditors; instead, the statute simply requires that both types of entities must qualify as 'holders.'" He decided that "cases interpreting which entities are eligible as 'holders' under § 303(b) are as relevant to the eligibility of countable creditors as they are to the eligibility of petitioning creditors."

Judge Lafferty said that the language in "§ 303(b) is explicit and specific about which entities qualify as countable creditors." Although a fully secured creditor could not be the sole involuntary petitioner, he said that "§ 303(b) does not otherwise expressly prevent fully secured creditors from qualifying as either a petitioning creditor or a countable creditor."

While a majority of courts "also support this interpretation," Judge Lafferty scrutinized but rejected two opinions holding to the contrary, both from bankruptcy courts in Texas.

Judge Lafferty found support for his conclusion both from legislative history and policy considerations. He observed that fully secured creditors were not counted under the former Bankruptcy Act. He concluded that the omission from the Bankruptcy Code was "intentional" and provided further evidence supporting his holding.

Judge Lafferty identified several policy reasons supporting his conclusion. Affirming the bankruptcy court, he held that "fully secured creditors, whether recourse or nonrecourse, qualify as countable creditors under § 303(b)."

Paid Claims Are Still Counted

Judge Lafferty's second opinion involved a creditor who was leasing a fence to the debtor for $45 a month. The creditor joined as an involuntary petitioner after the filing date but had a $45 claim on the filing date. Sometime after the filing date, a third party paid the $45 claim that existed on the filing date.

When the debtor was challenging the involuntary petition, the $45 creditor had unpaid claims that arose after filing. Later still, the $45 creditor sought to withdraw its joinder in the involuntary petition.

Relying largely on the word "holder" in Section 303(b)(1), the bankruptcy court decided that the $45 creditor could not be an involuntary petitioner because the claim that existed on the filing date had been paid. Judge Lafferty disagreed, although he said it was "a difficult question" and that he "could not find . . . any authorities directly addressing the issues raised in this appeal."

Although the word "holder" was "relevant," Judge Lafferty said that "other statutory provisions compel a different interpretation than the one reached by the bankruptcy court."

Judge Lafferty cited Section 303(c), which says that creditors join as involuntary petitioners "with the same effect as if such joining creditor were a petitioning creditor under section (b) of this section." He went on to explain why "the qualifications of petitioning creditors are assessed as of the petition date."

Judge Lafferty did "not believe that postpetition satisfaction of a party's claim necessarily renders that party a 'noncreditor.'" He cited Section 101(10), which defines a "creditor" as an "entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor." If an order for relief is entered, the court determines the allowance of the claim as of the date of filing.

Even if eligibility for being an involuntary creditor is not determined as of the filing date, Judge Lafferty noted that the creditor held a claim when it joined as a petitioner. Furthermore, as of the filing date, the creditor's future claims were not "contingent." Rather, they were "simply unmatured."

"Because § 303(c) does not explicitly restrict creditors holding unmatured claims from joining a petition," Judge Lafferty held, "a creditor owed a continuing obligation at the time it joins a petition **presently** holds a claim, even if a particular invoice is not due at the time the creditor files its joinder." [Emphasis in original.]

Judge Lafferty reversed the bankruptcy court for failing to count the $45 creditor among the involuntary petitioners. However, he remanded for the bankruptcy court to consider whether the creditor could withdraw its joinder in the involuntary petition.

The opinions are *Wolverine Endeavors VIII LLC v. East West Bank (In re King)*, 24-1007 and 24-1008 (B.A.P. 9th Cir. Oct. 29, 2024).

If a lender could collect only once outside of bankruptcy when both spouses guaranteed a debt, the result is the same in a single or joint bankruptcy by the spouses.

Lender Collects Only Once When Both Spouses Personally Guarantee a Debt

When a bank had personal guarantees from both the husband and wife, the bank had only one claim in the couple's joint chapter 7 case, for reasons explained by Bankruptcy Judge Rachel M. Blise of Milwaukee, Wis.

The husband owned a corporation that owed about $240,000 to a bank. The lender had obtained commercial guaranty agreements from both the husband and the wife. The bank also received a marital purpose statement, where the couple agreed that their obligations were incurred in the interest of the marriage and family.

After the company and the couple defaulted on both the loans and the guaranties, the couple filed a joint chapter 7 petition. The bank filed two proofs of claim, one against the husband and the other against the wife. Both claims were for the same $240,000.

The trustee objected to one of the claims, alleging that the two claims were for the same debt. Judge Blise sustained the objection in an opinion on September 30.

"While the statute does not list duplicative claims as a basis for disallowance," Judge Blise said, "it is generally understood that '[a] claim that seeks duplicate recovery for the same debt is partially unenforceable to the extent of the duplication,'" citing Illinois bankruptcy court decisions.

Substantive Consolidation

Addressing the merits, Judge Blise began with Section 302(a), which allows spouses to file a joint petition. "After the commencement of a joint case," Section 302(b) goes on to say that "the court shall determine the extent, if any, to which the debtors' estates shall be consolidated."

For joint cases, Judge Blise pointed to a local rule, which states that spouses' joint cases "will be administered jointly and substantively consolidated, unless the court directs otherwise." In the case at issue, she said that the case was substantively consolidated on filing because she had not directed otherwise.

Automatic substantive consolidation "makes sense for spouses in Wisconsin," Judge Blise said. She pointed to two features of state law. One presumes that an obligation incurred by one spouse was incurred in the interest of the marriage. The second provides that obligations incurred in the interest of the marriage can be satisfied from all marital assets and all other property of the incurring spouse.

In Wisconsin, Judge Blise said, creditors "typically deal with spouses as a single economic unit."

Judge Blise said that substantive consolidation "means that [the lender] has just one claim against that consolidated estate because the liabilities of the debtors are collapsed into a single set of claims." Stated in other terms, "There is but one bankruptcy estate from which [the bank] can collect."

Separate Cases, Same Result

What if the couple had filed separate cases? Judge Blise explained why the result would be the same.

"The first-filed estate," Judge Blise said, "would include all that spouse's individual property, as well as all the couple's marital property; the second-filed estate would include only the property not part of the first-filed estate." Although the bank could assert its claims in full against both estates, she explained that "the distributions made by the trustees in the separate [cases] would not be from the same property."

Even if there were two cases, Judge Blise said that the bank "would essentially receive a single distribution from the entirety of the [debtors'] property."

Had only one spouse filed, the bank again would have had only one recovery, because the bank could collect only once from nonexempt property. If the bank could collect only once, Judge Blise said "it should not receive two distributions from the bankruptcy trustee for the same non-exempt property in bankruptcy."

Judge Blise sustained the trustee's objection by disallowing one of the bank's claims.

The opinion is *In re Kahle*, 24-20054 (Bankr. E.D. Wis. Sept. 30, 2025).

Having 51% consumer debt doesn't necessarily mean that the debtor has 'primarily' consumer debt.

Even Expecting Profit on the Investment, a Home Mortgage Is Still Consumer Debt

Perhaps on a longshot, creative counsel advanced a theory that would have made many homeowners immune from the test for presumption of abuse under Section 707(b)(2)(A)(i) if a home mortgage were characterized as something other than consumer debt.

Bankruptcy Judge Maria Ellena Chavez-Ruark of Greenbelt, Md., didn't buy the idea that a home mortgage isn't consumer debt because people buy homes with an expectation of profit. However, she refused to adopt a bright-line rule that a debtor has "primarily" consumer debts whenever 51% or more of total debt is consumer debt.

The Debtor's Consumer and Business Debts

The individual debtor owned a small business that failed. He owed about $360,000 on a home mortgage and some $160,000 to 11 unsecured creditors, of which eight claims for almost $145,000 were business debts.

In his petition and related filings, the chapter 7 debtor stated that his debts were not primarily consumer debts. On Form 122A, the debtor claimed there was no presumption of abuse.

The U.S. Trustee filed a presumption of abuse followed by a motion to dismiss or convert the case, asserting that the mortgage loan was consumer debt giving rise to a presumption of abuse under Section 707(b)(2)(A)(i). Following submission of stipulated facts, the U.S. Trustee filed a motion for partial summary judgment, asking Judge Chavez-Ruark to rule that the mortgage was a consumer debt and that the debtor had "primarily consumer debts."

Legislative History and Plain Language

The debtor relied in part on legislative history from the Bankruptcy Reform Act of 1978, in which Senator Dennis DeConcini and Congressman Donald Edwards said that consumer debts would not include debt secured by real property for purposes of Section 707. Section 101(8) defines "consumer debt" to mean "debt incurred by an individual primarily for a personal, family, or household purpose."

Although the debtor stipulated that he had taken down the mortgage loan for personal, family or household purposes, he contended that the mortgage should not be consumer debt because mortgage loans are typically an individual's largest debt. As Judge Chavez-Ruark characterized the argument, the debtor took the position that classifying mortgages as consumer debt "unjustly favors a finding of presumed abuse to the detriment of a small business debtor."

Judge Chavez-Ruark also described the debtor as contending "that a home mortgage should be excluded from the Section 707(b) analysis because . . . there is an underlying profit motive in home buying that takes a home mortgage outside the purview of consumer debt."

Regarding legislative history, Judge Chavez-Ruark said "there is no need to consider anything beyond the plain language of Sections 101(8) and 707(b) to conclude that the Mortgage Loan is a consumer debt that must be included in the Section 707(b) debt analysis." Furthermore, "The Bankruptcy Code's definition of 'consumer debt' makes no exception for secured debt or debt that a debtor intends to repay."

Following Bankruptcy Judge Michelle M. Harner, a colleague on the bankruptcy bench in Maryland, Judge Chavez-Ruark held that "the Bankruptcy Code's definition of 'consumer debt' includes all debt incurred for personal, family, or household purposes — including home mortgages and other secured debt that a debtor continues to pay — provided that the debt was incurred to serve the debtor's 'private affairs.'" *In re Durant,* 586 B.R. 212, 219 (Bankr. D. Md. 2018).

Regarding homes as business investments, Judge Chavez-Ruark was "not persuaded." Although "all family homes are [arguably] purchased with the hopeful expectation that the property will increase in value over time," she said that "may not be the sole or even primary purpose for every home purchase." Even if there is a profit motive, she saw "nothing in the plain language of Sections 101(8) or 707(b) that warrants different consideration for home mortgages or other secured debt that a debtor continues to pay and for which there will be no personal liability discharged through the debtor's bankruptcy."

What Does 'Primarily' Mean?

Having concluded that the mortgage loan was consumer debt, Judge Chavez-Ruark turned to the question of "whether the Debtor's debts are 'primarily consumer debts,' thereby triggering the application of Section 707(b)(1)." The U.S. Trustee urged her to rule that a debtor has primarily consumer debts if at least 51% of total debts are consumer debts.

The debtor wanted to count the number of creditors, not the amount of debt, and to remove secured debt that the debtor was continuing to pay. The debtor argued that Congress used the word "primarily" to give the court flexibility. Apart from the mortgage loan, the debtor emphasized how the majority of his debts were business debts, in both amount and number of creditors.

Unwilling to adopt the U.S. Trustee's idea of a "stringent test based on a certain percentage of overall debt," Judge Chavez-Ruark decided to use "a more fluid approach." Considering the "totality of the circumstances," she held that the debtor had primarily consumer debt because personal or family debt was 72% of the total, compared to 27% for business debt.

Judge Chavez-Ruark granted partial summary judgment in favor of the U.S. Trustee by holding that the mortgage loan was consumer debt and that the debtor primarily had consumer debt.

The opinion is *In re Garner*, 24-16770 (Bankr. D. Md. Sept. 23, 2025).

Cross-Border Insolvency

Second Circuit dismisses the last of 300 lawsuits by foreign liquidators to recover $6 billion for defrauded Madoff investors.

Second Circuit Extends the Section 546(e) Safe Harbor to Cover Foreign Law

The Second Circuit slammed the door on the idea that a foreign representative in a chapter 15 cross-border insolvency is somehow exempt from the so-called safe harbor in Section 546(e) that bars actions to avoid a "settlement payment." The opinion meant the end of the last of 300 lawsuits by a foreign liquidator aimed at recovering $6 billion for people who were defrauded by Bernard Madoff.

Likewise, the circuit's August 5 opinion knocks out clever arguments that ordinary trustees might make to avoid the safe harbor.

The Bermudian Feeder Fund

The appeal arose from the chapter 15 case resulting from the Bermudian liquidation of Fairfield Sentry Ltd., the largest feeder fund into the infamous Madoff Ponzi scheme. A few months after the fraud was revealed in late 2008 and Madoff went into liquidation in the New York bankruptcy court under the Securities Investor Protection Act, Fairfield began liquidating in Bermuda. As foreign representatives, the Bermudian liquidators filed a chapter 15 petition in New York and won foreign main recognition.

In the U.S. bankruptcy court, the liquidators were prosecuting some 300 lawsuits to recover $6 billion in fictitious profits that some investors in Fairfield had taken out before Madoff went bust. As the result of a series of motions and appeals, the defendants had succeeded in whittling down the lawsuits. All claims had been dismissed other than claims arising under Bermudian law and claims based on the idea that the calculations were incorrect because they should have shown that Fairfield had nothing for distribution to its investors.

In the last spate of litigation leading to the circuit's opinion on August 5, the district court had affirmed the bankruptcy court's dismissal of all claims aside from Bermudian constructive trust. In the circuit, the defendants appealed the failure to dismiss the constructive trust claims, and the liquidators cross-appealed the decision that the bankruptcy court lacked personal jurisdiction over the defendants.

Forum Selection and Personal Jurisdiction

The subscription agreement between Fairfield and its investors contained a broadly worded forum-selection clause under which investors submitted to the jurisdiction of courts in New York with respect to disputes regarding the subscription agreement. The district court had held that the forum-selection clause did not subject investors to personal jurisdiction in the bankruptcy court.

In his opinion for the circuit, Circuit Judge Steven J. Menashi reversed and found submission to personal jurisdiction. As we shall see later, personal jurisdiction didn't help the liquidators because they lost the whole shooting match under the safe harbor.

Deciding whether the investors were subject to personal jurisdiction in New York depended on the interpretation of the word "and" in the forum-selection clause. Judge Menashi decided that "and" means "related to."

Judge Menashi explained how the "bankruptcy and district courts expressed skepticism of the liquidators' interpretation of the forum selection clause on the ground that it would sweep almost any litigation between the [investors] and [Fairfield] into New York." He agreed with the liquidators that the breadth of the submission to jurisdiction was "a feature of the clause, not a bug."

Judge Menashi reversed the lower courts, holding "that the forum-selection clause established personal jurisdiction over all of the defendants."

Extraterritoriality

Having found personal jurisdiction, Judge Menashi turned to the merits, namely, the safe harbor in Section 546(e). Pertinent to the appeal, the subsection provides:

> Notwithstanding sections 544, 545, 547, 548(a)(1)(B), and 548(b) of this title, the trustee may not avoid a transfer that is a . . . settlement payment, as defined in section 101 or 741 of this title, made by or to (or for the benefit of) a . . . financial institution . . . in connection with a securities contract, as defined in section 741(7), . . . except under section 548(a)(1)(A) of this title.

The lower courts had decided that the safe harbor barred claims under Bermudian statutory law but not those arising under Bermudian common law. The common law claims included unjust enrichment and constructive trust resulting from investors' net asset values that did not reflect the reality that Madoff account statements were wholly fictitious. The liquidators also contended that application of the safe harbor violated the presumption against extraterritoriality.

First dealing with extraterritoriality, Judge Menashi quoted the Supreme Court: "'Absent clearly expressed congressional intent to the contrary, federal laws will be construed to have only domestic application.'"

Although the safe harbor by its own terms does not apply extraterritorially, he pointed to Section 561(d), which says, "Any provisions of this title relating to securities contracts . . . shall apply in a case under chapter 15 . . . ." The "only plausible reading," he said, is that the safe harbor "applies extraterritorially." Indeed, he said, "Section 561(d) must apply extraterritorially if it is to have any effect at all."

Judge Menashi therefore held that chapter 15 "expressly prohibits a foreign representative from using the statutory avoidance powers of the Bankruptcy Code." For him, it was "implausible that Congress intended to allow a foreign debtor and its representative to take advantage of U.S. bankruptcy law to bring avoidance actions unconstrained by the safe harbor that applies to the avoidance actions of a domestic trustee or debtor-in-possession."

The Carveout for Intentional Fraud

Having decided that "the safe harbor of § 546(e) applies extraterritorially through § 561(d)," Judge Menashi turned to the question of "whether the safe harbor bars the liquidators' claims." He first dealt with the liquidators' contention that the safe harbor did not apply because the claims were based on actual fraudulent transfers under Section 548(a)(1)(A).

The liquidators' actual fraud claims were based on the role of the third party that calculated the amount that Fairfield investors could withdraw.

Judge Menashi said that "the liquidators have not plausibly alleged that [the third party] actually intended to hinder, delay, or defraud creditors." Rather, he said, the "allegations might establish that [the third party] was negligent or reckless with respect to the risk of fraud at [Madoff] but do not establish that [the third party] intended to hinder, delay, or defraud creditors." The third party, he said, "suspected — but did not know — that [Madoff] was engaging in fraud."

Judge Menashi held "that the liquidators' claims do not qualify for the carve-out for intentional fraudulent transfer claims under § 546(e)," because the "allegations do not establish either that [the third party] acted with the actual intent to hinder, delay, or defraud creditors or that [the third party's] knowledge of the possible fraud at [Madoff] is attributable to the [Fairfield] Funds."

Save Harbor Covers Foreign Law

Having decided that the liquidators were not making claims for actual fraud that are excepted from the safe harbor, Judge Menashi turned to the question of whether the liquidators' common law Bermudian claims were covered by the safe harbor. First, he deconstructed the liquidators' contention that their claims were not "avoidance actions" under Sections 544, 545, 547, and 548.

Judge Menashi held that "the notwithstanding clause of § 546(e) . . . does not imply that the operative language of the safe harbor . . . limits only the use of the enumerated statutory avoidance powers." He went on to say that the "liquidators' contention that the safe harbor does not directly apply to common-law claims is wrong even based on their technical reading of the notwithstanding clause."

Given the liquidators' concession that the safe harbor incorporates Section 544, Judge Menashi said that the section "expressly empowers the trustee to avoid transfers that could be avoided by an unsecured creditor under applicable state law, including state common law." He went on to cite a New York bankruptcy court for having said that Section 544(b)(1) is not limited to fraudulent transfers under state statutes.

"In fact," Judge Menashi said, "an avoidance claim on behalf of creditors based on a common-law theory such as unjust enrichment or constructive trust could be brought by the trustee only pursuant to § 544(b)." He therefore held that "the safe harbor operates in Chapter 15 to prohibit claims under foreign statutory or common law that seek to avoid the same category of covered transactions."

Judge Menashi affirmed except for reversing "the judgment of the district court insofar as it allowed the constructive trust claims to proceed."

Note: The appeal was *sub judice* for 16 months. The liquidators will be filing a motion for rehearing and rehearing *en banc* in September.

The opinion is *In re Fairfield Sentry Ltd.*, 22-2101 (2d Cir. Aug. 5, 2025).

The Federal Circuit upheld the claims court's decision that taking away bondholders' collateral wasn't an unconstitutional taking.

Puerto Rico's Debt-Adjustment Proceedings Weren't Unconstitutional 'Takings'

In May 2023, the Supreme Court held that nothing in the Puerto Rico Oversight, Management, and Economic Stability Act, or PROMESA (48 U.S.C. §§ 2161 *et. seq.*), waived the Puerto Rico Oversight Board's sovereign immunity. *Financial Oversight & Management Board for Puerto Rico v. Centro de Periodismo Investigativo Inc.*, 598 U.S. 339 (Sup. Ct. May 11, 2023). To read ABI's report, click here.

Adding another constitutional dimension to PROMESA, the U.S. Court of Appeals for the Federal Circuit held on July 31 that the haircut given to holders of so-called Cofina bonds in the PROMESA proceedings were not "takings" under the Fifth Amendment.

The Cofina Bonds

The Commonwealth of Puerto Rico and its instrumentalities were in financial straits. They were butting up against debt limits in the Puerto Rico Constitution and were unable to access bond markets. To generate borrowing power, Puerto Rico created Cofina as a public corporation, independent from the government.

Cofina was empowered to sell bonds secured by Puerto Rico's collection of sales taxes. As Circuit Judge Kara Farnandez Stoll said in her opinion for the Federal Circuit, Cofina had sole ownership and control of the fund created to hold sales taxes.

When Puerto Rico was held ineligible for a federal municipal debt adjustment under chapter 9 of the Bankruptcy Code, Congress quickly enacted PROMESA, which adopts large portions of chapter 9. Puerto Rico and many of its instrumentalities sought relief under PROMESA in 2017 in what is known as Title III debt-adjustment proceedings.

In the Title III proceedings, Puerto Rico's federally appointed Financial Oversight and Management Board in substance represented Puerto Rico and its instrumentalities. In April 2022, the First Circuit upheld confirmation of the Oversight Board's plan of adjustment for the Commonwealth of Puerto Rico. *Federacion de Maestros de Puerto Rico v. Financial Oversight and Management Board for Puerto Rico (In re Financial Oversight and Management Board for Puerto Rico)*, 32 F.4th 67 (1st Cir. April 26, 2022).To read ABI's report, click here.

Cofina was among the instrumentalities that the Oversight Board put into Title III proceedings. The ultimate outcome was a plan of adjustment giving 54% of sales tax revenues to Cofina's bondholders and 46% to Puerto Rico.

After the Cofina arrangement was confirmed, Cofina bondholders filed a class action in the U.S. Court of Federal Claims, contending that sales tax revenue taken away from bondholders violated the Takings Clause of the Fifth Amendment of the U.S. Constitution.

The claims court denied the government's motion to dismiss based on the idea that PROMESA took away the claims court's Tucker Act jurisdiction. However, the claims court went on to dismiss the complaint, holding that the PROMESA arrangement was not an unconstitutional taking.

The bondholders appealed to the Federal Circuit.

Tucker Act Jurisdiction

Judge Stoll explained that the Tucker Act, 28 U.S.C. § 1491(a)(1), "waives sovereign immunity for, and provides for Claims Court jurisdiction over, monetary claims against the United States 'founded [] upon . . . the Constitution . . . or upon any express or implied contract with the United States.'" Of course, a takings claim falls within the claims court's jurisdiction, she said.

The government nonetheless contended that PROMESA "displaced" the claims court's jurisdiction. Quoting the Supreme Court, Judge Stoll said that a "determination of displacement of jurisdiction requires 'an unambiguous [congressional] intention to withdraw the Tucker Act remedy.'" She also cited the Supreme Court for holding that the Tucker Act and another statute both remain effective when they can coexist.

As for PROMESA, Judge Stoll said that its "provision falls short of the 'specific and comprehensive scheme for administrative and judicial review' that we have found sufficient to displace the Tucker Act." As an example of a shortcoming, she pointed to "PROMESA's failure to mention or provide for recourse against the Government as reflecting Congress's belief that the general grant of jurisdiction under the Tucker Act would provide the necessary remedy for any taking that may occur."

Finding "no such expressed intention to withdraw Tucker Act jurisdiction," Judge Stoll upheld the claims court's finding that it had jurisdiction over the bondholders' constitutional claim.

No Takings Claim

Turning to the bondholders' takings claim, Judge Stoll cited 1982 and 1991 opinions where the Supreme Court found unconstitutional takings because "the Government directly took the

property owner's right to exclude when it authorized the third party to enter onto private property." In both cases, she said that "the Government compelled the property owners to suffer an invasion of their property" and that it was "immaterial that the invasion was executed by a third party because it was the Government who directly took the property owner's right to exclude."

There are two tests, Judge Stoll said, in deciding whether the government's "instigation" of third-party action becomes a governmental taking. In the case on appeal, the government's action failed the second test because the government's influence over the third party was "merely coercive." The Oversight Board, she said, was not an agent of the government. Indeed, she said that the government lacked the ability to exercise "general control" over the Oversight Board.

Judge Stoll agreed with the claims court "that providing Puerto Rico with additional tools to manage its economic security, as PROMESA does, does not equate to 'the government instigat[ing] action by a third party,'" quoting Federal Circuit precedent. In fact, she said that PROMESA gives the Oversight Board power to initiate debt-adjustment proceedings, "but the Oversight Board is not required to do so." Furthermore, when the Oversight Board does act, she said it is acting on behalf of the interests of Puerto Rico, not the U.S.

Agreeing "with the Claims Court that the United States lacks the requisite amount of coercive control over the Oversight Board's actions to create liability under the Fifth Amendment," Judge Stoll affirmed dismissal of the constitutional Takings Clause claim.

The opinion is *Dinh v. U.S.*, 2023-2100 (Fed. Cir. July 31, 2025).

The Fourth Circuit's nonprecedential opinion means that chapter 15 doesn't have the exclusive remedy for enjoining U.S. litigation in cross-border bankruptcies.

Forum Non Conveniens Applied When Chapter 15 Would Have Been a Better Fit

Over a strident but respectful dissent, the Fourth Circuit upheld the district court's ruling based on *forum non conveniens* that required a U.S. plaintiff to sue a U.S. defendant in Australia, because the U.S. defendant was a subsidiary of an Australian company in administration in Australia.

The outcome is more perplexing because the U.S. plaintiff was suing in the U.S. to recover for services it provided in the U.S. to the U.S. subsidiary of the Australian parent.

Don't worry; we won't be dissecting the *forum non conveniens* aspect of the Fourth Circuit's nonprecedential opinion. The July 16 opinion had a few words to say about chapter 15, however.

Parent in Australia, Subsidiary in the U.S.

The U.S. creditor was a consulting firm located in Virginia. It provided consulting services to an Australian company that developed diagnostic health care products. The Australian parent did business in the U.S. through a subsidiary incorporated in Delaware.

Assume the creditor was providing services for both the Australian parent and its U.S. subsidiary. In some of the written agreements, the U.S. creditor submitted to the exclusive jurisdiction of Australian courts.

Financial problems befell both the Australian parent and its U.S. subsidiary. After the parent began voluntary administration proceedings in Australia, the U.S. creditor filed a claim in Australia for about $9 million arising from unpaid consulting services.

Later, the U.S. creditor sued both the Australian parent and its U.S. subsidiary in federal district court in Virginia. Among other claims, the creditor alleged that the U.S. subsidiary was liable for debts owed by the Australian parent.

The defendants moved to dismiss the U.S. lawsuit based on *forum non conveniens*. Both sides agreed that Australia was an adequate and available forum. They only disagreed about whether the

U.S. or Australia was "more convenient," according to the majority opinion written by Circuit Judge Allison J. Rushing.

Based on *forum non conveniens*, the district court granted the motion and dismissed the U.S. suit without prejudice. The U.S. creditor appealed.

Forum Non Conveniens Upheld on Appeal

The appeals court reviewed dismissal for abuse of discretion and said that a "*forum non conveniens* dismissal must be based on a determination that a specific alternative forum is available, adequate, and 'more convenient in light of the relevant public and private interests involved.'"

For the majority, Judge Rushing found no abuse of discretion and affirmed, being "satisfied that the district court applied the correct legal framework, considered the relevant factors, and reached a permissible conclusion."

Circuit Judge Julius N. Richardson dissented. "At no point," he said, "does the majority explain why . . . the district court was permitted to . . . take the exceedingly rare step of dismissing a lawsuit filed by a citizen plaintiff in its home forum." He said that "neither law nor common sense supports the district court's decision to send the parties' dispute to Australia."

Chapter 15

The Australian parent could have filed a chapter 15 petition somewhere in the U.S. Foreign main recognition surely would have been granted for the parent, automatically halting the suit in the U.S. against the parent.

On application in the chapter 15 case, the parent might have persuaded the bankruptcy court to enjoin the suit against the subsidiary, given the allegation that the subsidiary was liable for debt owing by the parent. Or, the parent could have obtained a stay more readily by bringing the U.S. subsidiary into Australian administration.

However, there was no chapter 15 petition.

The majority recited how the U.S. creditor had argued "that the Australian proceedings must be recognized by a United States bankruptcy court pursuant to Chapter 15 of the Bankruptcy Code before the district court can afford them any weight in the *forum non conveniens* analysis."

Tersely, the majority said, "Nothing before us supports that argument." The majority said that the "statute does not apply here, where the defendants are not foreign representatives and do not

seek relief available under Chapter 15. *See Trikona Advisers Ltd. v. Chugh*, 846 F.3d 22, 31 (2d Cir. 2017)."

In the future, the majority could be quoted for saying that the U.S. creditor had cited "no authority that would require formal recognition of foreign proceedings before a court can consider them as a relevant factor in the *forum non conveniens* analysis."

Observations

Although nonprecedential, the majority opinion could be cited for the proposition that the availability of chapter 15 relief does not argue against dismissal based on *forum non conveniens*.

True, nothing in the statute says that chapter 15 provides the exclusive remedies in matters involving cross-border insolvencies. Moreover, international comity is the fundamental principle underpinning both chapter 15 and the doctrine of *forum non conveniens*.

On appeal, the outcome might have been different were review not based on abuse of discretion. In this writer's opinion, the Australian parties were lucky that the district court dismissed the U.S. lawsuits. The dissent shows that the decision could have gone the other way.

The opinion suggests that a foreign defendant in similar circumstances would be advised to pursue chapter 15 relief to enhance the odds of halting litigation in the U.S. Yes, chapter 15 might be more expensive, but the results should be more predictable, and the law is better developed.

The opinion is *Tiber Creek Partners LLC v. Ellume USA LLC*, 23-1882 (4th Cir. July 16, 2025).

Because all affected creditors were unanimous in support, Judge Michael Wiles didn't agonize over whether the debtor actually had its center of main interests in the U.K.

Foreign Main Recognition in Chapter 15 Is Easy When No One Objects

When no affected creditors objected, a decision from the bankruptcy court in New York could be read to mean that foreign main recognition in a chapter 15 case will be granted even if the foreign proceeding was pending in a country where the debtor arguably did not have its center of main interests.

The parent was a Mexican financial services company headquartered in Guadalajara. The parent had issued notes in 2020 under an indenture governed by New York law.

The parent negotiated a restructuring with holders of 25% of the U.S. notes. The deal left all creditors of the parent unaffected aside from holders of the U.S. notes. The holders were to receive either partial cash payments or new equity, plus the option to purchase new notes issued by the parent.

Creating a U.K. Subsidiary

In his February 24 opinion, Bankruptcy Judge Michael E. Wiles explained how the parent and the holders faced a problem in effectuating the deal. Among the available jurisdictions, he said that "most of those laws would not have permitted a surgical restructuring of just the U.S. Notes." However, he said,

> U.K. laws permit the approval of a consensual scheme of arrangement that deals with a single set of note obligations, and pursuing such a scheme of arrangement in the English Court also promised to be less expensive and time-consuming than other alternatives.

However, the parent had no connections with the U.K., a requirement for approval of a U.K. scheme of arrangement. To avail itself of U.K. law, the parent incorporated a subsidiary in the U.K. with a registered office in London. Destined to become the debtor, the subsidiary made itself an additional obligor on the U.S. notes, with the right to contribution from the parent for payments on the U.S. notes.

With appearances by 75% of the holders in the U.K court, the subsidiary proposed a scheme of arrangement that was approved without objection and with unanimous support by voting noteholders.

The subsidiary filed a chapter 15 petition in New York seeking foreign main recognition and enforcement of the scheme of arrangement in the U.S. No noteholders objected to recognition, but Judge Wiles was concerned that if he "were routinely to allow this structure in all cases, no matter what the circumstances, the ordinary predicates for Chapter 15 relief could be stripped of meaning."

Two Versions of Foreign Recognition

There are two forms of recognition under chapter 15, foreign nonmain recognition and foreign main recognition.

For foreign nonmain recognition, Judge Wiles said that Sections 1517(b)(2) and 1502 require "an 'establishment' [that] must be an actual place from which economic market-facing activities are regularly conducted," but the subsidiary had "never engaged in any business" in the U.K., and "restructuring activities . . . are not themselves sufficient to show the existence of an 'establishment' in the U.K."

For foreign main recognition, Judge Wiles said that the foreign proceeding must have "tak[en] place in the jurisdiction where the debtor has its center of main interests, or COMI," under Sections 1502(4) and 1517(b)(1).

With regard to the subsidiary, Judge Wiles observed that its registered office was in London and that there was "no 'contrary evidence' in the record before me that indicates that [the subsidiary's] own COMI is located outside the United Kingdom." He said that the "restructuring activities apparently are the only activities in which [the subsidiary] has ever engaged" and "may be considered in determining whether its COMI is in the U.K."

Still, Judge Wiles saw "significant risks in the structure that has been used here" because "the whole structure admittedly was created for the purpose of restructuring the U.S. Notes issued by the Parent."

Were he to grant foreign main recognition regardless of the circumstances, Judge Wiles said that a company "could restructure its obligations anywhere it chose without even subjecting itself to a foreign proceeding" simply by forming "a new subsidiary in a jurisdiction of its choice and then cause that new subsidiary to assume the parent company's obligations." In those circumstances, the "parent company's COMI would no longer be relevant to the parent's restructuring of its debts."

In the case before him, Judge Wiles saw no "frustration or thwarting of creditor rights." Indeed, he said that the proceedings were pursued "for laudable objectives" and enforcement of the U.K. scheme would be "fully consistent with the stated purposes of Chapter 15. See 11 U.S.C. § 1501(a)."

In cases of the sort, Judge Wiles said that "one of the main factors I ought to consider . . . is whether the affected creditors have asserted any objection." There having been no objections, it "would be absurd for me to thwart the creditors' constructive desires and expectations in the guise of supposedly protecting them."

Judge Wiles granted foreign main recognition and enforced the scheme in the U.S., in view of the "overwhelming consent to the English Scheme Proceeding and the approval of the Scheme of Arrangement." He saw "no cause . . . to look past the form of the transactions or to pursue theoretical issues that no affected party wishes to pursue."

The opinion is *In re Mega Newco Ltd.*, 24-12031 (Bankr. S.D.N.Y. Feb. 24, 2025).

Bankruptcy courts in New York and Delaware believe that Purdue did not change the law and that nondebtor releases and exculpations are still permissible in chapter 15 cases.

After *Purdue*, Two Courts Still Permit Broad Nonconsensual Releases in '15'

Aligning himself with an April 1 decision by Bankruptcy Judge Thomas M. Horan of Delaware, New York's Bankruptcy Judge Martin Glenn approved additional, "appropriate" relief in a chapter 15 case with expansive nondebtor releases and exculpations. The releases and exculpations were broader than those granted by the foreign debtor's home court in Brazil.

Judge Glenn said that *Harrington v. Purdue Pharma L.P.*, 602 U.S. 204 (2024), "did not say anything about limitations on the power of courts to act as ancillaries to foreign proceedings under chapter 15." To read ABI's report on *Purdue*, click here.

Nondebtor Releases and Exculpations

The Brazilian debtors were construction companies with more than 17,000 employees and operations "primarily" in Brazil, Judge Glenn said in his April 21 opinion. The debtors began restructuring proceedings in Brazil in June 2024. With all voting creditor classes in support, the debtors obtained the Brazilian court's approval of a restructuring plan in March 2025.

The Brazilian plan discharged all claims against the debtors "and their officers, directors, agents, employees and representatives." One week after approval of the plan in Brazil, the debtors filed a chapter 15 petition in New York seeking foreign main recognition and approval of discretionary relief under Sections 1507 and 1521.

As part of requested discretionary relief, the debtors wanted "their officers, directors, agents, employees and representatives" to have no liability for "any action or inaction taken" in connection with the Brazilian case or the chapter 15 case, except for fraud, gross negligence or willful misconduct. The released parties included nondebtors like the noteholders' indenture trustee, clearing agents and the custodian of the U.S.-issued notes.

As part of requested discretionary relief, the debtors also wanted the U.S. court to issue a permanent injunction barring "all persons" from taking action in the territorial U.S. that would interfere with the implementation of the Brazilian plan.

There were no objections to the grant of foreign main recognition. Only the U.S. Trustee objected to the two proposed grants of discretionary relief. Judge Glenn described the U.S. Trustee as contending that the "limitation on liability is inappropriate because it is a 'veiled exculpation clause[]' [that] goes beyond the relief granted by the Brazilian court, [with] no statutory basis for granting the limitation."

The U.S. Trustee also argued that the debtors wanted the U.S. court to grant "impermissible nonconsensual third-party releases." According to the U.S. Trustee, both features were not "appropriate relief" permissible under Section 1521(a).

Existing Caselaw

Addressing the objections, Judge Glenn cited authorities for the proposition that the discretion to grant "appropriate relief" under Section 1521(a) is "exceedingly broad." The limitation, he said, is in Section 1506, which permits the court to refuse to take an "action [that] would be manifestly contrary to the public policy of the United States."

Looking to chapter 11 caselaw for guidance, Judge Glenn said it is well settled that exculpations may protect estate fiduciaries and that those who are not estate fiduciaries may be exculpated if they were actively involved in all aspects of the chapter 11 case and made "significant contributions."

In chapter 15 cases, Judge Glenn said, "Courts in this district have long enforced foreign restructuring plans in Chapter 15 cases which include nonconsensual third-party releases, most doing so pursuant to sections 1507 and 1521 of the Code." He added, "Exculpations have been granted by courts in this district in Chapter 15 cases, including protection of non-fiduciaries."

With regard to the law since *Purdue* was handed down, Judge Glenn said,

> To date, only one written decision has been issued on the question [of] whether *Purdue* applies in chapter 15 proceedings: *In re Crédito Real, S.A.B. de C.V., SOFOM, E.N.R.*, No. 25-10208 (TMH), 2025 WL 977967, at *1 (Bankr. D. Del. Apr. 1, 2025).

To read ABI's report on *Crédito Real*, click here.

Broad Enforcement Powers

The U.S. Trustee contended that both provisions sought by the debtors provide "relief beyond the scope provided by the Brazilian Confirmation Order and the [Brazilian] Plan," Judge Glenn said. The judge responded by saying that U.S. courts in chapter 15 cases "are

not limited in the discretionary relief they grant by that relief afforded by the foreign court or the plan of reorganization."

"The relief provided in the Recognition Order," Judge Glenn said, "puts an enforcement mechanism in the U.S. order that prevents disgruntled creditors who are bound by the [Brazilian] Plan from suing in the U.S. to recover on claims that are barred by the [Brazilian] Plan." He said that courts "in this district are not bound" by contrary authority from the Fifth Circuit in *In re Vitro S.A.B. de C.V.*, 701 F.3d 1031 (5th Cir. 2012).

Judge Glenn found that the "exculpation provision in the [recognition] Order is, therefore, integral to the recognition and enforcement of the [Brazilian] Plan" and that "the exculpation provision in the [recognition] Order complies with the requirements courts place on exculpation provisions in Chapter 11 cases."

Nondebtor Releases

The debtors conceded that neither the Brazilian plan nor the Brazilian court order approving the plan contained nondebtor releases. To the U.S. Trustee's argument that the additional relief included impermissible nondebtor releases, Judge Glenn said that "Judge Horan's recent opinion in *Crédito Real* provides a lucid explanation [for] why courts can enforce nonconsensual third-party releases found in foreign plans of reorganization."

Judge Glenn pointed out the difference between Section 1123(b)(6), applicable in *Purdue*, and Section 1521(a), which governs in chapter 15 cases. He said that Section 1123(b)(6) "enumerates boundaries," whereas Section 1506 has only one boundary by saying that the court may grant no relief "manifestly contrary" to U.S. public policy. He said that *Purdue* "cannot be read to hold that nonconsensual third-party releases are 'manifestly contrary to' U.S. public policy such that they would be barred by section 1506."

"Following the logic of *Crédito Real* and *Purdue*," Judge Glenn held, "the text of section 1521 permits the grant of a nonconsensual third-party release in support of a foreign debtor's plan of reorganization."

Judge Glenn ended his opinion by stating the holding more broadly:

> To summarize, (1) the plain text of Chapter 15, (2) caselaw under its predecessor (section 304), and (3) pre-*Purdue* caselaw in this district all support a finding that courts can, pursuant to section 1521 of the Code, issue orders pursuant to their discretionary powers under section 1521 which contain nonconsensual third-party releases, whether or not those releases originate from a foreign court.

Judge Glenn granted foreign main recognition with an order containing releases and exculpations for nondebtors.

Observations

Among the courts of appeals, the Fifth Circuit is the most adamant in limiting the breadth of releases and exculpations in favor of nondebtors. *See Highland Capital Management Fund Advisors LP v. Highland Capital Management LP (In re Highland Capital Management LP),* 132 F.4th 353 (5th Cir. March 18, 2025). To read ABI's report, click here.

Could a bankruptcy court in the Fifth Circuit reach the same result as Judges Glenn and Horan? Could a U.S. subsidiary of a foreign corporation obtain nondebtor releases and exculpations through the parent's bankruptcy abroad?

The opinion is *In re Odebrecht Engenharia e Construção S.A.*, 25-10482 (S.D.N.Y. April 21, 2025).

The leading commentators on chapter 15 and Bankruptcy Judge Philip Bentley reach the same result by different approaches to the requirements for chapter 15 recognition.

Should Property in the U.S. Be a Requisite for Chapter 15 Recognition?

A decision by Bankruptcy Judge Philip Bentley of New York draws into focus the Second Circuit's decision in 2013 requiring a foreign entity to have a domicile, place of business or property in the U.S. before the foreign bankruptcy proceeding is entitled to recognition under chapter 15. *In Drawbridge Special Opportunities Fund LP v. Barnet (In re Barnet)*, 737 F.3d 238 (2d Cir. 2013).

Since *Barnet*, foreign representatives have successfully manufactured property in the U.S. by giving a retainer to a law firm where the foreign representative intends on filing the chapter 15 petition.

The issue is not whether companies without U.S. assets should be ineligible for chapter 15. Rather, the question is whether Section 109(a) even applies to chapter 15 cases and whether the only conditions for chapter 15 recognition are contained in Section 1517(a).

The Retainers

The first of about a dozen companies began liquidating in Australia in 2017. In each case, the Australian liquidators gave retainers to their law firm in New York to satisfy the *Barnet* requirement of property in the U.S. The most recent chapter 15 filing occurred in March 2025, after a retainer was paid to the foreign representatives' counsel in New York.

In the new chapter 15 case, the only objection to foreign main recognition was lodged by the companies' owners, who contended that the Australian proceeding was not entitled to recognition on the theory that a retainer does not satisfy the property requirement of Section 109(a).

"Notwithstanding any other provision of this section," Section 109(a) says that "only a person that resides or has a domicile, a place of business, or property in the United States, or a municipality, *may be a debtor* under this title." [Emphasis added.]

In his July 8 opinion, Judge Bentley said that foreign main recognition was not in doubt aside from the question about a retainer as being compliant with Section 109(a).

Barnet Is the Law in the Second Circuit

Judge Bentley described *Barnet* as holding "that section 109(a) applies to chapter 15, as well as to other chapters of the Bankruptcy Code." He said that every court in New York "that has addressed the issue since 2018 has come to the same conclusion." He recognized, however, that "the court of appeals of one other circuit has declined to follow it, *see Al Zawawi v. Diss (In re Al Zawawi)*, 97 F.4th 1244 (11th Cir. 2024) (continuing to follow contrary rule adopted under Bankruptcy Act)."

Citing D. Glosband & J. Westbrook, *Chapter 15 Recognition in the U.S.: Is a Debtor "Presence" Required?*, 24 Int. Insolv. Rev. 28- 56 (2015) [https://perma.cc/D59D-SPGM], Judge Bentley said that "some commentators have criticized [*Barnet*]." Nonetheless, he recognized that *Barnet* "remains the law of this Circuit."

Property Requirement Is 'Toothless' but Ok

Judge Bentley described the owners' objection to recognition as asserting that reliance on retainers "makes section 109(a)'s eligibility requirements so easy to circumvent that it essentially nullifies those requirements" and is "tantamount no requirement at all."

Contrary to the owner's argument, Judge Bentley was unwilling to apply the surplusage canon to upset the use of retainers "because as the courts have uniformly held, the text of section 109(a) is unambiguous." He said that any reference was "[n]otably absent]" in Section 109(a) to any "requirement that the debtor have any minimum amount of property in the U.S. or that the debtor have owned its U.S. property for any minimum length of time."

"Consequently," Judge Bentley said, "the courts are required to apply section 109(a) as written, unless doing so would produce an absurd result." Even if the property requirement were "toothless," he said that "being toothless does not warrant setting aside the provision on absurdity grounds unless it is 'quite impossible that Congress could have intended [this] result.'" [Citation omitted.]

On the other hand, Judge Bentley said that using retainers to satisfy the property requirement "furthers the core objectives of chapter 15," such as cooperation between U.S. and foreign courts.

Judge Bentley overruled the objection and granted foreign main recognition.

Observations

Judge Bentley cited the definitive critique of *Barnet* written by Daniel S. Glosband and Prof. Jay L. Westbrook, the leading authorities in the U.S. on cross-border insolvency.

As Mr. Glosband and Prof. Westbrook concede in their article, *supra*, Section 109(a) does apply in chapter 15 cases, but they explain how the Second Circuit misinterpreted the language in the section.

The statute says that recognition "shall be" granted if the conditions in Section 1517(a) are met. Section 1517(a) does not reference Section 109(a).

As Mr. Glosband and Prof. Westbrook explained,

> [T]he reason that section 109(a) does not apply to recognition is that the debtor in the foreign proceeding will not, by virtue of Chapter 15 recognition of the foreign proceeding, become "a debtor under this title."

They go on to explain that "section 109(a) does apply in a Chapter 15 case after recognition when a foreign representative exercises its authority under section 1511 to commence a case under section 301, 302, or 303."

Judge Bentley noted that the conditions in Section 1517(a) had been satisfied in the case before him. Bound by *Barnet*, however, he was required to impose an additional condition in Section 109(a) that is not contained in Section 1517(a).

Requiring property in the U.S. will have no sensible utility in some circumstances. Take a case where a foreign debtor submitted to jurisdiction in the U.S. by issuing debt in dollars, governed by U.S. law.

While in bankruptcy abroad, the debtor could be sued in the U.S., because the foreign bankruptcy would not stay the lawsuit in the U.S. Absent a stay arising from chapter 15, the debt holders could obtain a judgment in the U.S. for transmission throughout the world, thereby interfering with the debtor's bankruptcy in its home country.

In cooperation with a bankruptcy abroad by imposing the automatic stay to halt lawsuits in the U.S., the U.S. bankruptcy court should be able to grant chapter 15 recognition without property in the U.S. Similarly, a foreign representative should be able to obtain chapter 15 recognition as the basis for taking discovery in the U.S.

In chapter 15, the foreign representative is not liquidating or reorganizing the debtor in the U.S. The foreign representative is obtaining assistance from the U.S. court to aid the bankruptcy abroad. Requiring assets in the U.S. doesn't make sense when the U.S. court is not administering assets in the U.S. but is assisting a court elsewhere.

As this writer understands Mr. Glosband and Prof. Westbrook, satisfaction of the requirements in Section 1517(a) should be enough for recognition. One day perhaps, there will be a split of circuits importuning the Supreme Court to decide whether Mr. Glosband and Prof. Westbrook properly interpreted the statute.

The foregoing are the opinions of this writer and not ABI.

The opinion is *In re B.C.I. Finances Pty Ltd.*, 17-11266 (Bankr. S.D.N.Y. July 8, 2025).

Foreign reorganizations with nondebtor releases are not 'manifestly contrary' to public policy after Purdue, according to Delaware's Bankruptcy Judge Thomas Horan.

Nondebtor Releases Are Still Permissible in Chapter 15, Delaware Judge Says

The *Purdue* decision from the Supreme Court banning nonconsensual releases of nondebtors does not preclude a U.S. bankruptcy court in chapter 15 from enforcing foreign plans with nondebtor releases, for reasons explained by Bankruptcy Judge Thomas M. Horan of Delaware.

In his April 1 opinion, Judge Horan described how the "*Purdue* Court held that [Section 1123(b)(6)] does not allow a chapter 11 plan to include nonconsensual third-party releases." Distinguishing the language in Section 1123(b)(6) from the relevant provisions in chapter 15, he held that "the plain language of both section 1521(a)(7) and section 1507(a) permit a U.S. court to enforce a foreign order for nonconsensual third-party releases."

The Mexican Plan

The debtor was one of Mexico's largest nonbank lenders. Financial problems began in 2021 and led to a liquidation proceeding in a Mexican court in 2022. Discussions culminated when the debtor, the Mexican liquidators and an *ad hoc* group of creditors developed a restructuring support agreement. The Mexican liquidator then commenced a proceeding in Mexico to implement the prepackaged plan.

When the plan received support from almost 57% of creditors, the Mexican court overruled objections and approved the prepackaged plan.

The plan contained releases for the *ad hoc* committee members, the Mexican liquidator, the indenture trustee and related parties. The releases barred claims for actions taken during the restructuring. Judge Horan said the releases were "customary in Mexican settlement agreements and . . . permitted under Mexican Bankruptcy Law."

An agency of the U.S. government, the U.S. International Development Finance Corporation, or DFC, had objected unsuccessfully to the Mexican court's approval of the plan. Until appealing in Mexico, the DFC had not objected to the nondebtor releases. The DFC's appeal remains pending in Mexico.

The debtor's foreign representative commenced the chapter 15 case in early February, seeking foreign main recognition and enforcement of the Mexican plan and its releases in the U.S. The DFC lodged the only objection to recognition.

Judge Horan characterized the DFC as contending that the releases are "not authorized under Bankruptcy Code sections 1507 and 1521" and that "appropriate relief" available to a foreign debtor "refers to relief available under the Bankruptcy Code."

Sections 1501, 1506, 1507 and 1521(a)

The outcome turned primarily on four sections in chapter 15. Section 1507(a) provides that the bankruptcy court "may provide additional assistance to a foreign representative . . . ." Upon recognition, Section 1521(a) similarly provides that the court "may . . . grant any appropriate relief, including" seven specific types of relief.

"In determining whether to provide additional assistance," Section 1507(b) directs the U.S. court to "consider whether such additional assistance [is] consistent with the principles of comity."

In addition, Section 1501 states that one of the purposes of chapter 15 is to promote "cooperation" with courts abroad. On the other hand, Section 1506 allows the court to refuse "to take an action governed by this chapter if the action would be manifestly contrary to the public policy of the United States."

In deciding how to rule, Judge Horan said he would "consider[] the centrality of cooperation and comity in reaching [his] decision" and "maximize assistance to the foreign court conducting the foreign main proceeding."

Regarding Section 1506, Judge Horan said that the foreign proceeding must "afford litigants the same fundamental protections that they would have received in a U.S. court," but that the relief need not "be identical to relief that might be available in a U.S. proceeding."

The Differences Between Chapters 11 and 15

For Judge Horan, the question was whether "*Purdue* changes the way courts should interpret sections 1521(a) and 1507," given the Supreme Court's conclusion that Section 1123(b)(6) "does not allow a chapter 11 plan to include nonconsensual third-party releases." The DFC wanted him to apply the same analysis to chapter 15, because Sections 1521(a)(7) and 1507(a) are "catchalls," just like Section 1123(b)(6).

Judge Horan answered the argument by stressing the linguistic differences between the sections in chapter 11 and those in chapter 15.

Unlike Section 1123(b)(6), Section 1521(a) uses the word "including" to show that "appropriate relief" is not limited to the seven specifically listed types of relief. Judge Horan went on to say that "section 1521(a)(7) qualifies its 'any . . . including' language by listing specific relief that a court is not permitted to grant under that section" and that the "list of prohibited relief does not include nonconsensual third-party releases."

Employing the canon "*expressio unius est exclusio alterius,*" Judge Horan concluded that the "list of relief that courts should not grant under section 1521(a)(7) . . . implies that other forms of relief not expressly prohibited are permitted." He therefore deduced that "enforcing foreign orders providing for nonconsensual third-party releases is within the scope of authority that section 1521(a) provides." Because "comity is central to chapter 15, the relief granted in the foreign court does not have to be available in U.S. courts under chapter 11."

Judge Horan held that "the plain language of both section 1521(a)(7) and section 1507(a) permit[s] a U.S. court to enforce a foreign order for nonconsensual third-party releases." Even if chapter 15 were ambiguous, he concluded that "the legislative history and canons of statutory construction confirm this interpretation and corresponding Congressional intent."

Judge Horan noted that "nonconsensual third-party releases are widely accepted by foreign courts." Therefore, "granting bankruptcy courts the authority to enforce nonconsensual third-party releases originating in foreign courts would promote chapter 15's goals of comity and providing assistance to foreign courts."

'Manifestly Contrary'

The DFC argued that enforcing nondebtor releases would be "manifestly contrary" to public policy under Section 1506 as a result of *Purdue*.

Judge Horan retorted by saying that "the Mexican proceeding comported with U.S. standards of procedural fairness[;] . . . the Concurso Plan does not violate any constitutional or statutory rights," and the releases were "customary and permitted under Mexican law."

Far from being "manifestly contrary," Judge Horan said that nondebtor releases are permitted in "asbestos" cases by Section 524(g). Furthermore, he noted how the Supreme Court in *Purdue* said that Congress could have permitted nondebtor releases. "Lack of specific availability in U.S. courts does not equate to manifest contrariness to U.S. public policy," he said.

Judge Horan noted possibly contrary authority from the Fifth Circuit in *Ad Hoc Group of Vitro Noteholders v. Vitro S.A.B. de C.V. (In re Vitro S.A.B. de C.V.)*, 701 F.3d 1031 (5th Cir. 2012). He said the Fifth Circuit "could not deny the relief simply on the basis that third-party releases were not available in its jurisdiction." Rather, he said that the *Vitro* "court only declined to enforce the

plan in that case because of the role in the approval process of the votes of insiders holding intercompany claims."

Judge Horan granted foreign main recognition and enforced the Mexican plan in the U.S., since the "plain language of Bankruptcy Code sections 1521(a) and 1507 giv[es] this Court a broad grant of discretion to aid foreign courts in accordance with principles of comity." He added, "The simple fact that a U.S. court could not grant such releases in a typical chapter 11 plan does not make them manifestly contrary to U.S. public policy."

The DFC is appealing.

Observations

Would Judge Horan's decision give Johnson & Johnson a fourth shot at nondebtor releases?

Assume J&J incorporates a subsidiary abroad, and the subsidiary assumes all of J&J's mass tort liability. Further assume that the foreign court approves a reorganization with discharges for the debtor-subsidiary and for the parent and all affiliates. Assuming the requisites for foreign main recognition were shown, would a U.S. bankruptcy court enforce the nondebtor releases in the U.S.?

Answer: Probably not, but why not?

What about this: A foreign parent has guaranteed a loan from a U.S. bank to one of its subsidiaries. The subsidiary reorganizes abroad with a plan giving a release to the nondebtor parent. Again assuming foreign main recognition, would a U.S. bankruptcy court enforce the release in favor of the nondebtor parent, barring the U.S. bank from collecting from the parent's assets in the U.S.?

In the comment box below, we invite our readers to say how a U.S. bankruptcy court would or should rule.

The opinion is *In re Crédito Real SAB de CV*, 25-10208 (Bankr. D. Del. April 1, 2025).

U.S. subsidiaries of a Canadian parent were under the control of a Canadian receiver, switching COMI from the U.S. to Canada.

U.S. Incorporated Subsidiaries 'Likely' Have Chapter 15 COMI in Canada, Not the U.S.

Before obtaining recognition, chapter 15 debtors filed a motion for provisional relief. Chief Bankruptcy Judge Martin Glenn of New York decided he was likely to find that the centers of main interest (COMIs) for the U.S.-incorporated subsidiaries of a Canadian parent were in Canada, not the U.S.

Judge Glenn reasoned that the U.S. subsidiaries' COMIs likely were in Canada because their operations had been taken over before the chapter 15 filing by a Canadian receiver appointed by a Canadian court.

In his May 4 opinion, Judge Glenn said that he did "not reach this conclusion lightly, as Chapter 15 is not a substitute for Chapters 7 and 11 for U.S.-based debtors." Judge Glenn also said he would be "vigilant of the potential for U.S. debtors to abuse the Chapter 15 process by bypassing Chapters 7 and 11."

In the case before him, however, Judge Glenn said he was "ultimately . . . satisfied that, at least for the purposes of provisional relief, the Foreign Representative is likely to demonstrate that the COMI of each of the [U.S. incorporated debtors], as of the Petition Date, is Canada."

The Canadian Receivership

The Canadian parent and its subsidiaries sold gifts, apparel, jewelry and other items primarily online. The companies ran into financial trouble this year when sales declined because most of the product came from China. Most of the companies' employees and officers were based in Canada. Those in the U.S. worked remotely. The subsidiaries incorporated in the U.S. evidently generated the bulk of their income from internet sales to customers in the U.S.

The companies owed their Canadian bank about US$35 million. Following default under a forbearance agreement, the Canadian bank prevailed on a Canadian court to appoint a Canadian accounting firm to serve as receiver for the Canadian and U.S. companies in the group. The receiver was given exclusive control of all of the companies' properties and assets.

The receiver had the power, among other things, to liquidate the companies' assets and administer claims under the supervision of a Canadian court.

Filing chapter 15 petitions for the Canadian and U.S. companies, the Canadian receiver sought provisional relief under Section 1519. The receiver wanted automatic stay protection under Section 362 and other provisional relief.

The U.S. Trustee objected to the motion for provisional relief, contending that the U.S. debtors were unlikely to obtain recognition as either foreign main or foreign nonmain proceedings.

Overcoming the COMI Presumption

To decide whether the receiver was entitled to provisional relief, Judge Glenn was obliged to apply the standards for issuance of a preliminary injunction. Regarding the primary issue of likelihood of success on the merits, Judge Glenn focused on whether the U.S. debtors could establish that Canada was their "center of main interests," the requisite for recognition as a foreign main proceeding under Section 1517(b).

Under Section 1516(c), the center of main interests, or COMI, is presumed to be the country with the debtor's registered office. The three U.S. subsidiaries were incorporated in three different states in the U.S., meaning that their COMI was presumed to be in the U.S.

Judge Glenn said there are nonexclusive factors that can overcome the COMI presumption. He noted how the "Second Circuit in [*Morning Mist Holdings Ltd. v. Krys (In re Fairfield Sentry Ltd.)*, 714 F.3d 127, 138 (2d Cir. 2013)] clarified that 'the factors that a court may consider in this analysis are not limited and may include the debtor's liquidation activities.'" Judge Glenn also cited *In re Modern Land (China) Co., Ltd.*, 641 B.R. 768 (Bankr. S.D.N.Y. 2022), where he held that the Cayman Islands can be the center of main interests in a chapter 15 case even though the company's assets, management and business were in mainland China, in the absence of an objection by an affected creditor.

In *Modern Land*, the debtor had negotiated a scheme of arrangement to be implemented under Caymans law in a court in the Caymans. The scheme was accepted by 99% in number and 95% in amount of notes voting in an arrangement proceeding in the Caymans. No other creditors were to be affected by the scheme.

In *Modern Land*, Judge Glenn found that a Cayman Islands court's supervision of a debtor's scheme of arrangement established the Cayman Islands as the debtor's COMI, despite the debtor's real estate investments in China. To read ABI's report on *Modern Land*, click here.

Judge Glenn went on to say that "the Second Circuit and this Court have examined the expectations of creditors and other interested parties, as a company's COMI must be 'ascertainable by third parties.'" In turn, he said that the "expectations of creditors can be assessed through examination of the public documents and information available to guide creditor understanding of the nature and risks of their investments."

One of the three U.S. incorporated companies had office space exclusively in Canada, where its books and records were located. All of its managerial decisions were made by executives of the Canadian parent. In addition, its most significant creditor was a Canadian bank.

When the chapter 15 petition was filed, Judge Glenn noted that the Canadian receiver had been given "broad power" over the assets and management of the subsidiary. As of the petition date, Judge Glenn found that the receiver was likely to obtain foreign main recognition for the U.S. subsidiary because its COMI "was likely [in] Canada."

The other two subsidiaries were incorporated in other U.S. states, but the Canadian receiver had authority over their assets. The Canadian receivership, Judge Glenn said, "similarly constitutes pre-filing restructuring activities likely to establish [the subsidiaries'] COMI in Canada."

Judge Glenn found that the Canadian receiver "is therefore also likely to succeed on [foreign-main] recognition."

In satisfaction of the other requirements for issuance of a preliminary injunction, Judge Glenn found that the likelihood of irreparable harm absent provisional relief favored the Canadian receiver. Likewise, he found the balance of harm and the public interest in favor of issuing provisional relief.

Caveat

In opposition to the grant of provisional relief, the U.S. Trustee cited *In re Black Press Ltd.*, 24-10044 (Bankr. D. Del. Feb. 8, 2024), where Judge Glenn described the Delaware bankruptcy court as having "declined to find COMI with respect to an international conglomerate's U.S.-incorporated subsidiaries." However, he noted that the Delaware judge had granted provisional relief because the foreign representative "had demonstrated a likelihood of success at recognition as to all the debtors, including those entities incorporated in the U.S."

In the *Black Press* case, Judge Glenn observed that the U.S. subsidiaries operated independently from the Canadian debtors. "By contrast," he said, "it does not appear that the COMI of the U.S. entities is the United States rather than in Canada, particularly after the initiation of the [Canadian receivership]."

Judge Glenn overruled the objection and granted provisional relief.

The opinion is *In re Giftcraft Ltd.*, 25-11030 (Bankr. S.D.N.Y. June 4, 2025).

Faculty

Hon. Daniel P. Collins is a U.S. Bankruptcy Judge for the District of Arizona in Phoenix, appointed on Jan. 18, 2013. He served as chief judge from 2014-17 and as a conflicts judge in the Districts of Guam, Hawaii and Southern California. Previously, Judge Collins was a shareholder with the Collins, May, Potenza, Baran & Gillespie, P.C. in Phoenix, practicing primarily in the areas of bankruptcy, commercial litigation and commercial transactions. Judge Collins was the 2023 president of the National Conference of Bankruptcy Judges, is a Fellow in the American College of Bankruptcy, is on the Ninth Circuit's Trial Improvement Committee, sits on the JCUS's Bankruptcy Judges Advisory Group, served on ABI's Board of Directors and is currently a Business Court Representative in the American Bar Association's Business Law Section. In addition, he was a founder of the Arizona Bankruptcy American Inn of Court chapter, served as the board chair for the Foundation for Senior Living, was on the St. Teresa Parish Finance Committee and Parish Council, received the St. Thomas More Award for the St. Thomas More Society, was named a Significant Sig by the Sigma Chi fraternity and was named to the Sigma Chi's Beta Phi Chapter Hall of Fame. Judge Collins received both his B.S. in finance and accounting in 1980 and his J.D. in 1983 from the University of Arizona.

Hon. Laurel Myerson Isicoff is a U.S. Bankruptcy Judge for the Southern District of Florida in Miami, initially appointed on Feb. 13, 2006. She served as Chief Judge from October 2016 until October 2023. Judge Isicoff serves on the Judicial Conference Committee on the Administration of the Bankruptcy System. Judge Isicoff serves on the Judicial Conference Committee on the Administration of the Bankruptcy System and on its subcommittee on Diversity, Equity and Inclusion. She serves as vice president of the American College of Bankruptcy, is a member of its *Pro Bono* Committee and is a past chair of its Judicial Outreach Committee, and from 2021-22 she co-chaired the College's Commission on Diversity, Equity and Inclusion. In recognition of that service, as well as her longstanding commitment to diversity, equity and inclusion, she received the inaugural DEI Excellence Award from the College. In further recognition of her contributions to DEI, she was awarded the 2023 NCBJ DEI Leadership Award from the National Conference of Bankruptcy Judges. Judge Isicoff currently serves as judicial chair of the *Pro Bono* Committee of the Business Law Section of the Florida Bar and is a member of the Florida Bar Standing Committee on *Pro Bono*. Prior to becoming a judge, she specialized in commercial bankruptcy, foreclosure and workout matters, both as a transactional attorney and litigator for 14 years with the law firm of Kozyak Tropin & Throckmorton, after practicing for eight years with Squire, Sanders & Dempsey, now known as Squire Patton Boggs. After graduating from law school, Judge Isicoff clerked for Hon. Daniel S. Pearson at the Florida Third District Court of Appeal before entering private practice. She is a past president of the National Conference of Bankruptcy Judges and of the Bankruptcy Bar Association (BBA) of the Southern District of Florida, and, until she took the bench, she served as the chair of the *Pro Bono* Task Force for the BBA. In addition, she received the 2026 Lifetime Achievement Award from The M&A Advisors. Judge Isicoff speaks extensively on bankruptcy around the country, and is committed to increasing *pro bono* service, diversity, equity and inclusion, and financial literacy for all. She received her J.D. from the University of Miami School of Law in 1982.

Hon. Christopher M. Lopez is a U.S. Bankruptcy Judge for the Southern District of Texas in Houston, appointed on Aug. 14, 2019. He previously was a member of the Business, Finance & Restructur-

ing Group of Weil, Gotshal & Manges LLP and focused on representations ranging from top global corporations in mega-restructurings to middle-market debtor and creditor representations. Judge Lopez lectures across the country on bankruptcy issues. He also serves as an adjunct professor at Thurgood Marshall School of Law. Judge Lopez currently serves as a council member of the State Bar of Texas's Bankruptcy Law Section, an advisor to the State Bar of Texas Young Lawyers Committee, a member of the Nominations Committee for the National Conference of Bankruptcy Judges, and a member of the National Bankruptcy Conference. He received his B.A. in psychology in 1996 from the University of Houston, his M.A. in religion in 1999 from Yale Divinity School and his J.D. from the University of Texas School of Law in 2003.

Bill Rochelle is ABI's editor-at-large, based in New York. He joined ABI in 2015 and writes every day on developments in consumer and reorganization law. For the prior nine years, Mr. Rochelle was the bankruptcy columnist for Bloomberg News. Before turning to journalism, he practiced bankruptcy law for 35 years, including 17 years as a partner in the New York office of Fulbright & Jaworski LLP. In addition to writing, Mr. Rochelle travels the country for ABI, speaking to bar groups and professional organizations on hot topics in the turnaround community and trends in consumer bankruptcies. He earned his undergraduate and law degrees from Columbia University, where he was a Harlan Fiske Stone Scholar.

Hon. Sage M. Sigler is a U.S. Bankruptcy Judge for the Northern District of Georgia in Atlanta, appointed in March 2018. She succeeded Hon. Mary Grace Diehl, for whom she clerked after graduating from law school. Prior to her appointment to the bench, Judge Sigler was a partner in Alston & Bird LLP's Bankruptcy Group. She is an active member of ABI's Board of Directors, NCBJ, IWIRC, TMA and the Bankruptcy Section of the Atlanta Bar Association, and she has been a volunteer presenter for the Credit Abuse Resistance Education (CARE) program. Judge Sigler was an honoree in ABI's inaugural class of "40 Under 40" in 2017, and she served on the program's steering committee from 2022-23, as well as on the publications committee in 2023 as an ABI Board member, and as the judicial chair for ABI's Southeast Bankruptcy Workshop in 2024. She received her B.A. in political science from the University of Florida in 2001 and her J.D. in 2006 from Emory University School of Law, where she was the executive symposium editor of the *Emory Bankruptcy Developments Journal*.

Hon. Elizabeth S. Stong has served as a U.S. Bankruptcy Judge for the Eastern District of New York in Brooklyn since 2003. Prior to her appointment the bench, she was a litigation partner and associate at Willkie Farr & Gallagher in New York, an associate at Cravath, Swaine & Moore, and law clerk to Hon. A. David Mazzone, U.S. District Judge in the District of Massachusetts. Judge Stong is a member of the Council on Foreign Relations, the Council of the American Law Institute, and the boards of the National Conference of Bankruptcy Judges, the Practising Law Institute, the New York County Lawyers' Association and the New York Law Institute. She is a member of the Advisory Committee of Columbia University's Committee on Global Thought and the Advisory Board of P.R.I.M.E. Finance, an international dispute resolution and judicial training organization, as well as co-chair of the New York City Bar's Middle East-North Africa Law Committee. Judge Stong regularly serves as a delegate to UNCITRAL's Working Groups on Arbitration and Conciliation and Insolvency, and is an elected member of the European Law Institute. She also chairs the ABA Standing Committee on Continuing Legal Education and holds leadership roles in the International Insolvency Institute, ABI

and the ABA's Business Law Section, International Law Section and Judicial Division. In addition, she is an adjunct professor at Brooklyn Law School. Judge Stong has trained judges in more than 25 countries on five continents, including North, Central and West Africa, Central Europe, Central Asia, the Middle East, the Arabian Peninsula and South America, with the U.S. Commerce Department Commercial Law Development Program, the World Bank, INSOL and the ABA-Rule of Law Initiative, among other entities. She also has consulted with the Supreme Court of China and People's High Courts in Beijing and Guangzhou, the Uganda Registration Services Bureau, and recently has led judicial workshops and consultations in Bahrain, Kuwait, Kazakhstan, Nigeria and Brazil, among other venues. Judge Stong received the ABA International Law Section's Mayre Rasmussen Award for the Advancement of Women in International Law, the New York City Bar "Her Hero" Lifetime Achievement Award, the American Bar Foundation's Outstanding State Chair Award, the ABA Glass Cutter Award, the NYIC Honorable Burton R. Lifland Mentor of the Year Award, the NYIC Hon. Cecelia Goetz Award, the Association of Insolvency and Restructuring Advisors Judicial Service Award, the MFY Legal Services Scales of Justice Award, and the Brooklyn Bar Association's Freda Nisnewitz Award for *Pro Bono* Service, among others. She received her A.B. *magna cum laude* from Harvard University and her J.D. from Harvard Law School, where she received the Williston Prize, and she studied at the Université des Sciences Sociales in Toulouse, France, as a Rotary Foundation Graduate Fellow.