CLW COMMERCIAL LAW WORLD MAGAZINE

JULY / AUGUST / SEPTEMBER 2024
VOL 38 / ISSUE 3

*An Official Publication of the **Commercial Law League of America***

THE ANNUAL BANKRUPTCY ISSUE

CLLA

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CLW COMMERCIAL LAW WORLD MAGAZINE

An Official Publication of the Commercial Law League of America

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THE CLLA PRESENTS THE BEST OF THE BEST IN PROFESSIONAL PRACTICE

For this bankruptcy issue, it is with great pleasure that, as the current President of the Commercial Law League of America (CLLA), I have the honor of attending the National Conference of Bankruptcy Judges (NCBJ) to be held in Seattle this year. The Commercial Law League luncheon at the NCBJ conference is a highlight. I am also honored to attend this convention for the League, as many years ago I attended this conference as a law student when my uncle, Glen Clark, who has since passed away, was the Chief Judge for the United States Bankruptcy Court for the District of Utah and President of the NCBJ at the time.

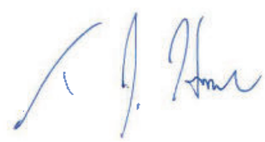
I recall with great fondness attending the NCBJ conference in 1992 in Orlando as I graduated from law school. For those of you who may have been there, I was the piano player in the Presidential suite. For a young lawyer, to hobnob among the judges was quite an honor. Of course, I feel the same today. The U.S. bankruptcy judiciary and bankruptcy bar include some of the most intelligent lawyers practicing today. The CLLA is honored to have many of these attorneys and judges among our membership.

To this end, it was with great pleasure that on June 28, 2024, the CLLA hosted one of the first online seminars to discuss the recent Supreme Court decision in the *Purdue Pharma* case. This seminar, arranged by League members Candice Kline, the Honorable Judith Fitzgerald (ret.) and Eric Van Horn, garnered national attention. The recording is available through the League office if you want to see it.

The *Purdue Pharma* case will have a rippling effect throughout bankruptcy and the commercial and retail collection space. For many non-bankruptcy practitioners in the League, the case presents an opportunity to continue pursuing guarantors when a corporation files for bankruptcy protection. The *Purdue Pharma* decision makes it much more difficult for a corporate debtor to include any non-debtor guarantor as part of a bankruptcy plan. For bankruptcy practitioners, the case presents an opportunity for creative solutions and alternatives, as well as potential legislative opportunities.

The League is not done touting itself to new bankruptcy members. Membership in the League lends credibility to your practice and allows attorneys and the judiciary to mentor and present to some of the best minds in the business. From attendance at League events to publishing and speaking, the CLLA presents the best of the best in professional practice. We are honored to have such an amazing opportunity to host the annual CLLA Luncheon and the Hon. Frank Koger Memorial Program at the NCBJ conference. Thanks for being part of the CLLA. ■

Theodore J. Hamilton
2024-2025 CLLA President
Wetherington Hamilton, P.A.



From *FTX to Purdue Pharma*, it has been a newsworthy year in the bankruptcy arena and we are extremely pleased to cover it in the annual Bankruptcy Issue of the Commercial Law World.

We will get to the headliners in a minute, but I wanted to thank the contributors of all the articles in this issue. The Sixth Circuit issued an important opinion outlining the applicability of fee shifting statutes in bankruptcy cases, and Mason Shelton of Bernstein-Burkley analyses the case and its impact. (Bernstein-Burkley earns our special thanks for multiple submission this year, with Kirk Burkley contributing to the prior issue.)

Also coming in with multiple contributions this year is Joe Peiffer, who with Austin Peiffer calls for uniformity in the bankruptcy code application of “disinterestedness.” Highlighting a provision in Subchapter V that smooths the way for small businesses to utilize the services of professionals who might be owed a few thousand dollars as of the petition date, the Peiffers point out that this provision would be beneficial in Chapter 12 bankruptcies. (Since my simplistic view is that Chapter 12 and Subchapter V serve the same goals – namely to streamline the bankruptcy process for small businesses, whether they sell garage doors or grow cotton – this seems like a call for reform that practitioners can get behind.).

In a more general vein, we have Harrison Willis on dischargeability and the variation in proof required in Chapter 13 dischargeability versus the discharge exemption provided in Section 523. (While the discrepancy in the language of the statutes which he highlights is definitely there, this may be a situation where the impact of the different wording is limited – as malicious and willful tend to go together in cases where this exception to discharge will apply. But as with the disinterestedness mentioned before, uniformity would be preferable.)

Additionally, Kathleen DiSanto has written a thorough analysis of the 11th Circuit’s recent opinion holding that the bankruptcy court retains the final word on whether a debtor’s claimed state law exemptions will be permitted. Following along an interesting fact pattern regarding exempt retirement accounts and the right of a creditor to set off funds, DiSanto details how the 11th Circuit upheld an Alabama bankruptcy court decision in the face of challenges based on collateral estoppel, full faith and credit and *Rooker-Feldman*.

Jack Rose and Kerri Ussher write about the 3rd Circuit’s opinion in FTX, holding that the appointment of an examiner is mandated by Section 1104 whenever the debtor’s debt exceeds $5 Million. This decision, which seems firmly grounded in the language of the statute, may provide additional leverage to creditors facing a Chapter 11 debtor whose financial transactions merit scrutiny. (It was recently cited in a case I am tangentially connected with, where the concerned creditors basically asked the court to appoint either a trustee or an examiner based on the debtor’s post-filing conduct.)

No discussion of bankruptcy practice in 2024 is complete without addressing *Purdue Pharma* – for the impact which the decision will have on mass tort Chapter 11 cases and on smaller Chapter 11 cases as well. It is also important for the marker laid down by the Supreme Court limiting the use of the “any other appropriate provision” language in section 1123(b)(6) to expand the powers of the bankruptcy courts to fashion relief. As the dissent highlighted, a number of common components in Chapter 11 plans, in cases large and small, rely on powers not expressly found in the Bankruptcy Code. *Purdue Pharma* appears to call into question the ability to use any such “necessary or appropriate” language to assist the court and parties in crafting a workable plan.

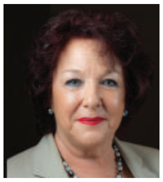
The analysis of *Purdue Pharma* puts a capstone on our multi-year series of articles by Candice Kline on mass torts in bankruptcy. Entirely coincidentally, Candice is taking her talents to Toledo, specifically the law school there, where her thoughtful analyses and delighted approach to all issues of bankruptcy law will likely be wasted on her students. We are hoping that we can convince Candice to keep writing, because *Purdue Pharma* was definitely not the final word on mass torts in bankruptcy. (If anyone else would like to take on this mammoth task going forward, please let us know.)

And we need to always recognize the continuing contributions of Ron Peterson, with his annual summary important bankruptcy cases. Again, we are hoping to convince him to continue in his role as the link to both the historical past of bankruptcy practice (no one else references the Bankruptcy Act of 1898 with quite so much authority – it only *seems* like he was there) and to the active future.

The coming year is apt to be a little less tumultuous, in bankruptcy law at least, and we look forward to telling you all about it next fall. ■

Beau Hays
Co-Chair of the Board of Associate Editors

Beau



Wanda Borges, Esq.

Principal Member,
Borges and Associates, LLC
www.borgeslawllc.com

Wanda is the principal member of Borges & Associates, LLC, a law firm based in Syosset, NY. For more than 40 years, Ms. Borges has concentrated her practice on commercial litigation and creditors' rights in bankruptcy matters, representing corporate clients and creditors' committees throughout the United States in Chapter 11 proceedings, out-of-court settlements, commercial transactions and preference litigation.

Kathleen L. DiSanto

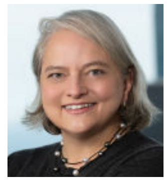
Shareholder,
Bush Ross, P.A.
www.bushross.com

Kathleen L. DiSanto is a shareholder with Bush Ross, P.A., in Tampa, and is the practice group leader of the firm's Bankruptcy Department. She is board certified in business bankruptcy law by the American Board of Certification. Di Santo serves as vice chair of the Business Law Section's CLE Committee.

Beau Hays

Partner,
Hays & Potter, LLP

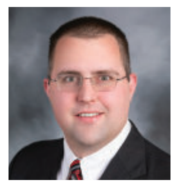
Beau is a 1986 graduate of the University of North Carolina School of Law, after receiving a B.A. in Political Science from UNC in 1983. He was admitted to the Georgia Bar in 1986, and has been admitted in the federal courts in all three districts in Georgia. He has acted as lead counsel in litigation matters for over twenty years, specializing in commercial disputes and bankruptcy law. Mr. Hays is a Past President of the Commercial Law League of America, having served as Recording Secretary of the League and Chair of the Creditor's Rights Section and chaired numerous committees. In addition to being active in the Bankruptcy Section of CLLA, he is an Associate Member of the National Association of Bankruptcy Trustees, and has been a presenter to that organization on issues involving hiring outside counsel. He has also served as Legislative Liaison for the Georgia Bar's Creditor's Rights Section. Mr. Hays is an editor for the National Association of Credit Management's Handbook of Credit and Commercial Laws, chapters related to materialman's liens and construction bonds.



Candice L. Kline, Esq.

Partner,
Saul Ewing LLP
www.saul.com

Candice Kline is a partner at Saul Ewing LLP focused on bankruptcy and restructuring situations. Her practice includes loan and deal work, including M&A, workouts, and loan administration. She represents debtors, creditors, fiduciaries, and public interest stakeholders. Candice serves in leadership at various bar and trade associations and on boards and advisory boards for nonprofit organizations, including the CLLA. She is also a part-time lecturer in law at the University of Toledo College of Law. Candice has an MBA (Chicago Booth) and began her legal career after many years in global commercial banking and business. She practices in Illinois and Ohio with a nationwide docket in complex commercial matters.



Austin J. Peiffer, Esq.

Associate Attorney,
Ag & Business Legal Strategies
www.ablsonline.com

Austin J. Peiffer joined Ag & Business Legal Strategies in 2020, after spending a year clerking for the Honorable A. Benjamin Goldgar, Chief Judge of the United States Bankruptcy Court for the Northern District of Illinois in Chicago. He earned his law degree from the Washington University School of Law in St. Louis, Missouri, with a certificate in Business & Corporate Law. While in law school he worked with the school's Low-Income Taxpayer Clinic and served as a judicial extern with the Honorable Charles E. Rendlen III (ret.) with the United States Bankruptcy Court for the Eastern District of Missouri. He is licensed in Iowa and Missouri.

Joseph A. Peiffer, Esq.

Shareholder,
Ag & Business Legal Strategies
www.ablsonline.com

Joseph A. Peiffer has focused his practice on business bankruptcy for more than 30 years, and established Ag & Business Legal Strategies (formerly Peiffer Law Office, P.C.) in 2016. As someone who grew up on an Iowa family farm in Delaware County, Iowa, Joe Peiffer has a keen interest in agricultural law. He graduated from Iowa State University as the top graduate in his class studying Dairy Science, as well as Public Service and Administration. Peiffer received his law degree, with Distinction, from the University of Iowa.

Ronald L. Peterson

Of Counsel,
Jenner & Block, LLP
www.jenner.com/en

Ron Peterson is a prolific lecturer and writer on bankruptcy and commercial law issues. Rob served on the panel of the Chapter 7 Trustees for the Northern District of Illinois, Eastern Division, from 1989 to 2021. He is a member of INSOL and served on the Board of the National Association of Bankruptcy Trustees. He served as co-chair of the Avoidance Action Committee for the ABI's Commission on the Reform of Commercial Bankruptcy Law. Ron also recently completed a term on the Board of Governors of the Commercial Law League of America.

Emory Potter, Esq.

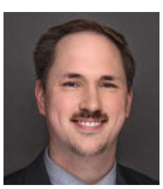
Partner,
Hays & Potter, LLP

Emory Potter is a construction, commercial and civil litigation attorney with extensive trial experience. His specialties include materialmen's lien and construction bond work, creditor's rights, and commercial collections, handling a large volume of litigation from initiation of suit through post-judgment collection.

Jack J. Rose

Managing Partner,
Jack Rose Law PLLC
www.jackroselaw.com

Jack J. Rose has been actively involved in the restructuring industry for over thirty years. His career developed in the Reorganization Departments of some of the largest national and international law firms, gaining him experience as lead counsel representing debtors, official committees, acquirers of assets and banks, lenders and other creditors in distressed situations and some of the nation's most historic cases, including, WeWork, Neiman Marcus, Lehman Brothers Holdings, Eastern Airlines and Olympia & York. Jack is a long-time member of CLLA, where he serves on the Board of Governors, ABA, ABI and NYCBA, where serves on the Bankruptcy and Reorganization Committee. Jack regularly speaks on topics involving restructuring, small business revitalization and has written a number of articles on these topics.



Mason S. Shelton

Associate,
Bernstein-Burkley, P.C.
www.bernsteinlaw.com

Mason's practice is focused on creditor's rights, workouts, and bankruptcy litigation. Prior to joining Bernstein-Burkley, P.C., Mason served as a term law clerk for the Honorable Gregory L. Taddonio in the U.S. Bankruptcy Court for the Western District of Pennsylvania. While attending law school, Mason participated as a judicial intern for the Honorable Charles M. Walker in the U.S. Bankruptcy Court for the Middle District of Tennessee and served as Acquisitions Editor for *Transactions: The Tennessee Journal of Business Law*.

Kerri Ussher

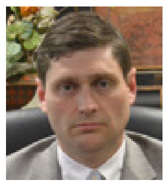
Counsel Partner,
Jack Rose Law PLLC
www.jackroselaw.com

Kerri Ussher is known for her ability to leverage astute strategic, business and financial acumen with her legal skills and experience to achieve client objectives and create favorable outcomes. She brings more than a decade of transactional restructuring practice experience to Jack Rose Law where she focuses her practice on the transactional side of restructurings. Prior to becoming a lawyer, Kerri held various positions in finance and banking.

Timothy Wan, Esq.

Senior Partner and CEO,
Smith Carroad Wan & Parikh
www.smithcarroad.com

Timothy Wan, Esq. is Senior Partner and the Chief Executive Officer (CEO) of Smith Carroad Wan & Parikh. His areas of expertise include managing the creditor's rights and collection law practice, serving as General Counsel to various small businesses in the local business community and spearheading practice areas of entertainment law, music law, copyright and intellectual property.



E.B. Harrison Willis

Partner,
Cloud & Willis, LLC
www.cloudwillis.com

Born and raised in Lexington, Virginia, Harrison Willis received his undergraduate degree at Rhodes College, where he graduated with a B.A. in history. In 2001, Mr. Willis graduated from Cumberland School of Law, Samford University with a J.D. He was licensed to practice law and admitted in the Commonwealth of Virginia and the State of Alabama.

After law school, Mr. Willis served as a judicial law clerk for the Honorable William F. Stone, Jr., U.S. Bankruptcy Judge for the Western District of Virginia. Prior to joining Cloud Willis & Ellis as an associate in 2008, Mr. Willis practiced with a Birmingham law firm maintaining a general practice with an emphasis towards bankruptcy law and commercial litigation.

Mr. Willis is committed to excellence in his practice and service to his clients. He practices in all state and federal courts in Alabama.

VIEWPOINT

We just wrapped up another successful National Convention in May while in Chicago. Three full days of exceptional education, multiple networking events, and a robust amount of energy among the attendees.

The Fall season always ushers in a busy conference season for the League. Here is a quick recap of the upcoming events taking place the rest of this year.

We will be honoring Ralph Brubaker at the Annual CLLA Luncheon and Honorable Frank Koger Memorial Educational Program at the National Conference of Bankruptcy Judges on September 19, 2024 in Seattle, WA. Mr. Brubaker is a Professor of Law at the University of Illinois, his alma mater, where he teaches courses in bankruptcy, bankruptcy procedure, corporate reorganizations, federal courts, conflict of laws (private international law), contracts, and restitution.

The Western Region Conference will take place at The Westin Rancho Mirage Golf Resort and Spa, a luxury resort located in the heart of the Palm Springs desert on September 25 & 26, 2024. The program will focus on trending issues in commercial collections.

The Eastern Region Conference will hold its annual conference in New York City on November 6 & 7, 2024 at the beautiful Manhattan Penthouse. The program will focus on Ethics and Etiquette in the Technological Age. We will be honoring Tim Wan as the recipient of the Warren Pinchuck Service Award. This award is bestowed upon a CLLA Eastern Region member in good standing based on their exemplary service and volunteerism to the Commercial Law League of America.

Looking ahead into 2025, the Southern Region Conference will be held on February 14 & 15, 2025 in historic New Orleans, LA. Additional information regarding this conference will be forthcoming. Last, but not least, the CLLA National Convention will take place on May 14-16, 2025 at the elegant Swissôtel in downtown Chicago. Please make sure to mark these dates in your calendar. ■

Phil Lattanzio
Executive Vice President

This summer seemed different than past summers. In the northeastern part of the U.S., spring seemed to come and go and summer was upon us before we were ready. Flowers that generally bloomed in July or August were already blooming in June and early July. It is now mid-August, and many of the gardens in my neighborhood are showing signs that autumn will soon be upon us. What does any of this have to do with the practice of law you may ask? The summer months have changed that practice as well. Summer used to be the time when the courts slowed down, vacation schedules determined how a law office would be managed and one did not expect to see opinions coming out of the courts that would have widespread consequences. Not so this year!!!

Barely into summer, and just when everyone was ready for a relaxing season, on June 27, 2024, the Supreme Court of the United States issued its 76 page decision in the matter of *Harrington, United States Trustee, Region 2 v. Purdue Pharma L.P. et al.* putting to rest the question which had been dividing the Circuits of whether or not nonconsensual third-party releases are allowable in bankruptcy cases. The majority decision says “no”. The dissent, showing tremendous concern for the victims in the Purdue Pharma case said, “Opioid victims and other future victims of mass torts will suffer greatly in the wake of today’s unfortunate and destabilizing decision.” It isn’t often that you see the majority opinion and dissenting opinion present such strong barbs at each other. It’s almost as though the Justices were taking this matter personally. Much has already been written about this decision. The CLLA is most fortunate to have its own member, Candice Kline, who has been digesting the Purdue Pharma case for us since its inception, provide her thorough analysis of the SCOTUS decision within this CLW issue.

On a completely different note, on August 20, 2024, U.S. District Court Judge Ada E. Brown issued her opinion striking down the Federal Trade Commission’s ban on non-compete clauses. On April 23, 2024, the FTC promulgated its **Non-Compete Rule** which was to take effect on September 4, 2024. That rule provided that it is an unfair method of competition for persons (remember that “persons” includes corporations and other artificial entities) to, among other things, enter into non-compete clauses (“non-competes”) with workers. The rule adopted a different approach for senior executives than for other workers, allowing those non-competes to remain in force. This non-compete rule was upsetting to many of the CLLA members, agencies in particular, who rely on these types of agreements to make sure an employee does not leave and take business with him/her. As soon as the Rule was issued, a lawsuit was filed against the FTC by Ryan LLC, a tax services firm in Dallas, Texas, joined by the Chamber of Commerce of the United States of America, Business Roundtable, Texas Association of Business, and Longview Chamber of Commerce as Plaintiff-Intervenors. The lawsuit asserted that the FTC’s issuance of this Non-Compete Rule was unlawful because (i) the FTC acted without statutory authority; (ii) the Rule is the product of an unconstitutional exercise of power; and (iii) the FTC’s acts, findings, and conclusions were arbitrary and capricious.

On August 20, 2024, U.S. District Court Judge Ada E. Brown agreed and determined that the FTC had no legal right to pass such a rule and specifically found that such Non-Compete Rule “shall not be enforced or otherwise take effect on September 4, 2024, or thereafter. This means that the FTC Non-Compete Rule is permanently blocked. The FTC is considering an appeal. In the meantime, the FTC intends to address non competes through case-by-case enforcement actions.

So the summer began and is ending with significant court decisions. We can only imagine what autumn will bring. ■

Wanda Borges, Esq.
Co-Chair of the Board of Associate Editors

Wanda Borges

A HORROW SHOW OF A SETTLEMENT

In Gotham, there was a dilapidated amusement park, the "Gotham Playland". You know the kind. Kiddie rides that had not been updated since they were installed in 1985. Concession stands where the paint on the counters was so worn, you can see where people rested their elbows, waiting for their funnel cake and soft hot pretzels. Old midway-games, like the ones that boast a "Prize for Every Player", plush bears larger than the child who wants to win them, and where you throw a dart into a field of balloons, to win a meager prize (no more worthy than that of the dollar store), just to realize the scheme that you need to win seven, in order to "trade-up" to that mega-bear your child is eye-ing.

Along came an investor, whom I shall refer to as "Zoltar". Zoltar grew up eating cotton candy at the Gotham Playland, going with his parents. Probably had his first kiss on the Ferris Wheel. Maybe even took his own kids there. Zoltar wanted nothing more than to revitalize the Playland. And so he took his life savings, drained his retirement accounts, and bought the Playland. But Zoltar embraced his darker desires, and steered away from common carnival attractions, and placed the "haunted house" as the bottom, most family-friendly attraction in the park, filling it with thrill rides and horror show oddities, hiring actors to play monsters, creatures, and even walking corpses.

Zoltar retained a marketing agency, whom I shall refer to as "MacMillan Marketing", to set up an advertising campaign, and MacMillan did just that. And, aligning with Halloween, the Gotham Playland become the Gotham Asylum, with patrons attending in droves.

Zoltar amped up the marketing efforts and ended up committing to a year's worth of television, print, and community sponsorships, at the recommendation of MacMillan. Everything would have worked out fine, except the contract was signed in the Fall of 2019, and the Asylum was closed between December 1 and, what they expected, to be an April 1, 2020 opening.

When the Asylum was unable to open in the Spring of 2020, MacMillan suspended the agreement until the Fall of 2020, but Zoltar was unable to get his staff back in order to re-open. MacMillan again suspended the agreement, until Spring 2021, and Zoltar was able to re-launch and re-open the Gotham Asylum. However, even though he re-opened, the revenue never reached its heights again, and closed in 2022.

However, Zoltar had signed a personal guarantee of the agreement with MacMillan, and still owed about $40,000.

MacMillan hired us to collect the debt, and we filed suit, after Zoltar ignored our outreach attempts. Zoltar never responded, and we obtained a default judgment.

In our enforcement attempts, Zoltar retained counsel, who agreed to a payment arrangement. We executed a stipulation of settlement, and the first payment was made timely. No second payment was made, and the attorney brought an application to be relieved as counsel, because his client was not returning his calls, either.

The Court granted the application, and it turns out that Zoltar was actually now a guest of the Federal Government. During 2020, Zoltar apparently obtained over $13 million in COVID-19 relief loans, which he used for personal purchases, such as paying off his personal mortgage, buying a Bentley, and acquiring a Cape Cod vineyard.

When we verified these facts, we had no choice but to advise the MacMillan that we would be closing the file as uncollectible. Zoltar went directly to jail; he did not pass go; he will not collect $200. But neither will we. ■

Timothy Wan, Esq.
Contributing Editor

Founded in Austin. Serving all of Texas.

Barnett & Garcia, PLLC is a civil litigation law firm located in Austin and San Antonio, Texas. Our attorneys are experienced in representing creditors, collection agencies, financial institutions and insurance carriers in alternative dispute forums and state, federal and appellate courts. With over fifty years of combined litigation experience, Barnett & Garcia's attorneys have earned a reputation for professionalism and zealousness in the representation of their clients.

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COUNSELORS AND ATTORNEYS AT LAW

MAIN OFFICES IN AUSTIN

3821 Juniper Trace
Suite 108
Austin, TX 78738
United States
p: 512.266.8830
f: 512.266.8803

Matt Garcia
(512)266-8830 x: 302
matt@barnettgarcia.com

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NUMBER OF MEMBERS	CURRENT RATE	ORGANIZATION RATE	ANNUAL SAVINGS	DISCOUNT SAVINGS
1	$540	–	–	–
2	$1,080	$972	$108	**10%**
3	$1,620	$1,377	$243	**15%**
4	$2,160	$1,728	$432	**20%**
5	$2,700	$2,025	$675	**25%**
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NO MORE DRAWING OUTSIDE THE LINES: U.S. Supreme Court's Purdue Pharma Decision Constrains Chapter 11 Bankruptcies

OVERVIEW

On June 27, 2024, the U.S. Supreme Court released its highly anticipated opinion in *Harrington v. Purdue Pharma L.P.*, Case No. 23-124 ("*Purdue*").[1] The question before the Court was whether the bankruptcy code lets a court approve, as part of a chapter 11 plan, a release that extinguishes claims held by nondebtors against nondebtor third parties, without such claimants' consent.[2] Nonconsensual third-party releases of nondebtors allow those nondebtors to escape the rigors of filing for bankruptcy protection themselves while still receiving its primary benefit: a discharge of all material liability under a confirmed chapter 11 plan.[3]

This outcome upends decades of chapter 11 practice in many circuits, including the Second and Third Circuits (though other circuits, such as the Fifth and Ninth, had banned the practice.)[4] The decision resolves that circuit split and imposes a uniform law prohibiting nonconsensual nondebtor releases and injunctions in chapter 11 plans.

Although highly controversial, plan proponents have used these releases in chapter 11 cases in the circuits permitting them for decades. This is especially true in mass tort bankruptcy plans.

Purdue is a mass tort bankruptcy case where the debtor leveraged the collective process of bankruptcy to corral thousands of torts claims into bankruptcy to resolve all tort liabilities through a chapter 11 plan. *Purdue* has put into question this strategy because nonconsensual nondebtor releases were an essential part of the intended chapter 11 plan.

The large settlements in mass tort cases like Purdue Pharma's require large financial contributions by nondebtors to satisfy billions in current and future tort claims. In *Purdue*, a nearly $6 billion settlement funded by the nondebtor Sackler family was at stake.[5] Without this settlement and its controversial nonconsensual third-party releases, plan proponents threatened an all-or-nothing tradeoff and the potential for no relief to opioid claimants if reversed.[6]

The bankruptcy court confirmed Purdue Pharma's proposed Chapter 11 plan, but the U.S. District Court reversed the confirmation order. The Second Circuit then reversed the District Court and affirmed the chapter 11 plan.[7] The U.S. Trustee and others sought relief at the Supreme Court.[8] In its 5-4 decision, the Supreme Court held that no authority exists for nonconsensual third party releases under the bankruptcy code and reversed the Second Circuit, again rejecting Purdue Pharma's plan.

Justice Gorsuch, writing for the Court, held "the bankruptcy code does not authorize a release and injunction that, as part of a plan of reorganization under Chapter 11, effectively seeks to discharge claims against a nondebtor without the consent of affected claimants."[9] The Court remanded the case to the bankruptcy court for further proceedings consistent with the majority opinion.

On remand, the debtors promptly sought court assistance at a July 9 status conference to resume mediation on a new plan.[10] The bankruptcy court granted relief and extended the litigation stay until September 9 to pause lawsuits during the mediation.[11] Plan proponents want fast-track negotiations on a new chapter 11 plan. Meanwhile, the creditor's committee has sought standing to pursue almost $12 billion in fraudulent transfer claims against the Sacklers.[12]

The Sacklers still seem committed to settlement, telling the press after the Supreme Court's decision "that a swift negotiated agreement to provide billions of dollars for people and communities in need is the best way forward."[13] The case is fast moving, and developments will occur after CLW's August publication deadline. This article discusses the majority and dissenting opinions in what seems to have been a close and heated call by the justices. It concludes with some preliminary views on the implications for chapter 11 practice.

1 603 U.S. – (2024); 144 S.Ct. 207 (2024).

2 *Id.* at 2077. For the Questions Presented, visit https://www.supremecourt.gov/qp/23-00124qp.pdf.

3 *Id.* at 2079, 2081. This article uses references third-party and nondebtor releases interchangeably.

4 For a discussion of the circuit court split, see Candice Kline, *Nonconsensual Third-Party Releases in the Spotlight: Challenging the Limits of the Law and Drawing Congressional Scrutiny*, COMMERCIAL LAW WORLD, Vol. 35, Issue 1, pp. 26–35 (2021).

5 *Id.* at 2088 (dissenting opinion).

6 *Id.* at 2015 (dissenting opinion); See also Brief for Debtor Respondents (filed Oct. 23, 2023), available at https://www.supremecourt.gov/DocketPDF/23/23-124/285728/20231020162712854_2023-10-20%20-%20SCT%20No.%2023-124%20-%20Debtor%20Respondents%20Merits%20Br.pdf ("As the bankruptcy court found, without the releases, the plan would 'unravel', and victims would likely recover nothing." *Id.* at p.4.)

7 144 S.Ct. at 2074.

8 *Id.* at 2080.

9 *Id.* at 2088.

10 *See* Letter to Chambers Requesting Status Conference, Docket No. 6498 (filed June 27, 2024), available at https://restructuring.ra.kroll.com/purduepharma/Home-DocketInfo website ("Kroll website").

11 *See* Order Appointing Co-Mediators, Docket No. 6537 (filed July 10, 2024), available at Kroll website.

12 *See* Motion of Official Committee of Unsecured Creditors for Sole Standing to Commence and Prosecute Estate Causes of Action, Docket No. 6523 (filed July 8, 2024).

13 Allison Durkee, *Billionaire Sackler Family Members Could Face Fresh Lawsuits After Purdue Opioid Settlement Falls Apart*, FORBES (July 9, 2024), available at https://www.forbes.com/sites/alisondurkee/2024/07/09/billionaire-sackler-family-members-could-face-fresh-lawsuits-after-purdue-opioid-settlement-falls-apart/.

1. PURDUE LEVERAGED CHAPTER 11 PLAN PROCESS TO SEEK RELIEF AND SETTLE WITH THE SACKERS USING NONCONSENSUAL NONDEBTOR RELEASES

Purdue Pharma, the maker of OxyContin, a pain-relieving opioid drug, filed bankruptcy in 2019 to address thousands of opioid-related claims totaling billions in claimed damages.[14] The opioid public health crisis hurt families and municipalities across the country.[15] Claimants alleged Purdue had a significant role in the crisis by aggressively marketing OxyContin using deceptive marketing practices.[16] That aggressive marketing push resulted in $34 billion in revenue for Purdue from 1996 to 2019, mostly earned from OxyContin sales.[17] The Sackler family, which owned and controlled the company, likewise amassed great wealth – estimated at $14 billion in net worth.[18]

Aware of the litigation and risk after a Purdue affiliate pled guilty to a federal felony for misbranding OxyContin, from 2008 through 2016 the Sacklers transferred around $11 billion to themselves, draining Purdue's financial resources.[19] The Sacklers then placed much of the transferred money in overseas trusts as additional asset protection,[20] and also secured an indemnification agreement with Purdue.[21] When Purdue filed for bankruptcy, the transfers to the Sacklers had weakened its financial health and depleted its remaining assets to the point that there they were not enough assets to satisfy the growing volume of claims against it. Purdue required an outside contribution to its chapter 11 plan and that contribution was coming from the Sacklers.[22]

After significant effort to negotiate a chapter 11 plan, including through extensive use of mediation, the proposed plan intended to convert Purdue to a public benefit corporation and provide distributions to victims and creditors.[23] Purdue's proposed plan included a $4.5 billion contribution from the Sacklers in exchange for a full and comprehensive release of all claims, including those held by nondebtors who did not consent to the plan.[24] Following extensive fact-finding and a six-day confirmation trial, the bankruptcy court confirmed Purdue's chapter 11 plan with the Sackler nondebtor releases mostly intact.[25]

The bankruptcy court concluded that the Sackler releases were appropriate given their large contribution to the plan and the practical considerations around mass tort settlements, such as providing equitable distributions, and the difficulties creditors and victims would face if they sought recovery outside the plan.[26] Citing Second Circuit precedent, the bankruptcy court confirmed the plan.[27]

Various claimants appealed to the district court.[28] While that appeal was pending, the parties revised the proposed settlement with the Sacklers, raising the contribution to $5.5 to $6 billion, which had the result of resolving most of the remaining objections, including those of the handful of states' AGs which had opposed the plan.[29] Improved funding notwithstanding, the district court reversed plan confirmation, finding no authority in the bankruptcy code for the nonconsensual releases of the Sacklers.[30]

The debtors and plan proponents appealed to the Second Circuit, which reversed the district court and revived the bankruptcy court's confirmation order approving the plan.[31] The U.S. Trustee for Region 2, William Harrington, applied to the Supreme Court to stay the decision, which the Court granted when it agreed to take the case.[32]

In the Supreme Court, the primary remaining plan opponent was Harrington.[33] The U.S. Trustee is neither a debtor nor creditor, but a "watchdog" charged with overseeing the integrity of the bankruptcy system. (Some parties and observers questioned his standing to challenge the plan on appeal.) Over 90% of creditors who had voted on the plan approved it, and the unsecured creditors' committee supported the plan.[34] All fifty state attorneys general eventually supported the plan.[35] Regardless, the U.S. Trustee persisted–to finally get a decision on whether authority existed under the bankruptcy code for nonconsensual nondebtor releases in chapter 11 plans.

14 144 S.Ct. at 2077–79.
15 *Id.* at 2078.
16 *Id.*
17 *Id.*
18 *Id.*
19 *Id.* at 2078–79.
20 *Id.* at 2079.
21 *Id.* at 2081, n.7.
22 *Id.* at 2101.
23 *Id.* at 2079.
24 *Id.*

25 *Id.* at 2080, 2101.
26 *Id.* at 2101.
27 Id. at 2080 (citing confirmation decision, 633 B.R. 53, 95–115 (Bankr. S.D.N.Y. 2021)).The dissenting opinion provides an extensive discussion of the bankruptcy court and second circuit decisions, id. at 2098–2104.
28 Id. at 2080.
29 *Id.* at 2101–02.
30 *Id.* at 2080 (citing the district court decision, 635 B.R. 26 (S.D.N.Y. 2021)). An article earlier in this CLW series discussed the district court decision, which caught practitioners by surprise given the decades of precedent in the Second Circuit. See Candice Kline, *Are Nonconsensual Third Party Releases Headed to the Supreme Court?*, COMMERCIAL LAW WORLD, Vol. 36, Issue 3, pp. 32–35 (2022).
31 144 S.Ct. at 2080.
32 *Id. See* Application, No. 23A87 (filed July 28, 2023), petition granted August 10, 2023, U.S. Supreme Court docket, available at https://www.supremecourt.gov.
33 *Id.* at 2103 & n.4.
34 *Id.* at 2103.
35 *Id.*

2. A DIVIDED COURT DEBATED LAW AND POLICY, AND THE ROLE OF THE COURT ITSELF

The Court split hard in *Purdue*, crossing ideological lines, and highlighting the tough call. Justice Jackson of the progressive wing of the Court joined the majority comprised of Justice Gorsuch, writing for the Court, and Justices Alito, Barrett, and Thomas. The dissent, by Justice Kavanaugh, included the remaining progressive Justices Sotomayor and Kagan, and Chief Justice Roberts.

That Chief Justice Roberts joined the dissent was intriguing. His questions at oral argument explored the limitations of courts making public policy versus the role of Congress.[36] He also raised the "no elephants in mouse holes" approach to divining Congressional statutory intent. The majority opinion reflected these views and directed the policy issues back to Congress; yet the Chief joined the dissent.

The majority and the dissent offered differing visions of bankruptcy, interpretations of the bankruptcy code, and even where we go from here. The first line of the majority opinion began with the bankruptcy code and the essence of bankruptcy law.[37] The first line of the dissent berated the decision as "wrong on the law and devastating for more than 100,000 opioid victims and their families."[38] The majority and dissent found little common ground and drew wildly different pictures of the future after the decision. The majority was hopeful a better deal may occur, following the U.S. Trustee's position, but the dissent expected a disaster, a viewpoint argued throughout the plan disputes if the court rejected the Sackler releases.

The dissent was remarkable for its strident and aggressive tone toward the majority, undermining perceptions of civility and collegiality among justices. It argued "today's decision makes little sense legally, practically, or economically."[39] The dissenters, so moved to preserve Purdue's plan and avoid grave injustices from losing the Sackler "all or nothing" settlement, infused their criticism with energetic zeal and urgency. For every criticism, though, the majority answered.

36 The author attended oral argument on December 4, 2023.

37 144 S.Ct. at 2077 ("The bankruptcy code contains hundreds of interlocking rules about 'the relations between' a 'debtor and [its] creditors.'").

38 *Id.* at 2088.

39 *Id.* at 2115.

3. THE MAJORITY OPINION STUCK THE LANDING ON STATUTORY INTERPRETATION

In a 20-page opinion, Justice Gorsuch focused on the bankruptcy code and found no statutory support for nonconsensual third-party releases. His analysis was efficient and adhered closely to the bankruptcy code. It closed gaps long relied on by bankruptcy courts and practitioners to get more from the bankruptcy code than provided by the statute.

For example, the decision left little room under section 105(a) for bankruptcy courts to find reserve equitable power not otherwise permitted by another code provision.[40] This alone may compel practitioners to look carefully at additional statutory authority before seeking equitable relief.

Plan proponents relied on code section 1123(b)(6), which states a plan may "include any other appropriate provision not inconsistent with the applicable provisions of this title" [41] to permit nonconsensual third-party releases.[42] The Second Circuit relied on this catchall clause relied on to allow the nondebtor releases in the *Purdue* plan.[43] The majority opinion, though, narrowly interpreted section 1123(b)(6), holding that the provisions only apply to the debtor and finding that they provide no authority for nondebtor releases.[44] The dissent would have interpreted the provision broadly and permitted them.[45] (The majority also found important the existence of section 524(g), which allows injunctions against nondebtors but only in asbestos cases, as undercutting the dissent's argument that 1123(b)(6) "is best read to afford courts that same authority in *every* context.")[46]

The opinion also dismissed as "word games" the debate that a release such as the Sacklers received in the plan is not a "discharge." [47] A confirmed plan discharges the debtor under section 1141(d)(1)(A) and "does not affect the liability of any other entity" under section 524(e).[48] Plan proponents and their supporters argued that the releases granted to the Sacklers differed from the discharge granted under code section 524(e), reasoning that the plan's releases addressed less than all

40 *Id.* at 2082 & n.2. References to bankruptcy code sections are to chapter 11 of title 11 of the U.S. Code, e.g., 11 U.S.C. 105(a).

41 *Id.* at 2081-84.

42 *Id.* at 2081–82.

43 *Id.* at 2082. For the Second Circuit's decision affirming plan confirmation, see *In re Purdue Pharma L.P.*, 69 F.4th 45 (2d. Cir. 2023).

44 *Id.* at 2084–85.

45 *Id.* at 2088, 2095.

46 Compare majority view restricting section 524(g)) to asbestos cases only, id. at 2085, *with* dissenting view providing an expansive mass tort application based on congressional intent, id. at 2111–12 .

47 *Id.* at 2085–86.

48 *Id.* at 2081.

the claims and debts facing the Sacklers.[49] The majority, though, found that the plan's releases covered the claims most material to the Sacklers and viewed this as a distinction without a difference.[50]

The majority opinion focused on the law and the "simple bargain" underlying the bankruptcy system: to obtain a discharge of claims, a debtor must have acted honestly and put its assets on the table for creditors.[51] What the majority found difficult to accept was that the Sacklers did not do this.[52] The opinion noted on a couple of occasions that the Sacklers never filed for bankruptcy protection but would receive the practical benefits of a bankruptcy discharge.[53]

The majority also seemed dismayed by the gap between the $11 billion extracted from Purdue by the Sacklers in the years before the bankruptcy filing and the far smaller $4.5 billion first offered (though improved to $5.5-$6 billion during the appeal) in exchange for the releases.[54] The Sacklers' failure to put all their assets on the table was made worse for the majority by a proposed payment schedule for their contributions to the plan, stringing payments out over 10 years. In effect, this arrangement would let the Sacklers keep a significant portion of these monies, earning interest which would fund the contributions, potentially incurring no real loss at all.[55] In the majority's view, the settlement violated the basic principle underlying bankruptcy relief: The Sacklers were not humble and honest debtors holding their hats in hand, surrendering for judgment, and giving up. The majority saw them as abusing the system.

Additionally, the majority struggled with the Sacklers obtaining a full and comprehensive release of claims that might involve fraudulent and wrongful conduct. Section 523 ensnares fraudsters and excepts from discharge debts arising from wrongful acts by small businesses and individuals. Creditors use those provisions with some zeal in smaller cases outside the mass tort context. The majority widened its lens and looked to that same section in the case of the Sacklers and the $6 billion settlement, with no good result for settlement of such larger cases as *Purdue*.[56]

Offended by the Sacklers' effort to dodge accountability, the majority rejected the Sacklers attempt to "seek greater relief than a bankruptcy discharge normally affords ... and seek to do so without putting anything close to all their assets on the table." [57] Section 523 and the "simple bargain" are both policy decisions made by Congress when it enacted the bankruptcy code. That the Court applied them in *Purdue* suggests concerns about a two-tiered bankruptcy system that lets large corporations and billionaires buy releases for wrongful conduct by funding chapter 11 plan settlements when smaller debtors could never receive such a benefit because of the section 523 exceptions from discharge.

The majority relied on a rule of statutory construction called *ejusdem generis*.[58] Although described as an "ancient interpretive principle," this rule is probably foreign to most readers.[59] The rule means that a catchall clause like (b)(6) at the end of a list such as that in 1123(b) must reflect its "surrounding context and read to 'embrace only objects similar in nature' to the specific examples preceding it." [60] The idea, according to the majority, would "afford a statute the scope a reasonable reader would attribute to it." [61] The approach would confine all items in a list to the context and nature of the listed items before it.

Armed with these guidelines, the majority concluded the "appropriate" relief allowed under section 1123(b)(6) pertained to the debtor and in no way permitted nonconsensual nondebtor releases.[62] The result limited the equitable catch-all in (b)(6) to a downspout trickle of related items to those listed in subsections (b)(1)-(5). This restrained approach prevented the broad equitable language of (b)(6) from achieving a greater glory by permitting nonconsensual releases of nondebtors.

The majority also saw a more limited role for bankruptcy courts and criticized the suggestion that bankruptcy courts have "a roving commission to resolve all such problems that happen its way." [63] For the majority, "bankruptcy court's powers are not limitless and do not endow it with power to extinguish [nondebtors' claims] without their consent." [64]

The majority dismissed the many policy reasons for upholding the *Purdue* plan and the Sackler settlement and saw a narrow role for courts in addressing major policy questions. The Court deferred to Congress on the discharge and described its "only proper task is to interpret and apply the law as we find it; and nothing in present law authorizes the Sackler discharge." [65]

After analyzing the bankruptcy code and concluding no authority exists for bankruptcy courts to approve plans with nonconsensual third-party releases, the majority ended on an optimistic note, in contrast with the strident tone of the dissent. Filled with possibility, Justice Gorsuch leaned into an argument made on

49 *Id.* at 2082, 2012.
50 *Id.* at 2081, 2086.
51 *Id.* at 2077–78.
52 *Id.* at 2086.
53 *See, e.g.,* id. at 2077, 2086.
54 *Id.* at 2079–80.
55 *Id.* at 2079.
56 *Id.* at 2085.
57 *Id.* at 2086.

58 *Id.* at 2082–83.
59 *Id.*
60 *Id.* at 2082 (quoting *Epic Sys. Corp. v. Lewis,* 584 U.S. 497 (2018)).
61 *Id.* at 2083.
62 *Id.* at 2084–85.
63 *Id.* at 2084.
64 *Id.*
65 *Id.* at 2087

behalf of the U.S. Trustee that a better plan was still out there.[66]

It has happened before. The Purdue settlement with the Sacklers improved to nearly $6 billion from $4.5 billion after the district court rejected plan confirmation. A similar improvement could occur again.

4. THE DISSENT FOCUSED ON POLICY AND EQUITABLE CONCERNS, AND SOME LAW

The dissent came out swinging. The 54-page dissenting opinion by Justice Kavanaugh—almost three times longer than the majority opinion—simmered throughout with anger and outrage that the nonconsensual third-party releases were essential to the confirmed Purdue plan. If the majority opinion based its authority on the law, the dissent found its authority in public policy, concern for opioid victims, and in state mitigation programs that flowed from the plan. They believed the plan proponents' arguments that the consequences of reversal were nothing short of dire and would leave opioid victims and creditors with nothing. Reversal, warned the dissent, would unravel the plan, and destroy all the good expected from the settlement.[67]

The conventional-wisdom ideological leanings among the dissenting justices highlighted the nonpartisan nature of bankruptcy decisions. The dissent echoed the plan proponents on the merits of the settlement and the profound harm to victims if the plan did not survive. The dissent placed weight on the extensive deliberations and work by the bankruptcy judge to confirm the plan, calling the plan a "shining example of the bankruptcy system at work." [68] It focused on the overwhelming creditor support, though without concern for voting participation.[69] For the dissent, the plan process was thorough, inclusive, and should stand undisturbed.

This desire to leave the Sacker settlement alone and preserve the nonconsensual third-party releases declared essential to the Purdue plan is not new. Without saying so, the dissent leans into the equitable mootness doctrine. Equitable mootness is a court-made doctrine that protects plans after confirmation from the effects that a reversal based on errors of law would inflict and favors plan implementation over legal correctness when unraveling the plan would be inequitable or difficult. Equitable mootness is judicial deference to lower courts, a doctrine that protects reliance on the plan from the few remaining objectors still challenging it on appeal, even if the appeal presents merits.

The dissent found persuasive that there was diverse and overwhelming support for the Purdue Pharma plan, and particularly as relative to the few remaining objectors, described as "a sole individual and a small group of Canadian creditors" besides the U.S. Trustee.[70] (For the Trustee, the dissent in footnote 4 reserved special criticism of his dogged effort to challenge the Sackler releases in the Purdue Plan. The dissent called his position "mystifying" and reduced his role from "bankruptcy watchdog" to the "Regional Trustee for three States." [71] The criticism of the U.S. Trustee was direct: "U.S. Trustee purports to look out for victims and creditors, but here the victims and creditors made emphatically clear that the 'U.S. Trustee does not speak for the victims of the opioid crisis' and is thwarting the opioid victims' efforts at fair and equitable recovery." [72])

This criticism would apply to any objector—and any public interest objector—where threats of standing and a lack of economic stakes could hamper meritorious appeals in other chapter 11 cases. This term, however, the Supreme Court acknowledged a broad right for parties in interest to participate in bankruptcy cases in *Truck Insurance Exchange v. Kaiser Gypsum Co. Inc*, an 8-0 opinion by Justice Sotomayor (who is in the dissent in *Purdue*).[73] This earlier clear statement that parties-in-interest have a valid place in the process may have kept the dissent from declaring that the U.S. Trustee lacked standing, despite plan proponents' invitation to do so.

Throughout the dissent, Justice Kavanaugh feared the total collapse of the Purdue plan and the $6 billion settlement at its heart. This fear and concern—the risk of unwinding a large chapter 11 plan—drove the dissenting justices to harden support for the offending releases, both legally and equitably. The dissent viewed the plan as "fair and equitable" and the only way to get relief for victims and creditors without the downsides of the "tort system" and the inevitable value-destroying race to the courthouse.[74]

Only bankruptcy offers an automatic stay of litigation and an adjudication process that stops the race to the courthouse and forces all parties to the bargaining table. The dissent embraced the superiority of bankruptcy over all other approaches to resolving mass tort liabilities, relying on cases reflecting decades of experience using bankruptcy to resolve mass tort cases (conveniently ignoring several circuits having rejected the approach used by Purdue here) and felt the practice should continue.[75]

66 *Id.*
67 *Id.* at 2115 (relying on oral argument).
68 *Id.* at 2088, 2101–02.
69 *Id.* at 2101.

70 *Id.* at 2103.
71 *Id.*, n.4.
72 *Id.* (citing oral argument transcript).
73 No. 22-1079, 603 U.S. –, 144 S.Ct. 325 (2024).
74 144 S.Ct. at 2101–02, 2092.
75 *Id.* at 2092–93, 2096, 2104, 2114. For the majority's response to "decades" of precedent, see id. at 2086.

For the dissent, the "collective action problem" justified the unique position of chapter 11 bankruptcy courts as a forum for resolving mass tort cases.[76] Professors Casey and Macey developed this argument in their essay, "In Defense of Chapter 11 for Mass Torts" [77] and the dissent heavily relied on their scholarship, citing the essay seven times.[78] It appears that this one essay had more influence than any brief filed. Professors Casey and Macey may be correct in arguing that bankruptcy is the right forum to address mass torts (though with reforms which they explain), but for the majority the cold, dry bankruptcy code is not there yet.

Although policy arguments consume pages of the dissent, it is not without legal criticism. The dissent confronted the majority head on, exclaiming "It is hard to conjure up a weaker *ejusdem generis* argument than the one put forth by the Court today." [79] For the dissent, the purpose of section 1123, the powers embedded in the other subsections (b)(1)-(5), and precedent supported a reserve of "broad powers" for the bankruptcy court in the equitable catchall section 1123(b)(6).[80]

Examples of those powers included the bankruptcy court's power to approve plans that release derivative claims held by nondebtors as part of the debtors' releases under (b)(3) as evidence of nonconsensual releases allowed by the code.[81] The majority, however, distinguished direct claims from derivative claims that belong to the debtor's estate and seemed unconcerned with potential indemnifications claims in *Purdue* or generally, given the potential (as cited by the U.S. Trustee in his Reply Brief) for disallowance or equitable subordination of indemnification claims under code sections 502(e)(1)(B) and 510(c)(1).[82]

The dissent argued that support for *consensual* releases and for full-satisfaction releases, both widely used, can only be found in §1123(b)(6) itself.[83] Since bankruptcy courts regularly approve of both types of releases, such statutory authority must exist. Similarly, bankruptcy courts routinely approve exculpation clauses that protect corporate directors and officers and professionals who work on chapter 11 cases, though such clauses are also without direct statutory authority.[84]

Although the Court's majority opinion did not rule on each of these other types of releases, their vulnerability is obvious: without express statutory authority, any nondebtor release or injunction in a chapter 11 plan is now subject to reversal. It is time for Congress to respond and change the bankruptcy code to align with current chapter 11 practice. The dissent sought to preserve the status quo and defer to practitioners and commentors. The majority reminded us it is statute that matters.

76 *Id.* at 2090–91.
77 90 U. Chi. L. Rev. 973 (2023).
78 *Id.* at 2089, 2092–94, 2102, and 2116.
79 *Id.* at 2106.
80 *Id.* at 2109–11.
81 *Id.* at 2109.
82 *Id.* at 2087, n.7.
83 *Id.* at 2108–09.
84 *Id.* at 2109.

5. GAMES CONCLUDED: CHAPTER 11 CASES FACE CHANGE AND UNCERTAINTY

Supreme Court decisions are often more important for what they leave for another day. Indeed, Justice Gorsuch concluded: "As important as the question we decide today are ones we do not." [85] The Court left unanswered what is consent and whether support exists for bankruptcy courts to approve consensual releases, something presently taken for granted in chapter 11 practice. Foreshadowing the issue, in oral argument Justice Thomas questioned the authority for bankruptcy courts to grant consensual releases; for practitioners this is an ominous sign.

The cure is congressional action, something hard to expect from the same congress that allowed the lapse of the Subchapter V debt limit extension in June 2024. But the Court has told practitioners that policy decisions are up to Congress.

What more can we discern from the opinion? A few selected observations, all subject to the caveat that courts are wrestling with the implications in real time, appeals take a long time to percolate up to the Court, and the Court generally does not try to answer questions not directly before it. It took over three decades for nonconsensual third-party releases to have their day in court.

The Holding: Chapter 11 plans with releases and injunctions that protect nondebtors from direct claims held by other nondebtors are now impermissible if without the consent of the affected nondebtors. Releases by the debtor remain valid and are unaffected by the decision.

Asbestos Cases: The Court highlighted that code section 524(g) permits injunctions and releases protecting certain nondebtors, but only for asbestos cases and within the express scope of that code provision. Following that same model framework, cases like *Purdue* and *Boy Scouts* extended section 523(g) beyond asbestos cases to apply to non-asbestos mass tort liabilities, being opioids and abuse cases, respectively.[86] The Court rejected this evolution as being

85 *Id.* at 2087.
86 For information on the *Boy Scouts* chapter 11 case, see https://cases.omniagentsolutions.com/?clientId=3552.

without legal basis until Congress has revised the bankruptcy code.

Boards, Officers, and Professionals: The bar on nonconsensual nondebtor releases will change how companies and their stakeholders and professionals approach chapter 11 plans. Nonconsensual nondebtor releases have proliferated beyond the asbestos and even mass tort cases; in many plans, these broad releases have become expected and form part of routine chapter 11 plans. *Purdue* closes the door on approving such plans.

Consensual Releases: The Court declined to address consensual nondebtor releases and what is consent, leaving both issues unresolved. Plans that let creditors opt out of nondebtor releases seem unaffected by the opinion, though we can expect future disputes around questions of consent, for example, how to solicit consent and what to do with non-participating creditors. The Opt-in approach seems favored by the U.S. Trustee's office and some courts in the immediate aftermath of Purdue.[87] Opt-in plans that require affirmative creditor consent may yet remain valid. Plans based on consensual nondebtor releases seem consistent with the *Purdue* opinion and may remain lawful.

Full-Satisfaction Releases: The Court declined to address nonconsensual nondebtor releases in plans that provide for the full satisfaction of claims against the released nondebtor, leaving open a question about what full satisfaction is. This is an issue as plans confirmed as full satisfaction plans seem to show substantial impairment post-confirmation. A recent example is the *Boy Scouts* case.

Substantially Consummated Plans: The Court did not say what should happen to plans with nonconsensual nondebtor releases that have gone into effect, with plan distributions commenced. This deference may protect cases like *Boy Scouts* that have gone effective. The *Boy Scouts* plan has escaped this snare, though it and other non-asbestos cases with active appeals could stumble on further review.

Equitable Mootness: The equitable mootness doctrine may be the next longstanding bankruptcy doctrine to fall. Equitable mootness protects plans from being unraveled by objectors who appeal plan confirmation. After *Purdue*, though, this judge-made doctrine seems vulnerable, as it exists outside any statutory authority under the bankruptcy code except section 105(a). The *Purdue* majority rejected any standalone authority under section 105(a). Equitable mootness, long enforced by policy to protect reliance on confirmed plans and to avoid practical difficulties of unwinding chapter 11 plans, may fall short. An expansion of statutory mootness under code section 363(m), which protects reliance on bankruptcy sale and lease transactions, may hint at a possible legislative fix.

Exculpation: Exculpation clauses seem vulnerable after the *Purdue* opinion as nonconsensual third-party releases. An approach could have debtors solicit consent for these releases like the other releases. A practical near-term approach is for chapter 11 plans to maintain the existing plan form treatment and see how the exculpation clause and injunction weather plan objections.

For example, post-*Purdue*, the Southern District of New York bankruptcy court denied releases to corporate officers and directors based on violating the executive compensation restrictions in code section 503(c) while allowing the releases for non-insiders over the objection of the U.S. Trustee, without mentioning Purdue or otherwise ruling on the permissibility of the releases.[88]

Texas Two-Step: The Court did not address divisive mergers and the "Texas Two-Step" maneuver increasingly common in mass tort cases. Although enterprise liability management seems likely to persist, the attractiveness of using bankruptcy to resolve the mass tort liabilities of the liability-laden affiliate may wane. J&J/LLT Management (formerly LTL Management) is probably the first test case post-*Purdue* in its third attempt at securing bankruptcy relief (now planned to occur in Texas instead of New Jersey, the place of its twice dismissed attempts at bankruptcy relief) to control and resolve its substantial talc-based product liability issues.[89]

Meanwhile, congressional leaders have introduced bipartisan legislation aimed at banning the two-step practice. The legislation, called the Ending Corporate Bankruptcy Abuse Act of 2024, would require bankruptcy courts to presume bad faith under several scenarios common to Texas Two-Step transaction and limit preliminary injunctions protecting nondebtor entities.[90]

Preliminary Injunctions: Preliminary injunctions at the outset of the case still seem possible, though they too accrue skepticism in some courts, e.g., *3M/Aearo Technologies*.[91] While it is an essential part of the mass tort playbook to obtain a stay of all litigation on day one, courts do not always grant them and even on remand in *Purdue*, the injunction is a short 60 days.

87 *See* Dietrich Knauth, *Red Lobster Can't Use 'Opt-Out' Liability Releases for Bankruptcy, Judge Rules,* REUTERS (July 26, 2024), available at https://www.reuters.com/legal/litigation.

88 *See* Decision, *In re Mercon Coffee Corp.*, No. 23-11945, Docket No. 674 (Bankr. S.D.N.Y. July 19, 2024) (Wiles, J.).

89 For information about the J&J/LLT Management (fka LTL Management) chapter 11 case, see https://dm.epiq11.com/case/redrivertalc/info. J&J also issues press releases about the bankruptcy at https://www.jnj.com/media-center/press-releases.

90 For the bill's text, see Press Release, *Whitehouse, Hawley, Sykes, Gooden Introduce Bipartisan Legislation to Deter 'Texas Two-Step' Bankruptcy Trick* (July 23, 2024), available at https://whitehouse.senate.gov/news/release/.

91 For information on the Aearo Techs. chapter 11 case, see https://restructuring.ra.kroll.com/aearotechnologies/Home-Index.

Courts since the *Purdue* decision seem cautious yet permissive under the right facts.[92]

Forum-Shopping to Foreign Jurisdictions: Several commentators and practitioners predict a movement to use foreign insolvency regimes that grant nonconsensual third-party releases and then seek recognition of the foreign main proceeding under the chapter 15 cross-border insolvency provision to enforce the releases in the U.S. as a matter of comity.

Forum shopping is already rife in chapter 11 practice. Before *Purdue*, it was essential in mass tort cases to shop the case into a circuit that granted nonconsensual third-party releases. With a uniform ban on nonconsensual third-party releases across the country, there will be less necessity to shop a case on that basis alone, although other reasons cited for venue shopping will persist. Time will tell if releases alone would compel a large company to file the case in a foreign country. Other factors, such as flexibility and costs, may drive insolvency cases to foreign lands.

CONCLUSION

Any future authority for nonconsensual third-party releases beyond the section 524(g) for asbestos cases must come from Congress and not the courts. Whether this constraint and others that may evolve in the courts cause less demand for bankruptcy filings is an open question. Major chapter 11 stakeholders, such as insurers and senior lenders who often were reliant on comprehensive releases, must adapt to post-*Purdue* realities. It remains true that bankruptcy offers an experienced forum for addressing the collective action problem; the creativity and resilience of bankruptcy practitioners seem likely to find a path forward.

As embraced by plan proponents and the dissent, pessimism reigns over prospect of any better deal with the Sacklers, let alone the efficacy of chapter 11 in mass tort cases post decision. The majority and the U.S. Trustee suggest optimism deserves its due. That optimism—and respect for the rule of law—lies at the heart of the hard work of restructuring and settlements.

[Ed. Note - The CLLA's bankruptcy section has a subcommittee on third-party releases and has been working on proposed legislation to solve this practical problem. The league also filed an amicus brief in Purdue. Please contact Dawn Federico at CLLA.org if you want to learn about or join our efforts.] ■

92 For a post-*Purdue* opinion describing updates to preliminary injunction analysis, see *In re Parlement Techs., Inc.*, No. 24-10755, Docket No. 102, 2024 WL 3417084 (Bankr. D. Del. July 15, 2024) (Goldblatt, J.).

EXAMINE YOUR OPTIONS FOR EXAMINERS

The Leverage May Be Greater Than You Think

Since the United States Court of Appeals for the Third Circuit entered its decision in *In re FTX Trading Ltd,* 91 F.4th 148 (3d Cir. 2024), much has been written about the appointment of an examiner. Lauren M. Wagner may have captured the essence of *FTX* best in the title of her article *A Simple Decision in a Complex Case: Appointment of an Examiner is Not Discretionary*, in the ABI July's 2024 Journal. Lauren M. Wagner, ABI Journal, July, 2024. The facts of *FTX* gave rise to great discussions and much fanfare. And its CEO, his behavior (and his hair) helped keep it interesting. But now that time has passed – what does *FTX* really mean to the Chapter 11 practice and will it change the dynamic between Debtors and Creditors?

Section 1104(c)(2) of the Bankruptcy Code provides,

> (c) If the court does not order the appointment of a trustee under this section, then at any time before the confirmation of a plan, on request of a party in interest or the United States trustee, and after notice and a hearing, the court shall order the appointment of an examiner to conduct such an investigation of the debtor as is appropriate, including an investigation of any allegations of fraud, dishonesty, incompetence, misconduct, mismanagement, or irregularity in the management of the affairs of the debtor of or by current or former management of the debtor, if—
>
> * * *
>
> (2) the debtor's fixed, liquidated, unsecured debts, other than debts for goods, services, or taxes, or owing to an insider, exceed $5,000,000.

11 USC §1104(c)(2).

The United States Court of Appeals for the Third Circuit read the statute as written in *In re FTX Trading Ltd,* 91 F.4th 148 (3d Cir. 2024), holding

> The issue before us is one of statutory interpretation: whether the plain text of Section 1104(c)(2) requires a bankruptcy court to appoint

an examiner, if requested by the U.S. Trustee or a party in interest, and if "the debtor's total fixed, liquidated, unsecured debt" exceeds $5 million.

91 F4th at 153. The Court's discussion focuses on the differences between Sections 1104(c)(1) and 1104(c)(2). In particular, the Court notes that the Section 1104(c)(1) gives the Court substantial discretion to determine whether to appoint an Examiner. While Section 1104(c)(2) of the Bankruptcy Code, contains the word "shall."

The Court found,

> Congress made plain its intention to mandate the appointment of an examiner by using the word "shall," as in the Bankruptcy Court "shall" appoint an examiner if the terms of the statute have been met. 11 U.S.C. § 1104(c). [Citations Omitted]. The meaning of the word "shall" is not ambiguous. It is a "word of command," *Black's Law Dictionary* (5th ed. 1979), that "normally creates an obligation

Jack Rose
Managing Partner
Law Offices of
Jack Rose Law PLLC

Kerri Ussher
Counsel
Law Offices of
Jack Rose Law PLLC

> impervious to judicial discretion," [Citations Omitted]. We have held that "shall" in a statute is interpreted as "must," which means "shall" signals when a court must follow a statute's directive regardless of whether it agrees with the result. [Citations Omitted]. To interpret "shall" as anything but an obligatory command to appoint an examiner, when the conditions of subsection 1104(c)(2) have been met, would require us "to abandon plain meanings altogether." [Citations Omitted]. Instead, the language of subsection 1104(c)(2) requires us to command the Bankruptcy Court to grant the U.S. Trustee's request for an examiner in this instance. [Citations Omitted].

91 F4th at 153. The Court in *FTX* also looked to the legislative history for support, finding:

> In obtaining passage of the Bankruptcy Code, the Senate floor manager explained the "business reorganization chapter" ensures "special protection for the large cases having great public interest." [Citations omitted.] Such protection comes from a provision guaranteeing an "automatically appointed" examiner in large cases, a measure designed to "preserve[] and enhance[]" debtors' and creditors' interests, "as well as the public interest." Id. The Code's sponsors agreed that, in cases where the "fixed, liquidated, unsecured debt" reached $5 million, the appointment of an examiner is required to [ensure] that adequate investigation of the debtor is conducted to determine fraud or wrongdoing on the part of present management." [Citations omitted] To guarantee that "the examiner's report will be expeditious and fair," the sponsors forbade the examiner from acting as or representing a trustee in the bankruptcy and required that the investigation remain separate from the reorganization process. [Citations omitted].

See FTX, 91 F.4th at 154-5.

The Court continued noting that notwithstanding its holding requiring mandatory appointment of an examiner (assuming the requirements set forth in the statute are satisfied), certain protections are built into the system. Specifically, the court found that:

> To the extent the mandatory nature of subsection 1104(c)(2) encourages parties in interest to invoke an investigation to tactically delay proceedings, the bankruptcy court has the discretion to continue with the confirmation process without receiving the examiner's findings or public report. [Citations omitted.]

Id. at 156.

Yet, the Court continued looking at the benefits derived from the appointment of an examiner. Once again, looking to the legislative history and found value in having a report upon which (a) the court could rely in making its determinations (including during the plan confirmation process) and (b) through which the public could obtain visibility. In the case of FTX, where the facts were particularly complex, the Court found,

> Requiring a public report furthers congress's intent, to protect the public's interest as well as those creditors and debtors directly impacted by the bankruptcy. Such protection seems particularly appropriate here. The collapse of FTX caused catastrophic losses for its worldwide investors, but also raised implications for the evolving and volatile cryptocurrency industry. For example, an investigation into FTX Group's use of its own cryptocurrency token, FTT's, to inflate the value of FTX and Alameda Research could bring this practice under further scrutiny, thereby alerting potential investors to undisclosed credit risk in other cryptocurrency companies. In addition to providing much-needed elucidation, the

investigation and examiners report ensure that the Bankruptcy Court will have the opportunity to consider the greater public interest when approving the FTX Group's reorganization plan.

Id at 157.

Thus, following the decision of the Third Circuit in *FTX*, there is a bright line test for appointment of an examiner. To do what – we don't know? For what purpose – we don't know? By what date – we don't know? For while the appointment may be mandatory the role appears to remain squarely in the hands of the Bankruptcy Judge.

And thus in any case where there is debt in excess of the statutorily required amounts, a creditor can file a motion seeking appointment of an examiner and gain substantial negotiating leverage.

The standards across the Circuits are not uniform. The Sixth Circuit's views align with those of the Third Circuit. The Sixth Circuit has held that appointment of an examiner is mandatory. See *In re Revco D.S., Inc.*, 898 F. 2d 498 (6th Cir. 1990). However, other courts have found that appointment of an examiner is discretionary relying on the language in the statute "as is appropriate". The same language that the *FTX* Court found to be used to limit only the scope of the examiner's role, these courts find to provide a court with discretion as to whether to appoint an examiner.

In the First Circuit, a court must determine whether the appointment of an examiner is in the interests of creditors, equity holders, and other interests of the estate and is weighed against the costs and expenses associated with the appointment of an examiner. See e.g. *In re: Table Talk, Inc.*, 22 B.R. 706 (D. Mass. 1982). There is no Circuit Court decision in the Second Circuit. However, a by the United States District Court for the Southern District of New York, followed the *Revco* holding that the appointment of an examiner is mandatory under Section 1104(c)(2) (when the statutory requirements of fixed, liquidated, unsecured debts, other than debts for goods, services or taxes, owing to an insider that exceed $5,000,000 are satisfied). The Fourth Circuit has not directly addressed requirements for the appointment of an examiner under Section 1104(c)(2).

The majority view is that the appointment of an examiner is mandatory where the statutory requirements are satisfied. However, depending on the jurisdiction in which you are located and court in which you are appearing before, it is important to do your homework as a different venues may have very different laws and even subtle differences could be meaningful in how a case should be presented and what type of evidence is persuasive.

COURT'S RELATED FINDINGS OF FACT OR MATTERS DISCRETION CAN COMPLICATE EXAMINER MOTIONS.

Putting aside such differences in standards pursuant to which to an examiner shall be appointed pursuant to Section 1104(c)(2) of the Bankruptcy Code, it is worth noting some courts have found ways to minimize the impact of an a examiner upon a case. This may include appointing an examiner with no duties, unless and until otherwise ordered by the court. See Order Directing Appointment of Examiner, *In re Asarco, LLC*, No. 05-21207, docket entry 7081 (Bankr. S.D. Tex. March 4, 2008), (finding in light of the mandate of Section 1104(c), the court has control over the nature, extent, and duration of the investigation and can limit the examiner to conduct such an investigation as the court deems appropriate and would (again, were there no standing/waiver issue) appoint an examiner with no duties, unless and until otherwise ordered by the court). This decision acknowledges the mandatory nature of the appointment of an examiner pursuant to section 1104(c)(2) while at the same time limiting the examiner's role to avoid unnecessary interference or cost to the estate.

If an examiner can be appointed but be impotent – why bother? Requesting an examiner under Section 1104(c) of the Bankruptcy Code can provide several practical benefits for a creditor, including the following:

- Leverage: while the motion is pending, the moving party is granted a seat at the table that it might otherwise not be able to attain.
- Independent Party to Conduct an Investigation: an independent and thorough investigation of the debtor's affairs may be conducted and delivered to the Court that no other party may have the resources to undertake.
- Moreover, the examiner's report is made public, providing transparency into the case that is often otherwise lacking – this is particularly important in a case like FTX where significant confusion may exist.

The Third Circuit in *FTX* states that confirmation may proceed without the court receiving a report from the examiner. The appointment satisfies the statutory mandate. Butthis raises the question – What is the value of appointment of an examiner?

- Perhaps – just the possibility that an examiner will be appointed can expedite the reorganization process, prevent unnecessary delays and thereby control costs. *See In re FTX Trading Ltd.,* 91 F4th 148; In re: *Loral Space & Communs., Ltd., Id.* ■

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Of Counsel
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CASE LAW UPDATE

The Supreme Court handed down three decisions in bankruptcy cases this term. *Harrington v. Purdue Pharma* is treated at length by Candice Kline elsewhere in this issue. This case law update will review the other Supreme Court cases and cases of interest to practitioners issued over the past year.

A. *OFFICE OF THE U.S. TRUSTEE V. JOHN Q. HAMMONS FALL* 2006 LLC,

_ U.S._,144 S. CT. 1588 (2024)

Two terms ago in *Siegel v. Fitzgerald* 596 U.S. 464 (2022) the U.S. Supreme Court declared unconstitutional a statute that Congress had passed that raised the U.S. Trustee fees in Chapter 11 cases. Unfortunately, the statute left unchanged the fees that were charged in North Carolina and Alabama, the two states that did not have a U.S. Trustee system. The Court found it a mystery as to why the fees were not increased in these two states. The Court held that such an arrangement violated the uniform laws of bankruptcy provisions of Article I of the U.S. Constitution. The Court left it up to the lower courts to determine a remedy.

Debtors or trustees in 48 of the states sought refunds of the excess fees that they had paid. But did the estates in the two non–U.S. Trustee estates owe additional fees? The amount of overpaid fees totaled $326,000,000.

Writing for the majority Justice Jackson noted that the period during which this disparity existed was relatively short. Justice Jackson was concerned that a program that was self-funding could cost taxpayers hundreds of millions of dollars. Further, she concluded that Congress would have preferred prospective and not retroactive relief. Justice Jackson was also troubled that many of the debtor's cases had closed and that the debtor's ceased to exist. She also addressed the problem of whether the 50 confirmed Chapter 11 cases in North Carolina and Alabama would have to pay additional fees. Clearly the Court was concerned that this was a mess that would take years to unravel if it could be unraveled at all. That concern came out in the oral argument as the justices struggled for a solution. Thus, the Court concluded that any relief would be prospective and not retroactive.

The dissent by Justice Gorsuch started with a memorable quote "What's a constitutional wrong worth these days. The majority's answer is not much."

B. *TRUCK INSURANCE EXCHANGE V. KAISER GYPSUM CO.*

_ U.S._, 144 S. CT. 1414, 219 L.ED.2D 41 (2024)

Truck Insurance was the primary insurer of the debtor. The debtor filed a plan of reorganization that stripped the insurance company of certain protections. The Bankruptcy Court, the District Court and the Court of Appeals held that the insurance company that had no direct claim against the debtor had standing to hear or complain about treatment in a plan of reorganization.

Rather than decide this case on constitutional standing, the Court held that 11 U.S.C. 1109 gave the insurance company standing because its rights were being impaired by the plan.

No one ever messed up a case by giving too much notice.

C. *U.S. V. MILLER*

71 F.4TH 1247 (10TH CIR. 2023); *CERT* GRANTED JUNE 2, 2024 #23-824

So far U.S. v. Miller is the only bankruptcy case that will be on next term's U.S. Supreme Court docket.

Facts: This case arose from the bankruptcy of All Resorts Group, Inc. In 2014 the debtor paid the I.R.S. $145,138.78, for the personal tax liabilities of two of the debtor's officers, directors and shareholders. These payments were made more than two years prior to the Debtor's bankruptcy.

Prior proceedings: The Chapter 7 trustee brought an adversary proceeding against the I.R.S. for the return of the payments pursuant to 11 U.S.C. 544(b). The I.R.S. asserted sovereign immunity because no creditor could sue the I.R.S. to set aside a voidable transfer and thus, the Trustee would not have a "Golden or Promethius creditor" in a 11 U.S.C. 544(b) case. Nevertheless, the bankruptcy court granted the trustee's summary judgment motion against the I.R.S. Both the U.S. District court for the District of Utah and the Court of Appeals for the 10th Cir. affirmed.

Issues:

1. For the trustee to prevail, the trustee must show that there was a creditor who could have avoided the payment to the I.R.S.
2. Under non-bankruptcy federal law, sovereign immunity prevents any creditor from suing the I.R.S. to undue a fraudulent transfer. Thus, is there a no Golden or Prometheus creditor?
3. 11 U.S.C. 106(a) is a waiver of the government's sovereign immunity and specifically mentions 11 U.S.C.544(b) actions.
4. The key issue is whether the waiver simply applies to the trustee's adversary itself or removes the government's ability to assert the defense in the underlying state law avoidance action under 11 U.S.C. 544(b).

Ruling of the Court of Appeals: The Court of Appeals analyzed 11 U.S.C, 106(a) and concluded that the language "with respect to" broadened the reach of

11 U.S.C. 106(a), and this language manifested Congress' intent that the waiver reaches any subject that the statute or the topics the statue enumerates. In addition, if the I.R.S. could assert sovereign immunity to defeat the existence of a Prometheus creditor, it would render 11 U.S.C. 106(a)'s reference to 11 U.S.C. 544 meaningless. It would be merely surplusage.

Split in the Circuits: Besides the 10th Circuit Court of Appeals, the Fourth Circuit Court of Appeals adopted the same reasoning. *Cook v. U.S. (In re Yahwe Ctrs. Inc)* 27 F. 4th 960 (4th Cir. 2022). However, the Court of Appeals for the 7th Circuit in *In re Equipment Resources, Inc.* 742 F.3rd 743 (7th Cir. 2014) ruled for the I.R.S.

COURT OF APPEALS CASES OF INTEREST

A. *FLISS V. GENERATION CAP. I, LLC*, 87 F.4TH 348 (7TH CIR. 2023).

The Seventh Circuit recently held that the *Rooker-Feldman* doctrine, collateral estoppel, and res judicata did not preclude a bankruptcy court from disallowing a claim for a consent judgment issued in state court.

In this case, John Fliss and Larry Wojciak were business partners whose jointly owned companies defaulted on a bank loan that they had personally guaranteed. After the bank obtained a consent judgment (the "Judgment") in state court, Wojciak used one of his companies, Generation Capital I, LLC ("Generation"), to purchase the bank's Judgment and attempt to enforce the Judgment against Fliss.

Generation commenced a supplemental proceeding to compel Fliss to turnover property to satisfy the Judgment. In response, Fliss filed a motion for determination in the main proceeding, arguing that Generation's purchase of the Judgment extinguished the debt. The state court sided with Generation and entered a determination order (the "Order") stating that the debt was still owed. Fliss then filed a voluntary Chapter 13 petition in bankruptcy court. Generation filed a secured claim for the Judgment plus interest, and upon Fliss's objection, the bankruptcy court disallowed the claim. The bankruptcy court found that the debt was extinguished because Wojciak, through Generation, was impermissibly both the creditor and debtor of the Judgment. The bankruptcy court further held that the doctrines of *Rooker-Feldman*, res judicata, and collateral estoppel did not bar it from deciding whether the claim should be disallowed. The district court affirmed, and Generation appealed to the Seventh Circuit.

The Seventh Circuit affirmed in all respects. It held that the bankruptcy court properly exercised subject matter jurisdiction when it disallowed Generation's claim. The Court reasoned that the bankruptcy court did not violate the *Rooker-Feldman* doctrine—that precludes a federal court from overturning a state court order—because Fliss did not file a federal suit seeking to set aside a state court order and the state court never decided whether Generation's claim in bankruptcy was allowed. Instead, Fliss merely sought protections afforded to him under federal bankruptcy law.

The Seventh Circuit further held that neither the Judgment nor Order precluded Fliss from objecting to Generation's claim in bankruptcy under theories of collateral estoppel or res judicata. These theories preclude a party from re-litigating issues decided in a prior adjudication. The Court reasoned that the Judgment was not entitled to collateral estoppel because collateral estoppel relies on actual litigation of the issues in a prior proceeding, and consent judgments fall short of such actual litigation. The Court further reasoned that res judicata did not preclude Fliss's objection because the Judgment's preclusive effect was limited to the Judgment's scope: the existence of the debt and its amount. The Judgment did not decide whether Generation or Wojciak's enforcement of the Judgment as a claim in Fliss's bankruptcy was proper.

Finally, the Seventh Circuit reasoned that the Order was not subject to collateral estoppel or res judicata because the Order was not a final judgment under Illinois law. The Order did not dispose of the entire proceeding, and in such situations, Illinois Supreme Court Rule 304(a) requires an express written finding by the court "that there is no just reason for delaying either enforcement or appeal or both" to be a final judgment. Accordingly, the Seventh Circuit affirmed that Generation's claim was disallowed, extinguishing Fliss's debt.

B. *CARMICHAEL V BALKE (IN RE IMPERIAL PETROLEUM RECOVERY CORP.)*, 84 F.4TH 264 (5TH CIR. 2023).

The Fifth Circuit recently held that the plaintiff in a bankruptcy adversary proceeding was entitled to post-judgment interest under 28 U.S.C. § 1961 that permits such interest on "any money judgment in a civil case recovered in a district court."

In this case, Imperial Petroleum Recovery Corporation ("IPRC") marketed microwave separation technology ("MST") units that recovered usable oil from emulsions, and the Carmichaels held security interests in the MST units. In 2013, the Carmichaels filed an involuntary Chapter 7 liquidation proceeding against IPRC, and in 2014, the Trustee assigned IPRC's assets to the Carmichaels. The Carmichaels expected to recover two MST-1000 units, but instead, Thomas Balke and his company Basic Equipment - who were hired to refurbish the MST units - sent the Carmichaels a single MST-1000 unit that was partially disassembled and damaged.

The Carmichaels filed an adversary proceeding against Balke in bankruptcy court alleging that Balke violated the automatic stay by converting IPRC's physical assets and infringing IPRC's intellectual property. Bankruptcy Judge Bohm found that Balke had stolen one MST unit, destroyed one MST unit, and founded a business that improperly used IPRC's intellectual property. Judge Bohm awarded the Carmichaels $2 million in damages, $325k in attorney fees, and post-judgment interest. He ordered Balke to turnover any converted IPRC property to the Carmichaels.

Balke then appealed to the district court. While the appeal was pending, the case was reassigned to Bankruptcy Judge Isgur who commented that Balke's appeal raised an important issue regarding the meaning of Federal Rule of Bankruptcy Procedure 8008(a). This led the district court to remand the case.

On remand, Judge Isgur issued new findings, a final opinion, and an amended judgment that reduced damages to $4k, attorney fees to $92k, and did not specifically provide for post-judgment interest. Judge Isgur instead found that IPRC sent Balke two MST units, an MST-1000 and an MST-150, with the latter intended to be broken down and used to maintain the former, based on the testimony of an IPRC employee. The district court affirmed, and the Carmichaels appealed to the Fifth Circuit.

The Fifth Circuit held that Judge Isgur did not err in reaching his factual findings. The Court reasoned that Judge Isgur did not abuse his discretion in admitting the employee's testimony under the residual exception to hearsay rule and that Judge Isgur did not err merely because his findings did not match those of Judge Bohm. The Court further held that Judge Isgur did clearly err in calculating the cost to reassemble the MST-1000 because he used a "sufficient factual foundation" standard that elevated the burden of proof beyond preponderance.

The Fifth Circuit also held that the Carmichaels were entitled to post-judgment interest under 28 U.S.C. § 1961 that permits such interest on "any money judgment in a civil case recovered in a district court." The Court reasoned that bankruptcy adversary proceedings are civil cases, relying on references in the Federal Rule of Bankruptcy Procedure, Bankruptcy Code, and the Supreme Court's decision in *Grogan v. Garner*, 498 U.S. 279, 287 (1991) (treating a Title 11 dispute as a "civil action[]"). The Court further reasoned that bankruptcy courts are included under "district court[s]" because bankruptcy courts exercise jurisdiction at the suffering of supervising district courts. The Court held that the post-judgment interest began to accrue as of Judge Bohm's initial judgment.

The Fifth Circuit further held that IPRC's assignable intellectual property was assigned to the Carmichaels in 2014, that the Carmichaels are not estopped from arguing that IPRC's property is worth more than the value assigned in IPRC's bankruptcy petition, and that the Carmichaels' appeal is not frivolous and deserving of sanctions. The Fifth Circuit then remanded the case to the bankruptcy court to determine the damage award, attorney fees, and post-judgment interest.

C. *MATTER OF THORNHILL BROS. FITNESS, L.L.C.*, 85 F.4TH 321 (5TH CIR. 2023).

The Fifth Circuit held that executory contracts cannot be partially assigned. In this case, William Flynn suffered neuromuscular injuries from an alleged equipment malfunction at an Anytime Fitness location. Flynn then filed a personal injury suit in state court against the franchisee, Thornhill Brothers Fitness, LCC ("Thornhill") and franchisor Anytime Fitness, LCC ("Anytime"). Anytime argued that the involved equipment was unauthorized by the Thornhill-Anytime franchise agreement (the "Franchise Agreement") and that Anytime was not otherwise liable for Flynn's injuries. The state court agreed and dismissed Anytime from the case with prejudice. The state appellate court affirmed.

Five days before Flynn's case against Thornhill went to a jury trial, Thornhill filed a voluntary petition for bankruptcy and listed Flynn's litigation claim as a liability with an unknown amount exceeding $1 million. Two days later, Thornhill informed the bankruptcy court that Flynn and Thornhill had reached a settlement, and the bankruptcy judge approved the settlement.

The settlement contained two important documents. First, the "Stipulation" stated that Thornhill's insurer would pay Flynn $1 million plus interest and that Flynn was able to sue Anytime despite the previous state court order dismissing these claims with prejudice. Second, the "Confession of Judgment" stated that Thornhill admitted $7 million in total liability to Flynn. In connection with the settlement, Thornhill assigned its indemnity rights contained in the Franchise Agreement to Flynn, and Thornhill otherwise retained the Franchise Agreement. Flynn and Thornhill further agreed that Thornhill would remain a defendant in name only because Thornhill needed to be on the jury verdict to recover against Anytime.

Anytime did not learn about this settlement until Flynn filed another state court suit against Anytime. In this suit, Flynn argued that Thornhill's Confession of Judgment, assignment of the Franchise Agreement's indemnity rights, and the bankruptcy court's approval of the foregoing, resulted in Anytime being liable for up to $7 million. The state court then denied Anytime's motion to dismiss. The bankruptcy court permitted Anytime a hearing, but ultimately entered an order ratifying its actions that was subsequently affirmed by the district court. Anytime then appealed to the Fifth Circuit.

The Fifth Circuit held that Thornhill's assignment of only the Franchise Agreement's indemnity rights to Flynn was noncompliant with the Bankruptcy Code. The Court held that the Franchise Agreement was likely an executory contract – a contract in which neither party has finished performing. A post-petition debtor may assume, reject, or assign that executory contract and it must be assumed, rejected, or assigned in its entirety. The Court reasoned that this interpretation was consistent with the statute's language that referred to executive contracts in their entirety and Supreme Court caselaw holding that a debtor cannot use the bankruptcy process to possess anything more than it did outside of bankruptcy. *See* 11 U.S.C. § 365(f); *Mission Prod. Holdings, Inc. v. Tempnology, LLC*, 139 S. Ct. 1652 (2019). The Court stated that permitting a debtor to partially assign executory contracts would impermissibly empower it with rights the debtor does not have outside of bankruptcy. Thus, the Court held that Thornhill's assignment of the Franchise Agreement's indemnity rights, while otherwise retaining the Franchise Agreement, was improper and remanded the case to the bankruptcy court.

D. *IN RE MYERS*, NO. 22-16615, 2023 WL 8047842 (9TH CIR. NOV. 21, 2023).

The Ninth Circuit Court of Appeals held that Rule 3001, not state law, controls the requirements for a proof of claim. LVNV Funding, LCC ("LVNV") filed a proof of claim in the bankruptcy proceeding of David and Mary Myers (the "Myers"). LVNV's claim was for credit card debt. The bankruptcy court allowed LVNV's proof of claim over the Myers' objection, and the Myers appealed to the United States Bankruptcy Appellate Panel of the Ninth Circuit (the "BAP").

The BAP held that, although LVNV's proof of claim was entitled to prima facie validity because it complied with Federal Rule of Bankruptcy Procedure 3001 ("Rule 3001"), the claim was disallowed under 11 U.S.C. § 502(b)(1) because the provided documentation was insufficient to enforce the credit debt under state law. Rule 3001 sets out the procedural requirements for a proof of claim and specifies when a proof of claim is prima facie valid. The BAP then vacated the bankruptcy court's order and remanded the case. On remand, the bankruptcy court disallowed LVNV's claim. LVNV then appealed the BAP's decision and bankruptcy court's order disallowing the claim to the Ninth Circuit.

The Ninth Circuit held that the principles of *Erie R.R. Co. v. Tompkins,* 304 U.S. 64 (1938), dictate that Rule 3001, not state law, controls the requirements for a proof of claim. The Court reasoned that *Erie* stands for the proposition that federal courts, including bankruptcy courts, should apply federal procedural law and state substantive law. Therefore, if a state law conflicts with a valid federal procedural law in a federal action, the federal procedural law will control and the conflicting state law will be rendered inapplicable. Here, the Ninth Circuit held that the state law requiring certain documentation to enforce LVNV's credit card debt claim conflicted with Rule 3001, a valid federal procedural law, because the laws required LVNV to provide different documentation to enforce its claim. Therefore, the Court held that Rule 3001 controls over the state law, and LVNV's failure to comply with the state law did not disallow its claim. The Ninth Circuit reversed the BAP decision.

E. *MONTOYA V. GOLDSTEIN (IN RE CHUZA OIL CO.)*, 88 F. 4TH 849 (10TH CIR. 2023).

The ear-marking doctrine requires satisfaction of the dominion/control and diminution of the estate tests. The closely-held debtor owed money to an insider on a note that was to receive no payments until a separate series of notes was paid in full. The debtor's principal loaned money to the debtor specifically to make payments on the insider note and the other notes. Upon the debtor's bankruptcy, the trustee sued to avoid and recover the payments on the insider note as preferences and as constructively fraudulent transfers. Both a preference and a fraudulent transfer are transfers of an interest, see *Montoya v. Goldstein (In re Chuza Oil Co.),* in property of the debtor that meets certain additional conditions. If a new creditor loans money to a debtor to pay an old creditor, the payment might be protected by the ear-marking doctrine, which deems the money not to have been property of the debtor. To satisfy the ear-marking doctrine, the new money must not be subject to the dominion or control of the debtor – that is, the debtor must be under a binding agreement to use the new money to pay the old creditor and not for any other purpose – and the transaction must not result in the diminution of the estate – that is, the reduction in the amount of assets available to pay creditors. The doctrine's application is clearer when the new creditor pays the money directly to the old creditor and the money does not pass through the debtor's account, but that is not required. Here, the new lender (the principal) required the debtor (controlled by the principal) to use the new loan to pay the insider note, so the debtor did not have dominion and control over the funds. Because the principal loaned substantially more to the debtor that was used for the insider note payments, the transaction did not result in a diminution of the estate. Therefore, the transfer was not property of the debtor and was not avoidable.

F. *IN RE FTX TRADING LTD.,*

91 F. 4TH 148 (3D CIR. 2024).

The new CEO determined that the debtor's books and records were in a shambles, with a complete failure of corporate controls and a complete absence of reliable financial information. The debtors lacked appropriate corporate governance and a functioning board of directors. The new CEO began an investigation into the multiple failures. Meanwhile, the former CEO was indicted and later convicted of numerous federal crimes in connection with the debtor's operation. Section 1104(c) provides that "on request of a party in interest or the United States trustee ..., the court shall order the appointment of an examiner to conduct such an investigation of the debtor as is appropriate" if unsecured debts exceed $5 million. The use of "shall" makes the appointment mandatory, not discretionary, with the bankruptcy court. The phrase "to conduct such an investigation of the debtor as is appropriate" addresses only the nature and scope of the investigation. "As is appropriate" modifies "investigation," not "shall order the appointment." Thus, the bankruptcy court may limit the investigation to prevent tactical delays or duplication of effort Recent Developments in Bankruptcy Law, January 2024, but may not dispense with it altogether.

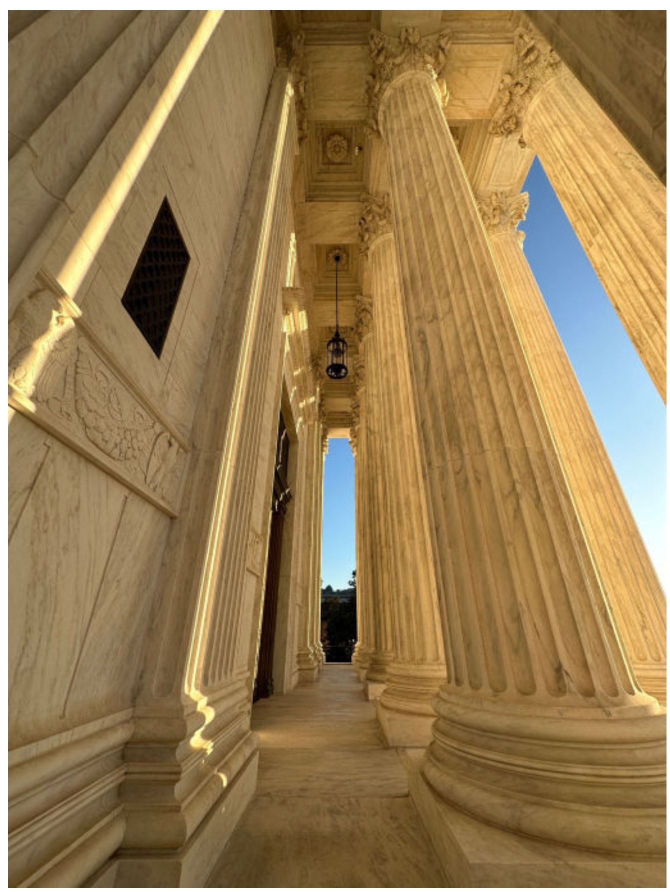
G. *FARM CREDIT SERVS. OF AM. V. TOPP (IN RE TOPP),* 75 F. 4TH 959 (8TH CIR. 2023).

The Court may use the Treasury rate as a starting point to determine the appropriate cram down interest rate. The chapter 12 debtor proposed a plan that would pay its largest secured creditor an interest rate equal to the Treasury bill rate, plus 2%. The creditor argued for the prime rate, plus 2%. Under *Till v. SCS Credit Corp.*, 541 U.S. 465 (2004), the Supreme Court approved using a formula approach – a risk free rate plus a risk adjustment – to determine an appropriate cram down interest rate. It did not require use of a bank prime rate as the risk-free rate, especially since the prime rate includes some risk of nonpayment. Which rate to use as the starting point is a question of fact for the bankruptcy court. Here, the bankruptcy court properly calculated the risk-free rate, based on Treasury rates, and the appropriate premium.

H. *KIRKLAND V. UNITED STATES,*

BANKR. COURT FOR THE CENT. DIST. OF CAL. (IN RE KIRKLAND), 75 F. 4TH 1030 (9TH CIR. 2023)

A remote witness may not be compelled to testify by video transmission. The trustee sued an investor in a Ponzi scheme. The investor had lived and worked in the debtor's city but had since moved to a distant location. The trustee issued a subpoena to compel the investor to testify at trial by contemporaneous video transmission. F.R.C.P. 45(c), made applicable in bankruptcy cases by Bankruptcy Rule 9016, permits a subpoena for testimony only at a place within 100 miles of the witness' residence or place of employment. F.R.C.P. 43(a), made applicable by Bankruptcy Rule 9017, requires a court to take trial testimony in open court, but "for good cause and in compelling circumstances, may permit testimony in open court by contemporaneous transmission from a different location." Rule 45 specifies who may be compelled to attend trial and testify; Rule 43 specifies how the testimony may be taken. Rule 43 addresses a different issue and does not override Rule 45's 100-mile limitation nor mean the place of testimony is wherever the witness is located. Otherwise, Rule 45's limitation and Rule 43's requirement that testimony be taken in open court would be effectively repealed. ■



Mason S. Shelton
Associate
Bernstein-Burkley, P.C.

SIXTH CIRCUIT NARROWS AVENUE FOR ATTORNEYS' FEES AWARDS

Frustrated debtors often look to their attorneys for recourse in recouping legal fees when defending against otherwise abusive motions in their bankruptcy case. 11 U.S.C. § 707(b)(5)(A) (the "Bankruptcy Code") authorizes bankruptcy courts to award attorneys' fees, but may other federal remedial statutes provide similar relief? According to the Sixth Circuit Court of Appeals (the "Sixth Circuit"), at least one such fee-shifting statute, the Equal Access to Justice Act ("EAJA") [1], does not. On January 3, 2024, the Sixth Circuit delivered its opinion[2] affirming the Bankruptcy Court for the Northern District of Ohio and the District Court for the Northern District of Ohio in denying an award of attorneys' fees under the EAJA because, among other reasons, "[t]he EAJA empowers 'a court' to award prevailing parties fees and costs incurred 'in any civil action'"[3] and defending against a motion to dismiss a debtor's case is not recognized as a civil action.

1 28 U.S.C. § 2412.
2 *Teter v. Baumgart (In re Teter)*, 90 F.4th 493 (6th Cir. 2024).
3 *Id.* at 496.

Megan Teter (the "Debtor") filed for Chapter 7 bankruptcy owing approximately $96,538.05 in debt, half of which being identified as unpaid student loans. The Debtor characterized her unpaid student loans as "business debts," while the United States Trustee (the "UST") contended that the loans were actually "consumer debt."[4] Upon further examination of the Debtor's financial affairs, the UST argued that the Debtor's case was abusive and filed a motion to dismiss under Section 707(b) of the Bankruptcy Code. While the Debtor contested the UST's motion to dismiss, the UST "bec[a]me aware of certain facts and circumstances which render[ed] the [m]otion [to dismiss] unwarranted."[5] Accordingly, the UST withdrew its motion, and the Debtor unsuccessfully moved for attorneys' fees under the EAJA.

The EAJA provides that

> [A] court shall award to a prevailing party other than the United States fees and other expenses . . . incurred by that party in any ***civil action*** (other than

4 *Id.*
5 *Id.*

> cases sounding in tort), including proceedings for judicial review of agency action, brought by or against the United States in any court having jurisdiction of that action, unless the court finds that the position of the United States was substantially justified or that special circumstances make an award unjust.[6]

The Sixth Circuit narrowed its scope of review to "civil action" and whether a motion to dismiss satisfied such requirement. The Court acknowledged that "the EAJA 'amounts to a partial waiver of sovereign immunity'" by the United States,[7] but continued stating that "any textual ambiguity [must be read] in favor of immunity, because 'the Government's consent to be sued is never enlarged beyond what a fair reading of the text requires.'" [8] Therefore, the Sixth Circuit concluded that the EAJA "excluded [Section] 707(b) motions to dismiss, leaving fees unavailable to a party like [the Debtor]." [9]

The Sixth Circuit's analysis centered around the plain meaning of "civil action" as identified in the Federal Rules of Civil Procedure (the "FRCP"). Namely, "there has been 'one form of action—the civil action.'"[10] Specifically, the Sixth Circuit noted that FRCP 2 provided "a watershed event [that] marked an 'abolition of forms of action and procedural distinctions' in favor of 'a single action and mode of procedure.'"[11] To that end, "'[a] civil action is commenced by filing a complaint'"[12] as opposed to a motion to dismiss, which is a mere tool within the context of the civil action.[13] The Sixth Circuit did not, however, provide a brightline ruling as to whether the EAJA has *any* "seat at the bankruptcy table" concluding that the argument remains "relatively underdeveloped." [14]

This decision created an apparent split between the Courts of Appeals, specifically the Tenth Circuit Court of Appeals (the "Tenth Circuit"), as to whether bankruptcy courts maintain the authority to grant awards of attorneys' fees under the EAJA. In *O'Connor v. United States Department of Energy*, 942 F.2d 771 (10th Cir. 1991), the Tenth Circuit reversed the District Court for the Western District of Oklahoma's denial of attorneys' fees for a debtor after the United States Department of Energy filed a motion to enforce a reorganization plan or, in the alternative, convert the debtor's case from a Chapter 11 to a Chapter 7 proceeding. The Tenth Circuit, however, addressed a different issue—whether the bankruptcy court is a "court" as contemplated by the EAJA. The Tenth Circuit concluded, yes, the EAJA grants authority to bankruptcy courts to award attorneys' fees in such actions involving the United States.

Subsequently, the Debtor appealed the Sixth Circuit's ruling, but the U.S. Supreme Court denied her petition for writ of certiorari on May 13, 2024.[15] ■

6 28 U.S.C. § 2412(d)(1)(A) (emphasis added).

7 *Id.* at 498 (citing *Ardestani v. INS,* 502 U.S. 129, 137, 112 S. Ct. 515, 116 L. Ed. 2d 496 (1991)).

8 *Id.* at 498 (citing *FAA v. Cooper,* 566 U.S. 284, 290, 132 S. Ct. 1441, 182 L. Ed. 2d 497 (2012)).

9 *Id.* at 498-499.

10 Id. at 499 (citing Fed. R. Civ. P. 2).

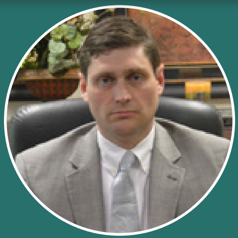
11 Id. (citing Fed. R. Civ. P. 2 advisory committee's note 3 to 1937 adoption).

12 Id. (citing Fed. R. Civ. P. 3).

13 *Id.* at 500 (citing *Banister v. Davis*, 140 S. Ct. 1698, 1715, 207 L. Ed. 2d 58 (2020) (Alito, J., dissenting) (describing motions to dismiss as part of the "civil action procedural sequencing")).

14 *Id.* at 501. ("Accordingly, we flag the issue for future cases, but we do not reach it today").

15 *Teter v. United States Tr.,* No. 23-1086, 2024 WL 2116337 (May 13, 2024).



E.B. Harrison Willis
Partner
Cloud Willis & Ellis

DON'T BE A VICTIM TWICE: 11 U.S.C. § 1328(A)(4) and 11 U.S.C. § 523 (A)(6).

At times, justice is a daunting concept for victims. As the title suggests, the aggrieved, the victim, or a person hurt, damaged or otherwise had a life changing event might get a judgment (criminal or civil) but what happens if that responsible person does not pay or otherwise fails to comply with a court order. Despite a bankruptcy, there might be a way forward.

Criminal trial concludes...the state/commonwealth convicts. A restitution order is entered in conjunction with a jail sentence. The Defendant will obviously pay... not a problem. The convict's promises of payment made to...the Judge, the victim and others ring hollow if money is not received. In a civil context, a successful plaintiff in a civil trial gets a default judgment or a successful verdict. Then the debtor/defendant files for bankruptcy. What are the creditor's options?[1]

I. 11 U.S.C. § 1328(A)(4): CHAPTER 13 IS BETTER THAN THE CHAPTER 7 FOR THE VICTIM."OR" IS A GOOD THING.

Mention the Bankruptcy Code[2] and eyes will glaze over or eyes will roll. Having a peer, a colleague or friend who has a working knowledge of bankruptcy can assist your clients. There are specific code sections which might help someone either in a criminal or a civil context.

Factual scenario, mommy and daddy are going through divorce. During the divorce, daddy beats up mommy causing lung collapse, permanent nerve damage and other significant injuries.[3] Daddy is charged with a second-degree felony under state law and he pleads guilty. Mommy, subsequently, files a civil action and is awarded a significant judgment. Mommy's post judgment actions result in a writ of garnishment taking $10,000 out of ex-husband's bank account. Daddy files a chapter 13 bankruptcy. State court lawyer calls his friend who is a bankruptcy attorney.

What does the successful victim do? Mommy has 60 DAYS from the date of the bankruptcy filing to commence an adversary proceeding (a new lawsuit) against daddy asking the Bankruptcy Court to make a determination as to the dischargeability of that prior state court judgment. 11 U.S.C § 1328(c). The bankruptcy court would eventually enter an order making her state court judgment nondischargeable as to

1 It is axiomatic that this article is starting point for a victim's attorneys. There are other code sections of Title 11 that might be applicable to your client's circumstances.

2 Title 11 of the United States Code.

3 This is a real case where the author represented mommy and obtained a nondischargeable judgment for her.

daddy's bankruptcy. Mommy's prior state court judgment would be excepted from discharge.

Daddy's attack on mommy is likely nondischargeable per 11 U.S.C. § 1328(a)(4). 11 U.S.C. § 1328(a)(4) excepts from discharge any debt that results

> for restitution or damages, awarded in a civil action against the debtor as a result of willful or malicious injury by the debtor that caused personal injury to an individual **<u>or</u>** the death of an individual

(emphasis added). 11 U.S.C. § 1328(a)(4).[4] For a successful plaintiff who has gone through this once before, this code section provides relief so that a person responsible can be held accountable and is unable to discharge this indebtedness.

Mommy's complaint in the adversary proceeding would state a claim for nondischargeability under 11 U.S.C. § 1328(a)(4). *In re Digirolamo*, 2014 WL 198780 (Bankr. W.D. Mo. 2014) (prior default judgment for battery held to be nondischargeable under 11 U.S.C. § 1328(a)(4)). *In re Denson*, 2020 WL 1547493 (Bankr. S.D. Ill. 2020) (prior default judgment for assault, battery and other international torts held nondischargeable under 11 U.S.C. § 1328(a)(4)). *In re Adams*, 478 B.R. 476 (Bankr. N.D. Ga. 2012); *see In re Bailey*, 555 B.R. 557, 564 (Bankr. N.D. Miss. 2016) (court held that unpaid wages were not "personal injuries" to creditors); *In re Deluty*, 540 B.R. 41, 46–48 (Bankr. E.D.N.Y. 2015) (bankruptcy court held that $302,154.88 default judgment entered against debtor was nondischargeable under 11 U.S.C. § 1328(a)(4)). Traditional personal injury torts resulting in emotional and reputational harm fall within the exception to discharge in § 1328(a)(4) if proven to be willful or malicious. *Adams*, 478 B.R. at 487. "[§] 1328(a)(4) should thus be construed as preventing the discharge of all liability arising from willful or malicious personal injury, including any award of punitive damages." *Id.* at 489.

11 U.S.C. § 1328(a)(4) differs from 11 U.S.C. § 523(a)(6): "(1) it applies to willful **<u>or</u>** malicious injuries instead of to willful and malicious injuries; (2) it applies to personal injuries or death and not to injuries to property; and (3) it applies to restitution and damages awarded in a civil action against the debtor as a result of such injuries." *Waag v. Permann (In re Waag)*, 418 B.R. 373, 377 (9th Cir. BAP 2009) (internal quotations omitted). When determining how these terms should be defined as they are used under § 1328(a)(4), other jurisdictions look to the definitions of the same terms as used when examining nondischargeability actions under 11 U.S.C § 523(a)(6).

> ...unlike § 523(a)(6)'s more stringent conjunctive standard, § 1328(a)(4) requires a plaintiff to show that debtor's actions were willful or malicious. **Only one need be proven**, not both as required by § 523(a)(6). *Id.*

Michael v. Denson (In re Denson), 2020 WL 1547493, at *3 (Bankr. S.D. Ind. March 30, 2020) (emphasis added). 11 U.S.C § 523(a)(6) does not apply to torts when "...the debtor was intoxicated from using alcohol, a drug, or another substance." 11 U.S.C. § 523(a)(9).

The conjunction "or" is significantly different in a Chapter 13 case then if a defendant files a Chapter 7 bankruptcy case. "Or" makes the evidentiary burden lesser than in a Chapter 7 context.

II. 11 U.S.C. § 523 (A)(6): CHAPTER 7 FOR THE VICTIM.

Same fact pattern...daddy attacked mommy. Instead of chapter 13, daddy files a Chapter 7 bankruptcy. "A discharge under section 727, 1141, 1192, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt-- ... (6) for willful **<u>and</u>** malicious injury by the debtor to another entity or to the property of another entity ..."11 U.S.C. § 523 (a)(6). (emphasis added). The conjunction "and" of 11 U.S.C. § 523 (a)(6) makes mommy's evidentiary burden regarding dischargeability steeper. She still has 60 days from the bankruptcy filing date to file an adversary proceeding against the Debtor. 11 U.S.C. § 523(c)(1).

Willfulness and maliciousness are distinct elements of a § 523(a)(6) claim. "The word 'willful' in (a)(6) modifies the word 'injury,' indicating that nondischargeability [under § 523(a)(6] takes a deliberate or intentional injury, not merely a deliberate or intentional act that leads to injury." *Kawaauhau v. Geiger*, 523 U.S. 57, 61, 118 S. Ct. 974, 977, 140 L. Ed. 2d 90 (1998). The debtor must have intended the consequences of an act, not merely the act.

In the Eleventh Circuit, "[a] debtor is responsible for a 'willful' injury when he or she commits an intentional act the purpose of which is to cause injury or which is substantially certain to cause injury." *In re Jennings*, 670 F.3d 1329, 1334 (11th Cir. 2012) (*quoting In re Walker*, 48 F.3d 1161, 1165 (11th Cir. 1995) and *citing Kawaauhau*, 523 U.S. at 61-62). "Malicious," on the other hand, "means wrongful and without just cause or excessive even in the absence of personal hatred, spite or ill-will." *Jennings*, 670 F.3d at 1334 (internal quotations omitted). Further, a showing of "specific intent to harm another is not necessary" to establish malice. *Id.* To date, the Eleventh Circuit has not definitively answered whether substantial certainty of injury is a subjective standard, "requiring a creditor to prove that a debtor actually knew that the act was substantially certain to injure the creditor, or an objective standard, requiring a creditor to show only that a debtor's act was in fact substantially certain to

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4 There is neither a published case from the Eleventh Circuit Court of Appeals nor any bankruptcy court in the state of Alabama which has addressed 11 U.S.C. § 1328(a)(4) in detail.

cause injury" to the creditor. *In re Kane*, 755 F.3d 1285, 1293 (11th Cir. 2014), *cert. denied*, 574 U.S. 1027 (2014); *see also In re Monson*, 661 F. App'x 675, n.9 (11th Cir. 2016)

The Supreme Court in interpreting 523(a)(6), held that the word "willful" in (a)(6) modifies the word "injury". *Kawaauhau v. Geiger*, 523 U.S. 57, 61, 118 S. Ct. 974, 977, 140 L. Ed. 2d 90 (1998). A finding of nondischargeability under 523(a)(6) requires a deliberate or intentional injury, not merely a deliberate or intentional act that leads to injury. *Id*. Not every tort judgment for conversion is exempt from discharge. *Davis v. Aetna Acceptance Co.*, 293 U.S. 328, 55 S.Ct. 151, 79 L.Ed. 393 (1934). Negligent or reckless acts, without more do not suffice to establish that a resulting injury is willful and malicious. *Id.* Again, death or personal injuries caused by the debtor when "the debtor was intoxicated from using alcohol, a drug, or another substance" fall under11 U.S.C. § 523(a)(9).

Proof of "willfulness" requires a showing of an intentional or deliberate act, which is not done merely in reckless disregard of the rights of another. *In re Walker*, 48 F.3d 1161, 1163 (11th Cir. 1995) (*quoting In re Ikner*, 883 F.2d 986, 991 (11th Cir. 1989)). "Malicious" means wrongful and without just cause or excessive even in the absence of personal hatred, spite, or ill-will. *Id*. To succeed on a dischargeability claim, the creditor must prove the applicability of § 523(a)(6) by a preponderance of the evidence. *In re Kane*, 755 F.3d 1285, 1293 (11th Cir. 2014) (*citing Grogan v. Garner*, 498 U.S. 279, 111 S. Ct. 654 (1991)). Therefore, determinations of whether a debtor's conduct justifies denial of dischargeability of a debt under § 523(a)(6) are fact intense.

Simply, the conjunction "and" can make all the difference. Chapter 7 is inherently more challenging for the victim to obtain a nondischargeable judgment because of the increased evidentiary burden.

III. MIND THE COLLATERAL.

Mind the collateral estoppel. "[C]ollateral estoppel" applies in dischargeability matters." *Grogan v. Garner*, 498 U.S. 279, 111 S.Ct. 654, 112 L.Ed.2d 755 (1991). Collateral estoppel bars daddy's efforts to re-litigate facts that have already been decided by a judge or which daddy freely admitted when he pled guilty in the criminal case. Under 28 U.S.C.A. § 1738 (the Full Faith and Credit Act), a bankruptcy court is required to "give effect" to the state court judgment.

Collateral estoppel prevents the re-litigation of issues already litigated and determined by a valid and final judgment in another court. *HSSM # 7 Limited Partnership v. Bilzerian (In re Bilzerian)*, 100 F.3d 886, 892 (11th Cir. 1996), *cert. denied,* 523 U.S. 1093, 118 S. Ct. 1559, 140 L.Ed.2d 791 (1998). The United States Supreme Court requires bankruptcy courts, in dischargeability proceedings, to utilize a state's principles of collateral estoppel to determine the issue preclusive effect of a judgment rendered by a court of that state. *Marrese v. American Academy of Orthopaedic Surgeons*, 470 U.S. 373, 105 S.Ct. 1327, 84 L.Ed.2d 274 (1985). "If the prior judgment was rendered by a state court, then the collateral estoppel law of that state must be applied to determine the judgment's preclusive effect." *St. Laurent v. Ambrose (In re St. Laurent)*, 991 F.2d 672, 676 (11th Cir. 1993).

"While collateral estoppel may bar a bankruptcy court from re-litigating factual issues previously decided in state court, however, the ultimate issue of <u>dischargeability</u> is a legal question to be addressed by the bankruptcy court. ..." (emphasis added) *St. Laurent,* 991 F.2d at 676 (*quoting In re Halpern*, 810 F.2d 1061, 1064 (11th Cir. 1987)). To determine whether collateral estoppel applies in a nondischargeability action, a bankruptcy court should use the state's collateral estoppel principles. *In re Guthrie*, 489 B.R. 440, 445 (Bankr. N.D. Ala. 2013).

In Alabama, a party seeking to invoke collateral estoppel must prove: (1) the issue must be identical to the one litigated in the prior suit; (2) that the issue must have been actually litigated in the prior suit; (3) that resolution of the issue must have been necessary to the prior judgment. *In re Dorand*, 2022 WL 2527640 (Bankr. N.D. Fla. July 6, 2022 (*citing Lee L. Saad Constr. Co. v. DPF Architects, PC*, 851 So. 2d 507 (Ala. 2002)). *In re Jones*, 611 B.R. 685 (Bankr. M.D. Ala. 2022)(*citing Martin v. Reed*, 480 So. 2d 1180, 1182 (Ala. 1985)). "Only issues actually decided in a former action are subject to collateral estoppel." *Leverette ex rel. Gilmore v. Leverette*, 479 So. 2d 1229, 1237 (Ala. 1985). The burden is on the party asserting collateral estoppel to prove that the issue it is seeking to bar was determined in the prior adjudication. *Lee L. Saad Constr. Co., Inc. v. DPF Architects, P.C.*, 851 So. 2d 507, 520 (Ala. 2002) (citations omitted); *see also Dunavant v. Sirote & Permutt, P.C.*, 603 Fed.Appx. 737, 741 (11th. Cir. 2015) ("[Under Alabama law], collateral estoppel precludes only the re-litigation of issues that already have been adjudicated in a previous action. To show that the same issue has already been adjudicated, collateral estoppel requires that the issue has been 'actually litigated,' 'necessary to the prior judgment,' and 'identical to the issue litigated in the present action.'").

V. CONCLUSION.

A creditor's rights attorney needs to understand the basics of 11 U.S.C. § 1328(a)(4) and 11 U.S.C. § 523(a)(6). These code sections give any lawyer a starting point when frustrated victims approach and need help. There are solutions. There are ways forward. ■

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FOCUS ON DISINTERESTEDNESS–All Debtors Should Have the Same Opportunities to Hire Professionals that Subchapter V Debtors Enjoy

Chapter 11 Subchapter V was enacted just before Covid-19 wracked the world.[1] One of its notable provision is 11 U.S.C. § 1195:

> Notwithstanding section 327(a) of this title, a person is not disqualified for employment under section 327 of this title, by a debtor solely because that person holds a claim of less than $10,000 that arose prior to commencement of the case.

In all bankruptcies, § 327(a) provides that the trustees, and debtors-in-possession in a Chapter 11 and Chapter 12 cases, can hire attorneys, accountants, appraisers, auctioneers, or other "professional persons," but only if those professional persons do not hold or represent an interest adverse to the estate and are disinterested persons. The purpose of this Code provision is to preclude the employment of professional persons whose interests are opposed to those of the bankruptcy estate. The interest of a professional who holds a pre-petition claim is most likely not in line with the interest of the general estate. *In re River Ranch*, *Inc.*, 176 B.R. 603, 605 (Bankr. M.D. Fla 1994).

Section 101(14) provides the definition of a disinterested person that means a person that

> (A) is not a creditor, an equity security holder, or an insider;
>
> (B) is not and was not, within 2 years before the date of the filing of the petition, a director, officer, or employee of the debtor; and
>
> (C) does not have an interest materially adverse to the interest of the estate or of any class of creditors or equity security holders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor, or for any other reason.

The legislative history of H. Rep. 116-171 – Small Business Reorganization Act of 2019 does not provide explanation for § 1195's expansion of the definition of disinterestedness.

1 Small Business Reorganization Act of 2019 enacted on August 23, 2019, effective February 19, 2020. Pub. L. No. 116-54, 133 Stat. 1079 (2019).

Recently the authors represented a Chapter 12 family farmer [2] who was involved in a divorce on the petition date. The farmer mistakenly believed that his divorce attorney had been paid in full. This Chapter 12 debtor was required to file a 100% plan as his Chapter 12 was due to cash flow insolvency, not balance sheet insolvency. The debtor applied to employ his divorce counsel, pointing out that the divorce counsel was owed less than $4,500 but was not disinterested.[3] The application also noted that the divorce counsel's pre-petition claim would, by necessity, be paid under his plan. The United States Trustee objected, citing the debtor's testimony at the meeting of creditors that he did not believe he owed his divorce counsel any money.[4] At the hearing on the United States Trustee's objection debtor's counsel argued that 11 U.S.C. § 327(e) provided an avenue for the bankruptcy judge to allow employment

Joseph A. Peiffer, Esq.
Shareholder
Ag & Business Legal Strategies

Austin J. Peiffer, Esq.
Associate Attorney
Ag & Business Legal Strategies

of the divorce counsel. That subsection provides:

> The trustee, with the court's approval, may employ, for a specified special purpose, other than to represent the trustee in conducting the case, an attorney that has represented the debtor, if in the best interest of the estate, and if such attorney does not represent or hold any interest adverse to the debtor or to the estate with respect to the matter on which such attorney is to be employed.

Counsel for the debtor argued that the employment of the divorce counsel to complete the divorce should be approved under § 327(e) as the attorney knew the case and it would cost significant time and money to switch counsel in the middle of the divorce and the plan had to pay the debt anyway.[5] The bankruptcy judge held that she was compelled to follow the plain language of § 327(a) and since the divorce counsel was not disinterested, the divorce counsel could only be retained if the divorce counsel filed a waiver of her pre-petition fees within one week.[6] The divorce counsel refused to waive her pre-petition fees. It took the debtor two months and a $10,000 retainer to obtain a different divorce counsel.[7,8] This delay forced the debtor to file two motions to extend time to file his Chapter 12 plan.

What purpose was served by requiring this debtor to hire a "disinterested" divorce attorney when he was required to file a 100% plan? If Subchapter V's disinterestedness exclusion for professionals owed less than $10,000 pre-petition applied in Chapter 12, he would not have had to switch his divorce counsel and delay his case.

All debtors should be treated alike with respect to hiring professionals. This could be accomplished by incorporating § 1195 into the end of § 327(a):

> A person is not disqualified for employment under this section by a debtor solely be-cause that person holds a claim of less than $10,000 that arose prior to commencement of the case.

Incorporating § 1195 into § 327(a) would eliminate nonsensical professional disqualifications in bankruptcies simply because the professional is owed insignificant sums of money for pre-petition services provided to the debtor. It would preserve estate assets as the debtor could retain professionals with case-specific knowledge and would not be required to hire new, totally "disinterested" professionals who would have to learn the case. It would also eliminate the delays finding, hiring, and familiarizing new professionals entail.

Strict adherence to the current disinterestedness standard outside Subchapter V bankruptcies serves no purpose, as § 1195's uncontroversial success in its four-and-a-half years of existence shows.[9] It is time to allow all reorganization debtors to hire professionals whose only stain of disinterestedness is being owed less than $10,000 for pre-petition services. ■

2 Vincent Jaeger, Bankr. S.D. Iowa 23-01663 filed on December 26, 2024.
3 *Id.,* Doc. 36.
4 *Id.,* Doc. 39.
5 The debtor filed his 100% plan on August 2, 2024. *Id.*, Doc. 102.
6 *Id.,* Doc. 58.
7 *Id.*
7 *Id.,* Doc. 78.
8 *Id.*, Doc. 84.
9 As of August 5, 2024 Westlaw notes 60 cases citing § 1195, all but a handful of which do so in the context of citing Chapter 11 as a whole (e.g., §§ 1101–1195) or Subchapter V as a whole (e.g., §§ 1185–1195). Of the few cases that engage with the provision, none are from appellate courts.

THE LAST WORD:

Kathleen L. DiSanto
Shareholder
Bush Ross, P.A.

Bankruptcy Courts Have Jurisdiction To Determine Property of the Bankruptcy Estate and State Law Exemptions

Even after years of state court litigation and collection efforts, a bankruptcy court, rather than the state trial court, may be the ultimate arbiter of a judgment debtor's claims of exemption. At least that is the law in the 11th Circuit after the decision in *The Alabama Creditors u. Dorand (In re Dorand)*, 95 F.4th 1355 (11th Cir. 2024).

Despite pre-petition rulings by an Alabama trial court denying a judgment debtor's state-law claim of exemption, the 11th Circuit in *Dorand* concluded that a bankruptcy court still has jurisdiction to determine whether property of the estate is exempt – all without violating the *Rooker-Feldman* doctrine, the full faith and credit clause of the Constitution, or collateral estoppel. As a result, a bankruptcy court's ruling can be determinative as to a debtor's entitlement to exemptions under state law, thereby allowing the issues to be evaluated through a different lens (and often to the benefit of a judgment debtor).

Prior to his filing a petition for relief under Ch. 7 of the Bankruptcy Code, Rodney Dorand's creditors obtained a $1.6 million default judgment against him after he failed to appear at trial on claims for damages arising from a failed condominium development.[1] His creditors then sought to enforce their judgment against Dorand's individual retirement account through a writ of garnishment.[2] Similar to Florida law, Alabama law exempts retirement accounts. Unsurprisingly, Dorand asserted the funds in the account were exempt from collection under Alabama law. But the creditors opposed Dorand's claim of exemption, arguing that Dorand had not met the procedural requirements of the exemption statute and had engaged in prohibited transactions.[3] The creditors double downed on their position that Dorand was not entitled to the funds in the retirement account, also contending that they were entitled to relief through a creditor's bill under Ala. Code §6-6-180. As explained by the Alabama Supreme Court, a creditor's bill is an "equitable proceeding brought by a creditor to enforce the payment of a debt out of property of his debtor." [4]

Dorand's arguments were largely rejected by the trial court. The trial court denied Dorand's claim of exemption and, based on the relief requested through the creditor's bill, entered a judgment nominally against Morgan Stanley in the amount of $856,622.39, which represented the balance of the retirement account.[5] The judgment further authorized Morgan Stanley to set off the amount of the judgment with the funds from the

1 *In re Dorand*, 95 F.4th at 1359.

2 *Id.*

3 *Id.*

4 *Id.* at 1363 (quoting *Wyers v. Keenon*, 762 So. 2d 353, 355 (Ala. 1999)).

5 Morgan Stanley had no obligation to pay the judgment from its own funds. *In re Dorand*, 95 F.4th at 1364.

retirement account upon payment of the funds to the clerk of the court.[6] But the judgment stated that Dorand still owned the account.[7]

Dorand sought relief from the judgment and for a stay pending appeal, but his motions were denied.[8] Morgan Stanley then converted the account to cash. But before the transfer of the funds from Dorand's retirement account occurred, Dorand filed his bankruptcy petition — critically, as of the petition date, the funds remained in Dorand's account.[9]

Under §541(a) of the Bankruptcy Code, "the commencement of a case under ... this title creates an estate." The estate consists of "all legal or equitable interests of the debtor in property as of the commencement of the case," among other things.[10] Thus, among the primary issues in Dorand's bankruptcy case was: 1) whether Dorand, as of the petition date, retained a legal or equitable interest in his retirement account; and 2) whether the retirement account was exempt from property of the estate.

With the creditors' consent, the bankruptcy court conducted an evidentiary hearing on whether the retirement account was exempt.[11] At the hearing, a Morgan Stanley representative testified that Dorand owned the retirement account at the moment the petition was filed.[12] Based on this evidence, the bankruptcy court concluded that — notwithstanding the *Rooker-Feldman* doctrine — it had jurisdiction to determine whether Dorand's retirement account was property of the bankruptcy estate because the Alabama judgment had not extinguished Dorand's interest in the retirement account before he filed bankruptcy.[13] The bankruptcy court further held that, while Morgan Stanley had acquired the right of set-off, as the right of set-off was triggered upon payment of the judgment, payment did not occur.[14] With that, the bankruptcy court determined the account was exempt under Alabama law.

On direct appeal, bypassing the district court, the 11th Circuit affirmed the bankruptcy court's rulings.

At the 11th Circuit, and despite having consented to the bankruptcy court deciding the issue, the creditors argued the bankruptcy court lacked jurisdiction to determine the exemption under the *Rooker-Feldman* doctrine.[15] But the 11th Circuit rejected this argument, emphasizing that the dispute centered on "the effect of the judgment," as opposed to seeking to "modify" or "overturn" the judgment.[16]

6 *Id.* at 1360-61.
7 *Id.* at 1363.
8 *Id.* at 1361.
9 *Id.*
10 11 U.S.C. §541(a)(1).
11 *Id.* at 1361.
12 *Id.*
13 *Id.*
14 *Id.*
15 *Id.* at 1362.
16 *Id.*

The 11th Circuit also rejected the creditor's argument that the judgment terminated Dorand's interest in the retirement account — the judgment contained no such findings and, to the contrary, found that Dorand owned the account.[17] The judgment only gave Morgan Stanley "a limited right to transfer Dorand's funds," and that transfer never occurred.[18] Had the transfer occurred before the bankruptcy, the outcome of the case may have been quite different, as Dorand likely would not have maintained a legal or equitable interest in the account.[19] But the transfer did not occur pre-petition and Dorand maintained his interest in the account at the time of the commencement of the case.[20]

The 11th Circuit also rejected the creditor's argument that the judgment created a right of setoff on its face.[21] Instead, the court held the right of setoff was triggered only when payment was made by Morgan Stanley to the clerk.[22] Indeed, '[t]he judgment did not — and could not — require Morgan Stanley to pay the judgment first and have Dorand reimburse it later."[23]

Finally, the 11th Circuit determined that neither the full faith and credit clause of the Constitution nor collateral estoppel were grounds for reversing the bankruptcy court's conclusion that Dorand's retirement account was exempt.[24] Dorand's arguments succeeded because he focused on "the effect of" the Alabama judgment, rather than attempting to argue that judgment should be ignored or set aside.[25] Collateral estoppel did not apply because the exemption issue was not a necessary part of the judgment: "the court never specified whether it was denying Dorand's claim of exemption on procedural grounds, substantive grounds, or both."[26]

While all clients may not be candidates for bankruptcy, as only "the honest but unfortunate debtor" is entitled to a discharge, bankruptcy should always be a consideration when defending litigation or the collection of a judgment. A properly timed bankruptcy filing may allow a debtor to enjoy the benefit of the automatic stay and preserve exempt property that would have otherwise been paid to creditors if the state court collection process had progressed. ■

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17 To properly invoke the *Rooker-Feldman* doctrine, a creditor's attorney may wish to urge a trial court to include in any judgment express findings of fact and conclusions of law fully and finally terminating the judgment debtor's interest in the subject property. However, such findings may not be appropriate depending on the statutory basis for granting the creditor relief.
18 *In re Dorand*, 95 F.4th at 1362-63.
19 *See In re Marona,* 54 B.R. 65 (Bankr. N.D. Ala. 1985).
20 *In re Dorand*, 95 F.4th at 1362-63.
21 *Id.* at 1365.
22 *Id.*
23 *Id.*
24 *Id.*
25 *Id.* at 1366.
26 *Id.* From the creditor's perspective, the more detail a judgment has regarding the basis for a state court's ruling on exemptions, the more likely the order will have collateral estoppel effect on the parties should a bankruptcy be filed.

YOUR TIME AND YOUR TALENT

There is an old saying in religious organizations that the time, talent and treasure of worshipers is what is wanted. The same tends to come true in a school setting also. My son, Cameron, was enrolled in a school where it was clear my treasure was not going to amount to much in comparison with others. In an attempt to give my time and talent, I signed up to help coach High School Mock Trial.

If you are unfamiliar with the program, two schools go head-to-head in competition to try a case in front of a real judge and three attorneys sit as the jury. The Plaintiff/Prosecution of each school goes against the Defense in two separate courtrooms. The winning school proceeds to the next round of competition, until there is a winner for the entire state.

I coached mock trial for 12 years, beginning when Cameron was in first grade and well outside of competition age. I started small as an assistant and eventually head coach. I looked at it as taking an active role in the best way I could, by giving of my time and talent. But, it ended up being so much more than that.

Spending time with young people over time allowed me to gain an understanding of how they looked at the world and kept me on the far edge of relevance to a younger generation. The main thing I learned about them was that all my curmudgeon friends on social media were wrong about these goalless young people adrift in a sea of apathy. They all had become like that old man screaming “Hey, you kids. Get off my lawn!”

The mantra as to kids having no goals has permeated our culture. But these kids were different than that. Heck, no one would have ever gotten me to do something this constructive in my evenings at that age, I had women to chase and partying to do.

So what is there to be gained by this experience? As it turns out, a great deal. If you have to teach the rules of trial evidence to highschoolers every winter, you get pretty good at quoting chapter and verse when you object in trial. You get to know young people in a different setting than family and friends and become a small fraction less uncool. But best of all, to me, is utterly changing someone’s speaking skills and watching them become comfortable in an adversarial situation.

Best of all was the last four years, teaching my son and having him see me in a totally different way. So, think about volunteering to help a HS mock trial team once a week. You may end up a coach and even compete in state level competitions. And it qualifies for CLE. ■

Emory Potter, Esq.
Partner
Hays & Potter, LLP

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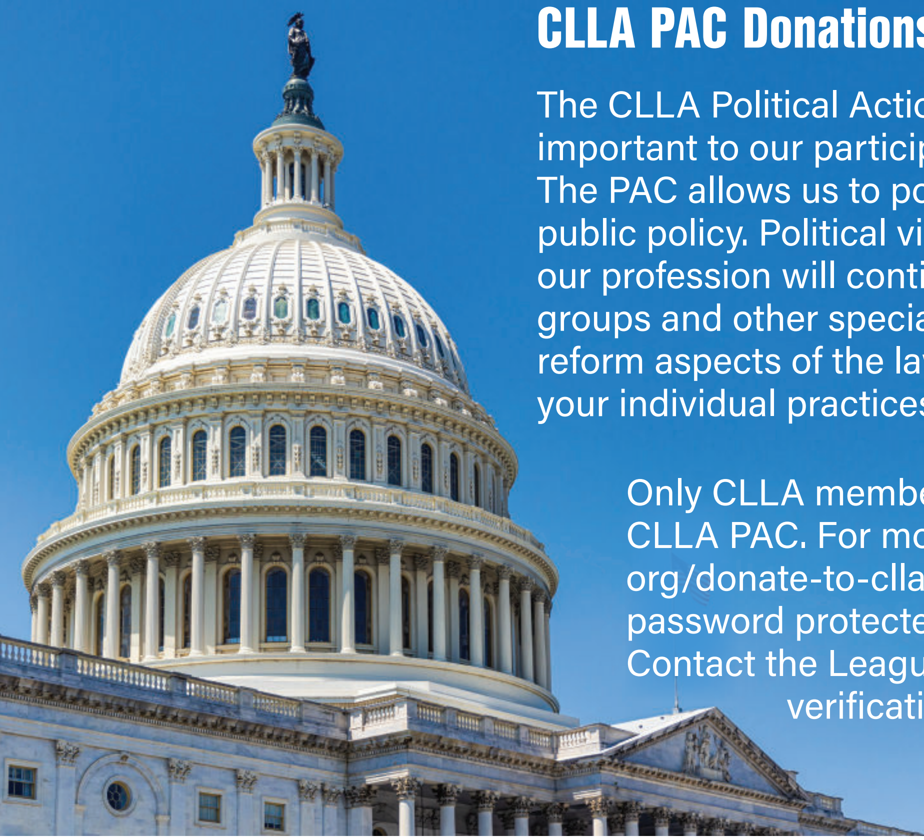

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