

2025 WL 98479

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UNPUBLISHED OPINION. CHECK
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Court of Chancery of Delaware.

CALIFORNIA SAFE SOIL, LLC, Plaintiff,

v.

KDC AGRIBUSINESS,

LLC, et al., Defendants.

KDC Agribusiness, LLC,

et al., Counter-Plaintiffs,

v.

California Safe Soil, LLC,

et al., Counter-Defendants.

C.A. No. 2021-0498-MTZ

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Date Submitted: May 24, 2024

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Date Decided: January 10, 2025

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MEMORANDUM OPINION

[ZURN](#), Vice Chancellor.

*1 The parties in this action had an honorable mission: reduce global food waste, and thereby decrease greenhouse gases and combat climate change. But the defendants pursued that mission through dishonorable means: the misappropriation of the plaintiff's combination trade secret. Through years of labor, the plaintiff developed a process to recycle food waste into a nutrient-rich byproduct that can be used to make environmentally-friendly fertilizer and animal feed. With permission granted by a license agreement, the defendants learned the minutiae of the plaintiff's entire process, and secured funding to build a large manufacturing facility. Having no further use for the plaintiff, the defendants ended the license agreement but continued to utilize the plaintiff's trade secret process.

This post-trial opinion finds in the plaintiff's favor on its statutory trade secret misappropriation claims. The defendants prevailed on the plaintiff's ancillary claims. The plaintiff is entitled to compensatory damages, and the defendants must return or destroy any records containing the plaintiff's information and are enjoined from using the plaintiff's process. But the plaintiff is not entitled to exemplary damages or fees.

I. BACKGROUND¹

Plaintiff California Safe Soil, LLC ("CSS") claims Harold ("Hal") Kamine, Matthew Kamine, Justin Kamine, and Barry Starkman (together the "Individual Defendants," and together with all other captioned defendants, "Defendants")² misappropriated CSS's combination trade secret. The corporate defendants are in bankruptcy, and the trustee elected not to defend their claims: on the plaintiff's motion, I granted a default judgment against them.³ The claims against the Individual Defendants were tried at a seven-day trial; this opinion resolves those.

CSS bears the burden of proving its misappropriation claim, and other related claims, by a preponderance of the evidence.⁴ "Proof by a preponderance of the evidence means proof that something is more likely than not. It means that certain evidence, when compared to the evidence opposed to it, has the more convincing force and makes you believe that something is more likely true than not."⁵ And "[i]t is well settled that the trier of fact is the sole judge of the credibility

of witnesses and the weight to be accorded their testimony and is responsible for resolving conflicts in the evidence.”⁶

***2** The following facts were proven by the preponderance of the evidence. I gave little weight to testimony from Hal, Matthew, Barry, and their food process engineering expert, finding it not credible.⁷ As this opinion concludes that CSS's process was a combination trade secret, this opinion describes certain aspects of that process in generalities, with citations to the unredacted, sealed trial transcript.

A. CSS's Process To Recycle Food Waste

Globally, one third of our food is wasted.⁸ CSS's mission is to reduce that problem by recycling food waste into a nutrient-rich slurry that can be used to make fertilizer and animal feed, thereby diverting food waste from landfills and reducing the amount of greenhouse gases released into the atmosphere. Nonparty Mark LeJeune and his company Organic Recovery, LLC, originated this process in 2006. LeJeune began developing a way to collect food waste and recycle it into a nutrient-dense and environmentally friendly fertilizer.⁹ CSS's founder Dan Morash invested in Organic Recovery in 2008 through his company Renewal Energy Development and Finance (“REDF”).¹⁰ In 2009, Organic Recovery licensed its intellectual property to REDF.¹¹ In 2011, after Organic Recovery began experiencing financial difficulties, Morash founded CSS and purchased Organic Recovery's technology.¹² LeJeune was hired as CSS's chief operating officer and remained in that position for a decade.¹³

B. CSS Seeks The Kamines' Capital And Expertise.

***3** Shortly after CSS bought Organic Recovery's technology in 2011, CSS conducted a round of financing. Morash turned to defendant Hal Kamine, whom he had known since the early 1990s.¹⁴ Morash sought out Hal because of his track record of investing in green technology, skill in bringing in investors, and experience in project management.¹⁵ Without a confidentiality agreement in place, Morash emailed Hal materials about CSS's business, including details about its first-generation process built with Organic Recovery.¹⁶ Morash informed Hal that if reception to the CSS Process was

positive, the two could enter into an arrangement for Hal to scale up the process.¹⁷

In February 2012, Hal invested \$200,000 in CSS.¹⁸ His sons Justin and Matthew each invested \$100,000.¹⁹ The Kamines were far from passive investors. During that critical growth stage, Hal and Justin helped CSS find additional investors.²⁰ Justin was appointed to CSS's board as the Kamines' representative, and was heavily involved in CSS's business.²¹ Justin attended monthly board meetings, and from 2012 through 2015 he was charged with bringing in additional investors.²² Justin pitched CSS to upwards of one hundred potential investors.²³ And Hal and Justin assisted CSS in pitching its business to various grocery store chains and other companies.²⁴ The Kamines made additional investments in CSS in the years that followed: Hal invested a total of approximately \$2,000,000, and Justin invested an additional \$100,000.²⁵

With financing in hand, in 2012 CSS built a small pilot plant in West Sacramento, California, to develop its second generation of technology.²⁶ The pilot plant was designed to produce just enough product to develop CSS's technology and conduct research trials.²⁷ Building off its purchase of Organic Recovery's infant first-generation technology, CSS continued testing, developing, and scaling up its food recycling process.²⁸ The West Sacramento plant served as the starting ground for much of CSS's initial research and development. To build its technology, CSS hired food scientists and experienced engineers, and forged partnerships with research institutions like the University of California, Davis and the University of Georgia.²⁹ As Morash described CSS's work: “When you start with a new technology, you don't know what you don't know. So you learn it the hard way. You fix problems as you go.”³⁰

CSS's food recycling process (the “CSS Process”), which Morash described as “biomimicry,” breaks food waste down to a slurry of amino acids, organic acids, and simple sugars.³¹ At a high level, the CSS Process begins with CSS's grocery store partners. When produce and meat pass their shelf life, but are still fresh, CSS's grocery store partners collect and store their food waste in specially designed insulated containers.³² The containers are sent to CSS on a strict timetable and immediately processed or refrigerated for later

processing.³³ At CSS's plant, the food waste is sorted so that the inputs of meat and produce can be calibrated to specific ratios.³⁴ After sorting and inspection, the waste is ground, blended, digested, and pasteurized, all using specific equipment, settings, and calibrations. The CSS Process utilizes enzymes to help break down food. Although enzymes are naturally present in animal and plant products, CSS typically adds commercial enzymes during digestion to accelerate the breakdown process.³⁵ After digestion, the product is reduced, separated, stored, and if not kept liquid, dried;³⁶ once stabilized, the product is used in fertilizer and animal feed.³⁷

C. CSS And KDC Enter Into A License Agreement.

*4 In 2015, CSS sought to expand the CSS Process to other markets outside California. Once again, CSS turned to the Individual Defendants, seeking Hal's experience in project development and in scaling up industrial processes.³⁸ The Kamines created KDC Agribusiness LLC ("KDC")³⁹ to enter into a licensing agreement with CSS.⁴⁰ KDC planned to scale up the CSS Process by building a much larger commercial facility in Pennsylvania. Hal was KDC's executive chairman, and Justin and Matthew were co-CEOs and directors.⁴¹ Justin "led much of the business development and public partnership efforts for KDC,"⁴² and Matthew "led the effort for the development, permitting, engineering, and construction" to scale up the CSS Process for KDC.⁴³ Barry, who has decades of engineering and manufacturing experience, was hired as KDC's chief manufacturing officer.⁴⁴ Barry led the operating and engineering team in charge of building up CSS's manufacturing process for KDC.⁴⁵

On December 11, 2015, CSS and KDC entered into a license agreement (the "License Agreement").⁴⁶ The License Agreement provided KDC with an exclusive license to use CSS's intellectual property within the United States, excluding California, where CSS's existing plant was located, and parts of Arizona.⁴⁷

During negotiations the parties discussed CSS's broad definition of Intellectual Property, which included both patents and trade secrets.⁴⁸ The Kamines were directly involved in negotiating the License Agreement.⁴⁹ Although

Barry was not involved in negotiations, he was aware of the License Agreement's contents.⁵⁰

The License Agreement defined CSS's intellectual property as certain patents, copyrights, and "Trade Secrets," defined as:

[T]rade secret and confidential information, including such rights in inventions (whether or not reduced to practice), know-how, customer lists, technical information, proprietary information, technologies, processes and formulae, software, data, plans, drawings and blue prints, whether tangible or intangible and whether stored, compiled or memorialized physically, electronically, photographically, or otherwise, including, but not limited to, as further described on Exhibit D⁵¹

Exhibit D's nonexhaustive list included the following categories of "Trade Secrets":

- Generic facility design and specifications;
- Equipment specifications and manufacturer information;
- Collection procedures and equipment information;
- Feedstock preparation methodology;
- Operating procedures and specifications;
- Workplace safety information;
- Representative Supermarket contract terms;
- Enzyme types, sources, and application methodologies;
- Product stabilization inputs, sources and methodologies;
- Certified organic production and methodology;
- Quality Control procedures and methodology;
- Quality Assurance procedures and methodology;
- Research and Field Trials results; and
- Representative Employee Handbook.⁵²

This list was meant to provide guidance to the parties about the types of confidential information CSS considered as trade secrets that CSS would be licensing to KDC.⁵³

The License Agreement granted KDC the right to make, sell, offer or otherwise distribute "Licensed Products," defined as "any liquid fertilizer, animal feed or blend produced ...

through a Licensed Process by the operation of a Licensed Facility, but excluding additives.”⁵⁴ “Licensed Process” was defined as “an aerobic, enzymatic digestion process covered by or using CSS’s Intellectual Property.”⁵⁵ And “Licensed Facility” was defined as “any facility that uses aerobic, enzymatic digestion ... to produce one or more Licensed Products.”⁵⁶ And the License Agreement provided KDC with a grant to use CSS’s intellectual property to “permit, construct and finance Licensed Facilities.”⁵⁷ The Individual Defendants understood they were licensing CSS trade secrets in connection with its enzymatic process.⁵⁸

*5 In exchange for using CSS’s intellectual property, KDC would pay CSS royalties and milestone payments.⁵⁹ KDC was required to “pay CSS royalties equal to twenty percent (20%) of Net Sales” by KDC, or any KDC affiliate, of any Licensed Products, on a running monthly basis.⁶⁰ In exchange for an exclusive license, KDC also agreed to pay CSS minimum royalties, credited against monthly running royalties, on a set schedule that stepped up each year. KDC owed \$0 in 2016 and \$100,000 in 2017; by 2020, it would owe \$5,000,000 in minimum royalties. After 2020, the minimum royalty would be equal to the prior year’s minimum plus 20% until 2030, when it would level.⁶¹ If KDC stopped those minimum payments, CSS had the right to convert KDC’s license to a nonexclusive license limited to existing Licensed Facilities, including those under construction, at the time of conversion.⁶²

Along with royalties, KDC owed certain milestone payments. It agreed to “pay CSS a ... milestone payment of \$250,000 within 30 days after closing of financing to fully fund construction of each ‘Train’ (a Train will be a single Licensed Product production line using approximately 5,000 tons/year of Residuals), for the first twelve (12) Trains ... for total potential Milestone Payments of \$3,000,000.”⁶³ In connection with the License Agreement, KDC also made a \$1,000,000 investment in CSS in exchange for equity membership interests.⁶⁴

Lastly, KDC granted CSS a license to use certain intellectual property KDC controlled.⁶⁵ KDC was required to inform CSS of all “Improvements” KDC made to CSS’s intellectual property.⁶⁶ “Improvements” meant “all modifications, adaptations, changes and improvements, whether developed or introduced by or on behalf of CSS or KDC in respect of

any CSS Intellectual Property.”⁶⁷ Other than that license, “all rights in the KDC Intellectual Property shall remain in KDC.”⁶⁸

D. CSS Continues To Build And Market Its Technology.

CSS continued to develop and expand its process. In December 2015, the same month it entered into the License Agreement, CSS closed financing to build a “demonstration scale” commercial plant. In 2016, CSS opened its larger operations in McClellan, California, where it would develop its third generation of technology.⁶⁹ The McClellan plant had one processing line and could process upwards of approximately 11,000 tons of material a year.⁷⁰ At the McClellan plant, CSS continued to improve its proprietary process through research and development in “manufacturing equipment, food chemistry, food safety, food nutrition, biological processing, logistics, contracts, and customer relations.”⁷¹

Parts of the CSS Process changed through its early development, including centrifugation, wastewater treatment, and the specific input ratio of produce to meat.⁷² CSS conducted its research and development with one overarching goal: to retain the nutritional value of food waste upon processing.⁷³ Between 2015 and 2022, CSS obtained six patents,⁷⁴ and as of trial, it had six more pending.⁷⁵ CSS created a unique food recycling process different from others in the industry.⁷⁶

CSS expanded its business with additional grocery store partners, potential investors, strategic partners, supply partners, and customers. When CSS shared information with these third parties, CSS typically entered into NDAs, and for the most part, stamped its materials as confidential.⁷⁷ Absent an NDA, CSS would typically receive verbal confirmation to keep its information confidential.⁷⁸ CSS employees entered into confidentiality agreements, and kept paper and digital records secure.⁷⁹

*6 CSS marketed itself through online videos and news articles.⁸⁰ Some of its marketing included video tours of both its pilot factory and its McClellan plant.⁸¹ CSS let potential grocery store partners and members of the public tour its

facilities.⁸² In 2016, when CSS opened its McClellan plant, CSS held a public ribbon cutting ceremony.⁸³ Attendees toured the plant and viewed CSS's equipment in place without signing an NDA.⁸⁴

E. The Individual Defendants Learn The CSS Process.

With the License Agreement granting use of the CSS Process, KDC started planning its scaled-up facility in Fairless Hills, Pennsylvania ("Fairless Hills"). KDC planned to build a facility 5.5x larger than McClellan.⁸⁵ None of the Individual Defendants had experience in food recycling before investing in CSS.⁸⁶ KDC hired DPS Group, Inc. ("DPS") to design its Fairless Hills Facility.⁸⁷ No one from DPS had prior experience in food recycling either.⁸⁸ As described in DPS's design proposal, Fairless Hills was meant to be "a near duplication of the California Safe Soil project except that the food waste processing capacity will be increased," but "the functional requirements, operation and complexity" would remain similar to CSS, albeit with some improvements.⁸⁹

Before KDC and its contractors could build a plant to scale up the CSS Process, they had to learn the CSS Process from CSS. KDC and DPS visited CSS's facilities at Hal's direction,⁹⁰ and Hal told his team to learn everything about the CSS Process to use at Fairless Hills.⁹¹ CSS had an "open-book philosophy" with KDC and DPS, and shared large amounts of information with them.⁹² While licensing its information to KDC, CSS gave the Individual Defendants, DPS, and E3 access to its facilities and information.⁹³ Each of the Individual Defendants visited CSS's facilities on multiple occasions,⁹⁴ and DPS was given full access to the CSS Process and the McClellan plant.⁹⁵ Barry visited CSS "more than anybody."⁹⁶ He visited CSS's pilot plant in 2016, and visited the McClellan plant so frequently in the next three years that he "could not recall how many times" at trial.⁹⁷

*7 When representatives from KDC and DPS visited CSS, sometimes for several days at a time, they would discuss the CSS Process, observe operations, inspect the facility, and collect samples.⁹⁸ DPS sought to learn the "current process steps/equipment" used by CSS in every step of its process, from receiving the food waste, to grinding, digestion, and separation.⁹⁹ These visits and walk-throughs with CSS

were "invaluable learning tools" for DPS and KDC, and provided them with "the technical details" needed to "design [a] similar process for KDC."¹⁰⁰ As Barry wrote to CSS after a May 2017 visit, they "learned a ton" from visiting CSS's facilities.¹⁰¹ DPS's notes from its first visit in 2017 reflect DPS learned about the CSS Process in great detail.¹⁰² DPS documented detailed specifications of the CSS Process including the exact temperatures used, how many grams of enzymes to add to each batch, the centrifuge pump rate, yield rates, and equipment details.¹⁰³

DPS intended to improve upon the CSS Process for Fairless Hills.¹⁰⁴ CSS shared with DPS the lessons CSS had learned the hard way, like reducing input of high fiber foods, artichoke skins, and bread because they jam the grinder.¹⁰⁵ Armed with this knowledge, DPS considered using stronger equipment that could withstand high-fiber and tougher foods.¹⁰⁶ KDC built on the information it learned from CSS in pursuit of improvements like automated weighing and scanning of bins upon receipt, and the use of a larger digester tank.¹⁰⁷

In addition to visits, DPS and KDC asked CSS for information on its process.¹⁰⁸ CSS gave KDC engineering drawings and equipment specifications,¹⁰⁹ copies of their design documents, and piping and instrumentation diagrams.¹¹⁰ Upon request, CSS also created samples and gave them to KDC.¹¹¹

DPS considered all the information it learned from CSS to be strictly confidential.¹¹² DPS entered into a confidentiality agreement with KDC and understood all information learned in connection with the Fairless Hills project, including information from CSS, was confidential.¹¹³

F. KDC Pulls Away From CSS.

As KDC scaled up the CSS Process, it performed additional research and development on its food recycling process. As of 2019, some of KDC's "[i]mprovements to base CSS process" included redesigning bins that carry the food waste, automating cleaning and sanitizing the bins, replacing the ribbon blenders, changes to the formulation, and modifying the drying method.¹¹⁴ Among other modifications, KDC aimed to modify the grinders used, its plumbing systems, and

food inspection technology.¹¹⁵ KDC also grew its business and entered into arrangements with grocery stores and food company partners.¹¹⁶

By late 2017, KDC started moving away from CSS's focus on fertilizer created with added enzymes.¹¹⁷ In 2018, it began to explore a process that would not require adding enzymes, while retaining the flexibility to add them.¹¹⁸ Because of KDC's focus on a nonenzymatic process, other elements of its process needed to change, such as the size of the pumps used for the more viscous nonenzymatic product.¹¹⁹ Hal first informed Morash about KDC's plan to explore a nonenzymatic process in the summer of 2018.¹²⁰

*8 KDC ventured from fertilizer into dry chicken feed, then pet food palatant. In connection with producing feed, KDC experimented with modifications to the CSS Process to make its feed more digestible for chickens, ultimately shifting to a new drying method.¹²¹

In 2018, CSS and KDC amended the License Agreement.¹²² KDC's running royalty rate was reduced from 20% to 10% for its "Qualified First Customer," which was defined as "KDC's first long term off-take client for Licensed Product used for animal feed."¹²³ KDC agreed to notify CSS when it signed an agreement with its Qualified First Customer.¹²⁴

In the fall of 2019, KDC sought further amendments to the License Agreement, including reduced royalty rates.¹²⁵ On September 17, KDC's bond underwriter sent CSS a letter explaining that in its opinion amendments were needed to the License Agreement to make an investment in Fairless Hills more attractive to risk adverse bond purchasers.¹²⁶ But trial uncovered this letter was written not by the underwriter, but by Hal, who "took the liberty to write th[e letter] as if [he] was [the underwriter]."¹²⁷ The parties negotiated for a few months, but could not agree.¹²⁸ Morash felt the amendments consisted only of "a series of unilateral give-ups" for CSS,¹²⁹ and KDC eventually "g[a]ve up with CSS" because it thought CSS's "demands ha[d] been outrageous" and they "couldn't negotiate anything reasonable."¹³⁰

Having failed to secure a lower royalty, in December 2019, KDC informed CSS it would stop making its minimum royalty payments under the License Agreement,¹³¹ and Justin

resigned from CSS's board.¹³² CSS responded by converting KDC's exclusive license to a nonexclusive license for any existing Licensed Facilities, but noted CSS was unaware of any existing Licensed Facilities.¹³³ CSS requested that KDC provide CSS with evidence of any Licensed Facility.¹³⁴ In January 2020, Hal responded that Fairless Hills was under construction and operating, and so it was a Licensed Facility.¹³⁵ He stated that "[w]ith the necessary equipment installed, KDC Ag has produced numerous variations of the Licensed Products."¹³⁶ CSS requested proof that Fairless Hills was under construction. As of that time, KDC had built and was operating a small laboratory at the Fairless Hills location.¹³⁷ But construction on the full-scale Fairless Hills facility did not start until June 2020.¹³⁸ KDC then changed its story. On May 26, the Individual Defendants told CSS that KDC had no Licensed Facilities because KDC "decided not to use a Licensed Process to create Licensed Products at any of its facilities."¹³⁹ KDC believed a nonenzymatic process did not fit the definition of a Licensed Process, so KDC would not be required to pay royalties if it utilized only a nonenzymatic process.¹⁴⁰

*9 As of May 2020, it is undisputed that KDC did not have any license, exclusive or nonexclusive, from CSS.

G. KDC Obtains Funding For Fairless Hills Based On The CSS Process.

Even as KDC shifted away from CSS, KDC sought funding for Fairless Hills with open reliance on the CSS Process and all it learned from CSS. KDC retained E3 Consulting Services, LLC ("E3") to draft an independent engineer's report in connection with obtaining financing to construct Fairless Hills (the "E3 Report").¹⁴¹ E3 visited CSS in August 2019.¹⁴² The E3 Report stated it would "[r]eview and summarize [the] operating history of existing facility in Sacramento" and to "[d]iscuss how any past performance issues will be addressed in the new facility."¹⁴³ Drafts explicitly acknowledged the Fairless Hills facility was based on the CSS Process.¹⁴⁴ A draft report from November 2019, just a few months before the License Agreement ended, described KDC as "operating a small-scale plant ... in conjunction with" CSS.¹⁴⁵ The draft report stated that KDC's proposed "overall digestion and product finishing

process ha[d] been successfully piloted at the CSS facility in Sacramento.”¹⁴⁶

The bond financing memorandum contained an Appendix A that detailed the plans for Fairless Hills. Matthew wrote the first draft of Appendix A, and Hal, Justin, and Barry all reviewed drafts or sent revisions.¹⁴⁷ A draft Appendix A Justin circulated to potential investors in January 2020 stated that KDC utilized CSS’s “proprietary and patented technology.”¹⁴⁸ That same month, Justin emailed videos of the CSS Process to the bond underwriter, explaining the videos showed the “collection process, the depackaging, the bins and the production process” to be used by KDC.¹⁴⁹ Justin explained that KDC’s “production line is a ~1.5x scale up with some automatization / optimizations from what is shown in the video” and that people can see “the entire process from start to finish at the CA facility that we are implementing into Fairless Hills, PA.”¹⁵⁰ In February 2020, Justin sent materials to other potential investors that explained KDC had “successfully patented and commercialized a process” over “the past 6 years.”¹⁵¹

As financing looked more promising, Individual Defendants began wiping CSS from KDC’s materials. In February 2020, Justin and Matthew decided to remove any references to CSS from KDC’s website “prior to the bond[]” financing.¹⁵² Justin largely “scrapped CSS” from KDC’s website, leaving only some limited videos and pictures for “substance.”¹⁵³ Around the same time, references to CSS were wiped from the E3 Report drafts, leaving only vague references to a facility in California.¹⁵⁴

*10 On May 14, 2020, the Pennsylvania Economic Development Financing Authority issued a Limited Offering Memorandum for a total of \$126,130,000 in bonds to finance Fairless Hills.¹⁵⁵ The E3 Report and Appendix A were attached. While CSS was not mentioned by name, the E3 Report still described and utilized information KDC learned from the CSS Process.¹⁵⁶ The final bond offering and E3 Report described KDC’s food recycling process in a manner that is substantially similar to the CSS Process.¹⁵⁷ The “KDC Ag Process” described was similar to the CSS Process: food waste is collected, transported to KDC, sorted, ground, and digested.¹⁵⁸ Appendix A provided an overview of KDC’s process, which stemmed from the CSS Process.¹⁵⁹

Although KDC shifted to a nonenzymatic process, its bond offering touted the flexibility of its process to use additional enzymes, which stated,

[t]here are potential applications where adding enzymatic digestion of the material to the Process can create additional benefits for the end products. These enzymatic digestion solutions, if ever implemented by the Project, are expected to provide KDC Ag the option and flexibility to offer additional benefits to KDC Ag customers specifically for palatants.¹⁶⁰

The bond offering also stated that

[i]f, in the future, [KDC] determines that there are viable product solutions using enzymatic digestion ... the enzymatic digestion step would occur after the material is ground into the heating and mixing vessel, with the enzymes being added into the vessel during that step of the process. The remainder of the KDC Ag Process would remain the same.¹⁶¹

By touting CSS’s process, KDC obtained approximately \$126,000,000 in bond financing to fund Fairless Hills.¹⁶² The “bond closing occurred on or before September 22, 2020.”¹⁶³

H. KDC Treats The CSS Process As Confidential And Trade Secret.

In connection with financing and constructing the Fairless Hills facility, the Individual Defendants told third parties that the process contained trade secrets. In August 2019, Matthew sent a draft Appendix A to KDC’s bond financing materials to the underwriter, copying Hal and Justin.¹⁶⁴ Under a heading titled “Technology Review and License Agreement,” it stated, “[t]he CSS Process has multiple patents with significant IP and trade secrets associated with it.”¹⁶⁵

In 2017, 2018, and 2020, Matthew sent information to the Pennsylvania Department of Environmental Protection (“PADEP”) concerning KDC’s application for a permit in connection with Fairless Hills.¹⁶⁶ Matthew requested KDC’s information be kept confidential, as information surrounding the Fairless Hills permit would otherwise be published.¹⁶⁷ Matthew described the process as confidential, and stamped the portions of the application describing the process with a footer stating, “Confidential Trade Secret, Commercial, or Financial Information.”¹⁶⁸ In another email,

Matthew attached documents “related to the confidential and patented KDC Ag process” and stated that “[d]ocuments submitted with this application have been designated CONFIDENTIAL TRADE SECRET, COMMERICAL OR FINANCIAL INFORMATION KDC Ag believes that each document contains commercial valuable, proprietary, non-public information, including related to its finances, processes and operations.”¹⁶⁹ Another set of materials Matthew sent the PADEP also described KDC's process description as a confidential trade secret.¹⁷⁰

***11** In a 2020 email to a Pennsylvania senator, Matthew noted KDC's request for construction be kept confidential because it included “some trade secrets related to how we handle our raw material and our overall process.”¹⁷¹ Matthew confirmed at trial that he wanted diagrams summarizing KDC's overall process to be kept confidential.¹⁷²

I. KDC Builds Fairless Hills To Use A Process Derived From The CSS Process.

With funding in place, but without a license to use the CSS Process, KDC pressed forward with its work derived from the CSS Process: it did not pause and start from scratch.¹⁷³ Rather, KDC continued to tell third parties that it utilized the CSS Process. In August 2020, Justin told other potential investors that KDC used a “patented process” to recycle food waste.¹⁷⁴ Because KDC had no patents, this was a reference to the CSS Process.¹⁷⁵ In a November 2020 email, Barry informed a third party that the fertilizer “California Safe Soil produces ... was the basis for [KDC's] current process.”¹⁷⁶

To continue research and development into a process that did not include additional enzymes, Hal and Barry decided to open a pilot facility.¹⁷⁷ In September 2020, KDC leased a facility in North Dakota for that purpose.¹⁷⁸ The North Dakota plant operated until 2021.

Fairless Hills was completed in late 2021, and began production within the following months.¹⁷⁹ There was no delay to create a new process from scratch before constructing the facility.¹⁸⁰ Fairless Hills was a large commercial-scale plant; while CSS's McClellan plant had the capacity to process approximately 11,000 tons of residuals a year, Fairless Hills could process 60,000 tons a year.¹⁸¹ Fairless

Hills was more automated, designed with the capacity to run 24/7, and had more production lines than CSS. As the E3 Report explained, Fairless Hills would “have three operating lines instead of one at California.”¹⁸²

***12** KDC's process at Fairless Hills was derived from the CSS Process. According to DPS, while Fairless Hills contained some modifications to the CSS Process, Fairless Hills was still derived from that process.¹⁸³ At trial, the DPS lead confirmed “the process that was contemplated as of July 2020 to be used at the Fairless Hills facility still [was] ... derived from the CSS [P]rocess and used at the CSS facility.”¹⁸⁴ DPS also confirmed as of its last visit to Fairless Hills, in August 2021, the process used was “derived from the base process that was used at the CSS facility,”¹⁸⁵ and that he “not believe that [Fairless Hills] could be redesigned from scratch in three months.”¹⁸⁶

CSS's food recycling expert, Dr. Kevin Keener, visited Fairless Hills and reported the same. He observed “no substantial changes to the original process designed by DPS that was derived from the CSS Process.”¹⁸⁷ He reported that Fairless Hills was derived from CSS and observed similarities to the CSS Process throughout KDC's process.¹⁸⁸ Dr. Keener reported observing collection totes of similar sizes and insulation, and a similar sorting procedure including the removal of certain produce that may clog the machines. He observed similar digestion, processing, centrifugation and drying processes.¹⁸⁹

J. KDC Shifts To Poultry, Then Shuts Down.

KDC expanded its business further and changed its revenue model. In November 2020, KDC created Do Good Foods LLC and Do Good Chicken LLC (together, “DGC”) to enter into the poultry business,¹⁹⁰ with Justin and Matthew as the face of DGC.¹⁹¹ Eventually DGC began selling chicken feed and poultry raised on Fairless Hills chicken feed.¹⁹² On August 2, 2021, DGC entered into a master co-pack agreement with Allen Harim Foods, LLC (“Allen Harim”).¹⁹³ And by early 2022, it began supplying Allen Harim chicken feed for free; Allen Harim would feed it to chickens, and then process, package, and sell the chickens back to DGC to sell to retailers.¹⁹⁴

On October 28, 2022, DGC entered into a purchase and distribution agreement with Michael Foods, Inc.¹⁹⁵ Through that agreement, DGC agreed to sell Michael Foods Fairless Hills chicken feed for \$3.40 per pound.¹⁹⁶

The Corporate Defendants continued operations through 2022 and part of 2023 but struggled financially. KDC began to cease operations in September 2023, but as an attempt to stay in business DGC identified a third party, Bright Feeds, as an alternative chicken feed supplier for Allen Harim.¹⁹⁷ Bright Feeds supplied feed based on excess bakery meal that “was mostly bread and cookies and other products like that, crackers.”¹⁹⁸

K. CSS Initiates Litigation And KDC Enters Bankruptcy.

On June 8, 2021, CSS sued KDC and the Individual Defendants for trade secret misappropriation, breach of the License Agreement, and other wrongs.¹⁹⁹ The complaint was amended three times. The operative complaint, filed October 27, 2022, brings sixteen counts against the Individual Defendants and Corporate Defendants.²⁰⁰ A subset of the Defendants brought counterclaims.²⁰¹ As required in trade secret misappropriation actions, CSS provided trade secret identification disclosures to Defendants on July 9, 2021, April 26, 2022, and September 30, 2022.²⁰²

***13** On February 6, 2023, I entered a partial summary judgment against CSS on Count IV in full, Count XV in part as to KDC Agribusiness Fairless Hills and KDC Agribusiness North Dakota, and Count VI in part “to the extent Count VI seeks declaratory judgment that [KDC] breached the License Agreement and that [KDC] violated the implied covenant of good faith and fair dealing.”²⁰³ As to the Defendants’ counterclaims, I granted summary judgment in CSS’s favor on Counts III and IV.²⁰⁴

Trial was originally scheduled for June 20 through June 28, 2023, but was postponed when the Corporate Defendants filed for Chapter 11 bankruptcy four days before trial.²⁰⁵ This action was automatically stayed pursuant to 11 U.S.C. § 362. On August 18, upon CSS’s motion, the bankruptcy court lifted the automatic stay and permitted CSS to continue prosecuting its claims in this Court.²⁰⁶ In November 2023, the bankruptcy court converted the Corporate Defendants’

bankruptcy to Chapter 7.²⁰⁷ The Corporate Defendants are either in bankruptcy or dissolved; the Chapter 7 trustee declined to retain counsel to defend against CSS’s claims.²⁰⁸ They are being liquidated.

On April 22, 2024, I found the Corporate Defendants in default on all remaining counts,²⁰⁹ but deferred entry of a final judgment until entry of a judgment regarding the Individual Defendants.²¹⁰ CSS’s remaining claims against the Individual Defendants were tried on February 28 through March 7, 2024. Those claims include misappropriation of trade secrets under federal and state law (Counts VII, VIII, IX), tortious interference with the License Agreement (Count V),²¹¹ fraud (Count XIV), civil conspiracy (Count XV), and unjust enrichment (Count XVI). The Defendants abandoned their remaining counterclaims at trial.²¹² Trial consisted of 1531 exhibits, 13 lay witnesses, and 4 expert witnesses. Post-trial argument was held on May 24, 2024.

This post-trial opinion concludes judgment should be entered against the Individual Defendants on Counts VII and VIII. Judgment is entered against the Corporate Defendants, and in favor of CSS, for Counts I–III and V–XVI.²¹³

II. ANALYSIS

CSS asserts five theories against the Individual Defendants: (1) trade secret misappropriation under federal and state laws; (2) tortious interference with the performance of a contract; (3) conspiracy; (4) unjust enrichment; and (5) fraud. I find in favor of CSS on statutory trade secret misappropriation but enter judgment in favor of the Individual Defendants on tortious interference, conspiracy, unjust enrichment, fraud, and common law misappropriation.

A. Trade Secret Misappropriation

CSS brings claims for trade secret misappropriation related to the CSS Process against the Individual Defendants. It brings claims under federal law (Count VII), under Delaware and other state statutes (Count VIII), and under the common law (Count IX).²¹⁴ Judgment is entered in CSS’s favor on Counts VII and VIII. Count IX is statutorily preempted, so judgment is entered for the Individual Defendants.

1. Choice Of Law

*14 CSS brought trade secret misappropriation claims under statutes from Delaware (the forum state), California (where the Individual Defendants learned the CSS process), New Jersey (KDC's principal place of business), Pennsylvania (the site of the Fairless Hills facility), “and other relevant jurisdictions.”²¹⁵ At first glance, this appears to present a gating choice-of-law conundrum. But choice of law does not need to be resolved. As CSS explained, “[a] choice of law analysis is unnecessary where, as here, the result would be the same under any applicable law.”²¹⁶ No party has shown any substantive difference between those statutes, which is unlikely as each statute CSS cites is based on the Uniform Trade Secrets Act. For this opinion, I will proceed under the Delaware statute and law for Count VIII, and federal law for Count VII.

2. CSS's Process Is A Combination Trade Secret.²¹⁷

To prove trade secret misappropriation under Delaware and federal law, CSS must show “(1) it possessed a trade secret, and (2) the defendant misappropriated the trade secret.”²¹⁸ Federal law also requires that “the trade secret [be] related to a product or service used in, or intended for use in, interstate or foreign commerce.”²¹⁹ Finally, another “element in each [trade secret] claim[] is the need to identify each trade secret asserted with particularity.”²²⁰

At trial, CSS pressed that its entire process is a combination or compilation trade secret. I begin with whether CSS proved that to be so; then consider whether CSS identified that trade secret with adequate specificity; then address the remaining elements of trade secret misappropriation.

a. Existence Of A Trade Secret

The first element of trade secret misappropriation is the existence of a trade secret. That element has several sub-elements under the similar trade secret definitions in the federal Defend Trade Secrets Act (“Federal Act”) and the Delaware Uniform Trade Secrets Act (“Delaware Act”). The Delaware Act defines a trade secret as “information, including a formula, pattern, compilation, program, device, method,

technique or process” that “[d]erives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use,” and is “the subject of efforts that are reasonable under the circumstances to maintain its secrecy.”²²¹ The Federal Act's definition is substantively the same.²²²

i. The CSS Process Derives Independent Economic Value From Not Being Known Or Readily Ascertainable And Is Unique.

*15 “For information to be classified as a trade secret it must ‘derive [] independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use.’”²²³ “[I]t is ‘well-established that if a method, technique or process in question can be found in the public domain or public literature, it is considered to be generally known and readily ascertainable and thus, cannot qualify as a trade secret.’”²²⁴ But even if “some or all of the components of the trade secret are well-known [it] does not preclude protection for a secret combination, compilation, or integration of the individual elements.”²²⁵ Instead “it is the secrecy of the claimed trade secret as a whole that is determinative.”²²⁶ “Whether the trade secrets were generally known or readily ascertainable ... is a question of fact.”²²⁷ In *Merck & Co., Inc. v. Smithkline Beecham Pharmaceuticals Co.*, this Court explained “[t]he mere fact that aspects of a trade secret process can be found in publications does not mean that the process is not a trade secret.”²²⁸ “[A] defendant that has had access to such a process may not evade misappropriation on the basis that particular information learned from its access could be found in a publication.”²²⁹ “The combination of steps into a process is a trade secret, even if all the component steps are known, so long as it is a ‘unique process which is not known in the industry.’”²³⁰

The CSS Process was not generally known or readily ascertainable. CSS's expert provided a credible opinion that although some components of CSS's process are public, it cannot be fully replicated from public sources.²³¹ As explained in Dr. Keener's report, “neither the [CSS] patents nor any other public information ... are sufficient to provide

a ‘roadmap’ of how to assemble the numerous learnings that comprise the CSS Process into a viable business model and manufacturing process.”²³² Dr. Keener testified the same at trial.²³³ His opinion stands un rebutted.²³⁴

***16** “An alleged trade secret derives actual or potential independent economic value if a competitor cannot produce a comparable product without a similar expenditure of time and money.”²³⁵ KDC agreed to pay a lot of money for access to the CSS Process so that it could scale it up and expand its geographic reach. The Individual Defendants offered no explanation as to why KDC agreed to those terms if its principals, or anyone else, could have replicated or recreated that process from public sources. KDC also acknowledged the economic value in CSS’s Process to third parties.²³⁶

The public tours of CSS’s facilities, videos, and other materials showing its process did not destroy the CSS Process’s economic value. A tour or other overview of CSS’s facilities would not disclose all components of the CSS Process. For example, a tour would not allow an individual to determine exact equipment specifications, temperatures, quantities, ratios, or other more detailed technical information.²³⁷ So although certain components of the CSS Process may not be “sufficiently secret to be trade secrets,” the CSS Process as a whole is “sufficiently secret such that [CSS] derived economic value from its not being generally known.”²³⁸

The Individual Defendants assert certain portions of the CSS Process were disclosed in separate litigation. In 2012, an REDF affiliate sued Rainbow Disposal Co. for breach of contract, unjust enrichment, and unfair competition.²³⁹ The Individual Defendants have not demonstrated the court documents are public.²⁴⁰ And the claims concern confidential and proprietary information, but not trade secrets.

And the CSS Process is unique in its combination, as credibly reported by Dr. Keener.²⁴¹ The Individual Defendants contend the CSS Process is not unique and that “numerous third parties, including prior to CSS, used food waste/residuals to create useful products, including fertilizer and animal feed, further disproving any so-called newness or uniqueness.”²⁴² But the CSS Process is unique in its ability to maintain the nutritional value of food waste and was designed to achieve that outcome.²⁴³ The CSS Process was developed over more than fifteen years with that goal in mind. “The

extensive work by [CSS] and its predecessors in developing a successful [process] ... demonstrates the ... independent economic value” of the CSS Process.²⁴⁴

ii. CSS Has Taken Reasonable Efforts To Maintain The Secrecy Of Its Process.²⁴⁵

CSS must also prove it used reasonable efforts to maintain secrecy.²⁴⁶ To be a trade secret, an owner must have “taken reasonable measures to keep such information secret.”²⁴⁷ But “[a]lthough the law requires secrecy, it need not be absolute.”²⁴⁸ “[Confidentiality] agreements are not necessary in every case ... if the other precautions taken by the plaintiff are sufficient.”²⁴⁹ “Rather, a duty of confidentiality may be implied from the circumstances surrounding the parties’ relationship.”²⁵⁰ “And the duty of confidentiality is not destroyed merely because the holder ‘disclosed its trade secrets to a limited number of outsiders for a particular purpose’ ”²⁵¹ Limited disclosure in furtherance of investment does not preclude a finding of secrecy.²⁵² Indeed, “[a]n owner is not required to maintain absolute secrecy to retain trade secret protection.”²⁵³ Delaware courts have “found that reasonable efforts [are] taken to preserve confidentiality when ... a company [i]s in an industry where custom dictated that certain information be kept confidential.”²⁵⁴ Employee confidentiality agreements and protecting documents from being generally accessible are reasonable efforts to protect secrecy.²⁵⁵

***17** CSS met its burden to demonstrate reasonable efforts to maintain the secrecy of the CSS Process. Its employees signed NDAs that generally extended past their time of employment, and its information was kept securely.²⁵⁶ CSS’s physical records were kept locked, and its digital data was password-protected.²⁵⁷ CSS entered into approximately two hundred NDAs with third parties before distributing information on its combination trade secret.²⁵⁸ Overall, it was uncommon for CSS to provide information without an NDA.²⁵⁹ And when there was not an NDA in place, CSS typically relied on verbal confirmation to keep its information confidential,²⁶⁰ and only provided information to corporations that Morash felt were trustworthy and practiced good corporate governance.²⁶¹ It was CSS’s practice to stamp

information as confidential.²⁶² CSS's infrequent disclosures without NDAs were in furtherance of economic investment, and the record showed certain potential investors would not sign NDAs.²⁶³

The Individual Defendants point to emails in which CSS shared information without NDAs.²⁶⁴ CSS sent materials to venture capital firms or other potential investors without NDAs.²⁶⁵ Some of the disclosures cited by the Individual Defendants were from 2011, early on in CSS's development, before it even opened its pilot operations.²⁶⁶ For others, Morash credibly testified that NDAs were indeed in place.²⁶⁷ In other instances where the Individual Defendants say information was sent without an NDA, the record shows NDAs were in place or put in place after sending introductory materials.²⁶⁸ And almost all of the shared materials were stamped confidential.²⁶⁹ Much of the materials flagged by the Independent Defendants contained merely introductory overviews or high-level information.²⁷⁰ While some of the information sent without an NDA includes some details on the CSS Process, they do not disclose the minutiae of the entire combination, like what was shared with KDC.²⁷¹

***18** And Morash credibly testified at trial that CSS struggled with getting certain investors to sign confidentiality agreements.²⁷² This is supported by the record. One venture capital firm told CSS that it could not sign an NDA, explaining that refusal “[was]n’t unusual” and that “[m]any VCs as a policy cannot sign an NDA due to the deal volume they are exposed to.”²⁷³ CSS needed to pitch its business to potential investors and customers. Because these limited “disclosure[s] to others [were] made to further [CSS’s] economic interests, [they] ... do[] not destroy the requisite secrecy.”²⁷⁴ “To hold otherwise would greatly limit the holder’s ability to profit from his secret.”²⁷⁵

The Individual Defendants also assert that because some of CSS’s NDAs were time-limited, CSS did not reasonably protect the CSS Process. These instances largely amount to situations where only portions of the CSS Process were disclosed.²⁷⁶ And even though time limited, the NDAs required destruction of CSS’s information upon written request.²⁷⁷ Many of these disclosures were to potential investors in furtherance of CSS’s economic interests.²⁷⁸

Finally, the Individual Defendants point out CSS’s lease allows its landlord and the United States Air Force to enter its premises without permission under certain conditions.²⁷⁹ Access by the party who owns the property, and the United States military, does not preclude a finding that CSS used reasonable efforts to protect its combination trade secret. I conclude these instances do not undermine CSS’s efforts to maintain secrecy or preclude the conclusion that it took such efforts. CSS was not perfect with protecting parts of the CSS Process. But the standard for protection is reasonableness, not perfection. The CSS Process as a whole was reasonably protected.²⁸⁰

b. CSS Has Shown Specificity.

“A compilation trade secret must be identified with a reasonable degree of precision and great specificity.”²⁸¹ “The existence of a trade secret, including whether it was adequately identified, is ‘a fact-specific question to be decided on a case-by-case basis.’”²⁸² A trade secret misappropriation plaintiff must identify the trade secret at two junctures: at the time of disclosure to the defendant, and during litigation against the defendant.²⁸³ Contrary to the Individual Defendants’ argument, CSS did both.

“Specificity is required at the moment of divulging so that the party to whom the secret is revealed understands the contours of the secret information and does not inadvertently or purposefully transgress its boundaries.”²⁸⁴ CSS gave the Individual Defendants notice that the CSS Process comprised trade secrets via the License Agreement. Through the License Agreement, KDC agreed to pay CSS to access and use the CSS Process, comprising both patented and trade secret information. Hal signed the License Agreement and acknowledged it defined broad trade secrets.²⁸⁵ The License Agreement’s definition of “Trade Secrets” contemplated CSS’s “technologies, processes and formulae.”²⁸⁶ Exhibit D included a nonexhaustive list of purported trade secrets including CSS’s facility design, equipment specifications, collection procedures, operating procedures, certificated organic production methodology, and research and field trial results.²⁸⁷

***19** So informed that the CSS Process contained trade secrets in those areas, and agreeing to pay for those trade secrets, the Individual Defendants proceeded to learn and

use the CSS Process. Each Individual Defendant visited CSS's facilities to learn the CSS Process, and KDC and DPS requested additional information from CSS about its process. With the understanding that it was licensing trade secrets, KDC learned the contours of the CSS Process, from receipt of its food waste, through digestion, separation, and drying, as they must have to accomplish the goal of the License Agreement: to scale up and expand the CSS Process across the United States. DPS understood the information it obtained at those visits was confidential, supporting the inference the Individual Defendants did as well.²⁸⁸

Thereafter, the Individual Defendants repeatedly told third parties the CSS Process, or KDC's process derived from it, was a trade secret, including in seeking financing and permits for the Fairless Hills facility.²⁸⁹ Matthew told a state senator there were "trade secrets related to ... our overall process,"²⁹⁰ and sent materials to state regulators referring to KDC's process description as a confidential trade secret.²⁹¹ The Individual Defendants' understanding that the CSS Process was a trade secret is evidenced by their own statements. The trial record demonstrates the Individual Defendants understood "the contours of the secret information."²⁹²

CSS also adequately identified its trade secret in litigation. "[S]pecificity is required before the court so that the defendant can defend himself adequately against claims of trade secret misappropriation, and can divine the line between secret and nonsecret information, and so that a [fact finder] can render a verdict based on a discriminating analysis of the evidence of disclosure and misappropriation."²⁹³ "In cases involving trade secrets, the plaintiff is required to disclose, before obtaining discovery of confidential proprietary information of its adversary, the trade secrets it claims were misappropriated."²⁹⁴ "The plaintiff must disclose the allegedly misappropriated trade secrets with reasonable particularity."²⁹⁵ CSS did not list a combination trade secret in its first complaint, filed June 8, 2021.²⁹⁶ In its preliminary identification of trade secrets the next month, CSS identified its "overall business model" as a combination trade secret.²⁹⁷ Two months after that, CSS amended its complaint and listed a combination trade secret.²⁹⁸ CSS pled its entire "business model connects its specific Trade Secrets with other Confidential Information, with information reflected in CSS's patents and patent applications, and with other information in order to form an overall business model that is together unique, secret, and valuable such that the

sum of all these parts is a Trade Secret."²⁹⁹ A year later, CSS amended its disclosure³⁰⁰ and complaint to state that its entire "business model and manufacturing process" is a combination trade secret.³⁰¹ And before expert discovery closed, CSS's expert described the CSS Process and opined it is a combination trade secret.³⁰² Dr. Keener's report explained each component of the CSS Process and how the components work together to create a combination trade secret.³⁰³

***20** Delaware law is clear that a plaintiff litigating misappropriation of a combination trade secret can satisfy the specificity requirement by identifying the combination trade secret, then hone in on components the defendant is using as proof of misappropriation.³⁰⁴ That is what CSS did. The Individual Defendants' cited authorities do not disturb that conclusion.³⁰⁵ CSS gave the Individual Defendants and this Court notice about its combination trade secret. CSS has satisfied the specificity requirement.³⁰⁶

c. Misappropriation

***21** CSS must prove misappropriation by a preponderance of the evidence. "Unauthorized use of trade secret information and unauthorized disclosure of trade secret information constitutes misappropriation."³⁰⁷ CSS has handily met its burden of showing both the use of the trade secret, and the fact that use was unauthorized.

Defendants knew they were licensing trade secrets through the License Agreement, and referred to the CSS Process, or the KDC process, as a trade secret. As the Individual Defendants wrote repeatedly, the KDC process was derived from and based on the CSS Process, albeit with improvements and modifications.³⁰⁸ Fairless Hills was designed to scale up the CSS Process; CSS and KDC intended it to be built upon information the Individual Defendants and DPS learned from CSS. Fairless Hills was financed through a bond offering in which the Individual Defendants described a fleshed-out process overtly based on the CSS Process.³⁰⁹ And Fairless Hills was built using the CSS Process, as intended: DPS made it plain that it built Fairless Hills based on the CSS Process, and the E3 Report said the same.³¹⁰ The experts agreed: CSS's expert determined the Fairless Hills facility and KDC's process was derived from the CSS Process,³¹¹ and the

Individual Defendants' expert admitted the CSS Process was KDC's starting point.³¹²

After cutting ties with CSS, KDC lost no momentum. KDC did not pause and start over. KDC broke ground on Fairless Hills by mid-2020; completed construction by late 2021; and started manufacturing shortly thereafter. KDC continued operations based on the CSS Process, which "would have been impossible without misappropriation of [CSS's] trade secret[]."³¹³ DPS's lead engineer called it as he saw it: he did "not believe that [Fairless Hills] could be redesigned from scratch in three months."³¹⁴

The Individual Defendants offered no other credible origin story at trial. None of the Individual Defendants or DPS had prior experience in food recycling. It is implausible they could have designed and operated Fairless Hills, or manufactured and sold product through KDC and DGC, without the CSS Process.³¹⁵

And Defendants used the CSS Process without authorization. KDC only had permission to use the CSS Process via the License Agreement. KDC learned the CSS Process because it had promised to pay for its use, then rode the CSS Process all the way to the bank; once KDC received funding for Fairless Hills, it backed away from CSS and the License Agreement's royalty obligations and continued to use the CSS Process for free. Without the License Agreement in place, KDC's use of the CSS Process was misappropriation.

To hold each Individual Defendant liable for misappropriation, CSS must prove Hal, Matthew, Justin, and Barry each participated in the misappropriation of the CSS Process. While an individual cannot be held liable for trade secret misappropriation merely by fact of his position, "a corporate official cannot shield himself behind a corporation when he is an actual participant in the tort."³¹⁶ "[C]onsidering the purpose of limited liability, a principle central to corporate law, an injured party must prove the officer, director or agent participated in the tort."³¹⁷ "[K]nowledge of the act is not enough The corporate officer must have been actively involved in that the officer directed, ordered, ratified, approved or consented to the tort."³¹⁸ In *Beard Research, Inc. v. Kates*, the Court of Chancery determined certain employees were liable for misappropriation because they helped "set up ... operations," had knowledge of the relevant "chemistry

and business models" of the corporations at issue and ran the related "projects from start the finish."³¹⁹

*22 Here, each of the Individual Defendants knew the CSS Process was a protected trade secret,³²⁰ and each directed, ordered, ratified, approved, consented, or otherwise participated in the continued use of the CSS Process after termination of the License Agreement. Each was a member of KDC's "essential operating team."³²¹ "Justin, Hal and Matthew Kamine all cofounded KDC AG together to deploy the CSS Technology nationwide" through Fairless Hills.³²² Hal, as founder and executive chairman, oversaw everything concerning KDC and Fairless Hills.³²³ Matthew and Justin were KDC's co-CEOs, and managed the company as directors alongside Hal. Barry was KDC's chief manufacturing officer who led the engineering team designing Fairless Hills.

The Individual Defendants were involved in Fairless Hills operations, and the improper continued use of the CSS Process. Hal, who held the highest position at KDC, admitted at trial that he directed the businesses.³²⁴ Hal, Matthew, and Justin worked together to make major decisions for KDC and its related entities.³²⁵ Barry visited CSS "more than anybody" and "ran the lab" at the Fairless Hills site.³²⁶ Barry and Matthew were involved with developing Fairless Hills, leading the engineering team that got Fairless Hills off the ground.³²⁷ Their positions did not change after the License Agreement ended: Matthew and Barry continued designing and building Fairless Hills after the breakup with CSS.³²⁸ Hal and Barry decided to open the North Dakota facility in 2020 to continue testing KDC's nonenzymatic process.³²⁹ Barry took the lead in further developing KDC's process, based off the CSS Process.

While Justin was less involved in the construction or design of Fairless Hills, the evidence demonstrates it is more likely than not that he participated in the misappropriation. Justin took the lead in KDC's business development,³³⁰ and was involved in DGC and the process of selling feed derived from the CSS Process to customers.³³¹ Under Delaware law, Justin's knowledge of KDC and DGC's business plan, which included the misappropriation of the CSS Process, along with his participation in implementing those plans, is enough to find him liable for misappropriation.³³²

The Individual Defendants' misappropriation is further reflected in their reliance on the CSS process in seeking financing to construct Fairless Hills. All four of the Individual Defendants were aware of the substance of the bond offering, which described the KDC process as based off the CSS Process and the Fairless Hills project as a scale-up of CSS's facilities.³³³ Matthew was the primary author of the first draft of Appendix A, and each of the other Individual Defendants reviewed drafts and sent proposed revisions.³³⁴

CSS met its burden to prove trade secret misappropriation by the Individual Defendants.

d. The Individual Defendants' Arguments Fail.

***23** Faced with the truth that KDC's process is built upon and derived from the CSS Process, without authorization, the Individual Defendants' defense hinges on two main contentions. First, they argue KDC's process was different from the CSS Process, because it shifted to a non-enzymatic process, and so it does not constitute misappropriation. The Individual Defendants argue "KDC produced an entirely different product than CSS's ... and did so without adding enzymes—requiring equipment changes and adjustment to every equipment setting, and thus a very different process."³³⁵

But "[t]rade secret protection 'extends not only to the misappropriated trade secret itself but also to materials 'substantially derived' from that trade secret.'" ³³⁶ "Misappropriation occurs even where the trade secret is used only as a starting point or guide in developing a process."³³⁷ *Agilent Technologies, Inc. v. Kirkland* is instructive.³³⁸ This Court determined the defendants were liable for misappropriation even though the information was "not identical to th[at] used" by the plaintiff because it was "clear that [the plaintiff's] trade secrets served as a springboard for the defendants, allowing further development to take place."³³⁹ "[W]here a trade secret acts as a starting point for improvements, or a guide by which pitfalls may be avoided," that is trade secret misappropriation.³⁴⁰

Here too.³⁴¹ Trial showed the CSS Process was the starting point of the KDC process. The addition or removal of enzymes to one step of the CSS Process, and modifications to account for that flexibility, does not change that fact. As of its

bond offering, KDC explained it maintained flexibility to add enzymes back into its process and, if so, that "[t]he remainder of the KDC Ag Process would remain the same."³⁴² The Individual Defendants told third parties the CSS Process was the base of its own process.³⁴³ And CSS's expert offered the un rebutted opinion that KDC's process was not substantially different.³⁴⁴

Second, the Individual Defendants argue the License Agreement granted KDC the right to continue using the CSS Process because KDC had modified it.³⁴⁵ The License Agreement did no such thing. Section 2.3 granted CSS the right to use KDC Intellectual Property; it gives no separate contractual rights to KDC.³⁴⁶ KDC Intellectual Property was defined as "all Intellectual Property Controlled by KDC or any Affiliate as of the Effective Date or at any time during the Term, or hereinafter created by KDC or any party on behalf of KDC, to construct, own and operate Licensed Facilities and to make, have made, use, offer to sell, sell, import and otherwise exploit Licensed Products."³⁴⁷ And "Improvements" comprise "all modifications, adaptations, changes and improvements ... developed or introduced by or on behalf of ... KDC in respect of any CSS Intellectual Property."³⁴⁸ At most, KDC owned the rights to its Improvements—but only its Improvements. KDC's alterations may be its intellectual property, but not the underlying CSS information it altered. CSS has met its burden and demonstrated the Individual Defendants misappropriated its combination trade secret.

B. Delaware Statutory Preemption

***24** CSS brought a host of common law tort claims that all rely on the wrongful use of its trade secrets. "[I]f 'common law claims are based on the same alleged wrongful conduct as the trade secret claims, they are precluded under' the Delaware Act."³⁴⁹ "To determine whether a tort claim is preempted by [the Delaware Act], courts consider whether the claim is 'grounded in the same facts' as a misappropriation of trade secrets claim."³⁵⁰ Typically, "[a] common law claim is 'grounded in the same facts' as a trade secret claim 'if the failure of the misappropriation claim would doom the common law claim.'" ³⁵¹ "[The Delaware Act] preempts 'all claims stemming from the same acts as the alleged

misappropriation ... even if the information at issue is not a trade secret.’ ”³⁵²

Because CSS's common law misappropriation, conspiracy, fraud, and unjust enrichment claims “are based on the same alleged wrongful conduct as the trade secrets claims, they are precluded” by the Delaware Act.³⁵³ CSS's common law misappropriation claim, Count IX, is plainly coterminous with the statutory misappropriation claim.³⁵⁴ Its conspiracy claim, Count XV, is based upon the allegation that a “combination or confederation existed with the common purpose and goal of misappropriating CSS's Trade Secrets and perpetrating fraud upon CSS.”³⁵⁵ That allegation is “grounded in the same facts which purportedly support” CSS's misappropriation claim, so it is preempted.³⁵⁶ CSS's unjust enrichment claim, Count XVI, is preempted as well.³⁵⁷ CSS alleged the Individual Defendants “have been enriched by their access to and use of CSS's Trade Secrets, Intellectual Property, and/or Confidential Information.”³⁵⁸ That is based on the Individual Defendants’ unjust enrichment from CSS's protected information, so it is preempted.³⁵⁹ This is true even to the extent CSS contends the Individual Defendants were unjustly enriched by information that does not rise to the level of a trade secret.³⁶⁰

*25 That leaves CSS's fraud claim, Count XIV. It was undeveloped at trial, and hardly briefed: even setting preemption aside, CSS has not met its burden of proof.³⁶¹ Looking to CSS's complaint, CSS pled the Individual Defendants made “false representations and omissions with the intent that CSS would rely on them in providing CSS Intellectual Property and Confidential Information.”³⁶² CSS alleged the Individual Defendants made two misrepresentations. First, CSS asserts the Individual Defendants stated they “would pursue animal and pet food opportunities and that CSS should avoid such opportunities, thereby causing CSS to avoid work in the animal feed space on the false promise of substantial royalties” causing harm to CSS.³⁶³ CSS alleged the Individual Defendants made these statements “to misappropriate CSS Intellectual Property to develop the animal feed market for themselves and not pay CSS any future royalties.”³⁶⁴ Second, CSS asserts KDC's letters in January and May 2020, concerning whether it had a Licensed Facility, were fraudulent and “omitted that they are using, and would use, CSS Intellectual Property, Trade Secrets, and

Confidential Information for any purpose other than pursuant to the License Agreement.”³⁶⁵ CSS asserts the Individual Defendants made those statements so it could misappropriate the CSS Process and get away with it.³⁶⁶ Because CSS's claim is based on fraud with the intent to misappropriate the CSS Process, it is preempted by the Delaware Act.³⁶⁷

C. CSS's Tortious Interference With Contract Claim Fails.

Count V claims Hal, Justin and Matthew tortiously interfered with the License Agreement. “To state a claim for tortious interference with contract, a plaintiff must allege that the defendant ‘intentionally and improperly interfere[d] with the performance of a contract’ between the plaintiff ‘and a third person by inducing or otherwise causing the third person not to perform the contract.’ ”³⁶⁸ “To prevail on its claim of tortious interference, [CSS] must prove five elements: (1) there was a contract, (2) about which the defendant knew, (3) that the defendant committed an intentional act that is a significant factor in causing the breach of such contract, (4) the act(s) [were] without justification, and (5) the act caused injury.”³⁶⁹

But because the Kamines were KDC officers and directors, CSS has an initial hurdle for its tortious interference claim: it must show that the Individual Defendants’ actions were beyond the scope of their agency authority from KDC.³⁷⁰ “An officer of a Delaware limited liability company cannot be held liable for tortiously interfering with his own company's contract unless he ‘acted beyond the scope of [his] agency.’ ”³⁷¹ “The act must be committed beyond the authorized boundaries of the person's employment and must not be motivated by that person's employment. Acts that are considered outside the course and scope of one's employment are often those which are carried out for an employee's own personal motives and benefit and not for their employer.”³⁷² “Accordingly, in order to state a claim for tortious interference against a corporate officer, a plaintiff must plead adequately that the officer (1) ‘was not pursuing legitimate profit-seeking activities of the affiliated enterprise in good faith,’ or (2) ‘was motivated by some malicious or other bad faith purpose to injure the plaintiff.’ ”³⁷³

*26 CSS has not shown the Kamines acted outside their scope of employment. While CSS's brief asserts “[t]he record

is rife with ... examples of Individual Defendants acting intentionally for their own interests, and against KDC Ag's interests," I disagree.³⁷⁴ CSS cites no convincing evidence, and I see none. Rather, it appears the Kamines acted in KDC's interest—the company the father and sons founded—and that the Kamines decided to end the License Agreement and move forward with Fairless Hills to earn profits for KDC. Because CSS has not carried its burden to show the Kamines' "actions that cause[d] the corporation to breach a contract were [not] taken for the corporation's benefit,"³⁷⁵ judgment on Count V shall be entered in favor of the Kamines.

D. Remedies

CSS has proven by a preponderance of the evidence that the Individual Defendants are liable for trade secret misappropriation. CSS must prove damages by a preponderance of the evidence as well.³⁷⁶ This portion of the opinion also resolves damages from trade secret misappropriation for the Corporate Defendants whose liability was found by default.³⁷⁷

CSS requests a variety of remedies. It requests two alternative methods of compensatory damages: lost royalties and milestone payments under the License Agreement, or a hypothetical reasonable royalty. I find the appropriate method is to use the License Agreement to set an established royalty. CSS also requests an injunction, exemplary damages, and attorneys' fees and costs. I grant CSS a narrower injunction. I do not grant exemplary damages or fees.

1. License Agreement Royalties

"Damages in trade secrets cases are difficult to calculate."³⁷⁸ Delaware courts "do[] not 'require certainty in the award of damages where a wrong has been proven and injury established.'" ³⁷⁹ "[E]very case requires a flexible and imaginative approach to the problem of damages" and "each case is controlled by its own peculiar facts and circumstances."³⁸⁰ "[C]ases reveal that most courts adjust the measure of damages to accord with the commercial setting of the injury, the likely future consequences of the misappropriation, and the nature and extent of the use the defendant put the trade secret to after misappropriation."³⁸¹

The Federal Act and Delaware Act provide three grounds for damages for trade secret misappropriation. A court may grant an award of "damages for actual loss," "damages for any unjust enrichment" to the extent "that it is not addressed in computing damages for actual loss;" or, "in lieu of damages measured by any other methods, ... damages caused by the misappropriation measured by imposition of liability for a reasonable royalty."³⁸²

***27** Patent and trade secret jurisprudence has shaped various methods of quantifying damages for actual loss.³⁸³ One is to identify actual lost revenue, perhaps in the form of lost royalties. "The plaintiff's loss usually consists of profits lost on sales diverted from the plaintiff by the appropriation, loss of royalties or other income that would have been earned by the plaintiff but for the appropriation, or the value of the trade secret if it has been destroyed through a public disclosure by the defendant."³⁸⁴ Actual lost royalties will be granted when they are "not speculative," such as being "calculated based on ... the royalty agreements entered into."³⁸⁵

When lost profits are not identifiable, but there is evidence the parties previously agreed on a price to use the technology, damages may be calculated using an established royalty. This method "looks to whether the parties have themselves agreed to a remedy which is capable of a factual determination by the Court. Such situations arise, for example, where the parties have entered into or negotiated a royalty agreement."³⁸⁶ If "the parties have agreed to the value of the trade secrets, either in a royalty agreement, a licensing contract, or an 'agreement in principle,' such that the damages will be subject to exact measurement, that course should be followed."³⁸⁷

Established royalties may be set in multiple ways.³⁸⁸ An established royalty can be set when the parties to a litigation "previously entered into an agreement by which the [parties] set the price for a license, but one or both of the parties did not perform under the agreement."³⁸⁹ Even an agreement in principle, which was not consummated, offers the court "the value the parties themselves assigned to the appropriated information" and the use of an established royalty.³⁹⁰ And courts have set established royalties using third-party agreements licensing the same intellectual property at issue.³⁹¹

***28** When there is no evidence of actual lost royalties or a negotiated price, courts try to recreate a royalty that

would have been negotiated, called a reasonable royalty.³⁹² A reasonable royalty “attempts to measure a hypothetically agreed value of what the defendant wrongfully obtained from the plaintiff,”³⁹³ and there is a notable “high degree of artificiality involved in such an analysis.”³⁹⁴ “[T]he hypothetical negotiation approach attempts to ascertain the royalty upon which the parties would have agreed had they successfully negotiated an agreement just before [the misappropriation] began.”³⁹⁵ In making this determination, courts consider fifteen factors set out in the seminal patent case *Georgia-Pacific Corp. v. U.S. Plywood Corp.*³⁹⁶ One factor considers actual royalties the owner received for licensing the technology; the other fourteen factors look to “the licensor’s established policy and marketing program to maintain his patent monopoly,” “[t]he duration of the patent and term of the license,” “the nature of the patented invention,” “the extent to which the infringer has made use of the invention,” and the “opinion testimony of qualified experts,” among other factors.³⁹⁷ Courts have long recognized that “[d]etermining a reasonable royalty from a hypothetical negotiation is not easy; the process is truly artificial.”³⁹⁸ Others have described it as “a difficult judicial chore, seeming often to involve more the talents of a conjurer than those of a judge.”³⁹⁹

Here, trial showed the License Agreement ended, so no actual royalties were owed for the Defendants’ misappropriation; CSS has not been damaged in the form of actual lost royalties. Rather, CSS was damaged because Defendants continued to use the CSS Process after the License Agreement was terminated. The License Agreement provides evidence of how the parties valued the trade secret Defendants took, and therefore can be used to set an established royalty. The License Agreement granted KDC the right to use CSS intellectual property, which covers the CSS Process, for an agreed-upon price, and was in place until the moment of misappropriation. CSS’s expert economist Carla Mulhern agreed the License Agreement provides credible evidence of what CSS and KDC agreed the CSS Process was worth.⁴⁰⁰ As “what was agreed upon as compensation,” the set royalty in the License Agreement provides the appropriate measure to calculate damages.⁴⁰¹ It is the best evidence of how CSS valued the CSS Process and how much KDC was willing to pay to use it.⁴⁰² It saves the parties and the Court from the artificial and hypothetical measure of a reasonable royalty.⁴⁰³

*29 The License Agreement also sets the damages award against the defaulted Corporate Defendants. They are liable for both trade secret misappropriation and breach of the License Agreement, among other claims.⁴⁰⁴ Courts have granted lost royalty damages in cases involving related breaches of contract and trade secret misappropriation. For example, in *Thomas v. Hughes*, the United States Court of Appeals for the Fifth Circuit affirmed one combined award of damages for breach of contract and trade secret misappropriation made up of unpaid royalties under the breached licensing agreement.⁴⁰⁵ The Court explained that using “the value that the parties had previously assigned” had “allowed ‘damages [to] be ascertained with precision’ more exacting here than in the mine run of cases.”⁴⁰⁶

Using the License Agreement as the best evidence to price the CSS Process in an established royalty is a distinct exercise from using it to calculate actual lost royalties. Running royalties hinged on the production of a License Product, defined as fertilizer, animal feed, or blend product made using an “aerobic, enzymatic digestion” process.⁴⁰⁷ A nonexclusive license charging running royalties was only available to KDC when it had a facility, built or under construction, that made Licensed Product. KDC contends it shifted away from an enzymatic process by the time Fairless Hills opened. But KDC misappropriated the CSS Process for its nonenzymatic product process as well. Using the License Agreement to set an established royalty prices that entire process, not the royalties KDC would have actually owed. Because I am using the License Agreement to value the entire CSS Process, I need not reach whether KDC’s nonenzymatic process was a Licensed Product.

a. Exclusivity

Using the License Agreement to set an established royalty first requires choosing its terms for an exclusive or nonexclusive license. To maintain exclusivity, KDC had to pay minimum royalties; it did not owe those minimums for a nonexclusive license.⁴⁰⁸ Those minimums were \$5,000,000 in 2020, \$6,000,000 in 2021, \$7,200,000 in 2022, and \$7,920,000 in 2023.⁴⁰⁹ Not surprisingly, CSS seeks damages based on an exclusive license; the Individual Defendants posit nonexclusivity is appropriate. I find a nonexclusive license is appropriate here, for two reasons.

First, the best evidence of the CSS Process's standalone value is a nonexclusive royalty stripped of any exclusivity premium.⁴¹⁰ The minimum royalty for an exclusive license pays for KDC's right to exclusivity and compensates CSS for its lost opportunity to sell additional licenses. The nonexclusive terms price the CSS Process without that right and opportunity.

***30** Second, CSS did not lose exclusive license royalties due to any wrongful conduct by KDC, so it is not entitled to a damages award including an exclusivity premium. “The purpose of tort damages is to compensate the plaintiff for the harm that the defendant's tortious conduct proximately caused.”⁴¹¹ CSS did not suffer the harm of the loss of an exclusive license. As of December 2019, CSS was free to license its process to other business partners. And KDC's tortious conduct did not cause that harm. KDC had the right to stop paying minimum royalties under the License Agreement.⁴¹² KDC's misappropriation denied CSS only the value of KDC's use of the CSS Process: it did not preclude CSS from licensing its technology to others.⁴¹³

b. Calculations

The License Agreement granted KDC the right to use the CSS Process first to construct and finance facilities, then to make and sell product.⁴¹⁴ Tracking those uses, the License Agreement sets two buckets of royalties KDC owed CSS: milestone payments keyed to financing and construction, and a running royalty keyed to product.⁴¹⁵ In the established royalty exercise, these two payments price KDC's use of the CSS Process in financing and constructing Fairless Hills, and then in selling product.

The License Agreement's milestone payments set the established royalty for KDC's use of the CSS Process in financing Fairless Hills.⁴¹⁶ The License Agreement required KDC to “pay CSS a ... milestone payment of \$250,000 within 30 days after closing of financing to fully fund construction of each ‘Train.’”⁴¹⁷ KDC was required to pay that Milestone for its first twelve Trains.⁴¹⁸ A “Train” was defined as “a single Licensed Product production line using approximately 5,000 tons/year of Residuals.”⁴¹⁹ The parties dispute how many Trains KDC should pay for based on the bond financing. Both their positions have flaws.

According to CSS, because KDC obtained enough financing to process 60,000 tons of product, Defendants must pay for twelve Trains. KDC received funding for Fairless Hills to process 60,000 tons of food waste a year,⁴²⁰ and the License Agreement defined “Train” as a production line processing about 5,000 tons a year.⁴²¹ CSS presses the funded tonnage divides into twelve Trains. CSS's flaw is its focus on tonnage. The License Agreement's definition of “Train” as processing about 5,000 tons a year does not mean a production line can only process 5,000 tons a year. At one point, CSS was processing 11,000 tons a year with one processing line.⁴²² KDC touted the Fairless Hills lines as more automated, more efficient, and running on a 24/7 basis.⁴²³ I am unconvinced that the number of Trains funded can be reached by dividing 60,000 tons by 5,000.

The Individual Defendants argue that because KDC only ever constructed two production lines, the number of Trains is two.⁴²⁴ That argument's flaw is the focus on the number of Trains actually constructed. The License Agreement defines “Train” by the number of Trains KDC received funding to construct, not production lines that were actually built.⁴²⁵

***31** The preponderance of the evidence shows KDC received funding for three Trains. The E3 Report KDC submitted in seeking funding stated that Fairless Hills “will have three operating lines instead of one at California.”⁴²⁶ DPS testified the plan was for Fairless Hills to have three to four manufacturing lines.⁴²⁷ The milestone payments for three Trains is \$750,000.

Once KDC built Fairless Hills, the License Agreement sets an established royalty for use of the CSS Process in selling product. The License Agreement required KDC to pay a running royalty of 20% of its net sales of any Licensed Product, by KDC or its affiliates, on a monthly basis.⁴²⁸ For its Qualified First Customer, KDC had to pay only 10% of its net sales.⁴²⁹ KDC had two main sources of sales.

First, KDC entered into a purchase and distribution agreement with Michael Foods in 2022 in which Michael Foods agreed to pay \$3.40 per pound of chicken feed.⁴³⁰ KDC sold 31,432 pounds to Michael Foods,⁴³¹ which amounts to \$106,869 in total net sales, and \$21,374 in lost royalties at a 20% rate.

Second, KDC had a long-term agreement with Allen Harim. KDC's affiliate DGC provided Allen Harim with approximately 2.5 million pounds of KDC feed from 2021 through 2023.⁴³² DGC provided feed to Allen Harim as part of their broader agreement for Allen Harim to raise and sell back chickens to KDC. That agreement did not establish any price for the chicken feed, perhaps to avoid the License Agreement's running royalties.⁴³³ The Individual Defendants' expert, Clarke Nelson, valued that feed at \$0.12 per pound. Nelson used the price KDC paid Bright Feeds as a substitute after the Corporate Defendants ceased operations.⁴³⁴ I see no reason to use the value of what Defendants were willing to pay for another company's feed, which was made from bakery meal and not based off the CSS Process, and which the Individual Defendants have not shown was similar in value. As CSS's expert pointed out, the Individual Defendants ignore the obvious metric for valuing

what its chicken feed was worth: the price Michael Foods was willing to pay for KDC's product.⁴³⁵

The Individual Defendants contend a 10% royalty rate should be applied to Allen Harim sales because it was KDC's "Qualified First Customer" under the amended License Agreement. "Qualified First Customer" was defined as "KDC's first long term off-take client for Licensed Product used for animal feed."⁴³⁶ KDC and Allen Harim entered into their co-pack agreement in August 2021, and KDC sent Allen Harim chicken feed until it ceased operations in 2023. I am unaware of any earlier long-term arrangements with another customer that could fit this definition,⁴³⁷ and CSS does not put forth any persuasive evidence that Allen Harim would not qualify as KDC's Qualified First Customer.⁴³⁸ I will apply the 10% rate, which leads to an amount of \$854,127.60. In sum, KDC's running royalties are as follows:

	Michael Foods	Allen Harim
Pounds of Feed Sold	31,432	2,512,140
Price/Estimated Price	\$3.40	\$3.40
Net Sales	\$106,868.8	\$8,541,276
Royalty Rate	20%	10%
Established Royalty (Net sales x Rate)	\$21,374.76	\$854,127.60
Total	\$875,502.36	

***32** Combined with the milestone payments, CSS's total established royalty amounts to \$1,625,502.36.

CSS requests pre- and post-trial interest. Delaware courts routinely award such interest, using the "legal rate" as the default rate.⁴³⁹ "Seeing no reason to depart from this practice, I grant [CSS] pre-judgment interest on its compensatory damages ... compounded quarterly, at the legal rate. Additionally, I award postjudgment interest on the full amount of the judgment, including that part comprised of prejudgment interest."⁴⁴⁰

c. CSS's Request For A Reasonable Royalty

This established royalty award is substantially lower than what CSS requested at trial. CSS seeks a reasonable royalty

amounting to \$40,658,000, a 2,400% increase over what would have been required under the License Agreement. CSS did not start there: in November 2022, Mulhern opined the appropriate remedy for CSS was lost royalties under the License Agreement.⁴⁴¹ Mulhern ventured into a reasonable royalty only a month before trial: in January 2024, after the Corporate Defendants ceased operations, CSS submitted a supplemental damages report from Mulhern opining that reasonable royalties were appropriate.⁴⁴² At trial, CSS pressed reasonable royalties, with lost royalties requested only in the alternative. CSS's trial position is legally and factually unsupported.

First, as explained, there is no basis to venture into the speculative realm of a hypothetical reasonable royalty when the License Agreement offers a contemporaneous, negotiated, and consummated price for KDC's use of the CSS Process.

Mulhern appears to agree. As acknowledged at trial, she had never opined that a reasonable royalty is different than an established royalty specified in the license agreement between the parties.⁴⁴³ At her deposition, and as confirmed at trial, Mulhern testified that a reasonable royalty analysis was not required if an established rate existed.⁴⁴⁴

Second, Mulhern's reasonable royalty deviates from the License Agreement due to several assumptions that are improperly inconsistent with the trial record. A reasonable royalty is meant to "determine the amount the licensor and licensee would have agreed to just prior to the infringement."⁴⁴⁵ "[T]he extent of the deviation of existing license fees from a reasonable royalty must be determined solely on the basis of the submitted evidence and upon an evaluation of the factors that could affect the reasonable royalty rate, not upon mere conjecture."⁴⁴⁶

***33** Mulhern's reasonable royalty analysis assumes Defendants would maintain an exclusive license with CSS, which would require minimum royalties.⁴⁴⁷ That assumption is belied by the record. The License Agreement allowed for nonexclusivity, the Individual Defendants informed CSS it planned to stop minimum payments before the License Agreement terminated and misappropriation occurred, and by December 2019, CSS was not held back by an exclusivity agreement.

Mulhern also opined the Defendants would have agreed to pay an upfront lump sum between \$40.7 million to \$138 million, using projections post-dating the period of hypothetical negotiations.⁴⁴⁸ I see no basis to conclude KDC or the Individual Defendants would have agreed to pay such a large lump sum.⁴⁴⁹ The License Agreement did not require any such lump sum: it required a \$1,000,000 investment in CSS in exchange for equity, running royalties on net sales,⁴⁵⁰ and minimum annual royalties for an exclusive license set off by running royalties.⁴⁵¹ The evidence shows KDC's predilection was to pay less, not more: at the time of Mulhern's hypothetical negotiations, January 2020, KDC was still ramping up, Fairless Hills was unfunded,⁴⁵² and KDC and the Individual Defendants had negotiated for lower royalties in 2018 and 2019.⁴⁵³

CSS's original position, that the License Agreement reflects the value of what KDC took, carries the day. Its swing for the fences with a reasonable royalty fouls away.

2. Joint And Several Liability

***34** The next question is how to apportion the established royalty award among Defendants.⁴⁵⁴ This Court has held defendants "jointly and severally liable ... for misappropriation of trade secrets."⁴⁵⁵ "As joint-tortfeasors for the misappropriation of trade secrets, any liability ... would be joint and several."⁴⁵⁶ Indeed, "[t]here is no indication that joint and several liability does not apply to misappropriation of trade secrets."⁴⁵⁷ And "[c]ommentators on trade secret law also suggest that, in general, liability for misappropriation claims is joint and several."⁴⁵⁸ All Defendants owe the damages award jointly and severally.

3. Injunctive Relief

CSS also requests injunctive relief.⁴⁵⁹ CSS requests an order that Defendants return or destroy all documents containing CSS information and be enjoined from using such information. And CSS requests an order enjoining the Individual Defendants from the use of CSS's trade secrets and any development, marketing, commercialization, sales efforts, or any other activity in food recycling, fertilizer, pet food, animal feed business, or any related business.⁴⁶⁰ I grant CSS a more limited injunction.

"To merit a permanent injunction, a plaintiff must show: (1) actual success on the merits; (2) irreparable harm, and (3) the harm resulting from a failure to issue an injunction outweighs the harm to the opposing party if the court issues the injunction."⁴⁶¹ CSS has plainly prevailed on the merits, having secured a default judgment against the Corporate Defendants and proven by a preponderance of the evidence that the Individual Defendants misappropriated the trade secret CSS Process.⁴⁶²

While the License Agreement supported a damages award for past misappropriation in the form of an established royalty, and while the Corporate Defendants are being liquidated by a Chapter 7 trustee, I believe the Individual Defendants still pose a risk of irreparable harm to CSS in the form of future use of its trade secrets. After securing access to the CSS Process, the Individual Defendants spent years taking increasingly larger steps away from CSS in an effort to

use that information without paying for it: from turning towards a nonenzymatic process, to renegotiating the License Agreement, to ending the License Agreement on the premise they were not operating a Licensed Facility, to setting up the Do Good Foods business model that monetized CSS Process product without triggering royalties. Their lack of candor at trial, going so far as to testify that they had relevant food recycling experience and that KDC developed its process from scratch, suggests a continued predilection to using the CSS Process without attribution or compensation. It appears an injunction is necessary to stop the harm that would result to CSS from future unauthorized use of its process.

***35** The Individual Defendants oppose CSS's request for an injunction only on the basis of scope.⁴⁶³ They assert a sweeping injunction on their ability to develop, market, commercialize or conduct any other activity in food recycling and its related businesses is too broad. I agree. The balance of the equities favors CSS only for an injunction limited to its own information. The Individual Defendants are enjoined from the use of the CSS Process or any other confidential information the Defendants obtained from CSS. They must also return or destroy all information related to the CSS Process.⁴⁶⁴

4. Exemplary Damages And Attorneys' Fees

Lastly, CSS requests exemplary damages and attorneys' fees and costs.⁴⁶⁵ If a trade secret was "willfully and maliciously misappropriated," reasonable attorney's fees may be awarded to the prevailing party.⁴⁶⁶ The Federal Act contemplates exemplary damages "if [a] trade secret is willfully and maliciously misappropriated" of an "amount not more than 2 times the amount of the damages awarded."⁴⁶⁷ Here, exemplary damages may be granted up to \$3,251,004.72.

"[T]he issue of whether a defendant has acted willfully and/or maliciously is a 'highly fact-specific question best left to the [fact-finder].'"⁴⁶⁸ "A plaintiff claiming willful and malicious misappropriation must prove that the misappropriation was both willful *and* malicious."⁴⁶⁹ "[W]illfulness is defined as 'an awareness, either actual or constructive, of one's conduct and a realization of its probable consequences.'" ⁴⁷⁰ And malice is defined as 'ill-will, hatred or intent to cause injury.' ⁴⁷¹ Malice is not lightly found. In *EDIX Media Group, Inc. v. Mahani*, this Court determined the defendant acted with

malice where he engaged in "a continual and underhanded campaign to discredit [the plaintiff]" and "refus[ed] to cease his activities even after agreeing to a stipulated restraining order entered by this Court."⁴⁷² In *Nucar Consulting, Inc. v. Doyle*, the Court found malice where the defendant, an ex-employee of the plaintiff, used the plaintiff's trade secret information to "aggressively solicit[]" plaintiff's prospective clients "with the intent to cause injury."⁴⁷³ In *Storagecraft Tech. Corp. v. Kirby*, a case CSS relied upon, a federal district court found malice where the defendant admitted his conduct was "motivated by revenge" and he refused to produce certain emails despite court orders.⁴⁷⁴

***36** CSS made no similar showing of ill will, vindictiveness, or the intent to harm CSS. CSS asserts the Individual Defendants acted with malice because of their dishonesty with CSS, conduct during litigation, and alleged lack of remorse for their actions.⁴⁷⁵ As examples, CSS points to the Individual Defendants' attempts to wipe CSS from its materials, Matthew and Barry's visits to CSS right before the License Agreement ended, and the Individual Defendants' continued use of the CSS Process. While this conduct is key to CSS's misappropriation case, CSS has not proven the Individual Defendants acted with ill-will, hatred, or a desire to harm CSS. This behavior is consistent with misappropriating the CSS Process to benefit KDC, not to additionally harm CSS.

As for the Individual Defendants' litigation conduct, their defense was comprehensive, succeeded in delaying the day of reckoning, and culminated in trial testimony rife with impeachments and untruths. While their tactics were oppressive and defensive, I do not believe they rise to the level of malice or bad faith necessary for this Court to take the extraordinary steps of awarding exemplary damages or shifting fees. I do not grant CSS its request for exemplary damages and attorneys' fees.

III. CONCLUSION

Judgment on Counts VII and VIII will be entered in favor of CSS, and on Counts V, XIV, XV, XVI, and IX, in favor of the Individual Defendants. Defendants owe CSS \$1,625,502.36, plus pre- and post-judgment interest to be calculated by the parties. The parties are to submit a proposed stipulated final order and judgment within 7 days.

All Citations

Not Reported in Atl. Rptr., 2025 WL 98479

Footnotes

- 1 Citations in the form “[name] Tr. at –” refer to trial testimony of the referenced witness, available at docket item (“D.I.”) 464, D.I. 465, D.I. 466, D.I. 467, D.I. 468, D.I. 469, and D.I. 484. Citations in the form “PTOB” refer to the plaintiff’s post-trial opening brief, available at D.I. 461. Citations in the form “PTAB” refer to the individual defendants’ post-trial answering brief, available at D.I. 476. Citations in the form “PTRB” refer to the plaintiff’s post-trial reply brief, available at D.I. 482. Citations in the form “PTO” refer to the parties’ amended joint pre-trial stipulation, available at D.I. 431.
- 2 As this action involves three members of the Kamine family, I will refer to them by their first names to avoid confusion. For parity, I will also refer to Barry Starkman by his first name. I intend no familiarity or disrespect.
- 3 See D.I. 392; D.I. 375; D.I. 447; D.I. 470. The term “Corporate Defendants” refers to KDC Agribusiness LLC, KDC Agribusiness Fairless Hills LLC, KDC Agribusiness North Dakota, LLC, Do Good Foods LLC, Do Good Foods Managed Services LLC, Do Good Foods Facility Management LLC, and Do Good Chicken LLC.
- 4 See, e.g., *Beard Rsch., Inc. v. Kates*, 8 A.3d 573, 590 (Del. Ch. 2010) (finding “[t]he plaintiff bears the burden of proving both the existence and misappropriation of a trade secret”), *aff’d sub nom. ASDI, Inc. v. Beard Rsch., Inc.*, 11 A.3d 749 (Del. 2010); *Frye v. Est. of Raphaelson*, 2023 WL 5624717, at *8 (Del. Ch. Aug. 31, 2023) (“The parties have the burden of proving their [unjust enrichment] claims at trial by a preponderance of the evidence.”); *Wayman Fire Prot., Inc. v. Premium Fire & Sec., LLC*, 2014 WL 897223, at *8–9 (Del. Ch. Mar. 5, 2014); *Vichi v. Koninklijke Philips Elecs., N.V.*, 85 A.3d 725, 787 (Del. Ch. 2014).
- 5 *Agilent Techs., Inc. v. Kirkland*, 2010 WL 610725, at *13 (Del. Ch. Feb. 18, 2010) (quoting *Del.Exp. Shuttle, Inc. v. Older*, 2002 WL 31458243, at *17 (Del. Ch. Oct. 23, 2002)).
- 6 *Alabama By-Products Corp. v. Neal*, 588 A.2d 255, 259 (Del. 1991) (quoting *Shively v. Klein*, 551 A.2d 41, 45 (Del. 1988)); *Gatz Props., LLC v. Auriga Cap. Corp.*, 59 A.3d 1206, 1221 (Del. 2012) (“The law requires the trial judge to weigh the evidence, including the credibility of live witness testimony.”).
- 7 Hal, Matthew, and Barry were caught in lies both significant and immaterial. Hal misrepresented his salary, attempting to create the impression he had taken a much lower salary from KDC than he actually did. *Compare* Hal Tr. at 449–53 (testifying the Kamines at most made \$750,000 a year at KDC), *with* Matthew Tr. at 699 (acknowledging that Hal made \$1.37 million in the 12 months preceding KDC’s bankruptcy). On direct, Matthew testified that he received no more than 35% of his annual salary at KDC, giving the impression that metric was true every year. See Matthew Tr. at 478. On cross, Matthew confessed he made \$750,000 his last year with KDC—70% of his annual salary—and the 35% number was of the total across every year. *Id.* at 699–700. Hal implied he had relevant experience in the food recycling industry; in fact, he had merely worked one summer as a teenager at a meatpacking plant. *Compare* Hal Tr. at 263–66, *withid.* at 369. Documentary evidence undercuts Hal’s credibility as well. See JX 585 (reflecting Hal drafted a letter to CSS requesting an amendment to its contract with KDC as if he was KDC’s bond underwriter). As for Barry, he misrepresented that he had experience with enzymatic digestion and was quickly impeached. See Barry Tr. at 1173–74. Barry lied that KDC’s food recycling process was built “from scratch.” Barry Tr. at 1182–83, 1193–96. Matthew would not answer whether the KDC process was created from scratch, see Matthew Tr. at 655–56, and was impeached on other topics. See *id.* at 574–81. I give testimony from Hal, Matthew, and Barry the weight it deserves.

The Individual Defendants’ expert, Dr. Timothy Bowser, fell apart on cross-examination. He was impeached over two dozen times. See, e.g., Bowser Tr. at 1902–03, 1861–62, 1886–87, 1904, 1916, 1932–34, 1943–44; see also PTRB 2; *infra* n. 234. I give Dr. Bowser’s testimony no weight.
- 8 JX 982 at 15.

- 9 Morash Tr. at 12–14; JX 982 at 16.
- 10 Morash Tr. at 12–13. REDF was later merged into CSS. *Id.* at 14.
- 11 PTO ¶ 59.
- 12 Morash Tr. at 6, 16; PTO ¶¶ 1–3.
- 13 Dr. Steve Zicari became CSS's COO after LeJeune left. PTO ¶ 3. He had previously served as CSS's chief technology officer and director of engineering.
- 14 Morash Tr. at 29–30.
- 15 *Id.* at 30–32.
- 16 JX 11; see Morash Tr. at 19. Many of the attached materials were stamped confidential. See JX at 4–26.
- 17 Hal Tr. at 276–77; Morash Tr. at 31.
- 18 Morash Tr. at 30–31; Hal Tr. at 281.
- 19 Matthew Tr. at 479; Justin Tr. at 1293–94. At least one of Justin's investments came from his trust fund. Justin Tr. at 1316.
- 20 JX 44; JX 41.
- 21 JX 652; Morash Tr. at 31.
- 22 Justin Tr. at 1297–99.
- 23 *Id.*
- 24 Hal Tr. at 284–85.
- 25 *Id.* at 281–82; Justin Tr. at 1295–96.
- 26 PTO ¶ 19; Morash Tr. at 16–19.
- 27 Morash Tr. at 18–19.
- 28 JX 982 at 17.
- 29 Morash Tr. at 18, 24; see JX 37.
- 30 Morash Tr. at 28.
- 31 *Id.* at 9.
- 32 *Id.*; JX 982 at 27; Zicari Tr. at 1434–36.
- 33 Zicari Tr. at 1437–40.
- 34 *Id.* at 1443–46, 1454–61; JX 982 at 33.
- 35 Morash Tr. at 14.
- 36 JX 982 at 18–20.
- 37 CSS's products include a fertilizer called Harvest-to-Harvest and an animal feed called Hog Heaven.

- 38 Morash Tr. at 30–33; Hal Tr. at 276–77, 289.
- 39 KDC stands for Kamine Development Corp. See Morash Tr. at 33.
- 40 PTO ¶¶ 4–6.
- 41 *Id.* ¶¶ 8–10.
- 42 *Id.* ¶ 9.
- 43 *Id.* ¶ 10; see also JX 787 at 93.
- 44 PTO ¶ 11. The Individual Defendants also held positions with other KDC-affiliated entities. *Id.* ¶¶ 8–11.
- 45 *Id.* ¶ 11; Hal Tr. at 339.
- 46 PTO ¶ 21; JX 69.
- 47 JX 69 at 1, 3–5; *id.* § 2.1.
- 48 *Id.* at 3; JX 64 at 1; Hal Tr. at 372–74.
- 49 See Hal Tr. at 372–74; Matthew Tr. at 553; Justin Tr. at 1326 (“‘Q. And the agreement was negotiated by you, your father – you and your father and your brother; correct?’ ‘A. Correct.’”).
- 50 Barry Tr. at 1188.
- 51 JX 69 at 3, 5.
- 52 *Id.* at Ex. D.
- 53 Morash Tr. at 34–35.
- 54 JX 69 at 3.
- 55 *Id.*
- 56 *Id.*
- 57 *Id.* § 2.1.
- 58 Hal Tr. at 372–77 (“‘Q. Now you also admit, sir, that when you signed this license agreement, you understood that CSS was going to be licensing to you the use of its trade secrets; right?’ ‘A. Yes.’”); Matthew Tr. at 614–15; Justin Tr. at 1326–27; Barry Tr. at 1186–88; JX 580 at 10; JX 601 at 11.
- 59 JX 69 §§ 3.2, 3.3.
- 60 *Id.* § 3.3(a).
- 61 *Id.* § 3.3(b).
- 62 *Id.* § 3.3(c).
- 63 *Id.* § 3.2.
- 64 *Id.* § 3.1; JX 71a.
- 65 JX 69 § 2.3.

- 66 *Id.*
- 67 *Id.* at 2.
- 68 *Id.* § 2.3.
- 69 Morash Tr. at 19.
- 70 JX 675 at 26; JX 759 at 27.
- 71 JX 982 at 26.
- 72 Morash Tr. at 89–90; JX 982 at 54.
- 73 *Id.* at 21.
- 74 U.S. Patent Nos. 10,214,458, 9,416,062, 9,643,895, 10,252,950, 9,388,088, and 11,447,428; see PTO ¶ 67.
- 75 U.S. Patent Nos. 16/708,299, 16/102,669, 17/493,567, 17/891,933, 18/411,984, and 18/412,192; see PTO ¶ 67.
- 76 See JX 982 at 20–21.
- 77 Morash Tr. at 24–25.
- 78 *Id.* at 25.
- 79 *Id.* at 24–25.
- 80 *E.g.*, JX 1189; JX 1183; JX 1529.
- 81 *E.g.*, JX 36; JX 1389; JX 1401.
- 82 JX 1221 at 1–2; JX 84; see *also*, *e.g.*, JX 1203; JX 1218 at 1; JX 1452 at 1.
- 83 JX 95.
- 84 Keener Tr. at 1734–35.
- 85 JX 759 at 27.
- 86 Morash Tr. at 33; Matthew Tr. at 555; Barry Tr. at 1173; Justin Tr. at 1290. At trial, Hal implied he had relevant experience because he worked at a rendering plant when he was seventeen. Hal Tr. at 264–66, 369. Hal failed to convince me that childhood summer job offered relevant experience.
- 87 PTO ¶ 17.
- 88 Heil Tr. at 740–41.
- 89 JX 121 at 13.
- 90 Hal Tr. at 388.
- 91 *Id.* at 440–41.
- 92 Zicari Tr. at 1413–14; JX 700 at 53–54 (“As background, the Kamine family office invested in a fertilizer based business in 2011 which utilizes Diverted Grocery Products and produces fertilizer near Sacramento, California. Many of the pieces of equipment that the KDC Ag Project anticipates using are similar to those found in the California facility.”); JX 121 at 13.

- 93 KDC's underwriters, Piper Sandler & Co., and potential investors, also visited CSS's facilities. PTO ¶¶ 40–41.
- 94 *Id.* ¶¶ 27–35; Barry Tr. at 1180–82; Zicari Tr. at 1418–19; Hal Tr. at 283, 370; Matthew Tr. at 480; Morash Tr. at 39–40.
- 95 Matthew Tr. at 571; Heil Tr. at 752–53.
- 96 Morash Tr. at 41.
- 97 Barry Tr. at 1180–82.
- 98 Zicari Tr. at 1419–20; PTO ¶¶ 31–33.
- 99 JX 128 at 1.
- 100 Heil Tr. at 753–54; *id.* at 754 (“[T]here's just no substitute for, you know, physically seeing something yourself.”).
- 101 JX 141 at 1.
- 102 JX 133.
- 103 *See generally id.*
- 104 Heil Tr. at 766–67.
- 105 *Id.* at 765–66; JX 133.
- 106 Heil Tr. at 764–66.
- 107 JX 133 at 4, 6; *see also* JX 626 (listing KDC improvements to “base CSS process” as of October 2019).
- 108 JX 141 at 2.
- 109 PTO ¶¶ 29–30, 36–37.
- 110 Heil Tr. at 791.
- 111 Zicari Tr. at 1421–22.
- 112 Heil Tr. at 1002–03.
- 113 *Id.* at 743.
- 114 JX 626 at 2.
- 115 *Id.*; Heil Tr. at 1000, 1005, 1011.
- 116 Hal Tr. at 294–96, 306–07, 313–14.
- 117 Heil Tr. at 747.
- 118 Justin Tr. at 1302–03; Morash Tr. at 126–27; *see also* JX 754 at 46, 55.
- 119 Heil Tr. at 748–49.
- 120 Morash Tr. at 127.
- 121 JX 364; JX 425.
- 122 JX 361; PTO ¶ 23.

- 123 JX 361 at 1.
- 124 *Id.* at 3.
- 125 JX 610 at 2–4.
- 126 *Id.*
- 127 JX 585 at 1.
- 128 Morash Tr. at 53–55.
- 129 *Id.* at 54.
- 130 Hal Tr. at 422–23.
- 131 PTO ¶ 24; Morash Tr. at 56.
- 132 JX 652.
- 133 PTO ¶¶ 25–26.
- 134 JX 659 at 3; PTO ¶ 26.
- 135 JX 663 at 2–4; see also Morash Tr. at 125–26.
- 136 JX 663 at 3.
- 137 *Id.* at 2–3; Hal Tr. at 334–35.
- 138 Matthew Tr. at 603–05; see JX 754 at 11 (describing in bond offering that “[b]ased on the currently assumed financial closing schedule, the construction portion of the Project is expected to commence no later than June 2020”).
- 139 JX 761 at 8.
- 140 Hal Tr. at 323–24.
- 141 JX 759; PTO ¶¶ 18, 47.
- 142 PTO ¶ 34.
- 143 JX 646 at 10; JX 759 at 8.
- 144 JX 646 at 10, 14; JX 982 at 84–92.
- 145 JX 646 at 8.
- 146 *Id.* at 14.
- 147 JX 580; JX 581; JX 609; JX 616; Hal Tr. at 469–72.
- 148 JX 681 at 4 (sending email to potential investor attaching Appendix A to bond offering that discusses the CSS Process).
- 149 JX 664 at 1.
- 150 *Id.*
- 151 JX 700 at 2.

- 152 JX 694 at 2.
- 153 *Id.* at 1–2.
- 154 Compare JX 675, with JX 695; compare JX 580, with JX 698 (reflecting that references to CSS were removed from Appendix A).
- 155 PTO ¶ 43; JX 754.
- 156 JX 754; JX 759.
- 157 JX 754; JX 759 at 16–19; JX 982 at 89–92.
- 158 JX 754 at 55–56.
- 159 *Id.*
- 160 *Id.* at 46.
- 161 *Id.* at 56.
- 162 PTO ¶ 43; see JX 754; JX 764 at 1.
- 163 PTO ¶¶ 43–44.
- 164 JX 601.
- 165 *Id.* at 11; see also JX 580 at 10.
- 166 JX 218 (copying Hal and Barry); JX 402; JX 766.
- 167 See JX 218 at 1; JX 402; JX 766 at 4; Matthew Tr. at 680–81.
- 168 JX 402 at 144–59; *id.* at 1–3; Matthew Tr. at 680–82; JX 766 at 122.
- 169 JX 218 at 1; see JX 218 at 9.
- 170 JX 766 at 121–22.
- 171 JX 757 at 1–2.
- 172 Matthew Tr. at 680.
- 173 JX 798 at 1 (“H2H stands for Harvest to Harvest which is the trade name of the fertilizer product that California Safe Soil produces and was the basis for our current process. We own 20% of that company but no longer are directly involved with them.”); Heil Tr. at 753, 798, 835; Keener Tr. at 1684–85 (“My conclusion was that KDC did have an aerobic enzymatic digestion process and that facility was built based on the CSS process or derived from the CSS process.”); JX 632 at 13 (“The overall digestion and product finishing process has been successfully piloted at the CSS facility in Sacramento. The proposed Fairless Hills Project will be a scale-up of the Sacramento facility using additional processing lines and substantially the same equipment and process conditions.”). Despite the overwhelming evidence that KDC’s process was derived from the CSS Process, at trial, Barry testified that KDC’s process to make animal feed was built “from scratch.” Barry Tr. at 1182–83, 1193. Matthew, when faced with similar questions, refused to answer and only after instructed by the Court, Matthew testified he did not know how to answer, despite his proven involvement with developing Fairless Hills. See Matthew Tr. at 655–56, 798 (“‘The first sentence says, “The general process has been adopted from the currently operating plant designed and operated by California Safe Soil.” Is that a true statement?’ ‘Yes, it is.’”).
- 174 JX 789 at 3.

- 175 Justin Tr. at 1362.
- 176 JX 798 at 1.
- 177 PTO ¶ 49; Hal Tr. at 345–46.
- 178 PTO ¶ 49; Barry Tr. at 1139–41.
- 179 Hal Tr. at 346–47.
- 180 Heil Tr. at 1002 (testifying that Fairless Hills could not have been recreated from scratch in only a few months).
- 181 JX 759 at 6, 27; Morash Tr. at 20.
- 182 JX 759 at 91; see also Matthew Tr. at 633; JX 610 at 3 (noting plans for three production lines at Fairless Hills).
- 183 Heil Tr. at 752 (“Q. Okay. So the intent was that the process that would be designed at the Fairless Hills facility would have changes to the CSS process, but would ultimately be derived from the CSS process?” ‘A. Yes, that’s – that’s correct.’”); see also *id.* at 747–50, 1002; PTOB 30 (conceding at least “some superficial changes” were made “to make the addition of commercial enzymes as a digestion accelerant optional”).
- 184 Heil Tr. at 844.
- 185 *Id.* at 845.
- 186 *Id.* at 1002.
- 187 JX 982 at 75; see also *id.* at 69–70.
- 188 *See id.* at 73–82.
- 189 *Id.* at 79–81.
- 190 See PTO ¶¶ 52–55.
- 191 *Id.* ¶¶ 9–10; Matthew Tr. at 535.
- 192 PTO ¶¶ 56–57; JX 889; JX 1059; Hal Tr. at 347–49.
- 193 JX 889; PTO ¶ 56.
- 194 PTO ¶ 57; Matthew Tr. at 534–35; Hal Tr. at 349.
- 195 JX 1168.
- 196 *Id.* § 3.2.
- 197 Hal Tr. at 357–59; JX 1164.
- 198 Hal Tr. at 358.
- 199 See D.I. 1.
- 200 D.I. 223 [hereinafter “Am. Compl.”].
- 201 D.I. 224.
- 202 JX 880; JX 935; JX 971.

- 203 D.I. 308; D.I. 309.
- 204 D.I. 307.
- 205 PTO ¶ 68; JX 1115. KDC North Dakota was dissolved earlier.
- 206 D.I. 357.
- 207 PTO ¶ 69; JX 1127.
- 208 D.I. 392; D.I. 396; D.I. 470.
- 209 D.I. 470.
- 210 *Id.*
- 211 CSS no longer seeks relief for Count VI recognizing it is “effectively moot in light of the corporate Defendants’ bankruptcy.” PTOB 87 n.10.
- 212 *See generally* PTAB.
- 213 D.I. 470. The remaining claims against the Corporate Defendants, but not the Individual Defendants, were for breach of a License Agreement (Counts I and II), declaratory relief (Count III), violations of the Lanham Act (Count X), and unfair competition and deceptive trade practices (Count XI, XII, XIII).
- 214 Because of the overlap between the statutes, I will analyze the federal and state law claims together. *See Agrofresh Inc. v. Essentiv LLC*, 2020 WL 7024867, at *3 n.7 (D. Del. Nov. 30, 2020) (collecting cases).
- 215 Am. Compl. ¶ 262.
- 216 PTOB 46 n.8 (citing *Deuley v. DynCorp. Intern., Inc.*, 8 A.3d 1156, 1161 (Del. 2010)).
- 217 During this litigation, CSS argued components of its process are also independently trade secrets. I take no position on whether any individual components are trade secrets because I find the entire process is a combination trade secret.
- 218 *Better Holdco, Inc. v. Beeline Loans, Inc.*, 666 F. Supp. 3d 328, 384 (S.D.N.Y. 2023) (describing trade secret misappropriation claim under federal law (quoting *Democratic Nat’l Comm. v. Russian Fed.*, 392 F. Supp. 3d 410, 447 (S.D.N.Y. 2019))); *Agilent*, 2010 WL 610725, at *18 (explaining under Delaware law, “[a]fter proving trade secrecy, a plaintiff alleging trade secret misappropriation must demonstrate that the trade secret has been disclosed or used without authorization”).
- 219 18 U.S.C. § 1836(b)(1). This element is readily found here.
- 220 *Arconic Inc. v. Novelis Inc.*, 2020 WL 7247112, at *11 (W.D. Pa. Dec. 9, 2020); *Savor, Inc. v. FMR Corp.*, 2004 WL 1965869, at *6 (Del. Super. Ct. July 15, 2004) (“[Plaintiff] must describe its trade secret with a ‘reasonable degree of precision and specificity ... such that a reasonable [fact finder] could find that plaintiff established each statutory element of a trade secret.’ ” (quoting *IDX Sys. Corp. v. Epic Sys., Corp.*, 165 F.Supp.2d 812, 816–17 (W.D. Wisc. 2001))).
- 221 6 Del. C. § 2001(4).
- 222 18 U.S.C. § 1839(3) (defining a trade secret as “financial, business, scientific, technical, economic, or engineering information” where “the owner thereof has taken reasonable measures to keep such information secret” and “the information derives independent economic value ... from not being generally known to, and not being readily ascertainable through proper means by, another person who can obtain economic value from the disclosure or use of the information”); *see also Battaglia Mgmt., Inc. v. Abramowicz*, 2024 WL 3183063, at *3 (D. Del. June 26, 2024).
- 223 *Beard Rsch.*, 8 A.3d at 594 (quoting 6 Del. C. § 2001(4)).

- 224 *Nucar Consulting, Inc. v. Doyle*, 2005 WL 820706, at *6 (Del. Ch. Apr. 5, 2005), *aff'd*, 913 A.2d 569 (Del. 2006) (quoting *Miles*, 1994 WL 676761, at *11); *First Health Gp. Corp. v. Nat'l Prescription Adm'rs, Inc.*, 155 F. Supp. 2d 194, 225 (M.D. Pa. 2001) ("Trade secrets which are composed of a compilation or combination of elements must pass the same 'sufficiently secret' test as trade secrets composed of individual pieces of information.").
- 225 Restatement (Third) of Unfair Competition § 39 cmt. f (Am. L. Inst. 1995).
- 226 *Id.*
- 227 *SmithKline Beecham Pharms. Co. v. Merck & Co.*, 766 A.2d 442, 448 (Del. 2000).
- 228 1999 WL 669354, at *16 (Del. Ch. Aug. 5, 1999), *aff'd*, 746 A.2d 277 (Del. 2000), and *aff'd*, 766 A.2d 442 (Del. 2000).
- 229 *Id.* at *18.
- 230 *Id.* at *16 (quoting *Salsbury Labs., Inc. v. Merieux Labs., Inc.*, 735 F.Supp. 1555, 1569 (M.D. Ga. 1989), *aff'd*, 908 F.2d 706 (11th Cir. 1990)).
- 231 JX 982 at 26, 73–78; Keener Tr. at 1728.
- 232 *Id.* at 26; see *Tewari De-Ox Sys., Inc. v. Mountain States/Rosen, L.L.C.*, 637 F.3d 604, 613 (5th Cir. 2011) ("[Courts] have specifically rejected the contention that a combination of disclosed technologies cannot itself constitute a trade secret.").
- 233 Keener Tr. at 1676–78.
- 234 The Individual Defendants' expert, Dr. Bowser, opined the CSS Process is generally known and readily ascertainable through public sources, including videos, tours of the CSS facility, patent applications, and other disclosures to third parties. The Individual Defendants assert this supposed publication precludes the CSS Process from being a trade secret. Despite the Individual Defendants' effort to reframe this argument, they are effectively asserting a publication defense, which has been soundly rejected in Delaware. *Merck*, 1999 WL 669354, at *18. Even if their theory was cognizable, I would give Dr. Bowser's opinion no weight. Dr. Bowser was impeached repeatedly and relentlessly with his deposition, in a spectacle that eviscerated his opinion and his credibility. See, e.g., Bowser Tr. at 1861–64, 1886–87, 1892–93, 1896–97, 1902–04, 1916. His cross-examination revealed a deep lack of credibility. Dr. Bowser did not interview anyone from DPS, did not consider their detailed notes in forming his opinion, nor did he understand the extent of what DPS did. *Id.* at 1867–70, 1893. Dr. Bowser did not know who E3 was or that they prepared an independent engineer's report, see *id.* at 1870–71, and he did not seem to understand what a combination trade secret is. *Id.* at 1875–77. I give his opinion no weight.
- 235 *Miles Inc. v. Cookson Am., Inc.*, 1994 WL 676761, at *10 (Del. Ch. Nov. 15, 1994).
- 236 E.g., JX 580; JX 218; JX 402; JX 766.
- 237 JX 982 at 60–61.
- 238 *First Health.*, 155 F. Supp. 2d at 225.
- 239 See *REDF-Organic Recovery v. Rainbow Disposal Co.*, No. 654492/2012 (N.Y. Cty. Sup. Ct.).
- 240 See JX 312; JX 1239.
- 241 JX at 982.
- 242 PTAB 68.
- 243 JX 982 at 20–24, 16; see JX 580 at 10 ("The overall thesis of the technology is that there is a higher and better use for the leftover foods than current disposal capabilities (i.e. landfill, anaerobic digesters, composting) as all those technology's

waste the core nutrients of the food. The CSS technology upcycles and converts those nutrients to high value finished products.”).

- 244 *Agilent*, 2010 WL 610725, at *20; *Merck*, 1999 WL 669354, at *16–17.
- 245 “[W]hether [Plaintiff] took reasonable precautions to protect their secrecy is a question of fact.” *SmithKline Beecham*, 766 A.2d at 448; see also *Savor*, 2004 WL 1965869, at *7.
- 246 18 U.S.C. § 1839(3)(A); 6 *Del. C.* § 2001(4)(b).
- 247 18 U.S.C. § 1839(3)(A).
- 248 *Metallurgical Indus. Inc. v. Fourtek, Inc.*, 790 F.2d 1195, 1200 (5th Cir. 1986).
- 249 *Swift Bros. v. Swift & Sons, Inc.*, 921 F. Supp. 267, 277 (E.D. Pa. 1995); *EXL Labs., LLC v. Egolf*, 2010 WL 5000835, at *6 (E.D. Pa. Dec. 7, 2010).
- 250 *Savor*, 2004 WL 1965869, at *7 (quoting *Nilssen v. Motorola, Inc.*, 963 F. Supp. 664, 679 (N.D. Ill. 1997)).
- 251 *Id.* (quoting *Rockwell Graphic Sys., Inc. v. DEV Indus., Inc.*, 925 F.2d 174, 177 (7th Cir. 1991)).
- 252 *Metallurgical Indus.*, 790 F.2d at 1200.
- 253 *Catalyst & Chem. Servs., Inc. v. Glob. Ground Support*, 350 F. Supp. 2d 1, 10 (D.D.C. 2004), *aff’d*, 173 F. App’x 825 (Fed. Cir. 2006).
- 254 *Wayman*, 2014 WL 897223, at *15; *Beard Rsch.*, 8 A.3d at 596 (finding that reasonable efforts were made because “throughout the industry it was generally considered inappropriate to use [secret recipes] anywhere outside of the lab in which they were created”).
- 255 *Great Am. Opportunities, Inc. v. Cherrydale Fundraising*, 2010 WL 338219, at *17 (Del. Ch. Jan. 29, 2010); *c.f. Triton Const. Co. v. E. Shore Elec. Servs., Inc.*, 2009 WL 1387115, at *22 (Del. Ch. May 18, 2009), *aff’d*, 988 A.2d 938 (Del. 2010) (“Triton also has failed to show that it made reasonable efforts under the circumstances to maintain the secrecy of its alleged trade secrets. Triton did not mark any documents handled by Kirk or Bauguess as secret or confidential, and never conducted any training or provided any instructions to its employees on information that the Company considered secret or confidential.”).
- 256 *Morash Tr.* at 24.
- 257 *Id.*
- 258 *Id.* at 24, 251.
- 259 *Id.* at 25–26.
- 260 *Id.* at 25; see *2999TC Acqs., LLC v. 2999 Turtle Creek, LLC*, 2021 WL 3145986, at *3 (N.D. Tex. July 6, 2021) (“And ‘[a]n express contractual provision is not required to establish a duty of confidentiality,’ though ‘the absence of an agreement restricting disclosure of information is a factor the court may consider.’” (quoting *EEMSO, Inc. v. Compex Techs., Inc.*, 2006 WL 2583174, at *7 (N.D. Tex. Aug. 31, 2006))).
- 261 *Morash Tr.* at 25–26.
- 262 *Id.* at 25; *e.g.*, JX 1453; JX 1366; JX 1270; JX 726; JX 1272; JX 1411.
- 263 *Morash Tr.* at 26 (“The venture capital companies are particularly sticky about this because they look at so many different ideas that they don’t want to expose themselves by signing too many confidentiality too early in the process to potential misunderstandings and disputes. So, basically, we rely, at least in the initial stages, on their professional discretion.”);

JX 1430 at 3 (“Good Growth VC cannot sign an NDA. This isn’t unusual. Many VCs as a policy cannot sign an NDA due to the deal volume they are exposed to.”).

264 PTAB 70–73.

265 *E.g.*, JX 1272; JX 1280; JX 1260; JX 1415; JX 1242; see also Morash Tr. at 26.

266 *E.g.*, JX 11; JX 1213.

267 JX 726; Morash Tr. at 202, 216; JX 1477.

268 CSS did enter into confidential agreements with multiple potential investors flagged by the Individual Defendants. See PTAB 71–73; PTRB 20; compare JX 1279, with JX 1037 at 314; compare 1464, with JX 1307 at 503; compare JX 726, with JX 1037 at 168, 515; compare JX 1272, with JX 1037 at 463.

269 *E.g.*, JX 1453; JX 1366; JX 1270; JX 726; JX 1272; JX 1411; JX 1242.

270 JX 1464 (“Here is an introductory slide deck, so you can get an idea of our business.”); JX 1279 (“I’ve separately attached Exhibit C, which is the executive summary and introductory presentation, which you can send without an NDA.”); JX 1453 (“I’ve attached a slide deck summarizing our aerobic, enzymatic digestion technology”).

271 Morash Tr. at 27. For one commonly sent document, titled CSS’s “Process and Plant Functional Description,” Zicari testified it does not disclose the entire CSS Process such that someone could replicate it. Zicari Tr. at 1432–34; see, *e.g.*, JX 1260 at 212, JX 1480, JX 1482.

272 Morash Tr. at 26.

273 JX 1430 at 3.

274 *Metallurgical Indus.*, 790 F.2d at 1200.

275 *Id.*

276 *E.g.*, JX 1465 (disclosing financials and “introductory” materials, and plant re-design overview); JX 1471 (disclosing “Business Plan Outline” and plant re-design overview); JX 1466 (disclosing “Business Plan Outline”); JX 1479; JX 1480; JX 1482.

277 *E.g.*, JX 1484 § 4; JX 1471 at 6 § 7; JX 1037 at 450 § 2; JX 1472 at 3 § 3; JX 1479 at 107 § 7; JX 1037 at 272 § 3; JX 1037 at 242 § 7; JX 1037 at 470 § 7.

278 *E.g.*, JX 1470; JX 1471; JX 1479; JX 1478; JX 1484; JX 1465.

279 See JX 1276.

280 For the same reasons, I am also unconvinced these limited disclosures ruin the economic value of the CSS Process.

281 *Incyte Corp. v. Flexus Biosciences, Inc.*, 2018 WL 6333613, at *2 (Del. Super. Ct. Sept. 28, 2018).

282 *Syntel Sterling Best Shores Mauritius Ltd. v. The TriZetto Gp., Inc.*, 68 F.4th 792, 801 (2d Cir. 2023) (quoting *Oakwood Labs.LLC v. Thanoo*, 999 F.3d 892, 906 (3d Cir. 2021)).

283 *Arconic*, 2020 WL 7247112, at *11.

284 *Id.* (quoting *Big Vision Priv. Ltd. v. E.I. DuPont De Nemours & Co.*, 1 F. Supp. 3d 224, 258 (S.D.N.Y. 2014), *aff’d*, 610 F. App’x 69 (2d Cir. 2015)).

285 JX 69 at 3, 33; Hal Tr. at 373–74.

- 286 JX 69 at 3. The Individual Defendants argue trade secrets are defined by law, not by contract. That is true. I look to the License Agreement as evidence of CSS putting the Individual Defendants on notice they were going to access CSS trade secrets, not as evidence that the CSS Process actually was a trade secret.
- 287 JX 69 at 33.
- 288 Heil Tr. at 1002–03.
- 289 *E.g.*, JX 402 at 5 (describing process flow as “proprietary and internal documents that provide step by step operations and provide much more detail associated with our trade secrets, operational knowledge, and therefore should be kept all Confidential and would have material impact to KDC Ag’s business if disclosed”); *id.* at 144 (labeling process description as confidential trade secret); JX 218 at 1 (sending its “process description” labeled as a confidential trade secret); Matthew Tr. at 678–80.
- 290 JX 757 at 1–2.
- 291 JX 766 at 121–22; JX 218.
- 292 See Hal Tr. at 372–74; Matthew Tr. at 553; Justin Tr. at 1326 (“ ‘Q. And the agreement was negotiated by you, your father – you and your father and your brother; correct?’ ‘A. Correct.’ ”); Barry Tr. at 1188; JX 69 at 3, 33; *id.* at Ex. D; JX 402; Matthew Tr. at 678–80; JX 218.
- 293 *Arconic*, 2020 WL 7247112, at *11.
- 294 *SmithKline Beecham*, 766 A.2d at 447.
- 295 *Id.*
- 296 D.I. 1.
- 297 JX 880 at 2–4.
- 298 D.I. 72 ¶¶ 130–39.
- 299 *Id.* ¶ 132.
- 300 JX 971 at 3–4; see also JX 935 (amending disclosure in April 2022).
- 301 Am. Compl. ¶ 146.
- 302 JX 982; D.I. 226.
- 303 JX 982.
- 304 *SmithKline Beecham*, 766 A.2d at 448 (“In the present case, Merck’s initial disclosure described its entire process as a protectable trade secret. Then, following discovery, it narrowed that broad trade secret claim to fit the particular aspects of the production process Merck claimed were misappropriated by SmithKline. SmithKline was initially put on notice through Merck’s broad disclosure but was subsequently informed well in advance of trial of the specific aspects of the trade secret Merck believed SmithKline misappropriated. It cannot be said SmithKline was prejudiced in any way.”).
- 305 PTAB 60–65. In *Next Communications, Inc. v. Viber Media, Inc.*, the appellate court held the plaintiff did not identify its trade secret with enough specificity because the plaintiff changed its trade secrets to different components of its technology throughout the litigation, including on appeal. 758 F. App’x 46, 49 (2d Cir. 2018). In *Arconic Inc. v. Novelis Inc.*, the plaintiff “never explained where it disclosed to [defendant] a full combination or put [it] on notice that [plaintiff] claimed any particular combination as its trade secret.” 2020 WL 7247112, at *15. “In sum, [plaintiff] did not put [defendant] or the court on notice of what its trade secrets were.” *Id.*

- 306 Defendants moved to strike CSS's introduction of two trade secrets: (1) the input ratio of meat and produce and (2) the compositional analysis of processed food waste exiting the centrifuge. D.I. 321 at Mot. 2, 5. That motion is denied. Defendants argued CSS impermissibly identified these alleged trade secrets for the first time after the close of discovery to Defendants' prejudice. "The purpose of [the trade secret disclosure] requirement is to set the outer boundaries of discovery in order to avoid the needless exposure of a [party's] trade secrets." *Magnox v. Turner*, 1991 WL 182450, at *1 (Del. Ch. Sept. 10, 1991). It is "[o]nly after a plaintiff has identified the trade secret that has allegedly been misappropriated can the relevance, and therefore the scope, of discovery be determined." *Id.* Through its various trade secret disclosures, e.g., JX 880; JX 971, CSS set the outer bounds of discovery: its entire food waste recycling process. CSS's "disclosure described its entire process as a protectable trade secret" and "following discovery, it narrowed that broad trade secret claim to fit the particular aspects of the production process [Plaintiff] claimed were misappropriated." *SmithKline Beecham*, 766 A.2d at 448. And the Individual Defendants can hardly cry prejudice. Because of the Corporate Defendants' bankruptcy proceedings, trial was pushed nearly a year; the Individual Defendants were not surprised on the eve of trial. They had an additional year to prepare defenses and had an opportunity to cross examine witnesses at trial. Because Defendants were "initially put on notice through [Plaintiff's] broad disclosure" and "subsequently informed well in advance of trial of the specific aspects of the trade secret[s] ... [i]t cannot be said [Defendants] w[ere] prejudiced in any way." *Id.* Regardless, CSS has proven misappropriation of the CSS Process as a whole, and I have not focused on the input ratio or compositional analysis in this opinion.
- 307 *Merck*, 1999 WL 669354, at *19 (citing 6 Del. C. § 2001(2)).
- 308 JX 626 at 2; JX 789 at 3; JX 798 at 1; JX 632 at 13.
- 309 See JX 754; JX 759.
- 310 Heil Tr. at 845–55, 1002.
- 311 JX 982 at 68–104; Keener Tr. at 1684–85, 1714–15.
- 312 Bowser Tr. at 1898.
- 313 *Agilent*, 2010 WL 610725, at *23.
- 314 Heil Tr. at 1002.
- 315 JX 982 at 74.
- 316 *Sens Mech., Inc. v. Dewey Beach Enters., Inc.*, 2015 WL 4498900, at *3 (Del. Super. Ct. June 23, 2015); *Advanced Fluid Sys., Inc. v. Huber*, 381 F. Supp. 3d 362, 387 (M.D. Pa. 2019) ("[L]iability cannot be imposed on an individual defendant based solely on his status as a corporate officer or director, and that an officer can only be held personally liable if he directs, participates in, or cooperates with the commission of a wrongful act.") *aff'd*, 958 F.3d 168 (3d Cir. 2020).
- 317 *Ayers v. Quillen*, 2004 WL 1965866, at *3 (Del. Super. Ct. June 30, 2004); see also *Beard Rsch.*, 8 A.3d at 598 (finding executive liable for trade secret misappropriation).
- 318 *Ayers*, 2004 WL 1965866, at *3 (quoting *Heronemus v. Ulrick*, 1997 WL 524127, at *2 (Del. Super. Ct. July 9, 1997)).
- 319 8 A.3d at 598–99.
- 320 See e.g., Hal Tr. at 372–74; Matthew Tr. at 553; Justin Tr. at 1326 (" 'Q. And the agreement was negotiated by you, your father – you and your father and your brother; correct?' 'A. Correct.' "); Barry Tr. at 1188; JX 601 at 11; JX 218 at 1; JX 402 at 5; JX 766 at 4; JX 580; JX 581; JX 609; JX 616.
- 321 Hal Tr. at 294.
- 322 JX 787 at 93.

- 323 Hal Tr. at 432–34; PTO ¶ 8.
- 324 Hal Tr. at 432.
- 325 Matthew Tr. at 554–55.
- 326 Morash Tr. at 41; Hal Tr. at 425.
- 327 Hal Tr. at 339, 294, 434–35; Heil Tr. at 871–74; PTO ¶¶ 10–11.
- 328 Matthew Tr. at 596–97.
- 329 Hal Tr. at 345–46.
- 330 Justin Tr. at 1312–13; PTO ¶ 9 (“[Justin] led much of the business development and public partnership efforts for KDC.”).
- 331 Matthew Tr. at 533–35.
- 332 See *Beard Rsch.*, 8 A.3d at 598–99.
- 333 JX 754.
- 334 JX 580; JX 581; JX 609; JX 616; Hal Tr. at 469–72.
- 335 PTAB 65.
- 336 *Merck*, 1999 WL 669354, at *19 (quoting *Gen. Elec. Co. v. Sung*, 843 F. Supp. 776, 778 (D. Mass. 1994)).
- 337 *Id.* at *20.
- 338 2010 WL 610725.
- 339 *Id.* at *22.
- 340 *Agilent*, 2010 WL 610725, at *22.
- 341 At trial, the Individual Defendants asserted they did not use CSS's confidential trade secret information in its process, but only publicly available information. PTAB 40–45. I am not convinced. As already noted, Dr. Keener put forth a credible, un rebutted opinion that Fairless Hills was substantially similar to the CSS Process and that CSS Process could not be replicated using only public sources. And “courts have rejected the argument that one who has learned particular information from a trade secret process is not liable if it can show that the information learned is somewhere ‘published.’” *Merck*, 1999 WL 669354, at *16.
- 342 JX 754 at 56; JX 789 at 3; JX 798 at 1.
- 343 JX 789 at 3.
- 344 JX 982 at 85–106.
- 345 PTAB 45–50.
- 346 JX 69 § 2.3.
- 347 *Id.*
- 348 *Id.* at 2.
- 349 *Alarm.com Hldgs., Inc. v. ABS Cap. P'rs Inc.*, 2018 WL 3006118, at *9 (Del. Ch. June 15, 2018), *aff'd*, 204 A.3d 113 (Del. 2019) (quoting *Savor, Inc. v. FMR Corp.*, 812 A.2d 894, 898 (Del. 2002)); see 6 Del. C. § 2007 (“Except as provided in

subsection (b) of this section, this chapter displaces conflicting tort, restitutionary and other law of this State providing civil remedies for misappropriation of a trade secret.”); see also *FMR Corp.*, 812 A.2d at 898 (“[Plaintiff’s] common law claims seek civil remedies based solely on the alleged misappropriation of a trade secret. Thus, the Superior Court correctly ruled that Savor’s common law claims are precluded.”).

- 350 *Battaglia*, 2024 WL 3183063, at *4 (quoting *You Map, Inc. v. Snap Inc.*, 2024 WL 106498, at *8 (D. Del. Jan. 12, 2021)).
- 351 *Id.* (quoting *Ethypharm S.A. Fr. V. Bentley Pharm., Inc.*, 388 F. Supp. 2d 426, 433 (D. Del. 2005)).
- 352 *Id.*
- 353 *FMR Corp.*, 812 A.2d at 898.
- 354 CSS effectively abandoned this claim in its opening brief. See PTOB 46; PTAB 88.
- 355 Am. Compl. ¶ 355; see PTOB 69 (“Here, each of the Individual Defendants joined in a combination in furtherance of misappropriating CSS’s trade secrets and causing KDC Ag to breach the License Agreement.”). To the extent CSS claims the Individual Defendants “caus[ed] KDC Ag to breach the License Agreement,” CSS’s underlying tortious interference claim fails, and so the conspiracy claim tied to it must fail as well. *Kuroda v. SPJS Hldgs., L.L.C.*, 971 A.2d 872, 892 (Del. Ch. 2009) (dismissing conspiracy claim because it “ha[d] not properly alleged an underlying wrong on which a claim of conspiracy could be based,” including tortious interference with contract).
- 356 *Savor, Inc. v. FMR Corp.*, 2001 WL 541484, at *4 (Del. Super. Ct. Apr. 24, 2001), *aff’d*, 812 A.2d 894 (Del. 2002) (dismissing conspiracy claim because it was “grounded in the same facts which purportedly support the [m]isappropriation of [t]rade [s]ecrets claim”); see Am. Compl. ¶¶ 353–61.
- 357 *Id.* ¶¶ 362–72; PTOB 71 (“[E]ach of the Individual Defendants extracted extremely high compensation from KDC Ag, which should be disgorged as predicated entirely on the use of stolen trade secrets.”); *250ok, Inc. v. Message Sys., Inc.*, 2021 WL 225874, at *5 (Del. Ch. Jan. 22, 2021) (“[B]oth Delaware and federal courts have consistently held that unjust enrichment claims ‘based on the same alleged wrongful conduct as the trade secret claims’ are preempted by the [Delaware Act].” (quoting *Incyte Corp. v. Flexus Biosciences, Inc.*, 2017 WL 7803923, at *3 (Del. Super. Ct. Nov. 1, 2017))).
- 358 Am. Compl. ¶ 364; PTOB 71 (“Defendants were unjustly enriched by their misconduct.”).
- 359 *250ok*, 2021 WL 225874, at *6 (“Given the factual overlap, 250ok’s unjust enrichment claim is preempted by the DUTSA and, therefore, must be dismissed.”).
- 360 *iBio, Inc. v. Fraunhofer USA, Inc.*, 2020 WL 5745541, at *13 (Del. Ch. Sept. 25, 2020) (“Delaware ‘has joined the “majority view” that Section 2007 of [the Delaware Act] precludes common law claims based on misappropriation of business information even in cases in which the claim does not meet the statutory definition of “trade secret” under the Code.’ ”).
- 361 See *Revolution Retail Sys., LLC v. Sentinel Techs., Inc.*, 2015 WL 6611601, at *9 (Del. Ch. Oct. 30, 2015) (“Plaintiffs ... have the burden of proving each element, including damages, of each of their causes of action....”). CSS did not even provide the elements of common law fraud in its post-trial briefing, and it made no attempt to apply facts to those elements. Nor am I convinced by the trial record that fraud has occurred. See *HControl Hldgs. LLC v. Antin Infrastructure P’rs S.A.S.*, 2023 WL 3698535, at *31 (Del. Ch. May 29, 2023) (“Buyers have not briefed the law sufficiently to bear their burden of proving that they contracted for the right to terminate the Merger Agreement based on this aspect of Iqbal’s claim.”).
- 362 Am. Compl. ¶ 350.
- 363 PTOB 70; Am. Compl. ¶ 345.
- 364 Am. Compl. ¶ 345.
- 365 *Id.* ¶ 344; PTOB 70–71 (basing fraud claims on existence of trade secrets).

366 PTOB 70–71.

367 *Smash Franchise P'rs, LLC v. Kanda Hldgs., Inc.*, 2023 WL 4560984, at *17–18 (Del. Ch. July 14, 2023), *aff'd sub nom. McLaren v. Smash Franchise P'rs, LLC*, 319 A.3d 909 (Del. 2024).

368 *Am. Bottling Co. v. Repole*, 2020 WL 7787043, at *6 (Del. Super. Ct. Dec. 30, 2020) (quoting *Smith v. Hercules, Inc.*, 2002 WL 499817, at *2 (Del. Super. March 28, 2002)).

369 *Wavedivision Hldgs., LLC v. Highland Cap. Mgmt. L.P.*, 2011 WL 5314507, at *6 (Del. Super. Ct. Nov. 2, 2011), *aff'd*, 49 A.3d 1168 (Del. 2012).

370 CSS relied on Delaware law for its tortious interference claim; the parties did not brief choice of law and have thus waived any argument that another jurisdiction's law applies. *In re Am. Int'l Grp., Inc., Consol. Deriv. Litig.*, 976 A.2d 872, 882 (Del. Ch. 2009), *aff'd sub nom. Teachers' Ret. Sys. of La. v. Gen. Re Corp.*, 11 A.3d 228 (Del. 2010) ("The parties chose not to burden me with an analysis of what law applies Because the parties have failed to brief the issue, they tacitly concede that Delaware law is applicable."); *Oxbow Carbon & Mineral Hldgs., Inc. v. Crestview-Oxbow Acq., LLC*, 202 A.3d 482, 502 n.77 (Del. 2019) ("The practice in the Court of Chancery is to find that an issue not raised in post-trial briefing has been waived, even if it was properly raised pre-trial."). In any event, from my brief perusal, it appears all states at issue (Delaware, California, New Jersey, and Pennsylvania) have some sort of agent's privilege, finding company agents liable for tortious interference in only certain circumstances, such as acting outside the scope of employment or acting with malice. See *Vosough v. Kierce*, 97 A.3d 1150, 1160 (N.J. Super. Ct. App. Div. 2014) ("To recover for tortious interference, plaintiffs were required to prove that the alleged wrongful actions of [defendants] were outside the scope of their employment and done for personal motives, out of malice, beyond their authority, and otherwise not in good faith in the interests of [their employer]."); *Rutherford v. Presbyterian-Univ. Hosp.*, 612 A.2d 500, 508 (Pa. Super. Ct. 1992) ("Where employees or agents for the corporation act within the scope of their employment or agency, the employees, the agents and the corporation are one and the same; there is no third party."); *Huynh v. Vu*, 4 Cal. Rptr. 3d 595, 607 (Cal. Ct. App. 2003); *Calero v. Unisys Corp.*, 271 F. Supp. 2d 1172, 1179 (N.D. Cal. 2003).

371 *Am. Bottling*, 2020 WL 7787043, at *6 (quoting *Grand Ventures, Inc. v. Paoli's Rest., Inc.*, 1996 WL 30022, at *4–5 (Del. Super. Jan. 4, 1996)); *City of Pittsburgh Comprehensive Mun. Pension Tr. Fund v. Conway*, 2024 WL 1752419, at *23 (Del. Ch. Apr. 24, 2024); *Grand Ventures*, 1996 WL 30022, at *4 ("[A]n officer or director may be held personally liable for tortious interference with a contract of the corporation if, and only if, said officer or director exceeds the scope of his agency in so doing." (quoting *Local Union 42 v. Absolute Env't Serv.*, 814 F. Supp. 392, 400 (D. Del. 1993))).

Readers who have made it this far will observe that while agency law limits the instances in which an officer can be liable for interference with the company's contract, tort law supports holding company agents liable for trade secret misappropriation. The former is based on the premise that the agent cannot commit a separate act of tortious interference when causing her principal, the company, to breach a contract, except when acting outside the scope of that agency relationship. See *Am. Bottling*, 2020 WL 7787043, at *6; *Grand Ventures*, 1996 WL 30022, at *4. But the latter is based on the premise that an agent who commits a tort, even for the principal's benefit, remains responsible for her actions. See *Sens Mech.*, 2015 WL 4498900, at *3 ("According to the personal participation doctrine, a corporate official cannot shield himself behind a corporation when he is an actual participant in the tort.").

372 *Nye v. Univ. of Del.*, 2003 WL 22176412, at *7 (Del. Super. Ct. Sept. 17, 2003) ("An act that is considered outside the scope and course of the employment is an act that is different than that authorized under that person's employment."). For example, CSS can show the Kamines were "not pursuing legitimate profit-seeking activities of [KDC] in good faith," or were "motivated by some malicious or other bad faith purpose to injure the plaintiff." *Yu v. GSM Nation, LLC*, 2018 WL 2272708, at *15 (Del. Super. Ct. Apr. 24, 2018) (quoting *Shearin v. E.F. Hutton Gp., Inc.*, 652 A.2d 578, 591 (Del. Ch. 1994)); see also *Smith*, 2002 WL 499817, at *3 ("[A]n interference executed by [an officer] may not be improper, so long as he did not employ wrongful means, and he was acting to protect the welfare of [the company].").

373 *Am. Bottling*, 2020 WL 7787043, at *6 (quoting *Yu*, 2018 WL 2272708, at *15–16).

374 PTRB 30–31.

- 375 *Am. Bottling*, 2020 WL 7787043, at *6.
- 376 *Enhabit, Inc. v. Nautic P'rs IX, L.P.*, 2024 WL 4929729, at *29 (Del. Ch. Dec. 2, 2024).
- 377 CSS requested damages against the Individual Defendants on all claims. CSS's request for damages from the Corporate Defendants is focused on trade secret misappropriation. PTOB 88. It has not briefed or substantiated damages on the other claims found by default.
- 378 *Caudill Seed & Warehouse Co. v. Jarrow Formulas, Inc.*, 53 F.4th 368, 387 (6th Cir. 2022) (quoting *Acuity Brands Lighting, Inc. v. Bickley*, 2015 WL 12976104, at *2 n.2 (E.D. Ky. June 8, 2015)).
- 379 *Enhabit*, 2024 WL 4929729, at *29 (quoting *Red Sail Easter Ltd. P'rs, L.P. v. Radio City Music Hall Prods., Inc.*, 1992 WL 251380, at *7 (Del. Ch. Sept. 29, 1992)).
- 380 *Univ. Computing Co. v. Lykes-Youngstown Corp.*, 504 F.2d 518, 538 (5th Cir. 1974) (quoting *Enter. Mfg. Co. v. Shakespeare Co.*, 141 F.2d 916, 920 (6th Cir. 1944)).
- 381 *Id.*
- 382 18 U.S.C. § 1836(b)(3)(B); see *MedImpact Healthcare Sys., Inc. v. IQVIA Hldgs. Inc.*, 2022 WL 5460971, at *9 (S.D. Cal. Oct. 7, 2022) ("The [Federal Act] allows for the reasonable royalty as an alternative form of relief."); 6 *Del. C.* § 2003(a). Defendants have been found liable under federal and multiple state statutes. To avoid any choice of law issues that may arise under CSS's numerous state claims, I focus my damages inquiry under the federal claim.
- 383 It is "generally accepted that 'the proper measure of damages in the case of a trade secret appropriation is to be determined by reference to the analogous line of cases involving patent infringement.'" *Univ. Computing*, 504 F.2d at 535 (quoting *Int'l Indus., Inc. v. Warren Petroleum Corp.*, 248 F.2d 696, 699 (3d Cir. 1957)).
- 384 Restatement (Third) of Unfair Competition § 45 cmt. d (Am. L. Inst. 1995).
- 385 *Joseph Bancroft & Sons Co. v. Enter. Mach. & Dev. Corp.*, 1990 WL 63825, at *8 (Del. Super. Ct. May 2, 1990).
- 386 *Biodynamic Techs., Inc. v. Chattanooga Corp.*, 658 F. Supp. 266, 270 (S.D. Fla. 1987); accord *Univ. Computing*, 504 F.2d at 538–39 ("[I]n some cases the damages will be subject to exact measurement, either because the parties had previously agreed on a licensing price ... or because some industry standard provides a clear measure."); William C. Rooklidge et al., *Compensatory Damages Issues in Patent Infringement Cases*, at 8 (2017) ("Where it can be proven, an established royalty usually will be the best measure of damages.") [hereinafter "Rooklidge"].
- 387 *Biodynamic Techs.*, 658 F. Supp. at 270; *Comput. Assocs. Int'l, Inc. v. Am. Fundware, Inc.*, 831 F. Supp. 1516, 1527 (D. Colo. 1993) ("[C]ontractually established [royalties] will be the best measure of the parties' intent.").
- 388 Established royalties are more common in patent litigation, but trade secret cases have recognized the similar aim of valuing information used by a party that does not own it. See, e.g., *Vitro Corp. of Am. v. Hall Chem. Co.*, 292 F.2d 678 (6th Cir. 1961); *Biodynamic Techs., Inc.*, 658 F. Supp. at 270.
- 389 Rooklidge at 9 ("In that circumstance, the royalty required by the agreement ordinarily will be treated as an established royalty.").
- 390 *Biodynamic Techs.*, 658 F. Supp. at 270; see also *Vitro Corp. of Am. v. Hall Chem. Co.*, 292 F.2d 678, 682–83 (6th Cir. 1961); *Saco-Lowell Shops v. Reynolds*, 141 F.2d 587, 598 (4th Cir. 1944) ("In view of the provisions of the licensing agreement, however, the measure of the recovery is the royalties therein provided; for plaintiffs are entitled to recover merely what would have been theirs if defendant had done what it should have done, i.e. treated the ideas embodied in the [patented product] as belonging to the Reynolds invention and paid royalties on that basis.").
- 391 Rooklidge at 9–10. As seen primarily in patent cases, to determine if third party agreements amount to an established royalty, courts will analyze the contracts using a multifactor test. See *Mobil Oil Corp. v. Amoco Chemicals Corp.*, 915 F. Supp. 1333, 1342 (D. Del. 1994) ("In order for a patentee's negotiated royalties to constitute an 'established' royalty

they must meet five criteria: (1) they must be paid or secured before the infringement began; (2) they must be paid by a sufficient number of persons to indicate the reasonableness of the rate; (3) they must be uniform in amount; (4) they must not have been paid under threat of suit or in settlement of litigation; and (5) they must be for comparable rights or activity under the patent.”). This form of established royalty is not at issue in this case. See Rooklidge at 9–10 (explaining the difference between established rate in agreements between litigation parties and with third parties).

- 392 2 Dan B. Dobbs, *Law of Remedies: Damages–Equity–Restitution* § 6.2(3), at 35 (2d ed. 1996) (commending actual or established royalties as “excellent and objective evidence” of compensatory damages); *Biodynamic Techs.*, 658 F. Supp. at 270; *Computer Assocs.*, 831 F. Supp. at 1527. There is some lack of clarity in misappropriation caselaw on what to call an established royalty. Some cases refer to an established royalty as a “reasonable royalty,” while others treat it separately. Because I have distinguished this method from the reasonable royalty method CSS proposed, I will call my chosen method an established royalty.
- 393 *Vermont Microsystems, Inc. v. Autodesk, Inc.*, 88 F.3d 142, 151 (2d Cir. 1996).
- 394 *Mobil Oil.*, 915 F. Supp. at 1341.
- 395 *Bouchat v. Balt. Ravens Ltd. P’ship*, 2012 WL 6738321, at *4 n.7 (D. Md. Dec. 27, 2012).
- 396 318 F. Supp. 1116 (S.D.N.Y. 1970), *modified sub nom. Georgia-Pac. Corp. v. U.S. Plywood-Champion Papers, Inc.*, 446 F.2d 295 (2d Cir. 1971).
- 397 *Id.* at 1120.
- 398 *Am. Med. Sys., Inc. v. Med. Eng’g Corp.*, 794 F. Supp. 1370, 1394 (E.D. Wis. 1992), *rev’d in part on other grounds*, 6 F.3d 1523 (Fed. Cir. 1993).
- 399 *Fromson v. W. Litho Plate & Supply Co.*, 853 F.2d 1568, 1574 (Fed. Cir. 1988), *overruled on other grounds by Knorr-Bremse Systeme Fuer Nutzfahrzeuge GmbH v. Dana Corp.*, 383 F.3d 1337 (Fed. Cir. 2004); *Panduit Corp. v. Stahl Bros. Fibre Works*, 575 F.2d 1152, 1159 (6th Cir. 1978) (“Determination of a ‘reasonable royalty’ after infringement, like many devices in the law, rests on a legal fiction. Created in an effort to ‘compensate’ when profits are not provable, the ‘reasonable royalty’ device conjures a ‘willing’ licensor and licensee, who like Ghosts of Christmas Past, are dimly seen as ‘negotiating’ a ‘license.’ There is, of course, no actual willingness on either side, and no license to do anything, the infringer being normally enjoined, as is [the defendant], from further manufacture, use, or sale of the patented product.”).
- 400 JX 1108 at 24.
- 401 *Vitro Corp.*, 292 F.2d at 683.
- 402 *Id.* The Individual Defendants agreed the License Agreement offered the best measure of damages. PTAB 112.
- 403 *Phillips Petroleum Co. v. Rexene Corp.*, 1997 WL 781856, at *21 n.8 (D. Del. Sept. 4, 1997) (“Because the Court concludes that Phillips had an established royalty of one cent per pound (escalated) and that this rate constitutes a reasonable royalty, it will not perform a hypothetical negotiation analysis.”).
- 404 CSS’s request for damages in its post-trial briefing was focused on trade secret misappropriation. See *generally* PTOB; JX 1108.
- 405 27 F.4th 995, 1010 (5th Cir. 2022).
- 406 *Id.* (quoting *Sw. Energy Prod. Co. v. Berry-Helfand*, 491 S.W.3d 699, 711 (Tex. 2016)).
- 407 JX 69 § 3.3(c); *id.* at 3.
- 408 JX 69 § 3.3(b).

- 409 The 2023 number excludes December because the Corporate Defendants entered Chapter 7 bankruptcy on November 30, 2023.
- 410 To the extent CSS argues KDC “was required to pay minimum royalties in order to maintain any license (exclusive or non-exclusive) until it had a Licensed Facility under construction,” I disagree. PTOB 65. KDC only owed minimum royalties if it maintained an exclusive license. As CSS explained in its opening brief, “[t]o maintain the exclusive license, Section 3.3(b) requires KDC Ag to pay minimum annual royalties. If KDC Ag failed to pay minimum royalties when due, then CSS had the right to convert the exclusive license to a non-exclusive license, but only for Licensed Facilities then existing or under construction. If no such facilities were in existence or under construction when payments stopped, KDC Ag would no longer have any license at all.” *Id.* at 12.
- 411 *LCT Cap., LLC v. NGL Energy P’rs LP*, 249 A.3d 77, 94 (Del. 2021).
- 412 JX 69 § 3.3(c).
- 413 To the extent Mulhern posited that KDC’s conduct damaged CSS by delaying its ability to enter into another licensing deal with a third party, see JX 1108 at 16, that theory was dropped at trial. See *generally* PTOB (making no argument about damages due to delay in entering other agreements); PTRB (same); see *also* PTAB 107 (noting that CSS abandoned its delay damages at trial).
- 414 JX 69 § 2.1.
- 415 *Id.* § 3.2, 3.3(a).
- 416 *Id.* § 3.2. KDC’s bond offering was in May 2020, and the bond closing “occurred on or before September 22.” PTO ¶¶ 43–44. And construction for Fairless Hills began in or around June that same year, after it is undisputed that the License Agreement had ended.
- 417 JX 69 § 3.2.
- 418 *Id.*
- 419 *Id.*
- 420 JX 759 at 6.
- 421 JX 69 § 3.2.
- 422 JX 759 at 27.
- 423 *Id.* at 27–28.
- 424 Barry Tr. at 1157; Matthew Tr. at 527–28.
- 425 JX 69 § 3.2.
- 426 JX 759 at 91; see *also* Matthew Tr. at 663.
- 427 Heil Tr. at 737; see *also* JX 610 at 2 (noting Fairless Hills will have three lines).
- 428 JX 69 § 3.3(a).
- 429 JX 361 at 2–3.
- 430 JX 1168 § 3.2.
- 431 JX 1486 at 9, 23; JX 1166; JX 1167; Matthew Tr. at 542–43.

- 432 JX 1486 at 23, 10–11.
- 433 See generally JX 889.
- 434 JX 1486 at 8–10; JX 1164.
- 435 JX 1483 at 10.
- 436 JX 361 at 1.
- 437 Mulhern stated in her expert report that she was unaware of any Qualified First Customers existing. JX 982 at 36 n.165; see also JX 1482 at 11–12.
- 438 The amendment also stated that KDC “shall immediately notify CSS at the time KDC enters into a definitive agreement with a Qualified First Customer.” JX 361 at 3. KDC did not notify CSS it considered Allen Harim a Qualified First Customer. This is unsurprising, as KDC entered into the agreement after the License Agreement ended. Using the License Agreement as best evidence of the price of KDC’s use of the CSS Process, CSS was deprived only of a 10% royalty based on KDC’s Qualified First customer. See *Vitro Corp.*, 292 F.2d at 682–83 (using royalty rates agreed upon only in principle to calculate damages).
- 439 *Great Am. Opportunities*, 2010 WL 338219, at *30.
- 440 *Id.*
- 441 JX 983.
- 442 JX 1108 at 20 (“With respect to the misappropriation of trade secrets claims, I understand that a successful plaintiff is entitled to actual damages, unjust enrichment damages, or both, to the extent there is no double-counting. I further understand that an alternative form of compensation for misappropriation of trade secrets claims is a ‘reasonable royalty.’”). The Individual Defendants moved to strike Mulhern’s additional report. D.I. 395. In light of the Corporate Defendants’ changed circumstances between Mulhern’s initial report in 2022 and trial, I denied that motion in February. D.I. 410.
- 443 Mulhern Tr. at 1617.
- 444 *Id.* at 1615–16. The Individual Defendants’ expert also testified that an established royalty is proper here. Nelson Tr. at 2031.
- 445 *Automated Merch. Sys. Inc. v. Crane Co.*, 279 F.R.D. 366, 371–72 (N.D.W. Va. 2011).
- 446 *Trio Process Corp. v. L. Goldstein’s Sons, Inc.*, 533 F.2d 126, 130 (3d Cir. 1976).
- 447 JX 1108 at 28.
- 448 *Id.* at 4, 6, 37; Mulhern Tr. at 1651 (“[Q.] [T]he lump sum that you’re talking about, your opinion is that the parties in the hypothetical -- the parties in the hypothetical negotiation would have agreed to calculate and pay this life of the contract NPV sum in full, up front, as of January 2020; right?’ ‘A. That’s correct.’ ‘Q. And, again, that lump sum is between 40.7 million and could reasonably be 138.1 million in your opinion?’ ‘A. The later projections suggest a number as high as that. That’s correct.’”).
- 449 See *Lucent Techs., Inc. v. Gateway, Inc.*, 580 F.3d 1301, 1335 (Fed. Cir. 2009) (rejecting jury award of lump sum reasonable royalty payment because it was “not supported by substantial evidence, but [wa]s based mainly on speculation or guesswork” and was “against the clear weight of the evidence”).
- 450 See *id.* at 1326 (“Significant differences exist between a running royalty license and a lump-sum license. In a standard running royalty license, the amount of money payable by the licensee to the patentee is tied directly to how often the licensed invention is later used or incorporated into products by the licensee. A running royalty structure shifts many

licensing risks to the licensor because he does not receive a guaranteed payment. Royalties are dependent on the level of sales or usage by the licensee, which the licensee can often control.”).

- 451 JX 69 §§ 3.1, 3.2, 3.3; JX 71a; Mulhern Tr. at 1651–52 (admitting no lump sum in License Agreement); Matthew Tr. at 553–54 (testifying that KDC and CSS never considered or negotiated an upfront lump sum payment when negotiating the License Agreement).
- 452 See JX 754; *Lucent Techs.*, 580 F.3d at 1335 (rejecting lump sum reasonable royalty where “[t]he evidence does not sustain a finding that, at the time of infringement, Microsoft and Lucent would have agreed to a lump-sum royalty payment subsequently amounting to approximately 8% of Microsoft’s revenues for the sale of Outlook (and necessarily a larger percentage of Outlook’s profits)”).
- 453 JX 361; PTO ¶ 23; JX 585 at 3; JX 610 at 3.
- 454 CSS split its damages request between the Individual Defendants and the Corporate Defendants. PTOB 87 (seeking \$29.1 million from the Individual Defendants and \$31.5 million from the Corporate Defendants). It is unclear to me whether CSS takes the position that the Individual Defendants and Corporate Defendants owed wholly separate amounts, or that the Individual Defendants were only liable for a subset of the award. I see no basis for either position in law or in fact. All Defendants caused one harm to CSS.
- 455 *Beard Rsch.*, 8 A.3d at 621.
- 456 *CC Invs. Corp. v. Raytheon Co.*, 2005 WL 81591, at *3 (D. Del. Jan. 7, 2005).
- 457 *Alpha Pro Tech, Inc. v. VWR Int’l LLC*, 984 F. Supp. 2d 425, 458 (E.D. Pa. 2013).
- 458 *Fishkin v. Susquehanna P’rs., G.P.*, 2007 WL 853769, at *3 (E.D. Pa. Mar. 19, 2007).
- 459 18 U.S.C. § 1836(b)(3).
- 460 PTAB 73, 88.
- 461 *Agilent*, 2010 WL 610725, at *31 (quoting *COPI of Del. v. Kelly*, 1996 WL 633302, at *4 (Del. Ch. Oct. 25, 1996)).
- 462 See *FNF Hldgs. LLC v. Ricketts*, 2024 WL 5090283, at *1 (D. Del. Dec. 12, 2024) (granting permanent injunction against default judgment parties in trade secret case).
- 463 PTAB 116 (“[I]n the event the Court finds that trade secrets were misappropriated, the Individual Defendants do not dispute that a formal injunction prohibiting further use would be appropriate.”); see *Nucar*, 2005 WL 820706, at *14 (granting unopposed permanent injunction prohibiting further use of trade secret).
- 464 *Agilent*, 2010 WL 610725, at *32 (entering “a permanent injunction requiring the defendants to ... immediately return any and all [of plaintiff’s] property which the defendants took from [the plaintiff]”).
- 465 PTOB 87–88.
- 466 18 U.S.C. § 1836(b)(3)(D).
- 467 *Id.* § 1836(b)(3)(C).
- 468 *I-Mab Biopharma v. Inhibrx, Inc.*, 2024 WL 4437227, at *2 (D. Del. Oct. 1, 2024) (quoting *PetroChoice Hldgs., Inc. v. Orobono*, 2022 WL 138008, at *6 (E.D. Pa. Jan. 14, 2022)).
- 469 *Agilent*, 2010 WL 610725, at *33 (emphasis in original).
- 470 *Id.* (quoting *Nucar*, 2005 WL 820706, at *14).

471 *Id.* (quoting [Nucar](#), 2005 WL 820706, at *14).

472 2006 WL 3742595, at *3 (Del. Ch. Dec. 12, 2006); see also [Huber](#), 958 F.3d at 184–85 (affirming grant of punitive damages against defendant where he encouraged another defendant to harm plaintiff-employer and steer business away from plaintiff-employer).

473 2005 WL 820706, at *14.

474 2012 WL 4467519, at *6, 8 (D. Utah Sept. 27, 2012), *aff'd*, 744 F.3d 1183 (10th Cir. 2014).

475 PTOB 82–85.

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2023 WL 5274925

Only the Westlaw citation is currently available.

United States Bankruptcy Court, D. Delaware.

IN RE: **DECURTIS HOLDINGS**

LLC, et al.,¹ Debtors.

Case No. 23-10548 (JKS)

|

Signed August 14, 2023

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(Jointly Administered)

Related D.I. 317, 318, and 333

MEMORANDUM ORDER REGARDING CARNIVAL CORPORATION'S STANDING MOTION AND CREDIT BID MOTION

[J. Kate Stickles](#), United States Bankruptcy Judge

*1 Upon consideration of Carnival Corporation's ("Carnival") motions² seeking (i) standing to commence an adversary complaint for recharacterization, equitable subordination, and breach of fiduciary duty against Invictus Global Management, LLC ("Invictus"), Invictus Special Situations Master I, L.P. (collectively, the "[Invictus Parties](#)"), Corbin Capital Partners LP ("[Corbin](#)"), and CEOF Holdings LP (collectively, the "[Corbin Parties](#)") (the "[Standing Motion](#)"); and (ii) denying or limiting Invictus' right to credit bid on behalf of itself and/or any other prepetition senior secured lenders³ (the "[Credit Bid Motion](#)") in connection with the sale of assets contemplated by the DeCurtis Holdings LLC and DeCurtis LLC (together, "[DeCurtis](#)" or the "[Debtors](#)"); and the oppositions and related supporting declarations filed by the Debtors⁴ and Invictus;⁵ and Carnival's reply and related declaration;⁶ and the Court and having heard argument and reviewed the evidence presented on the Standing Motion and the Credit Bid Motion as pail of trial on July 18, 19, and 20, 2023;⁷ and the Court having considered the post-trial findings of fact and conclusions of law filed by Carnival and DeCurtis;⁸ and the post-trial briefs filed by Carnival, Invictus, DeCurtis, and City Nation Bank ("CNB");⁹ and the Court finding that it has jurisdiction to hear and determine the Standing Motion and the Credit Bid Motion under [28 U.S.C. § 1334\(b\)](#); venue is proper in this district pursuant to [28 U.S.C. §§ 1408](#) and [1409](#); and this is a core proceeding under [28 U.S.C. § 157\(b\)\(2\)\(A\) and \(O\)](#); and upon the record and proceedings before this Court; and after due deliberation and sufficient cause appearing therefor,

***2** IT IS HEREBY FOUND AND ORDERED THAT:

A. The Standing Motion

i. Factual Background

*a. The January 21, 2022 Credit Agreement*¹⁰

1. In 2021, the Florida Litigation¹¹ commenced and the Debtors were experiencing financial distress. In September 2021, Invictus was introduced to the Debtors for a potential restructuring transaction.¹² As part of that restructuring, the Debtors made accelerated prepayments of \$7 million of its existing debt to CNB out of new money financing in return for which CNB agreed that Invictus would prime CNB and assume a first lien position on most of the Debtors' assets.¹³

2. This restructuring led to the Debtors and Invictus, through its administrative agent Cantor Fitzgerald Securities ("Cantor"), entering into a credit agreement (the "Credit Agreement"), dated January 21, 2022, pursuant to which Invictus and Corbin advanced \$15 million to the Debtors.¹⁴ Debtor DeCurtis LLC is the borrower under the Credit Agreement¹⁵ and Debtor DeCurtis Holdings LLC ("Holdings") guarantees DeCurtis LLC's obligations under the Credit Agreement.¹⁶

3. Certain actions under the Credit Agreement require the consent of the "Required Lenders."¹⁷ Invictus acquired more than 50% of the Loans (\$10 million of the total \$15 million) and, thus, could act unilaterally in any situation requiring the consent of the Required Lenders.¹⁸

4. The stated purposes for the loan were to fund the Debtors' business operations, payment of the accelerated CNB Loans, and/or payment of Florida Litigation expenses.¹⁹ The loan was used to take care of the Debtors' monetary obligations.²⁰

***3** 5. According to the terms of the Credit Agreement, in the event of a "material adverse determination under the Florida Litigation with respect to the Intellectual Property rights of Holdings and its Subsidiaries, prohibiting, restricting or otherwise adversely affecting the ability of the Borrower to sell or license its products and services to the cruise-line industry that could reasonably be expected to result in a

negative impact on the Borrower's gross revenue," Invictus, as the Required Lender, could direct Cantor to declare a default and declare all of the Debtors' obligations under the Credit Agreement immediately due and payable.²¹

6. Pursuant to the Credit Agreement, the Debtors "had the option to either pay interest in cash or payment in kind,"²² at the applicable interest rate of 12% for payment in cash and 14% for payment in kind ("PIK").²³ The Debtors have always elected to pay interest as payment in kind.²⁴ The Debtors have never made any interest payments in cash under the agreement²⁵ and the agreement did not include a schedule of payments.²⁶

7. Section 2.3 of the Credit Agreement includes a "convertible loan," which has "an equity conversion feature that allowed Invictus to convert its investment into 30 percent equity in the [Debtors'] company."²⁷ Section 2.3 also conferred on Invictus a right to exercise the equity conversion feature at its sole discretion to convert all of its loans into shares of common equity at any time at an initial conversion price at \$1 per share.²⁸

8. Pursuant to Section 4.1(e) of the Credit Agreement, one of the conditions precedent to closing was the receipt by Cantor of an executed Fourth Amended and Restated Limited Liability Company Agreement for Holdings.²⁹

9. Under Section 7.1(m) of the Credit Agreement, an event of default included a "material adverse determination under the [Florida] Litigation."³⁰

10. Section 8.02(b)(iii) of Holdings' Fourth Amended and Restated LLC Agreement (the "Holdings A&R LLCA") authorized Invictus to appoint a representative to Holdings' Board of Managers (the "Board").³¹

b. The Sale Motion

11. On May 3, 2023, Debtors filed a motion to sell substantially all of their assets free and clear of all encumbrances pursuant to [section 363 of the Bankruptcy Code](#) ("Sale Motion").³²

12. The Debtors filed an executed Asset Purchase Agreement between the Debtors and Invictus' affiliate, Invictus Special Situations Master I, L.P. (or its designees or assignees)³³ as the stalking horse bidder (the "Stalking Horse Bid").³⁴ The Stalking Horse Bid provides for a credit bid pursuant to [section 363\(k\) of the Bankruptcy Code](#) in the "aggregate amount equal to one hundred percent (100%) of the Purchaser Secured Claims. ..."³⁵

*4 13. In addition, prior to trial, the Debtors announced certain bid enhancements (collectively, the "Invictus Bid Enhancements") by Invictus, subject to documentation and the closing of the sale to Invictus Special Situations Master I, L.P. as successful bidder, including: providing (i) \$250,000 in cash to facilitate an orderly wind-down of the chapter 11 estates; (ii) 10% percent of the common equity of the purchaser to be distributed pro rata to creditors holding allowed unsecured claims; and (iii) 25% of the net cash proceeds of certain specified estate causes of action to be distributed pro rata to creditors holding unsecured claims.³⁶

ii. Legal Standard

14. In *Cybergenics*, the Third Circuit recognized that the Bankruptcy Court, as a court of equity, has the power to authorize a creditor's committee to sue derivatively to recover property for the benefit of the estate.³⁷ Courts have held that although the *Cybergenics* decision discussed creditor's committees specifically, it applies to granting a single creditor standing.³⁸

15. Derivative standing requires the moving party to demonstrate that: (a) the debtor in possession has unjustifiably refused to pursue the claim or refused to consent to the moving party's pursuit of the claim on behalf of the debtor in possession; (b) the moving party has alleged a colorable claim or cause of action; and (c) the moving party has received leave to sue from the bankruptcy court.³⁹

16. "In deciding whether there is a colorable claim, the court should undertake the same analysis as when a defendant moves to dismiss a complaint for failure to state a claim."⁴⁰ The motion to dismiss standard is well known: "[to] survive a motion to dismiss, a complaint must contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.'" ⁴¹ "Threadbare recitals of the

elements of a cause of action, supported by mere conclusory statements, do not suffice."⁴²

17. The Third Circuit has expressed that granting derivative standing is uncommon and "is the exception rather than the rule."⁴³

*5 18. The burden is on Carnival to demonstrate that it has satisfied the prerequisites for derivative standing to pursue claims on behalf of the estate.⁴⁴

iii. Analysis

19. The Debtors have released all claims against Invictus under the *Final Order (I) Authorizing the Debtors to Obtain Postpetition Financing, (II) Authorizing the Debtors to Use Cash Collateral on a Limited Basis, (III) Granting Liens and Providing Superpriority Administrative Expense Status, (IV) Granting Adequate Protection, (V) Modifying the Automatic Stay, and (VI) Granting Related Relief*,⁴⁵ and oppose the Standing Motion,⁴⁶ thus the first prong is satisfied.

20. With respect to the second prong, whether Carnival has alleged a colorable claim or cause of action for (i) recharacterization, (ii) equitable subordination, or (iii) breach of fiduciary duty, the Court finds as follows:

a. Adversary Complaint

1. Recharacterization

21. Count One of the complaint seeks recharacterization of the Convertible Notes as equity, and corresponding declaratory relief (Count Two), deeming the Invictus Parties' and the Corbin Parties' asserted secured claims are disallowed in their entirety, that the asserted security interests and liens are void, and that such security interests and liens are preserved for the benefit of the Debtors' estates pursuant to [11 U.S.C. §§ 506\(d\)](#) and [551](#).⁴⁷

22. To show a colorable claim for recharacterization, plaintiff must allege facts showing that defendant's claims are not secured debt obligations but instead an "equity interest."⁴⁸ "Recharacterization of debt as equity is a recognized but challenging cause of action."⁴⁹ "The Third Circuit has held that the overarching inquiry with respect

to recharacterizing debt as equity is whether the parties to the transaction in question intended the loan to be a disguised equity contribution.”⁵⁰ While “[n]o mechanistic scorecard suffices,” the parties’ intent “may be inferred from what the parties say in their contracts, from what they do through their actions, and from the economic reality of the surrounding circumstance.”⁵¹ “No one factor is dispositive of either the intent of the parties or whether a loan should be recharacterized as equity. And a court can find recharacterization to be appropriate even if less than all of the factors weigh in favor of a capital contribution.”⁵² Furthermore “in characterizing an instrument as debt or equity, a court must focus its inquiry to a point at the very beginning of the parties’ relationship.”⁵³

*6 23. To distinguish between debt and equity, courts often consider the following eleven factors set forth by the Sixth Circuit in *In re Autostyle Plastics, Inc.*: (1) the names given to the instruments, if any, evidencing the indebtedness; (2) the presence or absence of a fixed maturity date and schedule of payments; (3) the presence or absence of a fixed rate of interest and interest payments; (4) the source of repayments; (5) the adequacy or inadequacy of capitalization; (6) the identity of interest between the creditor and the stockholder; (7) the security, if any, for the advances; (8) the corporation's ability to obtain financing from outside lending institutions; (9) the extent to which the advances were subordinated to the claims of outside creditors; (10) the extent to which the advances were used to acquire capital assets; and (11) the presence or absence of a sinking fund to provide repayments.⁵⁴ The Court considers each factor in turn.

1) Names Given to the Instruments, if any, Evidencing the Indebtedness

24. “The absence of notes or other instruments of indebtedness is a strong indication that the advances were capital contributions and not loans.”⁵⁵ The name of the instrument, “Credit Agreement” evidences a loan.⁵⁶ This factor weighs against recharacterization.

2) Presence or Absence of a Fixed Maturity Date and a Schedule of Payments

25. “The lack of a fixed maturity date or a fixed obligation to repay suggests the advances were not loans but equity contributions.”⁵⁷ The Credit Agreement has a maturity date of January 21, 2026.⁵⁸ Every fiscal year, 50% of Excess Cash Flow is required to be paid to the lenders in satisfaction of the loans.⁵⁹ However, there is not a schedule of payments. On balance, this factor weighs against recharacterization.

3) Presence or Absence of a Fixed Rate of Interest and Interest Payments

26. The absence of a fixed rate of interest and interest payments “is a strong indication the investment was a capital contribution, rather than a loan.”⁶⁰ The Credit Agreement specifies that interest was required to be paid in cash (at a rate of 12%) or PIK (at a rate of 14%),⁶¹ at the option of the Debtors. The “Interest Payment Date” is “the last Business Day of each calendar quarter to occur while any such Loan is outstanding; and (b) the day on which any such Loan becomes due and payable in full or is paid or prepaid in full.”⁶² Debtors elected the PIK interest and have not made any interest payments under the Credit Agreement.⁶³ “Deferral of interest payments does not by itself mean that the parties converted a debt transaction to equity since the defendants still expected to be repaid.”⁶⁴ This factor weighs against recharacterization.

4) Source of Repayment

*7 27. “If the expectation of repayment depends solely on the success of the borrower's business, the transaction has the appearance of a capital contribution.”⁶⁵ Courts look to the “underlying economic reality and the general tie between the loan's repayment and the success of the business;” so that a second source of repayment, such as a security interest, would mitigate against finding that the repayment depended on the success of the business.⁶⁶

28. Debtors have never made any principal payments under the Credit Agreement.⁶⁷ However, the Debtors’ financial projections that were prepared when the loan was executed showed \$22.8 million in remaining cash in the fourth quarter of 2025 and that junior secured and unsecured debt would be paid on a current basis, evidencing a likelihood of repayment

from the Debtors' operations.⁶⁸ This factor weighs against recharacterization.

5) *The Adequacy or Inadequacy of Capitalization*

29. "Thin or inadequate capitalization is strong evidence that the advances are capital contributions rather than loans."⁶⁹ "Capitalization is assessed both at the times of initial capitalization and subsequent transactions."⁷⁰ "Courts should not put too much emphasis on this factor, in any event, because all companies in bankruptcy are in some sense undercapitalized."⁷¹

30. "Cash was an issue from early on" for the Debtors, and the Debtors continued to have liquidity problems throughout 2020 and 2021.⁷² "DeCurtis was experiencing distress" in September 2021 and "facing severe liquidity constraints."⁷³ In September of 2021, CNB sent Debtors a notice of default under the CNB facility and MSLP loan.⁷⁴ Invictus was aware that DeCurtis was in default on loans totaling \$20 million from CNB and that CNB was threatening to foreclose.⁷⁵ Invictus knew that the Debtors were insolvent or nearly insolvent when they reached out to Invictus.⁷⁶ When DeCurtis was introduced to Invictus in September 2021, one of the reasons DeCurtis was planning to file for bankruptcy was to get relief from the financial burdens of the Florida Litigation "by facilitating an expedited litigation and/or funding a litigation trust."⁷⁷ However, the Debtors' projections showed a continued cash burn as a result of the Florida Litigation overhang.⁷⁸ This factor weights in favor of recharacterization.

6) *Identity of Interest Between Creditor and Stockholder*

*8 31. Under this factor, the Court examines the identity of interest between the proposed defendants and the Debtors' shareholders. "If stockholders make advances in proportion to their respective stock ownership, an equity contribution is indicated. On the other hand, a sharply disproportionate ratio between a stockholder's percentage interest in stock and debt is indicative of bona fide debt."⁷⁹ Invictus did not hold equity in the Debtors;⁸⁰ however, Invictus had a unilateral conversion option to acquire up to 30% of the outstanding equity in Holdings.⁸¹

32. While, at first blush, this equity conversion option signals an identity of interest, [section 101\(16\)\(C\) of the Bankruptcy Code](#) states that a "right to convert" is not an "equity security."⁸² Even though Invictus had the right to convert at its sole discretion, because Invictus did not exercise that right, there is no identity of interest between the Debtors and Invictus.⁸³ Additionally, Invictus did not have any voting rights in the Debtors. This factor weighs against recharacterization.

7) *Security, if any, for the Advances*

33. "The absence of a security for an advance is a strong indication that the advances were capital contributions rather than loans." The Credit Agreement is secured by a first lien on substantially all of Debtors' assets and UCC-1 financing statements were filed.⁸⁴ The Credit Agreement is secured by substantially all assets of the Debtors pursuant to the Guarantee and Security Agreement, dated as of January 21, 2022, and the Patent Security Agreement, dated as of January 22, 2022.⁸⁵ This factor weighs against recharacterization.

8) *Ability to Obtain Outside Financing from Outside Lending Institutions*

34. "When there is no evidence of other outside financing, the fact that no reasonable creditor would have acted in the same manner is strong evidence that the advances were capital contributions rather than loans."⁸⁶ Mr. Carino and Ms. Chen Delano testified the Debtors attempted to find financing from other sources but were unable to secure funding from sources other than Invictus.⁸⁷ This factor weights in favor of recharacterization.

9) *Extent to Which Advances Were Subordinated to the Claims of Outside Creditors*

*9 35. "Subordination of advances to claims of all other creditors indicates that the advances were capital contributions, not loans."⁸⁸ Despite Invictus' validly perfected first-lien security interests in the Debtors' assets,⁸⁹ the loan is subordinated under the Intercreditor Agreement as to specific sources of collateral, including the proceeds of

any Florida Litigation settlement or favorable judgment, to CNB.⁹⁰ This factor weighs in favor of recharacterization.

10) Extent to Which Advances Were Used to Acquire Capital Assets

36. “Use of advances to meet the daily operating needs of the corporation, rather than to purchase capital assets, is indicative of bona fide indebtedness.”⁹¹ The Credit Agreement states that “[t]he proceeds of the Loans shall be used by the Borrower (i) to finance the Initial CNB Payment, (ii) for general corporate purposes, including among other things, funding working capital and/or payment of litigation expenses and (iii) for the payment of Transaction Costs.”⁹² Ms. Chen Delano testified that one of the purposes of the credit facility was to fund working capital and/or payment of Florida Litigation expenses.⁹³ This factor weighs against recharacterization.

11) Presence or Absence of a Sinking Fund to Provide Repayments

37. “The failure to establish a sinking fund for repayment is evidence that the advances were capital contributions[.]”⁹⁴ Because the Credit Agreement is secured by substantially all of the Debtors’ assets, the need for, a sinking fund is obviated.⁹⁵ This factor weighs against recharacterization.

12) Other Considerations

38. In addition to the *Auto style* factors, Delaware courts have also considered the presence or absence of voting rights and a party’s participation in management, among others, as additional factors to weigh when analyzing recharacterization.

39. Voting Rights. Invictus did not have voting rights because it did not hold equity in DeCurtis. The Debtors’ equity was held by Shamrock Capital, DeCurtis Investments, LLC, and DeCurtis employees.⁹⁶ Under Section 2.3 of the Credit Agreement, Invictus’ voting rights would only be effective in the event Invictus elected to convert its debt into equity, but Invictus never exercised the equity conversion option.⁹⁷ This factor weighs against recharacterization.

*10 40. Participation in Management. The Credit Agreement provided the right for Invictus to appoint a representative to the DeCurtis Board.⁹⁸ After the Debtors failed to place an independent director on the Board, Ms. Chen Delano agreed to serve on the Board.⁹⁹ Ms. Chen Delano was one member of the Debtors’ six-member Board, her service on the Board post-dates the execution of the Credit Agreement and the operative inquiry is what the parties intended “at the time of transaction.”¹⁰⁰ Ms. Chen Delano testified that she did not exercise day-to-day control over the Debtors’ business.¹⁰¹ Similarly, Mr. Carino testified the Board authorized Ms. Chen Delano “to negotiate and enter into a settlement agreement with Carnival.”¹⁰² The Board was controlled by a supermajority of directors unaffiliated with Invictus.¹⁰³ Mr. Carino explained that the Board, with the input of counsel, in the exercise of its business judgment set forth negotiation guidelines to govern Ms. Chen Delano’s settlement discussions with Carnival, which she only undertook at the Board’s direction.¹⁰⁴ This factor weighs against recharacterization.

41. Intent of the Parties. The Debtors only ever viewed their transaction with Invictus as a commercial loan and debt.¹⁰⁵ Likewise, Invictus also viewed the \$15 million lent to DeCurtis as a loan.¹⁰⁶ This factor weighs against recharacterization.

42. Financial Statements and Accounting Records. With respect to “how the parties accounted for the advance on their financial statements and accounting records,”¹⁰⁷ contrary to arguments regarding mislabeling, certain documents referred to equity:

- After the Credit Agreement was executed, Invictus prepared a report titled “DeCurtis Corp. Investment Memo, January 24th, 2022” (the “Investment Memo”) for Corbin to explain Invictus’ evaluation of the DeCurtis “investment opportunity” so that Corbin’s investment committee could review and formally approve Corbin’s co-investment.¹⁰⁸ The Investment Memo refers to, among other things, the “Investment Idea,” “Investment Thesis,” “Competing investment Merits,” “DeCurtis Investments,” and “Invested Capital.”

- In a January 18, 2022 email from Invictus to the Debtors, titled “DeCurtis board approved budget,” Invictus attached a cash projection pro forma and the attachment reflects: “[T]here’s an entry for equity and it shows \$6 million in January of 2022” from Invictus.¹⁰⁹ The document also reflects that Invictus “[a]ssumes fifteen-million-dollar investment made [to] stabilize DeCurtis’] base and funding” and “a portion of that would fund liquidity to the company.”¹¹⁰
- A January 21, 2022 email from Invictus to the Debtors, attached a document with the Debtors’ cash projection.¹¹¹ In that attachment, under the heading “Sources of Cash,” there’s an entry for equity. And, again, in January 2022, there’s a \$6 million “equity” amount under the Credit Agreement.¹¹²

*11 • Other documents exchanged between the Debtors and Invictus also reflect that the Debtors recorded the loan as “equity,” not as “debt.”¹¹³

This factor weighs in favor of recharacterization.

13) Conclusion

43. After considering the arguments made and evidence presented at trial, and weighing the factors above and considering the intent of the parties, the Court finds that four factors weigh in favor of recharacterization: (i) inadequacy of the Debtors’ capitalization (factor 5), (ii) ability to obtain outside financing (factor 8), (iii) subordination to CNB (factor 9), and (iv) the Debtors’ financial statements and accounting records (other considerations—financial statements and accounting records).¹¹⁴ The Court, however, affords these four factors limited weight because, as to factors 5 and 8, the Credit Agreement was entered into in a distressed lending context; as to factor 9, Invictus was senior to all creditors except CNB; and, with respect to financial records labeled as equity, there are also documents labeled as debt.¹¹⁵ There is ample evidence, as shown by the remaining factors, to show that the parties intended the Credit Agreement to be debt and not equity. As a result, Carnival has not alleged a plausible claim for recharacterization.

44. The Standing Motion is denied as to recharacterization.

2. Equitable Subordination

45. Count three seeks equitable subordination of Invictus’ claims pursuant to 11 U.S.C. § 510(c).¹¹⁶

46. Section 510(c)(1) of the Bankruptcy Code provides that a court may “under principles of equitable subordination, subordinate for purposes of distribution all or part of an allowed claim to all or part of another allowed claim or all or part of an allowed interest to all or part of another allowed interest.”¹¹⁷ Courts in this district have held that equitable subordination is a “‘drastic’ and ‘unusual’ remedy.”¹¹⁸ The Third Circuit Court of Appeals has stated: “Before ordering equitable subordination, most courts require a showing involving three elements: (1) the claimant must have engaged in some type of inequitable conduct, (2) the misconduct must have resulted in injury to the creditors or conferred an unfair advantage on the claimant, and (3) equitable subordination of the claim must not be inconsistent with the provisions of the bankruptcy code.”¹¹⁹

*12 47. “Courts differentiate between insiders and outsiders when analyzing whether a claimant’s conduct was inequitable. An insider’s conduct is rigorously scrutinized, and the plaintiff bears the burden of presenting material evidence of unfair conduct that the insider claimant then must rebut by proving the fairness of his transactions with the debtor.”¹²⁰

48. For the purposes of a claim for equitable subordination, a party is an insider if it “(i) meets the statutory definition of insider,¹²¹ or (ii) is in a close relationship with the debtor to such an extent as to suggest transactions were not conducted at arm’s length.”¹²²

49. In determining inequitable conduct, courts in this district recognize three general categories of behavior: “1) fraud, illegality, or breach of fiduciary duties; 2) undercapitalization; and 3) claimant’s use of the debtors as a mere instrumentality or alter ego.”¹²³

50. First, Carnival alleges that Invictus is an insider of the Debtors as a result of the appointment of Invictus’ co-founder, Ms. Chen Delano, as one member of DeCurtis’ six-member Board and her alleged “control” of the Florida Litigation strategy and access “to review, analyze, and effect DeCurtis’ strategies, operations, and inner workings, including insider

financial information, litigation strategy and assessments.”¹²⁴ Carnival asserts Invictus, through Ms. Chen Delano, engaged in inequitable conduct and acted in its own self-interest and against the Debtors, their creditors, and their shareholders.¹²⁵

51. Under the Credit Agreement, Invictus had the right to appoint a representative to the DeCurtis Board.¹²⁶ This allegation is insufficient to support a finding of insider status.¹²⁷ The evidence indicates that Invictus did not have day-to-day control over the Debtors.¹²⁸ Mr. Carino testified that as one of the six members of the Board, the Board authorized Ms. Chen Delano “to negotiate and enter into a settlement agreement with Carnival.”¹²⁹ He said that at all times, the Board was controlled by a supermajority of directors unaffiliated with Invictus. The Board, with input from counsel and in the exercise of its business judgment, set forth negotiation guidelines to govern Ms. Chen Delano's settlement discussions, which she only undertook at the Board's direction.¹³⁰

*13 52. The evidence further indicates that Invictus did not exercise any operational control over the Debtors. Rather, Ms. Chen Delano testified “I was not involved in anything day to day related to the company or its operations,”¹³¹ When appropriate, and based on the Board's reasonable business judgment, Ms. Chen Delano was authorized to seek a value-maximizing consensual resolution to the Florida Litigation.¹³² Additionally, Invictus never held any equity or voting interests in DeCurtis.¹³³ These facts weigh against Invictus being an insider of DeCurtis.

53. Second, Carnival has not presented sufficient evidence to show injury to creditors as a result of Invictus' conduct. The evidence shows that Invictus' funding and support benefited DeCurtis and its creditors. Invictus provided benefits to DeCurtis through, among other things, (i) the \$15 million senior secured credit facility; (ii) the \$2.78 million emergency bridge loan; (iii) a debtor-in-possession financing facility; and (iv) a stalking horse bid by an Invictus affiliate (by, among other things, agreeing to extend the sale process, reducing the amount of its minimum overbid, and agreeing to enhance its bid to provide an opportunity for recoveries to unsecured creditors on top of the assumption of contracts and associated liabilities).¹³⁴

54. Carnival has not met its burden of showing a colorable equitable subordination claim because there are no plausible

allegations that Invictus is an insider or plausible allegations of inequitable conduct by Invictus.

55. The Standing Motion is denied as to equitable subordination.

3. Breach of Fiduciary Duty

56. Count Four of the Complaint requests judgment entered against Invictus for breach of fiduciary duty.¹³⁵

57. To show breach of fiduciary duty, a party must allege that “the defendant (i) owed a duty, (ii) breached that duty, and (iii) the breach of that duty resulted in injury to the plaintiff.”¹³⁶ Carnival alleges Invictus owed a duty of loyalty to the Debtors by virtue of its principal, Ms. Chen Delano, serving on the Debtors' Board of Directors and receiving privileged information regarding the Debtors' financial, strategic, and legal situations.

58. Carnival's breach of fiduciary duty claim is not colorable because, as set forth above, Invictus was not an insider and Invictus did not exercise control over DeCurtis; as a result, no fiduciary relationship between Invictus and the Debtors exists.

59. The Standing Motion is denied as to breach of fiduciary duty.

iv. Conclusion Regarding Standing Motion

60. The Court need not reach the third prong of derivative standing (moving party has received leave to sue from the court), since Carnival has not asserted plausible allegations to support its claims for recharacterization, equitable subordination, or breach of fiduciary duty. Therefore, the Standing Motion is denied.

B. Credit Bid Motion

i. Legal Standard

*14 61. Section 363 (k) of the Bankruptcy Code provides:

At a sale under subsection (b) of this section of property that is subject to a lien that secures *an allowed claim*, unless the court for cause orders otherwise the *holder of such claim may bid* at such sale, and, if the holder of such claim

purchases such property, such holder may offset such claim against the purchase price of such property.

11 U.S.C. § 363(k) (emphasis added). Only an allowed claim under section 502 is entitled to credit bid at a section 363 sale.

62. “Section 363(k) provides the holder of an allowed secured claim with two rights: (1) it ‘may bid at such sale’... and (2) if it is the purchaser at such sale, it ‘may offset [its] claim against the purchase price’....”¹³⁷ A court may deny or limit the right of a secured party to credit bid for “cause” under section 363(k). “[T]he right to credit bid is not absolute,” and the Bankruptcy Code “plainly contemplates situations in which estate assets encumbered by liens are sold without affording secured lenders the right to credit bid.”¹³⁸

63. “The term ‘cause’ is not defined in the Bankruptcy Code and is left to the courts to determine on a case-by-case basis.”¹³⁹ “Cause” has been found in “situations in which a secured creditor has engaged in inequitable conduct,”¹⁴⁰ or where “a sufficient dispute exists regarding the validity of the lien forming the basis for the credit bid.”¹⁴¹ A court may deny credit bidding “in the interest of any policy advanced by the Code, such as to ensure the success of the reorganization or to foster a competitive bidding environment.”¹⁴²

64. Here, as discussed above, Carnival's recharacterization claim, equitable subordination claim, and breach of fiduciary duty claim are not supported by the allegations in the proposed adversary complaint and the evidence presented at trial. As a result, the allegations in the Standing Motion do not support Carnival's request to deny or limit Invictus' right to credit bid.

ii. Cause to Limit Credit Bid

*15 65. Carnival argues that “cause” exists to limit Invictus' right to credit bid in order to facilitate a competitive bidding environment. Carnival argues that the lack of prepetition marketing, excessive financing fees, Invictus' failure to commit to supporting a plan, and lack of recovery to general unsecured creditors are cause to deny a credit bid.

66. With respect to the marketing process and competitive bidding environment, the uncontroverted testimony of Michael Atkinson establishes that Debtors have been marketing their assets since May 5, 2023.¹⁴³ He opined that “the Debtors’ marketing process for the sale of substantially all of their assets was designed to maximize the value of the Debtors’ assets and was reasonable in both time and manner.” He also opined “that Invictus’ ability to credit bid is not unjustifiably chilling bidding and that the reluctance of potential buyers to submit bids is based upon the Debtors’ historical operations, and the various risks attendant to their go-forward business.”¹⁴⁴

67. Carnival asserts that Invictus should not be able to credit bid Corbin's \$5 million in prepetition secured debt which will ride through the bankruptcy and become an obligation of the purchaser if Invictus is successful at the auction.¹⁴⁵ Here, Invictus is not the “holder” of the Corbin's secured claim¹⁴⁶ and as agreed in the Final DP Order, Invictus is not entitled to credit bid Corbin's secured claim.¹⁴⁷

iii. Conclusion on Credit Bid Motion

*16 68. As set forth above, the Court finds that Invictus may assert the full amount of its claims as a credit bid but cannot include Corbin's \$5 million secured claim as part of that credit bid.

C. Conclusion

69. The Standing Motion is DENIED.

70. The Credit Bid Motion is GRANTED, in part, and DENIED, in part.

71. The Court shall retain jurisdiction over any matter or dispute arising from or relating to the implementation of this Order.

All Citations

Not Reported in B.R. Rptr., 2023 WL 5274925

Footnotes

- 1 The Debtors in these chapter 11 cases, along with the last four digits of each Debtor's federal tax identification number include: DeCurtis Holdings LLC (2384) and DeCurtis LLC (9241). The location of the Debtors' service address in these chapter 11 cases is 3208 East Colonial Drive, Suite C190, Orlando, FL 32803.

- 2 D.I. 318 (sealed); D.I. 333 (redacted).
- 3 D.I. 317 (sealed); D.I. 334 (redacted).
- 4 D.I. 337; 338 (Atkinson Declaration sealed); D.I. 373 (Atkinson Declaration redacted); D.I. 339 (Carino Declaration sealed); D.I. 372 (Carino Declaration redacted).
- 5 D.I. 340, 341 (Chen Delano Declaration).
- 6 D.I. 359 (sealed); D.I. 360 (Trentin Declaration sealed).
- 7 See Trial Transcripts D.I. 401 (7/17/2023, pre-trial conference), 402 (7/18/2023), 403 (7/19/2023), and 404 (7/20/2023). In addition to the written and video record submitted, the Court heard the testimony of the following witnesses:
- **DeCurtis**
 - Derek Fournier, DeCurtis' President and Chief Executive Officer
 - James Learish, DeCurtis' Chief Operating Officer
 - Michael Atkinson, Principal of Province, LLC, Debtors' Financial Advisor
 - Joseph Carino, DeCurtis' Chief Financial Officer
 - Apurva Saxena (rebuttal witness), International Director of DeCurtis, LLC
 - **Carnival**
 - John Padgett, Chief Executive Officer of Princess Cruise Lines, a division of Carnival
 - Erik de la Iglesia, Carnival's Expert Witness
 - **Invictus**
 - Cindy Chen Delano, Partner and Co-Founder of Invictus Global Management
- 8 D.I. 421 (Carnival sealed); D.I. 451 (Carnival redacted); D.I. 425 (DeCurtis sealed); D.I. 436 (DeCurtis redacted); D.I. 444 (DeCurtis unsealed).
- 9 D.I. 421 (Carnival sealed); D.I. 423 (Invictus); 424 (DeCurtis sealed); D.I. 435 (DeCurtis unsealed); D.I. 446 (Carnival redacted); D.I. 447 (CNB). Capitalized terms not defined herein shall have the meaning ascribed to them in the Standing Motion, the Credit Bid Motion, and the Credit Agreement.
- 10 The parties submitted substantial briefing and presented evidence with respect to the Standing Motion. The Court does not address all of the facts herein but rather provides this summary of the Credit Agreement and cites to evidence solely for purposes of ruling on the Standing Motion, not the merits of the draft complaint attached to the Standing Motion. Additional factual background regarding the parties and the Florida Litigation is included in the Court's Opinion: [*Carnival Corp. v. DeCurtis Holdings LLC \(In re: DeCurtis Holdings LLC\)*, No. 23-10548 \(JKS\), 2023 WL 5153645, at *1 \(Bankr. D. Del. Aug. 9, 2023\)](#).
- 11 *DeCurtis LLC v. Carnival Corporation*, Case No. I-20-cv-22945 (hereafter the "[Florida Litigation](#)").
- 12 DeCurtis Ex. 38 (Carino Decl.) at ¶9.
- 13 Carnival Ex. 2015 (Summary of Terms and Conditions for Out-of-Court Restructuring); DeCurtis Ex. 38 (Carino Decl.); 7/20/2023 Tr. 94:24-95:25 (Chen Delano).

- 14 See Invictus Ex. 5; 7/20/2023 Tr. 44:15A5:3 (Carino); Invictus Ex. 4 (Chen Delano Decl) at ¶ 12. Although not defined in the Credit Agreement, Invictus and Corbin are the lenders who advanced \$15 million.
- 15 Invictus Ex. 5.
- 16 Carnival Ex. 2126.
- 17 Invictus Ex. 5. “Required Lenders” is defined as the “Lenders with outstanding Loans having an unpaid principal balance of more than 50% of the sum of the unpaid principal balance of all Loans outstanding; provided that the Loans of any Defaulting Lender shall be disregarded in determining Required Lenders at any time.” *Id.* at § 1.1 (Required Lenders).
- 18 Carnival Ex. 2207 (7/14/2023 Chen Delano Depo. Tr. 204:16-19).
- 19 Carnival Ex. 2015 (Summary of Terms and Conditions for Out-of-Court Restructuring); 7/20/2023 Tr. 98:7-10 (Chen Delano); Carnival Ex. 2207 (7/14/2023 Chen Delano Depo. Tr. 225:13-227:20); Invictus Ex. 5, § 3.14(b).
- 20 7/20/2023 Tr. 45:1-46:6 (Carino).
- 21 Invictus Ex. 5, § 7.1(m); 7/20/2023 Tr. 99:2-7 (Chen Delano).
- 22 Invictus Ex. 5, §§ 1.1 (Cash Applicable Rate and PIK Applicable Rate), 2.10(c); 7/20/2023 Tr. 47:9-14 (Carino).
- 23 Invictus Ex. 5, §§ 1.1 (PIK Applicable Rate), 2.10(c); 7/20/2023 Tr. 47:19-21 (Carino).
- 24 7/20/2023 Tr. 47:25-48:2, 48:12-14 (Carino).
- 25 7/20/2023 Tr. 48:3-5 (Carino).
- 26 7/20/2023 Tr. 48:15-20 (Carino).
- 27 7/20/2023 Tr. 86:20-87:7, 99:13- 22 (Chen Delano).
- 28 Carnival Ex. 2007; 7/20/2023 Tr. 46:20-23 (Carino); 7/20/2023 Tr. 98:14-20 (Chen Delano). The funding Invictus provided to the Debtors “is the only convertible loan in [Invictus] current portfolio” and the only investment Invictus has provided among its 30 or more “discrete investment opportunities” that involve an equity conversion feature. 7/20/2023 Tr. 78:8-19, 87:3-4, 87:13-14 (Chen Delano).
- 29 Carnival Ex. 2126; Carnival. Ex. 2207 (7/14/2023 Chen Delano Depo. Tr. 279:19-280:2).
- 30 Invictus Ex. 5, § 7.1(m); 7/20/2023 Tr. 99:23-100:7 (Chen Delano).
- 31 Carnival Ex. 2126; Invictus Ex. 4 (Chen Delano Decl.) at ¶ 14; 7/20/2023 Tr. 103:1-5 (Chen Delano); Carnival Ex. 2207 (7/14/2023 Chen Delano Depo. Tr. 257:8-17).
- 32 D.I. 73.
- 33 D.I. 88.
- 34 D.I. 73, ¶¶ 7 and 88.
- 35 D.I. 88 at § 4.1.
- 36 7/17/2023 Tr. 4:13-21; 7/20/2023 Tr. 38:20-30:3 (Atkinson). To date, no definitive documentation has been filed reflecting the Invictus Bid Enhancements.
- 37 *Official Comm. of Unsecured Creditors of Cybergenics Corp. ex rel. Cybergenics Corp. v. Chinery*,. 330 F.3d 548 (3d Cir. 2003).

- 38 *Infinity Investors Ltd. v. Kingsborough (In re Yes! Entm't Corp.)*, 316 B.R. 141, 145 (D. Del. 2004); *Hyundai Translead, Inc. v. Jackson Truck & Trailer Repair, Inc. (In re Trailer Source, Inc.)*, 555 F.3d 231, 243 (6th Cir. 2009).
- 39 *In re Cybergenic Corp.*, 330 F.3d 548.
- 40 *In re Centaur, LLC*, No. 10-10799 (KJC), 2010 WL 4624910, at *4 (Bankr. D. Del. Nov. 5, 2010) (citations omitted).
- 41 *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (quoting *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007)).
- 42 *In re Optim Energy LLC*, No. 14-10262 (BLS), 2014 WL 1924908, at *6 (Bankr. D. Del. May 13, 2014), *aff'd*, 527 B.R. 169 (D. Del. 2015) (quoting *Iqbal*, 556 U.S. at 678, 129 S. Ct. 1937).
- 43 *Merritt v. Cheshire Land Preservation Trust (In re Merritt)*, 711 F. App'x 83, 86 (3d Cir. 2017); *Airocare, Inc. v. Chambers (In re Airocare, Inc.)*, No. 10-14519-RGM, 2011 WL2133526, at *1 (Bankr. E.D. Va. May 24, 2011) ("The Bankruptcy Code does not expressly permit such parties to initiate adversary proceedings. Derivative standing is thus an implicit exception to the 'general rule' whereby the Bankruptcy Code assigns to the trustee or debtor-in-possession 'the privilege of prosecuting' various actions on behalf of the estate.") (internal citations omitted).
- 44 *G-I Holdings, Inc. v. Those Parties Listed On Exhibit A (In re G-I Holdings, Inc)*, 313 B.R. 612, 628 (Bankr. D. N.J. 2004).
- 45 D.I. 285 (the "Final DIP Order") at ¶ H.
- 46 D.I. 337.
- 47 D.I. 318 at Ex. B (Compl.) at ¶¶ 105-134.
- 48 *Elswick Co., LLC v. Comm2013 CCREI2 Crossing Mall Rd. LLC (In re Tara Retail Grp., LLC)*, 595 B.R. 215, 222 (N.D. W.Va. Bankr. Ct. 2018).
- 49 *In re Optim Energy, LLC*, No. 14-10262 (BLS), 2014 WL 1924908 at *7 (footnote omitted).
- 50 *Official Comm. of Unsecured Creditors of Fedders N. Am., Inc. v. Goldman Sachs Credit Partners L.P. (In re Fedders North Am., Inc.)*, 405 B.R. 527, 554 (Bankr. D. Del. 2009) (citing *Cohen v. KB Mezzanine Fund II, LP (In re SubMicron)*, 432 F.3d 448, 455-56 (3d Cir. 2006)).
- 51 *SubMicron*, 432 F.3d at 456; *In re Optim Energy, LLC*, No. 14-10262 (BLS), 2014 WL 1924908, at *7,
- 52 *Weisfelner v. Blavatnik (In re Lyondell Chem. Co.)*, 544 B.R. 75, 94 (Bankr. S.D.N.Y. 2016) (footnotes and citations omitted).
- 53 *United States v. State St. Bank & Tr. Co.*, 520 B.R. 29, 74 (Bankr. D. Del. 2014) (citations omitted).
- 54 *Bayer Corp. v. MascoTech, Inc. (In re AutoStyle Plastics, Inc.)*, 269 F.3d 726, 750 (6th Cir. 2001); see also *Off. Comm. of Unsecured Creditors v. Comvest Group Holdings, LLC (In re HH Liquidation, LLC)*, 590 B.R. 211 (Bankr. D. Del. 2018).
- 55 *In re AutoStyle Plastics, Inc.*, 269 F.3d at 750 (citing *Roth Steel Tube Co. v. Comm'r*, 800 F.2d 625, 631 (6th Cir. 1986)) (further citation omitted).
- 56 *Invictus Ex. 5* at p. 1.
- 57 *Miller v. ANConnect, LLC (In re Our Alchemy, LLC)*, No. 16-11596 (KG), 2019 WL 4447535, at *7 (Bankr. D. Del. Sept. 16, 2019) (citations omitted).
- 58 *Invictus Ex. 5*, § 1.1 (Maturity Date).
- 59 *Invictus Ex. 5*, § 2.7(e).

- 60 [Friedman's Liquidating Tr. v. Goldman Sachs Credit Partners, L.P. \(In re Friedman's Inc.\)](#), 452 B.R. 512, 521 (Bankr. D. Del. 2011) (footnote and citations omitted).
- 61 Invictus Ex. 5, § 2.10; 7/20/2023 Tr. at 47:7-24 (Carino).
- 62 Invictus Ex. 5, § 1.1 ("Interest Payment Date").
- 63 7/20/2023 Tr. 47:25-48:14 (Carino).
- 64 [AutoStyle](#), 269 F.3d at 751; [Off. Unsecured Creditors Comm. of Broadstripe, LLC v. Highland Cap. Mgmt. L.P. \(In re Broadstripe, LLC\)](#), 444 B.R., 51, 96 (Bankr. D. Del. 2010) ("presence of PIK interest is not decisive" of the recharacterization analysis "especially in a distressed investment context."). See also [State Street Bank](#), 520 B.R. at 79 ("The Junior PIK Notes reflect all indicia of indebtedness, including the issuance of notes with payment at a fixed interest rate (although payment of interest was deferred)....").
- 65 [In re Friedman's Inc.](#), 452 B.R. at 521 (citations and footnote omitted).
- 66 [Autobacs Strauss, Inc. v. Autobacs Seven Co. \(In re Autobacs Strauss, Inc.\)](#), 473 B.R. 525, 575 (Bankr. D. Del. 2012).
- 67 7/20/2023 Tr. 48:23-25 (Carino).
- 68 DeCurtis Exs. 43 (Q421 Board Meeting dec), 44 (DeCurtis financial projections); 7/20/2023 Tr. 68:10-15 (Carino).
- 69 [In re Autobacs Strauss, Inc.](#), 473 B.R. at 576 (citations, footnotes and internal quotations marks omitted).
- 70 *Id.* (citations, footnotes and internal quotations marks omitted).
- 71 [Off. Comm. of Unsecured Creditors v. Bay Harbour Master Ltd. \(In re BH S & B Holdings LLC\)](#), 420 B.R. 112, 159 (Bankr. S.D.N.Y. 2009), *aff'd as modified*, 807 F.Supp.2d 199 (S.D.N.Y. 2011) (citing [In re Lifschultz Fast Freight](#), 132 F.3d 339, 345 (7th Cir. 1997)); see also [In re Phase I Molecular Toxicology, Inc.](#), 287 B.R. 571, 578 (Bankr. D.N.M. 2002) (finding that "[w]hether the Debtor was undercapitalized at the time of the transaction, though relevant, is not determinative.").
- 72 7/20/2023 Tr. 41:6-13 (Carino).
- 73 7/20/2023 Tr. 88:22-89:2 (Chen Delano).
- 74 7/20/2023 Tr. 41:14-17 (Carino).
- 75 Carnival Ex2207 (7/14/2023 Chen Delano Depo.Tr. 164:1-165:25, 175:24-177:2).
- 76 7/20/2023 Tr. 80:8-11 (Chen Delano).
- 77 7/20/2023 Tr. 90:9-20 (Chen Delano); Carnival Ex. 2207 (7/14/2023 Chen Delano Depo. Tr. 146-23-151:14).
- 78 7/20/2023 Tr. 88:22-89:8 (Chen Delano) (Ms. Chen Delano "understood ... that the overhang of the Carnival litigation at the time had impact on its ability to win new businesses," *Id.* at 89:14-16. See also 7/20/2023 Tr. 64:7-11 (Carino) (a negative result in the Florida Litigation could trigger a default under the Credit Agreement).
- 79 [In re Autobacs Strauss, Inc.](#), 473 B.R. at 577-78 (referring to [In re AutoStyle Plastics, Inc.](#), 269 F.3d at 751) (citations, footnote, and quotation marks omitted).
- 80 DeCurtis Ex. 38 (Carino Decl.).
- 81 D.I. 318, Ex. B (Compl.) at ¶ 4; 7/20/2023 Tr. 64:7-11, 65:9-13, 70:13-71:9; 132:1-9 (Carino).

- 82 11 U.S.C. § 101(16). See *In re Am. W. Airlines, Inc.*, 179 B.R. 893, 897 (Bankr. D. Ariz. 1995) (citing Rep. No. 989, 95th Cong.2d Sess. (1978), 1978 U.S. Code Cong. & Admin. News 5787; Collier on Bankruptcy 101.16 (15th ed. 1993) (“The legislative history reveals that only a right to convert is not included in the definition of ‘equity security.’ ”).
- 83 *Beaufort Capital Partners, LLC v. Oxysure Sys.*, Case No. 16-CV-5176, 2017 WL 913791, *3 (S.D.N.Y. 2017) (“The conversion feature allowed [the fender] to redeem the Notes for equity at a discounted price after the maturity date. ... though the initial transaction took the form of a loan, upon conversion to equity, the loans likely have the character of an equity investment.”).
- 84 DeCurtis Exs. 41 (Guarantee and Security Agreement), 42 (UCC-1).
- 85 DeCurtis Ex. 41 (Guarantee and Security Agreement) at § 1.01 (defining “Collateral”); DeCurtis Ex. 41 (Patent Security Agreement) at § 2.
- 86 *In re Autobacs Strauss, Inc.*, 473 B.R. at 579 (citations and quotations marks omitted).
- 87 7/20/2023 Tr. 43:13-44:22 (Carino), 80:12-15 (Chen Delano).
- 88 *In re Friedman's Inc.*, 452 B.R. at 523 (quotation marks omitted, quoting *In re AutoStyle Plastics, Inc.*, 269 F.3d at 752).
- 89 But see *In re BH S & B Holdings LLC*, 420 B.R. at 160 (“The Finco Loan was junior to the Abelco Loan, but was senior to the claims of other creditors. This weighs in favor of a finding of indebtedness.”).
- 90 Carnival Ex. 2126 (Intercompany Agreement).
- 91 *In re Friedman's Inc.*, 452 B.R. at 523 (quotation marks omitted; quoting *In re AutoStyle Plastics, Inc.*, 269 F.3d at 752).
- 92 Invictus Ex. 5, § 3.14.
- 93 7/20/2023 Tr. 88:5-90:20 (Chen Delano). Ms. Chen Delano testified that in developing a proposal for an out-of-court restructuring of the Debtors, Invictus negotiated with CNB to pay down \$7 million of CNB's existing debt, in return for which CNB agreed that Invictus' would prime CNB and assume a first lien position on most of the Debtors' assets. 7/20/2023 Tr. 92:15-24 (Chen Delano).
- 94 *In re Our Alchemy, LLC*, No. 16-11596 (KG), 2019 WL 4447535 at *9 (quoting *In re AutoStyle Plastics, Inc.*, 269 F.3d at 753 (“The bankruptcy court noted the absence of a sinking fund and concluded that this factor weighed toward equity.”) (further citations omitted)).
- 95 Courts have recognized that, where a loan is “secured with liens,” the “need for any sinking fund” is “obviated” and this factor will not weigh in favor of recharacterization. *In re AutoStyle Plastics, Inc.*, 269 F.3d at 753.
- 96 DeCurtis Ex. 1 (Voluntary Petition for Non-Individuals Filing for Bankruptcy; List of Equity Security Holders); DeCurtis Ex. 38 (Carino Decl.) at ¶ 21.
- 97 Invictus Ex. 5, § 2.3.
- 98 7/20/2023 Tr. 61:1-17 (Carino).
- 99 DeCurtis Ex. 38 (Carino Decl.) at ¶¶ 19-21.
- 100 *In re SubMicron Sys. Corp.*, 432 F.3d at 457.
- 101 DeCurtis Ex. 38 (Carino Decl.) at ¶ 22; 7/20/2023 Tr. at 86:12-14 (Chen Delano) (“Invictus took aboard seat. We had a board designee as part of the senior secured loan. Having a board designee is not unusual.”); 7/20/2023 Tr. at 110:7-11; 07/18/2023 Tr. 37:15-38:9. (Chen Delano) (“I was not involved in anything day to day related to the company or its operations, yes.”).

- 102 7/20/2023 Tr. 61:18-62:4 (Carino); The Debtors' "board authorized Cindy to act on its behalf to try to settle" the Florida Litigation. 7/20/2023 Tr. 63:23 (Carino).
- 103 DeCurtis Ex. 38 (Carino Decl.) at ¶¶ 19-24.
- 104 DeCurtis Ex. 38 (Carino Decl.) at ¶¶ 19-24.
- 105 "At all relevant times, the proposed transaction with Invictus was intended to be, and was, a commercial loan and debt transaction that paid off an existing security facility. At no time did the Debtors view the Invictus transaction as an equity infusion," DeCurtis Ex. 38 at ¶ 13; see also 7/20/2023 Tr. 46:15-18 (Carino).
- 106 See Invictus Ex. 4 (Chen Delano Decl.) at ¶ 11 ("It was always Invictus' intent for its funding to be in the form of a loan, and it is my understanding that DeCurtis shared that intention.").
- 107 *In re HH Liquidation, LLC*, 590 B.R. at 296.
- 108 Carnival Ex. 2069 (Invictus DeCurtis Corp. Investment Memo, dated Jan. 24, 2022); Carnival Ex. 2207 (7/14/2023 Chen Delano Depo. Tr. 286:4-287:14); 7/20/2023 Tr. 111:12-22 (Chen Delano).
- 109 7/20/2023 Tr. 51:20-52:22 (Carino); Carnival Ex. 1999 (FY 22 Cash Projections, dated Jan. 14, 2022).
- 110 7/20/2023 Tr. 52:10-19 (Carino); Carnival Ex. 1999 (FY 22 Cash Projections, dated Jan. 14, 2022).
- 111 7/20/23 Tr. 54:4-7 (Carino); DeCurtis Ex. 38 (Carino Decl.) at Ex. 6 (sealed).
- 112 7/20/23 Tr. 54:8-15 (Carino).
- 113 7/20/2023 Tr. 59:10-19 (Carino); DeCurtis Ex. 38 (Carino Decl.) at Ex. 6 (sealed).
- 114 *In re Our Alchemy, LLC*, No. 16-11596 (KG), 2019 WL 4447535 at *10 (finding only four factors weighed in favor of recharacterization and thus finding that the plaintiff has failed to plead a claim to recharacterize).
- 115 See Carnival Ex. 2015 (reference to "Loan Documents," "loans under the Invictus Facility"), Invictus Ex. 5 ("Lenders," "Acquired Debt," "Loan," "Loan Documents," "Loan Parties").
- 116 D.I. 319, Ex. B (Compl.) at ¶¶ 135-145.
- 117 11 U.S.C. 510(c)(1).
- 118 *Off. Comm. of Unsecured Creditors v. Tennenbaum Cap. Partners, LLC (In re Radnor Holdings Corp.)*, 353 B.R. 820, 840 (Bankr. D. Del. 2006) (quoting *In re SubMicron*, 291 B.R. at 327-29).
- 119 *Citicorp Venture Capital, Ltd. v. Comm. of Creditors Holding Unsecured Claims*, 160 F.3d 982, 986-87 (3d Cir. 1998) (citing *US. v. Noland*, 517 U.S. 535, 116 S. Ct. 1524, 134 L.Ed. 2d 748 (1996)).
- 120 *In re Broadsiripe, LLC*, 444 B.R. at 79.
- 121 The statutory definition of an insider under the Bankruptcy Code includes an "affiliate, or insider of an affiliate as if such affiliate were the debtor." 11 U.S.C. § 101(31)(E). An affiliate includes a "corporation 20 percent or more of whose outstanding voting securities are directly or indirectly owned, controlled, or held with power to vote, by the debtor." 11 U.S.C. § 101(2)(B).
- 122 *In re Autobacs Strauss, Inc.*, 473 B.R. at 582-83.
- 123 *Bank of N. Y. v. Epic Resorts-Palm Springs Marquis Villas, LLC (In re Epic Capital Corp.)*, 290 B.R. 514, 524 (Bankr. D. Del. 2003); see also *Burtch v. Owlstone, Inc. (In re Advance Nanotech, Inc.)*, Adv. Pro. No. 13-51215 (MFW), 2014 WL 1320145, at *8 (Bankr. D. Del. 2014).

- 124 D.I. 318, Ex. B (Compl.) at ¶ 139.
- 125 D.I. 318, Ex. B (Compl.) at ¶ 41.
- 126 7/20/2023 Tr. 61:1-17 (Carino). According to Mr. Carino, Invictus initially proposed an independent director to serve as its Board designee, but DeCurtis was unsuccessful securing an independent director because it did not have funds available to pay the costs associated with hiring an independent director, Ms. Chen Delano agreed to serve at the Board's request and at no cost to the company, effective April 21, 2022. This is consistent with Ms. Chen Delano uncontroverted testimony that the company was unable to provide compensation for a third party designee so she volunteered as the Invictus designee. 7/20/2023 Tr. 104:19-105:4 (Chen Delano).
- 127 See *In re Radnor Holdings Corp.*, 353 B.R. at 841 (Bankr. D. Del. 2006) (lender's appointment of one of four members of debtors' prepetition board of directors did not make the lender an 'insider' for equitable subordination purposes because the plaintiff "failed to prove [the lender] exercised 'day-to-day control' over Radnor's business affairs and dictated Radnor's business.") (citing *Shubert v. Lucent Techs. Inc. (In re Winstar Communs., Inc.)*, 348 B.R. 234, 279 (Bankr. D. Del. 2005) ("there must be day-to-day control, rather than some monitoring or exertion of influence regarding financial transactions in which the creditor has a direct stake,")).
- 128 See, e.g., DeCurtis Ex. 38 (Carino Decl.) at ¶ 24; 07/18/2023 Tr. 38:6-8.
- 129 7/20/2023 Tr. 61:18-62:4 (Carino). The "board authorized Cindy to act on its behalf to try to settle" the Florida Litigation. 7/20/2023 Tr. 63:23-24 (Carino).
- 130 DeCurtis Ex. 38 (Carino Decl.) at ¶¶ 19-24.
- 131 7/20/23 Tr. 110:10-11 (Chen Delano).
- 132 See 7/20/2023 Tr. 110:16-25 (Chen Delano); see also DeCurtis Ex. 38 (Carino Decl.) at ¶ 22 ("[A]t no point did Ms. Chen Delano exercise control over the Debtors' litigation strategy, and all such decisions about litigation strategy remained with the board.>").
- 133 DeCurtis Ex. 38 (Carino Decl.) at ¶ 21.
- 134 DeCurtis Ex. 38 (Carino Decl.) at ¶¶ 9-11; id. ¶ 27; DeCurtis Ex. 36 (Atkinson Decl.) at ¶¶ 11, 14; see also 7/17/2023 Tr. 4:6-5:2; 7/20/2023 Tr. 19:14-20:8 (Atkinson).
- 135 D.I. 318, Ex. B (Compl.) at ¶¶ 146-153.
- 136 *Miller v. Nelson (In re Art Inst. Of Phila, LLC)*, No. 18-11535, 2022 WL 18401591, at *7 (Bankr. D. Del. Jan. 12, 2022).
- 137 *In re RML Development, Inc.*, 528 B.R. 150, 154 (Bankr. W.D. Term. 2014) (quoting 11 U.S.C. § 363(k); footnote omitted).
- 138 *In re Philadelphia Newspapers, LLC*, 599 F.3d 298, 315 (3d Cir. 2010) (citing 11 U.S.C. § 363(k)), as amended (May 7, 2010).
- 139 *In re Olde Prairie Block Owner, LLC*, 464 B.R. 337, 348 (Bankr. N.D. Ill. 2011) (citing *In re NJ Affordable Homes Corp.*, 05-60442 (DHS), 2006 WL 2128642, at *16 (Bankr. D.N.J. 2006) (limiting credit bid rights "for cause" is a flexible concept to be considered on a case-by-case basis)).
- 140 *In re Phila. Newspapers*, 599 F.3d at 316 n. 14.
- 141 *In re L.L. Murphrey Co.*, No. 12-03837, 2013 WL 2451368, at *1 n.1 (Bankr. E.D.N.C. June 6, 2013) (citations omitted); see also *In re Olde Prairie*, 464 B.R. at 348 (stating that "[c]ourts have found 'cause' under § 363(k) to bar a secured creditor from credit bidding when the creditor's lien is in question or otherwise in dispute.").

- 142 [In re Phila. Newspapers](#), 599 F.3d at 315-16 n. 14; [In re Fisker Automotive Holdings, Inc.](#), 510 B.R. 55, 60 (Bankr. D. Del. 2014).
- 143 DeCurtis Ex. 36 (Atkinson Decl.) at ¶¶ 13.
- 144 DeCurtis Ex. 36 (Atkinson Decl.) at ¶¶ 14, 16; (“On or about June 16, 2023, I re-contacted approximately 50 prospective buyers and informed them ... Invictus [had] agreed to reduce the minimum overbid to approximately \$28.5 million (which consists of roughly \$27.5 million of secured DIP claims and a \$1 million overbid) and that the auction had been postponed to July 13. Despite the approximately 50% reduction in the initial overbid amount on account of removing a \$4.5 million backstop, \$7.5 million exit fee and \$3 million stalking horse protection, and the further extended auction date, to date no party besides Invictus has expressed an interest in submitting a bid for the Debtors’ assets.”).
- 145 See Final DIP Order at ¶ 59 (“[T]he Prepetition Loans held by Corbin ... , which comprise a portion of the Prepetition Roll-Up, shall not be credit bid by the DIP Agent and shall instead be assumed liabilities of the Purchaser ...”).
- 146 11 U.S.C. § 363(k) (The “holder of such claim may bid at such sale ... such holder may offset such claim against the purchase price of such property” (emphasis added)). [In re Philadelphia Newspapers, LLC](#), 599 F.3d at 304 (“It is the cardinal canon of statutory interpretation that a court must begin with the statutory language. ‘[C]ourts must presume that a legislature says in a statute what it means and means in a statute what it says there. When the words of a statute are unambiguous, then this first canon is also the last: judicial inquiry is complete.’ ” (citations omitted)).
- 147 [In re The Free Lance-Star Publ'g Co. of Fredericksburg, VA](#), 512 B.R. 79S, 804-05 (Bankr. E.D. Va. 2014) (“Credit bidding ‘allows the secured creditor to bid for its collateral using the debt it is owed to offset the purchase price [.]’ which ‘ensures that, if the bidding at the sale is less than the amount of the claim the collateral secures, the secured creditor can, if it chooses, bid up the price to as high as the amount of its claim.’”) (quoting [Quality Props. Asset Mgmt. Co. v. Trump Va. Acquisitions, LLC](#), No. 3:11-CV-00053, 2012 WL 3542527, at *7 n. 13 (W.D. Va. Aug. 16, 2012); [RadLAX Gateway Hotel, LLC v. Amalgamated Bank](#), 566 U.S. 639, 645 n.2 (2012) (“The ability to credit-bid helps to protect a creditor against the risk that its collateral will be sold at a depressed price []” by enabling the secured “creditor to purchase the collateral for what it considers the fair market price (up to the amount of its security interest) without committing additional cash to protect the loan.”); [In re Couture Hotel Corp.](#), No. 14-34874-BJH-11, 2016 WL 91949, at *28 (Bankr. N.D. Tex. Jan. 5, 2016) (holding that “nothing herein allows Mansa to credit bid at such sale unless or until the Ability lien has been paid in full.”)).

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64 F.4th 84

United States Court of Appeals, Third Circuit.

IN RE: LTL MANAGEMENT, LLC, Debtor

LTL Management, LLC

v.

Those Parties Listed on Appendix A to
Complaint and John and Jane Does 1-1000

*Official Committee of Talc
Claimants, Appellant in case Nos.
22-2003, 22-2004 and 22-2005

*Official Committee of Talc
Claimants; Patricia Cook;
Evan Plotkin; Randy Derouen; Kristie
Doyle, as estate representative of
Dan Doyle; Katherine Tollefson;
Tonya Whetsel, as estate
representative of Brandon Wetsel;
Giovanni Sosa; Jan Deborah Michelson-Boyle,
Appellants in case Nos.
22-2006, 22-2007 and 22-2008
Arnold & Itkin LLP, on behalf of certain
personal injury claimants represented by
Arnold & Itkin, Appellant in case No. 22-2009
Aylstock Witkin Kreis & Overholtz
PLLC, on behalf of more than three
thousand holders of talc claims, Appellant
in case Nos. 22-2010 and 22-2011
*(Amended per Court's
Order dated 06/10/2022)

Nos. 22-2003, 22-2004, 22-2005, 22-2006,
22-0007, 22-2008, 22-2009, 22-2010, 22-2011

|
Argued September 19, 2022

|
(Opinion filed: January 30, 2023)

|
Entered March 31, 2023

Synopsis

Background: Official committee of talc claimants and law firm on behalf of certain talc personal injury claimants filed motions to dismiss Chapter 11 case of debtor, an indirect subsidiary of manufacturer of talc-based astringent powder which, through corporate restructuring, had assumed responsibility for manufacturer's talc-related liabilities, as not having been filed in good faith. Debtor filed motion seeking extension of order that had been entered by North Carolina bankruptcy court prior to case's transfer to New Jersey, which enjoined third-party claims against certain nondebtor "protected parties." The United States Bankruptcy Court for the District of New Jersey, [Michael B. Kaplan](#), Chief Judge, denied motions to dismiss, [637 B.R. 396](#), and granted injunction motion, [638 B.R. 291](#). Talc claimants appealed. Direct appeals to the Third Circuit were authorized, and the appeals consolidated.

Holdings: The Court of Appeals, [Ambro](#), Circuit Judge, held that:

in evaluating debtor's good faith, the Court of Appeals would consider only the financial condition of debtor, not its pre-bankruptcy predecessor which, due to corporate restructuring, no longer existed;

despite its massive talc-related liabilities, debtor was not in financial distress on the petition date and, thus, it could not show its petition served a valid bankruptcy purpose and was filed in good faith; and

"unusual circumstances" did not preclude dismissal.

Reversed and remanded with instructions.

Opinion, [58 F.4th 738](#), amended and superseded.

Procedural Posture(s): On Appeal; Motion to Convert or Dismiss Case; Motion for Preliminary Injunction.

***90** Appeal from the United States Bankruptcy Court for the District of New Jersey (District Court No.: 21-bk-30589; 21-ap-03032), Bankruptcy Judge: Honorable [Michael B. Kaplan](#)

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Before [AMBRO](#), [RESTREPO](#), and [FUENTES](#), Circuit Judges

OPINION OF THE COURT

[AMBRO](#), Circuit Judge

*92 Johnson & Johnson Consumer Inc. (“Old Consumer”), a wholly owned subsidiary of Johnson & Johnson (“J&J”), sold healthcare products with iconic [names](#) branded on consumers’ consciousness—Band-Aid, [Tylenol](#), Aveeno, and Listerine,

to list but a few. It also produced Johnson's Baby Powder, equally recognizable for well over a century as a skincare product. Its base was talc, a mineral mined and milled into a fine powder. Concerns that the talc contained traces of asbestos spawned in recent years a torrent of lawsuits against Old Consumer and J&J alleging Johnson's Baby Powder has caused ovarian [cancer](#) and [mesothelioma](#). Some of those suits succeeded [*93](#) in verdicts, some failed (outright or on appeal), and others settled. But more followed into the tens of thousands.

With mounting payouts and litigation costs, Old Consumer, through a series of intercompany transactions primarily under Texas state law, split into two new entities: LTL Management LLC ("LTL"), holding principally Old Consumer's liabilities relating to talc litigation and a funding support agreement from LTL's corporate parents; and Johnson & Johnson Consumer Inc. ("New Consumer"), holding virtually all the productive business assets previously held by Old Consumer. J&J's stated goal was to isolate the talc liabilities in a new subsidiary so that entity could file for Chapter 11 without subjecting Old Consumer's entire operating enterprise to bankruptcy proceedings.

Two days later, LTL filed a petition for Chapter 11 relief in the Bankruptcy Court for the Western District of North Carolina. That Court, however, transferred the case to the Bankruptcy Court for the District of New Jersey.

Talc claimants there moved to dismiss LTL's bankruptcy case as not filed in good faith. The Bankruptcy Court, in two thorough opinions, denied those motions and extended the automatic stay of actions against LTL to hundreds of nondebtors that included J&J and New Consumer. Appeals followed and are consolidated before us.

We start, and stay, with good faith. Good intentions—such as to protect the J&J brand or comprehensively resolve litigation—do not suffice alone. What counts to access the Bankruptcy Code's safe harbor is to meet its intended purposes. Only a putative debtor in financial distress can do so. LTL was not. Thus we dismiss its petition.

I. BACKGROUND

A. J&J, Baby Powder, and Old Consumer

The story of LTL begins with its parent company, J&J. It is a global company and household brand well-known to the public for its wide range of products relating to health and well-being. Many are consumer staples, filling pharmacies, supermarkets, and medicine cabinets throughout the country and beyond.

One of these products was Johnson's Baby Powder, first sold by J&J in 1894. It became particularly popular, being used by or on hundreds of millions of people at all stages of life.

J&J has not always sold baby powder directly, though. In 1979, it transferred all assets associated with its Baby Products division, including Johnson's Baby Powder, to Johnson & Johnson Baby Products Company ("J&J Baby Products"), a wholly owned subsidiary (the "1979 Spin-Off"). A series of further intercompany transactions in ensuing decades ultimately transferred Johnson's Baby Powder to Old Consumer.

So since 1979 only Old Consumer and its predecessors, and not J&J, have directly sold Johnson's Baby Powder. LTL maintains that the 1979 Spin-Off included an agreement between J&J and J&J Baby Products that makes Old Consumer, as successor to the latter, responsible for indemnifying J&J for all past, present, and future liabilities stemming from Johnson's Baby Powder. Thus, according to LTL, Old Consumer was liable for all claims relating to Johnson's Baby Powder, either directly or indirectly through its responsibility to indemnify J&J.

B. Baby Powder Litigation

Talc triggered little litigation against J&J entities before 2010. There had been [*94](#) but a small number of isolated claims alleging the products caused harms such as [talcosis](#) (a lung disease caused by inhalation of talc dust or talc), [mesothelioma](#) (a [cancer](#) of organ membranes, typically in the lungs, associated with exposure to asbestos), and rashes. But trials in 2013 and 2016 resulted in jury verdicts for plaintiffs alleging Old Consumer's talc-based products caused ovarian [cancer](#). Despite the first resulting in no monetary award, and the second being reversed on appeal, these trials ushered in a wave of lawsuits alleging Johnson's Baby Powder caused ovarian [cancer](#) and [mesothelioma](#).¹ Governmental actions, including the U.S. Food and Drug Administration's finding of asbestos traces in a sample of Johnson's Baby Powder in 2019 and Health Canada's confirmation in 2021 of its 2018 finding

of a significant association between exposure to talc and ovarian [cancer](#), also heightened J&J's and Old Consumer's potential exposure.

With the door wide open, over 38,000 ovarian [cancer](#) actions (most consolidated in federal multidistrict litigation in New Jersey) and over 400 [mesothelioma](#) actions were pending against Old Consumer and J&J when LTL filed its Chapter 11 petition. Expectations were for the lawsuits to continue, with thousands more in decades to come. The magnitude of the award in one case also raised the stakes. There, a Missouri jury awarded \$4.69 billion to 22 ovarian [cancer](#) plaintiffs, reduced on appeal to \$2.24 billion to 20 plaintiffs who were not dismissed. *Ingham v. Johnson & Johnson*, 608 S.W.3d 663 (Mo. Ct. App. 2020), cert. denied, — U.S. —, 141 S. Ct. 2716, 210 L.Ed.2d 879 (2021).

Yet other trials reaching verdicts for plaintiffs were not so damaging to J&J entities. Since 2018, damages in all other monetary awards to plaintiffs that were not reversed averaged about \$39.7 million per claim. Moreover, Old Consumer and J&J often succeeded at trial. According to LTL's expert, of 15 completed ovarian [cancer](#) trials, only *Ingham* resulted in a monetary award for the plaintiffs that was not reversed; and of 28 completed [mesothelioma](#) trials, fewer than half resulted in monetary awards for the plaintiffs that were not reversed (and many of those were on appeal at the time of LTL's bankruptcy filing). In addition, Old Consumer and J&J often avoided trial before bankruptcy, settling roughly 6,800 talc-related claims for just under \$1 billion in total and successfully obtaining dismissals without payment of about 1,300 ovarian [cancer](#), and over 250 [mesothelioma](#), actions.

Undoubtedly, the talc litigation put financial pressure on Old Consumer. Before LTL's petition, it paid approximately \$3.5 billion for talc-related verdicts and settlements. It also paid nearly \$1 billion in defense costs, and the continuing run rate was between \$10 million to \$20 million per month. LTL's expert identified talc-related costs as a primary driver that caused the income before tax of J&J's Consumer Health business segment (for which Old Consumer was the primary operating company in the U.S.) to drop from a \$2.1 billion profit in 2019 to a \$1.1 billion loss in 2020.

Old Consumer also faced billions in contested indemnification obligations to its bankrupt talc supplier, Imerys Talc America, Inc. and affiliates (collectively “Imerys”), ^{*95} as well as parties who had owned certain of Imerys's talc mines. These remained after J&J's settlement

proposal of about \$4 billion to \$5 billion in the Imerys bankruptcy case—which, per LTL, had been tentatively agreed by attorneys for talc plaintiffs—ultimately fell through by June 2021. An LTL representative testified that, if that proposal succeeded, it would have settled (subject to an opt-out) virtually all ovarian [cancer](#) claims in the multidistrict tort litigation and corresponding additional claims against J&J entities in the Imerys case. Old Consumer was also the target of both state and federal talc-related governmental complaints and investigations, as well as securities and shareholder actions, that could result in their own financial penalties and defense costs. LTL's expert opined, and the Bankruptcy Court accepted, that the total talc-related liabilities threatened Old Consumer's ability to make substantial talc-related payments from working capital or other readily marketable assets while funding its costs of operations (including marketing, distribution, research and development).

Still, Old Consumer was a highly valuable enterprise, estimated by LTL to be worth \$61.5 billion (excluding future talc liabilities), with many profitable products and brands. And much of its pre-filing talc costs were attributable to the payment of one verdict, *Ingham*, a liability J&J described in public securities filings as “unique” and “not representative of other claims.” App. 2692-93. Further, while it allocated all talc-related payments to Old Consumer per the 1979 Spin-Off, J&J functionally made talc payments from its accounts and received an intercompany payable from Old Consumer in return. Addressing the scope of its litigation exposure in an October 2021 management representation letter to its auditors, J&J valued its and its subsidiaries' probable and reasonably estimable contingent loss for products liability litigation, including for talc, under Generally Accepted Accounting Principles (“GAAP”), at \$2.4 billion for the next 24 months.² It also continued to stand by the safety of its talc products and deny liability relating to their use.

Consistent with their fiduciary duties, and likely spurred by the U.S. Supreme Court's denial of certiorari in *Ingham*, members of J&J's management explored ways to mitigate Old Consumer's exposure to talc litigation. In a July 2021 email with a ratings agency, J&J's treasurer described a potential restructuring that would capture all asbestos liability in a subsidiary to be put into bankruptcy.

C. Corporate Restructuring and Divisional Merger

On October 12, 2021, Old Consumer moved forward with this plan, undergoing a corporate restructuring relying principally on a merger under Texas law. Counterintuitively, this type of merger involves “the division of a [Texas] entity into two or more new ... entities.” *Tex. Bus. Orgs. Code Ann. § 1.002(55)(A)*; *see generally id.* §§ 10.001 *et seq.* When the original entity does not survive the merger, it allocates its property, liabilities, and obligations among the new entities according to a plan of merger and, on implementation, its separate existence ends. *Id.* §§ 10.003, 10.008(a)(1). Except as otherwise provided by law or contract, no entity created in the merger is “liable for the debt or other obligation” allocated to any other new entity. *Id.* § 10.008(a)(4). In simplified terms, *96 the merger splits a legal entity into two, divides its assets and liabilities between the two new entities, and terminates the original entity. While some pejoratively refer to it as the first step in a “Texas Two-Step” when followed by a bankruptcy filing, we more benignly call it a “divisional merger.”

In our case, Old Consumer’s restructuring was designed as a series of reorganizational steps with the divisional merger at center.³ Ultimately, the restructuring created two new entities, LTL and New Consumer, and on its completion Old Consumer ceased to exist. It also featured the creation of a Funding Agreement, which had Old Consumer stand in momentarily as the payee, but ultimately (after some corporate maneuvers⁴) gave LTL rights to funding from New Consumer and J&J.

As the most important step, the merger allocated LTL responsibility for essentially all liabilities of Old Consumer tied to talc-related claims.⁵ This meant, among other things, it would take the place of Old Consumer in current and future talc lawsuits and be responsible for their defense.

Old Consumer also transferred to LTL assets in the merger, including principally the former’s contracts related to talc litigation, indemnity rights, its equity interests in Royalty A&M LLC (“Royalty A&M”), and about \$6 million in cash. Carved out from Old Consumer and its affiliates just before the divisional merger, Royalty A&M owns a portfolio of royalty streams that derive from consumer brands and was valued by LTL at approximately \$367.1 million.

Of the assets Old Consumer passed to LTL, most important were Old Consumer’s rights as a payee under the Funding Agreement with J&J and New Consumer. On its transfer, that gave LTL, outside of bankruptcy, the ability to cause New

Consumer and J&J, jointly and severally, to pay it cash up to the value of New Consumer for purposes of satisfying any talc-related costs as well as normal course expenses. In bankruptcy, the Agreement gave LTL the right to cause New Consumer and J&J, jointly and severally, to pay it cash in the same amount to satisfy its administrative costs and to fund a trust, created in a plan of reorganization, to address talc liability for the benefit of existing and future claimants. In either scenario, there were few conditions to funding *97 and no repayment obligation.⁶ The value of the payment right could not drop below a floor defined as the value of New Consumer measured as of the time of the divisional merger, estimated by LTL at \$61.5 billion, and was subject to increase as the value of New Consumer increased after it.⁷

On the other side of the divisional-merger ledger, New Consumer received all assets and liabilities of Old Consumer not allocated to LTL. It thus held Old Consumer’s productive business assets, including its valuable consumer products, and, critically, none of its talc-related liabilities (except those related to workers’ compensation). After this, the organizational chart was reshuffled to make New Consumer the direct parent company of LTL.

When the ink dried, LTL—having received Old Consumer’s talc liability, rights under the Funding Agreement, a royalties business, and cash—was prepared to fulfill its reason for being: a bankruptcy filing. Meanwhile, New Consumer began operating the business formerly held by Old Consumer and would essentially remain unaffected (save for its funding obligation) by any bankruptcy filing of LTL.

LTL became in bankruptcy talk the “bad company,” and New Consumer became the “good company.” This completed the first steps toward J&J’s goal of “globally resolv[ing] talc-related claims through a chapter 11 reorganization without subjecting the entire Old [Consumer] enterprise to a bankruptcy proceeding.” App. 450 (Decl. of John Kim 6).

D. LTL Bankruptcy Filing and Procedural History

On October 14, 2021, two days after the divisional merger, LTL filed a petition for Chapter 11 relief in the Bankruptcy Court for the Western District of North Carolina. It also sought (1) to extend the automatic stay afforded to it under the Bankruptcy Code to talc claims arising from Johnson’s Baby Powder asserted against over six hundred nondebtors (the “Third-Party Claims”), including affiliates such as J&J

and New Consumer, as well as insurers and third-party retailers (all nondebtors collectively the “Protected Parties”), or alternatively, (2) a preliminary injunction enjoining those claims. LTL’s first-day filings described the bankruptcy as an effort to “equitably and permanently resolve all current and future talc-related claims against it through the consummation of a plan of reorganization that includes the establishment of a [funding] trust.” App. 3799 (LTL’s Compl. for Decl. and Inj. Relief 2); App. 316 (LTL’s Info. Br. 1).

A month later, the North Carolina Bankruptcy Court issued an order enjoining Third-Party Claims against the Protected Parties. But the order expired after 60 days and would not bind a subsequent court. The next day, following motions from interested parties (including representatives for talc claimants) and a Show Cause Order, the Court transferred LTL’s Chapter 11 case to the District of New Jersey under 28 U.S.C. § 1412. It rejected what it viewed as LTL’s effort to “manufacture *98 venue” and held that a preference to be subject to the Fourth Circuit’s two-prong bankruptcy dismissal standard⁸ could not justify its filing in North Carolina. App. 1515 (N.C. Transfer Order 10).

With the case pending in the Bankruptcy Court for the District of New Jersey, the Official Committee of Talc Claimants (the “Talc Claimants’ Committee”) moved to dismiss LTL’s petition under § 1112(b) of the Bankruptcy Code as not filed in good faith. Soon after, Arnold & Itkin LLP, on behalf of talc claimants it represented (“A&I”), also moved for dismissal on the same basis. LTL opposed the motions. Two other law firms—including Aylstock, Witkin, Kreis & Overholtz, PLLC, on behalf of talc claimants (“AWKO”)—joined the motions. For ease of reference, we refer collectively to the Talc Claimants’ Committee, A&I, and AWKO as the “Talc Claimants.”

At the same time, LTL urged the New Jersey Bankruptcy Court to extend the soon-to-expire order enjoining Third-Party Claims against the Protected Parties. The Talc Claimants’ Committee and AWKO opposed this motion.

In February 2022, the Bankruptcy Court held a five-day trial on the motions to dismiss and LTL’s third-party injunction motion. It denied soon thereafter the motions to dismiss and granted the injunction motion. App. 1, 57, 140, 194 (Mot. to Dismiss Op.; Mot. to Dismiss Order; Third-Party Inj. Op.; Third-Party Inj. Order).

In its opinion addressing the motions to dismiss, the Bankruptcy Court applied Third Circuit case law and held that LTL filed its bankruptcy petition in good faith. The Court ruled the filing served a valid bankruptcy purpose because it sought to resolve talc liability by creating a trust for the benefit of claimants under § 524(g) of the Bankruptcy Code. At a high level, that provision allows a debtor satisfying certain conditions to establish, in a plan of reorganization, a trust for the benefit of current and future claimants against which an injunction channels all asbestos litigation.⁹ The Court highlighted what it viewed as several benefits of claims administration through a § 524(g) trust, compared to mass asbestos litigation in trial courts, including the possibility it could resolve claims more efficiently (from both a cost and time perspective), ensure more balanced recoveries among claimants, and preserve funds for future claimants.

The Court also held LTL was in financial distress. It focused on the scope of litigation faced by Old Consumer (and transferred to LTL), the historic costs incurred by Old Consumer in connection with talc litigation, and the effect of these *99 costs on its business. It suggested that extrapolating this talc liability into the future showed the “continued viability of all J&J companies [was] imperiled.” App. 36 (Mot. to Dismiss Op. 36). Yet it appeared to doubt LTL would completely exhaust its payment right under the Funding Agreement. App. 35 (*Id.* at 35).

Finally, the Court determined LTL’s corporate restructuring and bankruptcy were not undertaken to secure an unfair tactical litigation advantage against talc claimants, but constituted “a single integrated transaction” that did not prejudice creditors and eliminated costs that would otherwise be imposed on Old Consumer’s operating business had it been subject to bankruptcy. App. 43 (*Id.* at 43). The Court ultimately saw the bankruptcy forum as having a superior ability, compared to trial courts, to protect the talc claimants’ interests, viewing this as an “unusual circumstance[]” that precluded dismissal under 11 U.S.C. § 1112(b)(2). App. 13 (*Id.* at 13 n.8).

At the same time the Bankruptcy Court grappled substantively with existing Circuit case law, it made much of LTL’s novel design and the reasons for it. Its bankruptcy, the Court believed, presented a “far more significant issue” than equitable limitations on bankruptcy filings: “which judicial system [better served talc claimants]—the state/federal court trial system, or a trust vehicle established under a chapter 11 reorganization plan ... [in Bankruptcy Court].” App. 12-13

(*Id.* at 12-13). Answering this question, it provided a full defense of its “strong conviction that the bankruptcy court is the optimal venue for redressing the harms of both present and future talc claimants in this case.” *App.* 19 (*Id.* at 19).¹⁰

The Talc Claimants timely appealed the Bankruptcy Court's order denying the motions to dismiss. The Talc Claimants' Committee and AWKO also appealed the order enjoining Third-Party Claims against the Protected Parties. On request of the Talc Claimants, the Bankruptcy Court certified the challenged orders to our Court under 28 U.S.C. § 158(d)(2). In May 2022, we authorized direct appeal of the orders under the same statute.

The Bankruptcy Court had jurisdiction of the bankruptcy case under, *inter alia*, 28 U.S.C. §§ 157(a) and 1334(a).¹¹ We have jurisdiction of the appeals under 28 U.S.C. § 158(d)(2)(A).

II. ANALYSIS

A. Standard of Review

We review for an abuse of discretion the Bankruptcy Court's denial of the motions to dismiss the Chapter 11 petition for lack of good faith. *In re 15375 Mem'l Corp. v. BEPCO, L.P.*, 589 F.3d 605, 616 (3d Cir. 2009). That exists when the decision “rests upon a clearly erroneous finding of fact, an errant conclusion of law, or an improper application of law to fact.” *Id.* (citation omitted). We give fresh (*i.e.*, plenary or *de novo*) review to a conclusion of law and review for clear error findings of fact leading to the decision. *Id.*

***100** Facts subject to clear-error review include those that are basic, “the historical and narrative events elicited from the evidence presented at trial ...,” and those that are inferred, which are “drawn from basic facts and are permitted only when, and to the extent that, logic and human experience indicate a probability that certain consequences can and do follow from the basic facts.” *Universal Mins., Inc. v. C.A. Hughes & Co.*, 669 F.2d 98, 102 (3d Cir. 1981). These are distinguished from an “ultimate fact,” which is a “legal concept with a factual component.” *Id.* at 103. Examples include negligence or reasonableness. *Wells Fargo, N.A. v. Bear Stearns & Co. (In re HomeBanc Mortg. Corp.)*, 945 F.3d 801, 810 (3d Cir. 2019). Reviewing an ultimate fact, “we separate [its] distinct factual and legal elements ... and apply the appropriate standard to each component.” *Universal Mins.*, 669 F.2d at 103.

Concluding a bankruptcy petition is filed in good faith is an “ultimate fact.” *BEPCO*, 589 F.3d at 616. While the underlying basic and inferred facts require clear-error review, the culminating determination of whether those facts support a conclusion of good faith gets plenary review as “essentially[] a conclusion of law.” *Id.*; *see also U.S. Bank Nat'l Ass'n ex. rel. CWC Capital Asset Mgmt. LLC v. Vill. at Lakeridge, LLC*, — U.S. —, 138 S. Ct. 960, 966-68, 200 L.Ed.2d 218 (2018). A conclusion of financial distress, like the broader good-faith inquiry of which it is a part, likewise is subject to mixed review. Whether financial distress exists depends on the underlying basic facts, such as the debtor's ability to pay its current debts, and inferred facts, such as projections of how much pending and future liabilities (like litigation) could cost it in the future. But the ultimate determination, like with good faith, is essentially a conclusion of law that gets a fresh look. *See id.*

B. Good Faith

Chapter 11 bankruptcy petitions are “subject to dismissal under 11 U.S.C. § 1112(b) unless filed in good faith.” *BEPCO*, 589 F.3d at 618 (citing *NMSBPCSLDHB, L.P. v. Integrated Telecom Express, Inc. (In re Integrated Telecom Express, Inc.)*, 384 F.3d 108, 118 (3d Cir. 2004)). Section 1112(b) provides for dismissal for “cause.” A lack of good faith constitutes “cause,” though it does not fall into one of the examples of cause specifically listed in the statute. *See In re SGL Carbon Corp.*, 200 F.3d 154, 159-62 (3d Cir. 1999). Because the Code's text neither sets nor bars explicitly a good-faith requirement, we have grounded it in the “equitable nature of bankruptcy” and the “purposes underlying Chapter 11.” *Id.* at 161-62 (“A debtor who attempts to garner shelter under the Bankruptcy Code ... must act in conformity with the Code's underlying principles.”).

Once at issue, the burden to establish good faith is on the debtor. *BEPCO*, 589 F.3d at 618 (citing *Integrated Telecom*, 384 F.3d at 118); *SGL Carbon*, 200 F.3d at 162 n.10. We “examine the totality of facts and circumstances and determine where a petition falls along the spectrum ranging from the clearly acceptable to the patently abusive.” *BEPCO*, 589 F.3d at 618 (internal quotation marks omitted) (citing *Integrated Telecom*, 384 F.3d at 118). Though a debtor's subjective intent may be relevant, good faith falls “more on [an] objective analysis of whether the debtor has sought to

step outside the ‘equitable limitations’ of Chapter 11.” *Id.* at 618 n.8 (citing *SGL Carbon*, 200 F.3d at 165).

“[T]wo inquiries ... are particularly relevant”: “(1) whether the petition *101 serves a valid bankruptcy purpose[;] and (2) whether [it] is filed merely to obtain a tactical litigation advantage.” *Id.* at 618 (internal quotation marks omitted) (citing *Integrated Telecom*, 384 F.3d at 119-20). Valid bankruptcy purposes include “preserv[ing] a going concern” or “maximiz[ing] the value of the debtor’s estate.” *Id.* at 619. Further, a valid bankruptcy purpose “assumes a debtor in financial distress.” *Integrated Telecom*, 384 F.3d at 128.

C. Financial Distress as a Requirement of Good Faith

Our precedents show a debtor who does not suffer from financial distress cannot demonstrate its Chapter 11 petition serves a valid bankruptcy purpose supporting good faith. We first applied this principle in *SGL Carbon*. The debtor there filed for Chapter 11 protection in the face of many antitrust lawsuits—in its words, to “protect itself against excessive demands made by plaintiffs” and “achieve an expeditious resolution of the claims.” 200 F.3d at 157. But we dismissed the petition for lack of good faith, relying on the debtor’s strong financial health. *Id.* at 162-70. We rejected arguments that the suits seriously threatened the company and could force it out of business, suggesting the magnitude of potential liability would not likely render it insolvent. *Id.* at 162-64. And the filing was premature, as one could be later made—without risking the debtor’s ability to reorganize—at a time a company-threatening judgment occurred. *Id.* at 163. Finally, in considering whether the petition served a valid bankruptcy purpose, we discerned none in light of the debtor’s substantial equity cushion and a lack of evidence suggesting it had trouble paying debts or impaired access to capital markets. *Id.* at 166. Were the debtor facing “serious financial and/or managerial difficulties at the time of filing,” the result may have been different. *Id.* at 164.

Integrated Telecom made clear that “good faith necessarily requires some degree of financial distress on the part of a debtor.” 384 F.3d at 121 (emphasis added). That debtor was a non-operating, nearly liquidated shell company that was “highly solvent and cash rich at the time of the bankruptcy.” *Id.* at 124. And its financial condition was key to the petition’s dismissal. We said that Chapter 11 could not improve its failing business model nor resolve pending securities

litigation in a way that increased recoveries for creditors. *Id.* at 120-26. Thus the proceeding could preserve no “value that otherwise would be lost outside of bankruptcy,” showing those problems were not the kinds of financial issues Chapter 11 aimed to address. *Id.* at 120, 129. And absent financial distress, the debtor’s desire to benefit from certain Code provisions (such as those capping claims for future rents) could not justify its presence in bankruptcy. *Id.* at 126-29.

We note that, when considering the whole of the circumstances in these decisions, we evaluated rationales for filing offered by the debtor that were only modestly related to its financial health—even after recognizing it was not in financial distress. Yet we rejected all of them and stuck to the debtor’s financial condition. *Id.*; *SGL Carbon*, 200 F.3d at 167-68.

The theme is clear: absent financial distress, there is no reason for Chapter 11 and no valid bankruptcy purpose. “Courts, therefore, have consistently dismissed ... petitions filed by financially healthy companies with no need to reorganize under the protection of Chapter 11.... [I]f a petitioner has no need to rehabilitate or reorganize, its petition cannot serve the rehabilitative purpose for which Chapter 11 was designed.” *102 *Integrated Telecom*, 384 F.3d at 122 (quoting *SGL Carbon*, 200 F.3d at 166).

But what degree of financial distress justifies a debtor’s filing? To say, for example, that a debtor must be in financial distress is not to say it must necessarily be insolvent. We recognize as much, as the Code conspicuously does not contain any particular insolvency requirement. See *SGL Carbon*, 200 F.3d at 163; *Integrated Telecom*, 384 F.3d at 121. And we need not set out any specific test to apply rigidly when evaluating financial distress. Nor does the Code direct us to apply one.

Instead, the good-faith gateway asks whether the debtor faces the kinds of problems that justify Chapter 11 relief. Though insolvency is not strictly required, and “no list is exhaustive of all the factors which could be relevant when analyzing a particular debtor’s good faith,” *SGL Carbon*, 200 F.3d at 166 n.16, we cannot ignore that a debtor’s balance-sheet insolvency or insufficient cash flows to pay liabilities (or the future likelihood of these issues occurring) are likely always relevant. This is because they pose a problem Chapter 11 is designed to address: “that the system of individual creditor remedies may be bad for the creditors *as a group* when there are not enough assets to go around.” *Integrated Telecom*, 384

[F.3d at 121](#) (second set of italics added) (quoting Thomas H. Jackson, *The Logic and Limits of Bankruptcy Law* 10 (1986)).

Still, we cannot today predict all forms of financial difficulties that may in some cases justify a debtor's presence in Chapter 11. Financial health can be threatened in other ways; for instance, uncertain and unliquidated future liabilities could pose an obstacle to a debtor efficiently obtaining financing and investment. As we acknowledged in [SGL Carbon](#), certain financial problems or litigation may require significant attention, resulting in “serious ... managerial difficulties.” [200 F.3d at 164](#). Mass tort cases may present these issues and others as well, like the exodus of customers and suppliers wary of a firm's credit-risk. *See, e.g.,* Mark J. Roe, *Bankruptcy and Mass Tort*, 84 Colum. L. Rev. 846, 855 (1984) (describing the “adverse” and “severe” effects large-scale, future tort claims may have on a firm). So many spokes can lead to financial distress in the right circumstances that we cannot divine them all. What we can do, case-by-case, is consider all relevant facts in light of the purposes of the Code.

Financial distress must not only be apparent, but it must be immediate enough to justify a filing. “[A]n attenuated possibility standing alone” that a debtor “may have to file for bankruptcy in the future” does not establish good faith. [SGL Carbon](#), 200 F.3d at 164; *see, e.g., Baker v. Latham Sparrowbush Assocs. (In re Cohoes Indus. Terminal, Inc.)*, 931 F.2d 222, 228 (2d Cir. 1991) (“Although a debtor need not be *in extremis* in order to file[,] ... it must, at least, face such financial difficulty that, if it did not file at that time, it could anticipate the need to file in the future.”). Yet we recognize the Code contemplates “the need for early access to bankruptcy relief to allow a debtor to rehabilitate its business before it is faced with a hopeless situation.” [SGL Carbon](#), 200 F.3d at 163. A “financially troubled” debtor facing mass tort liability, for example, may require bankruptcy to “enable a continuation of [its] business and to maintain access to the capital markets” even before it is insolvent. [Id. at 169](#).

Still, encouragement of early filing “does not open the door to premature filing.” [Id. at 163](#). This may be a fine line in some cases, but our bankruptcy system puts courts, vested with equitable powers, in the best position to draw it.

***103** Risks associated with premature filing may be particularly relevant in the context of a mass tort bankruptcy. Inevitably those cases will involve a bankruptcy court estimating claims on a great scale—introducing the possibility of undervaluing future claims (and underfunding

assets left to satisfy them)¹² and the difficulty of fairly compensating claimants with wide-ranging degrees of exposure and injury. On the other hand, a longer history of litigation outside of bankruptcy may provide a court with better guideposts when tackling these issues.¹³

To take a step back, testing the nature and immediacy of a debtor's financial troubles, and examining its good faith more generally, are necessary because bankruptcy significantly disrupts creditors' existing claims against the debtor: “Chapter 11 vests petitioners with considerable powers—the automatic stay, the exclusive right to propose a reorganization plan, the discharge of debts, etc.—that can impose significant hardship on particular creditors. When *financially troubled* petitioners seek a chance to remain in business, the exercise of those powers is justified.” [Integrated Telecom](#), 384 F.3d at 120 (emphasis added) (citing [SGL Carbon](#), 200 F.3d at 165-66). Accordingly, we have said the availability of certain debtor-favored Code provisions “assume[s] the existence of a valid bankruptcy, which, in turn, assumes a debtor in financial distress.” [Id. at 128](#). Put another way, “Congress designed Chapter 11 to give those businesses teetering on the verge of a fatal financial plummet an opportunity to reorganize on solid ground and try again, not to give profitable enterprises an opportunity to evade contractual or other liability.” [Cedar Shore Resort, Inc v. Mueller \(In re Cedar Shore Resort, Inc.\)](#), 235 F.3d 375, 381 (8th Cir. 2000) (internal quotation marks omitted).

Our confidence in the conclusion that financial distress is vital to good faith is reinforced by the central role it plays in other courts' inquiries.¹⁴ Chapter 11's legislative ***104** history also suggests it was meant to “deal[] with the reorganization of a financially distressed enterprise.” [SGL Carbon](#), 200 F.3d at 166 (quoting S. Rep. No. 95-989, at 9, reprinted in 1978 U.S.C.C.A.N. 5787, 5795).

The takeaway here is that when financial distress is present, bankruptcy may be an appropriate forum for a debtor to address mass tort liability. Our [SGL Carbon](#) decision specifically addressed this in distinguishing the financial distress faced by Johns-Manville in its Chapter 11 case. It was prompted by a tide of asbestos litigation that, but for its filing, would have forced the debtor to book a \$1.9 billion liability reserve “trigger[ing] the acceleration of approximately \$450 million of outstanding debt, [and] possibly resulting in a forced liquidation of key business segments.” [In re Johns-Manville Corp.](#), 36 B.R. 727, 730 (Bankr. S.D.N.Y. 1984). That created a “compelling need [for the debtor] to reorganize

in order to meet” its obligations to creditors. *Id.* This urgency stood in stark contrast to the circumstances in *SGL Carbon*, where the debtor faced no suits, or even liquidated judgments, that threatened its ongoing operations.

A.H. Robins Company, before its bankruptcy, faced financial woes like Johns-Manville's, in both cases caused by mass product liabilities litigation. Before filing, Robins had only \$5 million in unrestricted funds and a “financial picture ... so bleak that financial institutions were unwilling to lend it money.” *In re A.H. Robins Co., Inc.*, 89 B.R. 555, 558 (Bankr. E.D.V.A. 1988). The Court concluded Robins “had no choice but to file for relief under Chapter 11.” *Id.*

And in Dow Corning's Chapter 11 case, the Court described the company's resolve to address mass tort liability as “a legitimate effort to rehabilitate a solvent but *financially-distressed* corporation.” *In re Dow Corning Corp.*, 244 B.R. 673, 676-77 (Bankr. E.D. Mich. 1999) (emphasis added). It specifically recognized that “the legal costs and logistics of defending the worldwide product liability lawsuits against the [d]ebtor threatened its vitality by depleting its financial resources and preventing its management from focusing on core business matters.” *Id.* at 677.

These cases show that mass tort liability can push a debtor to the brink. But to measure the debtor's distance to it, courts must always weigh not just the scope of liabilities the debtor faces, but also the capacity it has to meet them. We now go there, but only after detouring to a problem particular to our case: For good-faith purposes, should we judge the financial condition of LTL by looking to Old Consumer—the operating business with valuable assets, but damaging tort liability, that the restructuring and filing here aimed to protect? Or should we look to LTL, the entity that actually filed for bankruptcy? Or finally, like the Bankruptcy Court, should we consider “the financial risks and burdens facing both Old [Consumer] and [LTL]”? *App. 14* (Mot. to Dismiss Op. 14).

***105 D. Only LTL's Financial Condition is Determinative.**

Weighing the totality of facts and circumstances might seem on the surface to require that we evaluate the state of affairs of both Old Consumer and LTL when judging the latter's financial distress. That said, we must not underappreciate the financial reality of LTL while unduly elevating the comparative relevance of its pre-bankruptcy predecessor that

no longer exists. Even were we unable to distinguish the financial burdens facing the two entities, we can distinguish their vastly different sets of available assets to address those burdens. On this we part from the Bankruptcy Court.

Thus for us, the financial state of LTL—a North Carolina limited liability company formed under state law and existing separate from both its predecessor company (Old Consumer) and its newly incorporated counterpart company (New Consumer)—should be tested independent of any other entity. That means we focus on its assets, liabilities, and, critically, the funding backstop it has in place to pay those liabilities.

Doing so reflects the principle that state-law property interests should generally be given the same effect inside and outside bankruptcy: “Property interests are created and defined by state law. Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding.” *Butner v. United States*, 440 U.S. 48, 55, 99 S.Ct. 914, 59 L.Ed.2d 136 (1979). No one doubts that the state-law divisional merger passed tort liabilities to LTL. Why in bankruptcy would we recognize the effectiveness of this state-law transaction, but at the same time ignore others that augment LTL's assets, such as its birth gift of the Funding Agreement? To say the financial condition of Old Consumer prior to the restructuring—which was not bolstered by such a contractual payment right—determines the availability of Chapter 11 to LTL would impose on the latter a lookback focused on the nonavailability of a funding backstop to what is now a nonentity.

Instead, we must evaluate the full set of state-law transactions involving LTL to understand the makeup of its financial rights and obligations that, in turn, dictate its financial condition. Even were we to agree that the full suite of reorganizational steps was a “single integrated transaction,” *App. 43* (Mot. to Dismiss Op. 43), this conclusion does not give us license to look past its effect: the creation of a new entity with a unique set of assets and liabilities, and the elimination of another. Only the former is in bankruptcy and subject to its good-faith requirement. *See* Ralph Brubaker, *Assessing the Legitimacy of the “Texas Two-Step” Mass-Tort Bankruptcy*, 42 No. 8 Bankr. L. Letter NL 1 (Aug. 2022) (observing that the Bankruptcy Code is designed to address the financial distress of the entity *in* bankruptcy).

We cannot say a “federal interest requires a different result.” *See Butner*, 440 U.S. at 55, 99 S.Ct. 914. That is because the

Bankruptcy Code is an amalgam of creditor-debtor tradeoffs balanced by a Congress that assumed courts applying it would respect the separateness of legal entities (and their respective assets and liabilities). “[T]he general expectation of state law and of the Bankruptcy Code ... is that courts respect entity separateness absent compelling circumstances calling equity ... into play.” *In re Owens Corning*, 419 F.3d 195, 211 (3d Cir. 2005). Put differently, as separateness is foundational to corporate law, which in turn is a predicate to bankruptcy law, it is not easily ignored. It is especially hard to ignore *106 when J&J’s pre-bankruptcy restructuring—ring-fencing talc liabilities in LTL and forming the basis for this filing—depended on courts honoring this principle.

The Bankruptcy Code is designed in important part to protect and distribute a debtor’s assets to satisfy its liabilities. It strains logic then to say the condition of a defunct entity should determine the availability of Chapter 11 to the only entity subject to it. To do so would introduce uncertainty regarding how far back and to what entities a court can look when evaluating a debtor’s financial distress.

Thus, while we agree with the Bankruptcy Court that both entities are part of our discussion of financial distress, the financial condition of Old Consumer is relevant only to the extent it informs our view of the financial condition of LTL itself.

E. LTL Was Not in Financial Distress.

With our focus properly set, we now evaluate the financial condition of LTL. It is here we most disagree with the Bankruptcy Court, as it erred by overemphasizing the relevance of Old Consumer’s financial condition. And while we do not second-guess its findings on the scope and costs of talc exposure up to the filing date, we do not accept its projections of future liability derived from those facts.

After these course corrections, we cannot agree LTL was in financial distress when it filed its Chapter 11 petition. The value and quality of its assets, which include a roughly \$61.5 billion payment right against J&J and New Consumer, make this holding untenable.

The Funding Agreement merits special mention. To recap, under it LTL had the right, outside of bankruptcy, to cause J&J and New Consumer, jointly and severally, to pay it cash up to the value of New Consumer as of the petition date (estimated

at \$61.5 billion) to satisfy any talc-related costs and normal course expenses. Plus this value would increase as the value of New Consumer’s business and assets increased. App. 4316-17 (Funding Agreement 4-5, § 1 Definition of “JJCI Value”).¹⁵ The Agreement provided LTL a right to cash that was very valuable, likely to grow, and minimally conditional. And this right was reliable, as J&J and New Consumer were highly creditworthy counterparties (an understatement) with the capacity to satisfy it.

As for New Consumer, it had access to Old Consumer’s cash-flowing brands and products along with the profits they produced, which underpinned the \$61.5 billion enterprise value of New Consumer as of LTL’s filing. And the sales and adjusted income of the consumer health business showed steady growth in the last several years when talc costs were excluded. Most important, though, the payment right gave LTL direct access to J&J’s exceptionally strong balance sheet. At the time of LTL’s filing, J&J had well over \$400 billion in equity value with a AAA credit rating and \$31 billion just in cash and marketable securities. It distributed over \$13 billion to shareholders in each of 2020 and 2021. It is hard to imagine a scenario where J&J and New Consumer would be unable to satisfy their joint obligations under the Funding Agreement. And, of course, J&J’s primary, contractual obligation to fund talc costs was one never owed to Old Consumer (save for the short moment during the *107 restructuring that it was technically a party to the Funding Agreement).

Yet the Bankruptcy Court hardly considered the value of LTL’s payment right to its financial condition. True, it noted its jurisdictional authority could “ensure that [LTL] pursue[d] its available rights” under the Funding Agreement. App. 43 (Mot. to Dismiss Op. 43). But, in discussing LTL’s financial condition, the Court was “at a loss to understand, why—merely because [LTL] contractually has the right to exhaust its funding options [under the Funding Agreement]”—it was “not to be regarded as being in ‘financial distress.’ ” App. 35 (*Id.* at 35). It speculated that a draw on the payment right could force J&J to deplete its available cash or pursue a forced liquidation of New Consumer and have a “horrific impact” on those companies. *Id.* The assumption seems to be that, out of concern for its affiliates, LTL may avoid drawing on the payment right to its full amount. But this is unsupported and disregards the duty of LTL to access its payment assets.

Ultimately, whether this assumption was made or not, the Bankruptcy Court did not consider the full value of LTL’s backstop when judging its financial condition. And at the

same time it acutely focused on how talc litigation affected *Old Consumer*. See, e.g., App. 34 (Mot. to Dismiss Op. 34) (“The evidence confirms that the talc litigation ... forced *Old [Consumer]* into a loss position in 2020”); App. 36 (*Id.* at 36) (“*Old [Consumer]* was not positioned to continue making substantial [t]alc [l]itigation payments”); App. 38 (*Id.* at 38) (“*Old [Consumer]* need not have waited until its viable business operations were threatened past the breaking point”) (emphasis added in each citation). Directing its sight to Old Consumer and away from the Funding Agreement’s benefit to LTL essentially made the financial means of Old Consumer, and not LTL, the lodestar of the Court’s financial-distress analysis. This misdirection was legal error.

We also find a variable missing in the Bankruptcy Court’s projections of future liability for LTL extrapolated from the history of Old Consumer’s talc litigation: the latter’s successes. To reiterate, before bankruptcy Old Consumer had settled about 6,800 talc-related claims for under \$1 billion and obtained dismissals of about 1,300 ovarian cancer and over 250 mesothelioma claims without payment. And a minority of the completed trials resulted in verdicts against it (with some of those verdicts reversed on appeal). Yet the Court invoked calculations that just the legal fees to defend all existing ovarian cancer claims (each through trial) would cost up to \$190 billion. App. 37 (*Id.* at 37). It surmised “one could argue” the exposure from the existing mesothelioma claims alone exceeded \$15 billion. App. 17 (*Id.* at 17). These conjectures ballooned its conclusion that, “[e]ven without a calculator or abacus, one can multiply multi-million dollar or multi-billion dollar verdicts by tens of thousands of existing claims, let alone future claims,” to see that “the continued viability of all J&J companies is imperiled.” App. 36 (*Id.* at 36).

What these projections ignore is the possibility of meaningful settlement, as well as successful defense and dismissal, of claims by assuming most, if not all, would go to and succeed at trial. In doing so, these projections contradict the record. And while the Bankruptcy Court questioned the continuing relevance of the past track record after *Ingham* and the breakdown of the Imerys settlement talks, this assumes too much too early. Nothing in the record suggests *Ingham*—one of 49 pre-bankruptcy trials and described even by J&J as “unique” and “not representative,” App. 2692-93—was the new norm. *108 Nor is there anything that shows all hope of a meaningful global or near-global settlement was lost after the initial Imerys offer was rebuffed. The Imerys bankruptcy remained a platform to negotiate settlement. And

the progression of the multidistrict litigation on a separate track would continue to sharpen all interested parties’ views of mutually beneficial settlement values.

Finally, we cannot help noting that the casualness of the calculations supporting the Court’s projections engenders doubt as to whether they were factual findings at all, but instead back-of-the-envelope forecasts of hypothetical worst-case scenarios. Still, to the extent they were findings of fact, we cannot say these were inferences permissibly drawn and entitled to deference. See *Universal Mins.*, 669 F.2d at 102. Hence, they were clearly erroneous. And as we locate no other inferences or support in the record to bear the Court’s assertion that the “talc liabilities” “far exceed [LTL’s] capacity to satisfy [them],” we cannot accept this conclusion either.¹⁶ App. 23 (Mot. to Dismiss Op. 23).

In this context, it becomes clear that, on its filing, LTL did not have any likely need in the present or the near-term, or even in the long-term, to exhaust its funding rights to pay talc liabilities. In the over five years of litigation to date, the aggregate costs had reached \$4.5 billion (less than 7.5% of the \$61.5 billion value on the petition date), with about half of these costs attributable to one ovarian cancer verdict, *Ingham*, to date an outlier victory for plaintiffs. While the number of talc claims had surged in recent years, still J&J, as of October 2021, valued the probable and reasonably estimable contingent loss for its products liability litigation, including for talc, under GAAP, at \$2.4 billion for the next two years. Further, though settlement offers are only that, we do not disregard LTL’s suggestion that \$4 billion to \$5 billion was at one time considered by plaintiffs’ lawyers to be in the ballpark to resolve virtually all multidistrict ovarian cancer claims as well as corresponding additional claims in the Imerys bankruptcy. And as noted, we view all this against a pre-bankruptcy backdrop where Old Consumer had success settling claims or obtaining dismissal orders, and where, at trial, ovarian cancer plaintiffs never won verdicts that withstood appeal outside of *Ingham* and mesothelioma plaintiffs had odds of prevailing that were less than stellar.

From these facts—presented by J&J and LTL themselves—we can infer only that LTL, at the time of its filing, was highly solvent with access to cash to meet comfortably its liabilities as they came due for the foreseeable future. It looks correct to have implied, in a prior court filing, that there was not “any imminent or even *109 likely need of [it] to invoke the Funding Agreement to its maximum amount or anything close to it.” App. 3747 (LTL’s Obj. to Mots.

for Cert. of Direct Appeal 22) (emphasis added). Indeed, the Funding Agreement itself recited that LTL, after the divisional merger and assumption of that Agreement, held “assets having a value at least equal to its liabilities and had financial capacity sufficient to satisfy its obligations as they become due in the ordinary course of business, *including any [i]alc [r]elated [l]iabilities.*” App. 4313 (Funding Agreement 1, ¶ E) (emphasis added). This all comports with the theme LTL proclaimed in this case from day one: it can pay current and future talc claimants in full. *See* App. 630 (Transcript of N.C. “First Day” Hearing, October 20, 2021) (LTL’s counsel telling the North Carolina bankruptcy court in his opening remarks that “[LTL], New [Consumer], and J&J believe that \$2 billion exceeds any liability [LTL] could reasonably have for talc-related claims” (emphasis added)).

We take J&J and LTL at their word and agree. LTL has a funding backstop, not unlike an ATM disguised as a contract, that it can draw on to pay liabilities without any disruption to its business or threat to its financial viability. It may be that a draw under the Funding Agreement results in payments by New Consumer that in theory might someday threaten its ability to sustain its operational costs. But those risks do not affect LTL, for J&J remains its ultimate safeguard. And we cannot say any potential liquidation by LTL of Royalty A&M—a collection of bare rights to streams of payments cobbled together on the eve of bankruptcy—to pay talc costs would amount to financial distress. Plus LTL had no obligation, outside of bankruptcy, to sell those assets for cash before drawing on the Funding Agreement.

At base level, LTL, whose employees are all J&J employees, is essentially a shell company “formed,” almost exclusively, “to manage and defend thousands of talc-related claims” while insulating at least the assets now in New Consumer. App. 449 (Decl. of John Kim 5). And LTL was well-funded to do this. As of the time of its filing, we cannot say there was any sign on the horizon it would be anything but successful in the enterprise. It is even more difficult to say it faced any “serious financial and/or managerial difficulties” calling for the need to reorganize during its short life outside of bankruptcy. *SGL Carbon*, 200 F.3d at 164.¹⁷

But what if, contrary to J&J’s statements, *Ingham* is not an anomaly but a harbinger of things to come? What if time shows, with the progression of litigation outside of bankruptcy, that cash available under the Funding Agreement cannot adequately address talc liability? Perhaps at that time LTL could show it belonged in bankruptcy. But it could not do

so in October 2021. While LTL inherited massive liabilities, its call on assets to fund them exceeded any reasonable projections available on the record before us. The “attenuated possibility” that talc litigation may require it to file for bankruptcy in the future does not establish its good faith as of its petition date. *Id.* at 164. At best the filing was premature.¹⁸

***110** In sum, while it is unwise today to attempt a tidy definition of financial distress justifying in all cases resort to Chapter 11, we can confidently say the circumstances here fall outside those bounds. Because LTL was not in financial distress, it cannot show its petition served a valid bankruptcy purpose and was filed in good faith under Code § 1112(b).¹⁹

F. “Unusual Circumstances” Do Not Preclude Dismissal

The Bankruptcy Court held, as an independent basis for its decision, that even if LTL’s petition were not filed in good faith, § 1112(b)(2) of the Code authorized it nonetheless to deny dismissal. For a petition to be saved under that provision, a court must identify “unusual circumstances establishing that ... [dismissal] is not in the best interests of creditors and the estate.” 11 U.S.C. § 1112(b)(2). The debtor (or any other party in interest) must also establish “the grounds for ... [dismissal] include an act or omission” (1) “for which there exists a reasonable justification” and (2) “that will be cured within a reasonable period of time.” *Id.*

The Bankruptcy Court ruled that “the interests of current tort creditors and the absence of viable protections for future tort claimants outside of bankruptcy ... constitute such ‘unusual circumstances’ as to preclude ... dismissal.” App. 13 (Mot. to Dismiss Op. 13 n.8). But what is unusual instead is that a debtor comes to bankruptcy with the insurance accorded LTL. Our ground for dismissal is LTL’s lack of financial distress. No “reasonable justification” validates that missing requirement in this case. And we cannot currently see how its lack of financial distress could be overcome. For these reasons, we go counter to the Bankruptcy Court’s conclusion that “unusual circumstances” sanction LTL’s Chapter 11 petition.

III. CONCLUSION

Our decision dismisses the bankruptcy filing of a company created to file for bankruptcy. It restricts J&J’s ability to move thousands of claims out of trial courts and into bankruptcy court so they may be resolved, in J&J’s words, “equitably”

and “efficiently.” LTL Br. 8. But given Chapter 11's ability to redefine fundamental rights of third parties, only those facing financial distress can call on bankruptcy's tools to do so. Applied here, while LTL faces substantial future talc liability, its funding backstop plainly mitigates any financial distress foreseen on its petition date.

We do not duck an apparent irony: that J&J's triple A-rated payment obligation for LTL's liabilities, which it views as a *111 generous protection it was never required to provide to claimants, weakened LTL's case to be in bankruptcy. Put another way, the bigger a backstop a parent company provides a subsidiary, the less fit that subsidiary is to file. But when the backstop provides ample financial support to a debtor who then seeks shelter in a system designed to protect those without it, we see this perceived incongruity dispelled.

That said, we mean not to discourage lawyers from being inventive and management from experimenting with novel solutions. Creative crafting in the law can at times accrue to the benefit of all, or nearly all, stakeholders. Thus we need not lay down a rule that no nontraditional debtor could ever satisfy the Code's good-faith requirement.

But here J&J's belief that this bankruptcy creates the best of all possible worlds for it and the talc claimants is not enough, no matter how sincerely held. Nor is the Bankruptcy Court's

commendable effort to resolve a more-than-thorny problem. These cannot displace the rule that resort to Chapter 11 is appropriate only for entities facing financial distress. This safeguard ensures that claimants' pre-bankruptcy remedies—here, the chance to prove to a jury of their peers injuries claimed to be caused by a consumer product—are disrupted only when necessary.

Some may argue any divisional merger to excise the liability and stigma of a product gone bad contradicts the principles and purposes of the Bankruptcy Code. But even that is a call that awaits another day and another case. For here the debtor was in no financial distress when it sought Chapter 11 protection. To ignore a parent (and grandparent) safety net shielding all liability then foreseen would allow tunnel vision to create a legal blind spot. We will not do so.

Because it abused its discretion in denying the motions to dismiss, we reverse the Bankruptcy Court's order denying the motions and remand this case with the instruction to dismiss LTL's Chapter 11 petition. Dismissing its case annuls the litigation stay ordered by the Court and makes moot the need to decide that issue.

All Citations

64 F.4th 84

Footnotes

- 1 The talc litigation also involves claims regarding Shower to Shower, a different talc-containing product initially produced by J&J and later by Old Consumer and its predecessors. LTL maintains intercompany transactions involving J&J and Old Consumer ultimately made the latter responsible for all claims stemming from Shower to Shower. Because the talc litigation concerns mainly Johnson's Baby Powder, for convenience references herein to that name may include other talc products.
- 2 Adam Lisman, assistant controller for J&J, suggested in his trial testimony that it was J&J's general policy to consider the next 24 months when calculating contingent costs under GAAP.
- 3 A slightly abbreviated summary of the many steps is as follows. Old Consumer merged into Chenango Zero, LLC, a Texas limited liability company and indirect, wholly owned subsidiary of J&J (“Chenango Zero”), with Chenango Zero surviving the merger. Chenango Zero (formerly Old Consumer) effected a divisional merger under the Texas Business Organizations Code by which two new Texas limited liability companies were created, Chenango One LLC (“Chenango One”) and Chenango Two LLC (“Chenango Two”), and Chenango Zero ceased to exist. Chenango One then converted into a North Carolina limited liability company and changed its name to “LTL Management LLC.” Chenango Two merged into Curahee Holding Company Inc., the direct parent company of LTL (“Curahee”). Curahee survived the merger and changed its name to “Johnson & Johnson Consumer Inc.” (now New Consumer).
- 4 On the day of the divisional merger, the Funding Agreement was executed by Chenango Zero (formerly Old Consumer), as payee, along with J&J and Curahee, as payors. Then, per the divisional merger, LTL was allocated rights as payee

under the Funding Agreement, replacing Chenango Zero. Chenango Two (which assumed Old Consumer's assets not allocated to LTL) then merged into Curahee, one of the two original payors, and became New Consumer.

- 5 LTL's liability was for all talc claims except those where the exclusive remedy existed under a workers' compensation statute or similar laws.
- 6 For LTL to require J&J and New Consumer to fund, certain customary representations and warranties made by LTL must be true, such as those addressing its good standing under state law, the due authorization of the Funding Agreement, and the absence of any required governmental approval. And LTL must not have violated its covenants, specifically, that it will use the funds for only permitted uses and materially perform its indemnification obligations owed to New Consumer for all talc liabilities as set out in the plan of divisional merger.
- 7 In each calculation of New Consumer's value, its obligation under the Funding Agreement is not included.
- 8 In the Fourth Circuit, a court can only dismiss a bankruptcy petition for lack of good faith on a showing of the debtor's "subjective bad faith" and the "objective futility of any possible reorganization." *Carolin Corp. v. Miller*, 886 F.2d 693, 694 (4th Cir. 1989). The Bankruptcy Court in the District of New Jersey described this as a "much more stringent standard for dismissal of a case for lacking good faith" than the Third Circuit's test. App. 13 (Mot. to Dismiss Op. 13). Perhaps not by coincidence then, debtors formed by divisional mergers and bearing substantial asbestos liability seem to prefer filing in the Fourth Circuit, with four such cases being filed in the Western District of North Carolina in the years before LTL's filing. See *In re Bestwall LLC*, Case No. 17-31795 (Bankr. W.D.N.C.); *In re DBMP LLC*, Case No. 20-30080 (Bankr. W.D.N.C.); *In re Aldrich Pump LLC*, Case No. 20-30608 (Bankr. W.D.N.C.); *In re Murray Boiler LLC*, Case No. 20-30609 (Bankr. W.D.N.C.).
- 9 Under certain conditions, the injunction can also channel to the trust claims against third parties affiliated with the debtor. 11 U.S.C. § 524(g)(4).
- 10 In the separate opinion explaining its order preserving the injunction of Third-Party Claims against Protected Parties, the Court held that "unusual circumstances" warranted extension of the automatic stay to those claims under *Bankruptcy Code* §§ 362(a)(1) and 362(a)(3). It also held that *Bankruptcy Code* § 105(a) provided it independent authority to issue a preliminary injunction enjoining them. App. 140 (Third-Party Inj. Op.).
- 11 The parties contest whether the Bankruptcy Court had jurisdiction to issue the order enjoining the Third-Party Claims against the Protected Parties. Dismissing LTL's petition obviates the need to reach that question.
- 12 See Report of the National Bankruptcy Review Commission 343-44 (Oct. 20, 1997) (recognizing claims-estimation accuracy is an important component of the integrity of the mass tort bankruptcy process and noting underestimation of claims occurred in the Johns-Manville case, one of the earliest asbestos bankruptcy cases, while also pointing to the adequate funding of trusts in subsequent cases to show those risks are surmountable).
- 13 For instance, the A.H. Robins claimants' trust has been recognized as one that functioned effectively and remained solvent for years. There the Court and stakeholders had the benefit of data from 15 years of tort litigation by A.H. Robins before its filing. See Report of the National Bankruptcy Review Commission 328 n.813, 344-45 (Oct. 20, 1997) (citing Jack B. Weinstein, *Individual Justice in Mass Tort Litigation: The Effect of Class Actions, Consolidations, and other Multiparty Devices* 280 n.88, 326 n.149 (Northwestern Press 1995), and Ralph R. Mabey & Peter A. Zisser, *Improving Treatment of Future Claims: The Unfinished Business Left by the Manville Amendments*, 69 Am. Bankr. L.J. 487, 497 n.45 (1995)).
- 14 See, e.g., *Little Creek Dev. Co. v. Commonw. Mortg. Corp.* (*In re Little Creek Dev. Co.*), 779 F.2d 1068, 1072 (5th Cir. 1986) ("Determining whether the debtor's filing for relief is in good faith depends largely upon the bankruptcy court's on-the-spot evaluation of the debtor's financial condition, motives, and the local financial realities."); *Cedar Shore Resort, Inc.*, 235 F.3d at 379-80 (in evaluating good faith, courts "consider the totality of the circumstances, including ... the debtor's financial condition, motives, and the local financial realities"; dismissing petition, in part, because the debtor was "not in dire financial straits"); *In re James Wilson Assocs.*, 965 F.2d 160, 170 (7th Cir. 1992) (recognizing that, while the Code permits a firm to file though it is not insolvent, such filings usually involve "impending insolvency"); *Cohoes Indus. Terminal*, 931 F.2d at 228 (in the context of whether a petition was frivolous under Bankruptcy Rule 9011, stating

"[a]lthough a debtor need not be *in extremis* in order to file[,] ... it must, at least, face such financial difficulty that, if it did not file at that time, it could anticipate the need to file in the future"); see also, e.g., *Barclays-Am./Bus. Credit, Inc. v. Radio WBHP, Inc. (In re Dixie Broad., Inc.)*, 871 F.2d 1023, 1027-28 (11th Cir. 1989) (stating that whether a debtor is "financially distressed" is one factor evidencing bad faith and that "the Bankruptcy Code is not intended to insulate 'financially secure' [debtors]"); *Carolin Corp.*, 886 F.2d at 701 (one prong of the good-faith inquiry is meant to ensure the petition bears "some relation to the statutory objective of resuscitating a financially troubled [debtor]") (brackets in original) (citing *Connell v. Coastal Cable T.V., Inc. (In re Coastal Cable T.V., Inc.)*, 709 F.2d 762, 765 (1st Cir. 1983)).

- 15 While, as described above, the uses for which LTL may draw on the payment right change in bankruptcy (*i.e.*, LTL is permitted to draw on it to fund a claimant trust and satisfy administrative expenses), we focus on the rights available to it just prior to its filing for good-faith purposes.
- 16 Because we arrive at the same result assuming the Bankruptcy Court was correct to determine LTL was responsible to indemnify J&J for *all* talc costs it incurs, we need not opine on this conclusion. Still, we note certain pertinent factors lack full discussion in the Court's analysis of the indemnity agreement relating to Johnson's Baby Powder in the 1979 Spin Off. App. 163-69 (Third-Party Inj. Op. 24-30). For example, it is not obvious LTL must indemnify J&J for the latter's independent, post-1979 conduct that is the basis of a verdict rendered against it. See App. 4957 (Agreement for Transfer of Assets and Bill of Sale 5 ¶ 4) (Old Consumer's predecessor agrees to assume and indemnify J&J against "all ... liabilities and obligations of every kind and description *which are allocated on the books or records of J&J* as pertaining to the BABY Division.") (emphasis added). It is also not clear the indemnity should be read to reach punitive damage verdicts rendered against J&J for its own conduct. Additionally, the Court never discussed how it reached its conclusion that Old Consumer assumed responsibility from J&J for *all* claims relating to Shower to Shower.
- 17 In saying the nature of the payment right and a lack of meaningful operations show that LTL did not suffer from sufficient kinds of financial distress, we focus on the special circumstances here and do not suggest the presence of these characteristics would preclude a finding of financial distress in every case.
- 18 Some might read our logic to suggest LTL need only part with its funding backstop to render itself fit for a renewed filing. While this question is also premature, we note interested parties may seek to "avoid any transfer" made within two years of any bankruptcy filing by a debtor who "receive[s] less than a reasonably equivalent value in exchange for such transfer" and "became insolvent as a result of [it]." 11 U.S.C. § 548(a). So if the question becomes ripe, the next one might be: Did LTL receive reasonably equivalent value in exchange for forgoing its rights under the Funding Agreement?
- 19 Because we conclude LTL's petition has no valid bankruptcy purpose, we need not ask whether it was filed "merely to obtain a tactical litigation advantage." *BEPCO*, 589 F.3d at 618. Yet it is clear LTL's bankruptcy filing aimed to beat back talc litigation in trial courts. Still "[i]t is not bad faith to seek to gain an advantage from declaring bankruptcy—why else would one declare it?" *James Wilson Assoc.*, 965 F.2d at 170. While we ultimately leave the question unaddressed, a filing to change the forum of litigation where there is no financial distress raises, as it did in *SGL Carbon*, the specter of "abuse which must be guarded against to protect the integrity of the bankruptcy system." 200 F.3d at 169.

54 S.Ct. 298

Supreme Court of the United States.

FIRST NAT. BANK OF CINCINNATI et al.

v.

FLERSHEM et al. (two cases).

Nos. 62, 63.

ARZT et al.

v.

SAME.

No. 64.

CLAPIER

v.

SAME.

No. 65.

Nos. 62, 63, 64, 65.

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Argued Nov. 9, 10, 1933.

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Decided Jan. 8, 1934.

Synopsis

Suit by Rudolph B. Flershem and others, committee for the reorganization of the National Radiator Corporation, against the National Radiator Corporation, wherein the First National Bank of Cincinnati, Ohio, and the International Heater Company intervened as defendants, and the Bankers' Trust Company, trustee, intervened as party plaintiff, and receivers were appointed. Decrees were entered dismissing the suit by Lily Clapier in the nature of a bill of review, and directing and confirming judicial sale of the assets, property, and business of the defendant corporation and approving plan of reorganization. These decrees were affirmed by the Circuit Court of Appeals (64 F.(2d) 847), and the intervening defendants and Amy Arzt and another and Lily Clapier, all nonconsenting creditors, filed petitions for certiorari.

Decree modified and affirmed as to Lily Clapier, and decree reversed as to other petitioners for certiorari.

On Certiorari to the United States Circuit Court of Appeals for the Third Circuit.

Attorneys and Law Firms

***507 **299** Messrs. Ralph Royall and Manfred W. Ehrich, both of New York City, and Horace F. Baker and Sidney J. Watts, both of Pittsburgh, Pa., for petitioner First Nat. Bank of Cincinnati.

Mr. James F. Hubbell, of Utica, N.Y., for petitioner International Heater Co.

Mr. David M. Palley, of New York City (Messrs. Charles H. Sachs and Louis Caplan, both of Pittsburgh, Pa., of counsel), for petitioners Artz, Clapier et al.

Messrs. Lawrence Bennett, of New York City, Maynard Teall, of Pittsburgh, Pa., and G. Franklin Ludington, of New York City, for respondent Reorganization Committee.

Messrs. Grandin Tracy Vought, of New York City, and J. Garfield Houston, of Pittsburgh, Pa. (Mr. Carlos L. Israels, of New York City, on the brief), for respondent Bankers Trust Co.

Opinion

Mr. Justice BRANDEIS delivered the opinion of the Court.

These cases, which are here on certiorari to the Circuit Court of Appeals for the Third Circuit (289 U.S. 722, 53 S.Ct. 795, 77 L.Ed. 1473), were argued together. They arise ****300** out of the plan of reorganization of the National Radiator Corporation of Delaware dated February 11, 1931. The reorganization committee sought to effectuate its plan through securing, in a suit filed in the Western district of Pennsylvania, the appointment of receivers and a judicial sale of the property. In that suit the federal jurisdiction was invoked on the ground of diversity of citizenship; the original plaintiffs being citizens of states other than Delaware and one of them a citizen of the district in which the suit was brought. The corporation, a citizen of Delaware, was the sole defendant. The District Court appointed receivers, and entered decrees ordering the sale, confirming it, approving the plan, and directing the receivers to convey and deliver to the purchaser the entire property. The Circuit Court of Appeals affirmed the decrees. 64 F.(2d) 847. The petitioners in No. 64 urge that the final decrees should be reversed as to them on the ground that the court lacked equity jurisdiction or that the bill lacked equity. ***508** The petitioners in Nos. 62 and 63 urge that the decrees should be reversed as to them mainly because the property was sold at a grossly inadequate price. The petitioner in No. 65 is the plaintiff in a bill of review,

brought in the same court, praying that the order appointing receivers be vacated. Its dismissal, which was affirmed on appeal, is alleged to have been erroneous.

In August, 1927, National Radiator Corporation was organized to effect a merger of six independent manufacturers of radiators and boilers for heating purposes. The net assets of the consolidated corporation, which included ten manufacturing plants located in five states and warehouses in four others, were valued at \$26,192,261.72. The capital was represented by 270,000 shares of no par common stock; 60,000 shares of \$7 cumulative convertible no par preferred stock; and \$12,000,000 twenty-year 6 1/2 per cent. sinking fund gold debentures. These had been underwritten, and were marketed, by J. & W. Seligman & Co. and Bankers' Trust Company of New York. The terms governing the issue of the debentures and the rights and remedies of the holders thereof were fixed by an indenture between the corporation and the Bankers' Trust Company, as trustee.

In January, 1931, the management of the corporation concluded, after months of consideration and conference with the bankers, that a revision of its capital structure was desirable in order to effect a drastic reduction of the debenture liability and the elimination of all fixed charges, and that, to this end, default should be made in the payment of the February 1, 1931, interest on the debentures. Before the merger, the constituent concerns had operated successfully for many years. After the merger, the business ceased to prosper. By the end of 1931, all but three of the ten manufacturing plants had been closed; the outlook for the immediate future was ***509** obscure; and there was no definite promise of an early recovery in earning power.¹

A meeting of the board of directors was called for the purpose of taking formal action in respect to the payment of the February 1, 1931, interest. Although the corporation had suffered (including depreciation and sinking fund charges) large losses in each of the years 1928, 1929, and 1930, its financial condition was still excellent. On December 31, 1930, the ratio of current assets to all current liabilities was more than 10 to 1; the current assets, including raw material and stock in process and manufactured, being \$5,054,007.30. The ratio of cash on hand to all current liabilities was then 3 1/2 to 1. It had \$1,701,899.94 cash, and \$1,132,563.17 in good accounts receivable; whereas its debts presently payable were only \$46,787.60 (besides \$293,339.58 for semiannual interest accrued on the debentures but not payable until February 1, 1931, \$151,768.54 of accrued taxes and like items, and \$60,000 in notes payable in one, two, and three years). The

twenty-year debentures outstanding had been reduced from \$12,000,000 to \$10,716,000.²

After presenting to the board the December 31, 1930, financial statement, the chairman said:

‘That although the working capital of the Company as shown by the balance sheet was reasonably ample, it ***510** was evident that, if the Company were to do an increasing volume of business, it would require the use of all or a substantial part of this cash to carry larger inventories and receivables, and that it would also be necessary to make large expenditures for the design of new products and for equipment necessary in their manufacture. Otherwise, the Chairman pointed out it might well prove to be impossible to maintain the Company's competitive business as against other enterprises in the industry. The Chairman then referred to the fact that the management had considered the advisability of a reorganization and had requested Messrs. Rudolph ****301** B. Flershem (the Chairman of its Executive Committee), Charles O. Cornell (a member of a firm specializing in reorganizations) and John H. Waters (the corporation's President) to act as a Committee to consider the matter and to formulate a Plan of Reorganization which might be submitted to the security holders of the Company. The Chairman reported that this Committee was now considering the matter of reorganization and had formed the opinion that a reorganization was advisable.’

The recommendations of the management were adopted by the board of directors. It was voted to default in the payment of the February 1 interest; the holders of the debentures were notified that the default was deemed advisable in order to conserve the corporation's cash resources; and, under date of February 11, 1931, an elaborate ‘Plan and Agreement of Reorganization’ was submitted to the security holders for acceptance.

The plan did not provide for raising additional capital. It was directed solely to reducing the liability on the debentures and eliminating all fixed charges. It provided that a new corporation be organized which would take over all the assets of the existing one, continue the business, and pay in cash all the current debts for merchandise and services; that the debenture indebtedness be ***511** scaled by giving for each \$1,000 of the 6 1/2 per cent. twenty-year sinking fund debentures, \$500 of the new corporation's 5 per cent. fifteen-year income debentures (without sinking fund provision),³ 5 shares of its \$7 preferred stock (entitled to \$100 a share on involuntary liquidation and \$115 a share on voluntary

liquidation), and 20 shares of its common stock. Holders of the preferred stock in the existing company were to receive therefor, share for share, common stock in the new; and holders of the common stock of the existing company might (upon payment of \$1), receive for every three shares a stock warrant, entitling the holder to purchase on or before July 1, 1941, one share of common stock in the new company upon payment of \$20 per share. The plan made no provision for dissenting debenture holders.

The reorganization committee proceeded to solicit deposits of securities under the plan. Before September 15, 1931, it had secured the deposit of about 81 per cent. of the debentures and a large part of the preferred and common stocks. On that day it declared the plan operative. On the same day it made a settlement with an opposing bondholders' protective committee,⁴ whereby it secured additional deposits of about 9 per cent. of the debentures. Later, other deposits were received; so that ultimately more than 95 per cent. of all outstanding debentures were deposited under the plan.

Some holders of nonassenting debentures demanded payment of their overdue coupons, including those for the ***512** August 1, 1931, interest. When payment was refused, the holders of \$24,000 of the debentures brought an action therefor; and counsel gave notice of intention to bring a further action on coupons attached to others. In order to frustrate these attempts to collect the interest, and in order to compel the minority debenture holders to acquiesce in the plan of reorganization, the committee commenced, on October 5, 1931, this suit praying for the appointment of receivers with power to continue the business; for a sale of the properties as an entirety; and that meanwhile all creditors be enjoined from enforcing their claims. The bill set forth the existing capital structure, the defaults in the payment of interest, and the plan of reorganization. It did not allege that the corporation was unable to pay the interest; or that it was insolvent; or that its assets, while ample, were not then available for payment of its debts. The bill alleged merely that:

'The defendant has no means at hand with which to meet, pay or satisfy the interest charges on the Debentures overdue as aforesaid without seriously jeopardizing the ability of the defendant to continue its business and without making it difficult or impossible for the defendant to secure the necessary supplies, materials and labor to continue the operation of its plants and the sale of its products.'

'(That) certain holders of the debentures not deposited with the complainants have threatened to bring suits in respect of interest due on their coupons and may levy execution upon the property of the defendant. * * * (That) unless the Court will take jurisdiction in this cause for the protection of every interest in the property and assets of the defendant, the result will be a multiplicity of suits, a race of diligence, wasteful strife and controversy'; and dismemberment of the properties (and that) 'It is to the best interests of the defendant and the complainants and other creditors of the defendant that ***513** the going concern value of the defendant's business ****302** and properties should be maintained,' etc.

On October 9, 1931, the corporation entered its appearance; filed an answer admitting the truth of the allegations contained in the bill; joined in the prayers thereof; and consented to the appointment of receivers. On the same day receivers were appointed with power to continue the business; and creditors were restrained from enforcing their claims against the property. One of the receivers was Robert S. Waters, a vice president and general manager of the corporation and the son of John H. Waters, its president, chairman of its board of directors, and member of the reorganization committee. The other receiver was William G. Heiner, a Pittsburgh lawyer. With like consent, ancillary receivers were appointed in ten other jurisdictions in which the corporation had property, and also in Delaware where it had none.

When the bill was filed, and when the receivers were appointed, the corporation could have paid from the cash on hand all overdue debenture interest, as well as all its other current liabilities, without impairing its ability to continue the business. The cash on hand was \$1,257,381.59.⁵ The overdue interest amounted then to \$709,395.69.⁶ That \$547,985.90, the difference between these two amounts, was more than the amount required for working capital, is demonstrated by action of the receivers. Two weeks after their appointment, they applied ***514** for and obtained from the court leave to invest 'such amount or amounts of cash of the receivership estate as in the judgment of the receivers is not needed at the time for expenses and working capital.' Thereupon, they invested \$1,030,000 of the cash in United States Treasury certificates of indebtedness and in bank certificates of deposit.

The Bankers' Trust Company, as trustee for the debenture holders, co-operated in all respects with the reorganization committee; served as depository under the plan; made formal demand for payment of the overdue interest; and

brought, with leave of court, suit for the amount of the overdue interest on all outstanding debentures and recovered judgment therefor; thereupon declared the principal of the debentures immediately payable; recovered judgment therefor on December 30, 1931, and then intervened in the receivership suit as plaintiff.

In due course, application was made for an order of sale. The District Court did not make an appraisal by independent experts. In fixing the upset price and in confirming the sale, it relied practically upon the evidence given, or introduced, by officers of the corporation and the members of the reorganization committee. On May 31, 1932, the decree ordering a sale was entered; the upset price was fixed at \$2,500,000; and a date after the sale was set for a hearing on its confirmation and on the fairness of the plan. An appeal from this decree was taken forthwith. At the sale, held August 8, 1932, the property was purchased in behalf of the committee for \$2,550,000 cash. The purchasers assigned their rights to the new company, National Radiator Corporation of Maryland, which agreed to enter an appearance in this cause; and, upon the petition of the purchasers and the new company, a decree was entered finding the plan fair; confirming the sale; and directing that the property be transferred to the new corporation free and clear of all obligations to creditors of *515 the old. Thereupon the assets were conveyed to the new company, over the objection of some of the petitioners that the appeal already filed rendered the court powerless to take or approve further action. The same counsel acted for the reorganization committee, the receivers, and the new company.

While all the petitioners refused assent to the plan and all appealed to the Circuit Court of Appeals from action of the District Court, the differences in their several positions and contentions are such as to require separate consideration of their legal rights.

First. Amy Arzt and Josephine Ramsey, the petitioners in No. 64, hold \$121,000 of the debentures. They appeared specially at the hearing on the confirmation of the sale; objected, among other things, on the ground that the court lacked equity jurisdiction of the subject-matter; appealed to the Circuit Court of Appeals from the decree affirming the sale; and contended there and here that, since they refused assent to the plan, the decree should, as to them, be declared void and reversed. Whether strictly there was lack of equity jurisdiction, we need not decide. Compare [Burnrite Coal Briquette Co. v. Riggs](#), 274 U.S. 208, 47 S.Ct. 578, 71 L.Ed. 1002; [Lion Bonding & Surety Co. v. Karatz](#), 262 U.S. 640, 43 S.Ct. 641, 67 L.Ed. 1151; [Pusey & Jones Co. v. Hanssen](#), 261

[U.S. 491](#), 43 S.Ct. 454, 67 L.Ed. 763. For the suit is clearly without equity. The court's power was invoked for a purpose for which it may not be exercised.

We have no occasion to consider under what circumstances a court of equity may, through appointment of receivers and judicial sale, lend aid to protect the interests of creditors **303 and effect a reorganization of an insolvent corporation.⁷ Nor need we consider under what circumstances *516 a court of equity may, because the assets of a corporation are ample to meet all liabilities but cannot then be immediately converted into cash, properly appoint receivers in order to preserve values and prevent unequal treatment of creditors.⁸ The case before us is of a different character. The possibility of insolvency was not mentioned when the board of directors voted to make default in the payment of the semiannual interest on its funded indebtedness and approved the plan of reorganization. While defaulting on its debentures, the corporation continued its business operations and paid promptly its merchandise and other unfunded indebtedness. *517 Insolvency was not present or imminent. The debentures were not to mature until 1947. Insolvency even in the remote future was not certain. This company defaulted when it was both solvent and liquid. It defaulted, although it had cash in bank equal to three and a half times its total current liabilities, including this interest. It defaulted, although the amount of the cash on hand was so large that, even if the interest had been paid, the surplus of cash remaining would have been more than was then required for working capital.

This deliberate disregard by the corporation of the legal rights of the debenture holders is sought to be justified on the ground that the management, looking to the long future, concluded that the course taken would inure to the benefit of the business and all concerned-would benefit bondholders as well as stockholders. The default was the first step in a proposed revision of the capital structure by which the funded indebtedness would be cut in half and all fixed charges eliminated. The management, whose competency had been challenged, functioned as members of the reorganization committee. Having failed to obtain the assent of all the security holders to its plan, the committee sought the aid of a court of equity to compel the minority's acquiescence; and the corporation joined as defendant in the prayers of the bill. Reorganization was the primary relief sought. The appointment of the receivers and the judicial sale were the device employed to effect a transfer of the assets of the

existing corporation to a new one, thereby relieving both from the payment of the former's debts.⁹ By these means *518 it was hoped to subject all dissenting creditors to the condition of impotency so frequently occupied by minority stockholders.

The substantive law affords no warrant for so abridging the rights of individual creditors. There is no contention that the corporation laws of Delaware conferred such power upon the board of directors and the majority of the debenture holders. The purpose of the transaction was to hinder and delay certain creditors. If, acting upon purported authorizations from the board of directors and all stockholders, the Radiator Corporation **304 had sought to achieve the purpose of the reorganization committee by a voluntary transfer of all of the assets to a new corporation, the conveyance would have been fraudulent in law as to dissenting debenture holders. It would have been a fraudulent conveyance even if the transaction had been entered upon solely in the interest of the debenture holders, in a well-founded belief that it would prove to their advantage, and although full payment of the indebtedness had been contemplated. *Means v. Dowd*, 128 U.S. 273, 9 S.Ct. 65, 32 L.Ed. 429.¹⁰ The illegality would not have been avoided by coupling the transfer later with the appointment of a receiver. *Shapiro v. Wilgus*, 287 U.S. 348, 354, 355, 53 S.Ct. 142, 77 L.Ed. 355, 85 A.L.R. 128. Nor could the illegality be avoided by first securing the appointment of *519 receivers and then effecting the transfer through a receiver's sale. Since the purpose was fraudulent in law, the rights of the nonassenting creditors cannot be impaired by the corporation's admission of the self-serving allegations of the bill. Compare *Harkin v. Brundage*, 276 U.S. 36, 48 S.Ct. 268, 72 L.Ed. 457.

The power of the District Court was invoked, not to enforce rights of creditors, but to defeat them. The fact that the means employed to effect the fraudulent conveyance was the judgment of a court and not a voluntary transfer does not remove the taint of illegality.¹¹ *Jackson v. Ludeling*, 21 Wall. 616, 22 L.Ed. 492. Compare *James v. Milwaukee & M. Railroad Co.*, 6 Wall. 752, 18 L.Ed. 885; *Northern Pacific R. Co. v. Boyd*, 228 U.S. 482, 507, 33 S.Ct. 554, 57 L.Ed. 931. Nor is it material that the corporation became insolvent later, long before entry of the order of sale, and that, but for the appointment of receivers, some nonassenting debenture holders would have obtained a preference. The lack of equity in the bill when filed is not cured by the insolvency later occurring. Compare *Pusey & Jones Co. v. Hanssen*, 261 U.S. 491, 43 S.Ct. 454, 67 L.Ed. 763. Moreover the insolvency which supervened was precipitated by the reorganization committee, then the only plaintiffs in this suit.

It was at their request that the Bankers' Trust Company, as trustee, declared the principal of the debentures due, recovered judgment thereon for \$10,673,000, and intervened *520 as party plaintiff. These acts were steps in carrying out the plan in which the corporation, the committee, and the trust company co-operated.

The sale and reorganization being in law fraudulent as to the petitioners in No. 64, it remains to consider the relief to which they are entitled. If, as in *Shapiro v. Wilgus*, 287 U.S. 348, 357, 53 S.Ct. 142, 145, 77 L.Ed. 355, 85 A.L.R. 128, the reorganization had been effected by a voluntary transfer and thereafter receivers had been appointed by the federal court, these creditors would, upon recovery of judgment, have been 'entitled to an order in the alternative either for the payment of his judgment out of the assets in the hands of the receivers or in default thereof for leave to issue execution.' The relief and the procedure should be the same here, although these petitioners are not judgment creditors, and the transfer followed the appointment of receivers. They should be paid in full upon establishing their claims in this case, because they were prevented by the interlocutory order appointing receivers from proceeding against the assets, fraudulently transferred, and thereby securing a lien, which would have yielded them full payment. Compare *Metcalf v. Barker*, 187 U.S. 165, 174, 23 S.Ct. 67, 47 L.Ed. 122; *Freedman's Savings & T. Co. v. Earle*, 110 U.S. 710, 4 S.Ct. 226, 28 L.Ed. 301; *Chittenden v. Brewster*, 2 Wall. 191, 17 L.Ed. 839.¹²

Nothing in the indenture with the Bankers' Trust Company, or in its action as trustee thereunder, interferes with affording them this relief. That instrument expressly reserves to the individual debenture holders the right to collect interest and principal in an action at law. If that right was impaired by the acts of the trust company, in declaring the principal of the debentures due and securing judgment thereon, equity will grant relief; because those acts, done at the request of the reorganization committee, *521 were incidents of the plan which we hold was fraudulent in law as to these petitioners.¹³ **305 The debenture holders who, by assenting to the plan, co-operated with the corporation and the reorganization committee, are in no position to complain that these petitioners will fare better than they. Compare *Davis v. Virginia Railway & Power Co. (C.C.A.)* 229 F. 633, 642.¹⁴ Since the assets fraudulently conveyed far exceed the amount of the claims of all nonassenting creditors, none of these could have occasion to object to the payment to these petitioners in full.

Second. Lily Clapier, the petitioner in No. 65, is the holder of \$11,000 of the debentures. She refused to assent to the plan of reorganization, but did not seek to intervene in the receivership suit. Instead, she brought in the *522 same court a separate suit against the corporation and the receivers in the nature of a bill of review. Suing on behalf of herself and all other creditors who had refused to accept the plan, she charged that the court was without jurisdiction in equity to appoint receivers, and prayed that the decree appointing them be vacated and no further proceedings be had. The receivers and the corporation moved to dismiss the Clapier suit on the ground that the bill failed to set forth a cause of action. These motions were granted, without passing upon the question whether, in view of the fact that two of the defendants were citizens of the same state as the plaintiff, there was lack of federal jurisdiction. From the decree of dismissal she appealed to the Circuit Court of Appeals.

A bill of review is called for only after a final decree—one that finally adjudicates upon the entire merits, leaving nothing further to be done except the execution of it.' [John Simmons Co. v. Grier Bros. Co.](#), 258 U.S. 82, 88, 42 S.Ct. 196, 198, 66 L.Ed. 475. For this reason, a bill of review will not lie to review an interlocutory order appointing a receiver. The dismissal of the Clapier suit was therefore proper. But that decree should have been without prejudice to her right to prosecute her claim against the corporation, the assets in the hands of the receivers, and the new company. To this end she should be given leave to intervene in the receivership suit and there present her claim for such relief as may appear to be appropriate. As the new corporation became party to the suit when it applied for confirmation of the sale, there is here no obstacle to this procedure. Compare [National Surety Co. v. Coriell](#), 289 U.S. 426, 438, 53 S.Ct. 678, 77 L.Ed. 1300; [Kneeland v. American Loan & Trust Co.](#), 136 U.S. 89, 10 S.Ct. 950, 34 L.Ed. 379.

Third. The First National Bank, one of the two petitioners in Nos. 62 and 63, is the holder of \$68,000 of the debentures. It filed, before the hearing on ordering the sale, a petition for leave to intervene, and was permitted *523 to do so as party defendant, but only 'in subordination to and recognition of the propriety of the main proceeding.' In the hearings on ordering the sale, on approving the plan, and on confirming the sale, it took part by cross-examination of witnesses and by argument; but it did not introduce any evidence. It appealed from both the interlocutory and the final decree.

The bank does not claim that the District Court was without equity jurisdiction or that the bill lacked equity. It concedes that the court could properly lend its aid to effectuate the proposed reorganization and, to this end, might sell the assets as an entirety. Its contention is that the property held in receivership was a trust fund to be administered for the benefit of each and every creditor, and, since some of the debenture holders had refused to assent to the plan of reorganization, the court was under the duty to make the sale on such terms and under such conditions as would insure to them, as their distributive share of the assets, the largest amount in cash which could be realized therefrom, and that the court, basing its action upon estimates offered in support of the plan, fixed a grossly inadequate upset price and erred in confirming the sale. The respondents insist that the nonassenting debenture holders were entitled only to their distributive share of the sum for which the property could have been sold if scrapped, and that they would, under the price paid, receive that much.

It is clear from the evidence introduced by the reorganization committee and the receivers that the upset price and the sale price were far below even the scrap value. The upset price fixed was \$2,500,000. The entire property was sold to the reorganization committee for \$2,550,000. At that time the cash and assets equivalent to cash alone aggregated **306 \$2,192,804.95. There was cash \$1,551,615.78, and notes and accounts receivable (after deducting ample reserve for doubtful accounts) \$641,189.17. *524 Besides, there were \$1,671,605.91 in raw material, goods in process and manufactured; bonds, stocks, and like items valued at \$88,873.41; manufacturing plants, and the warehouses in the several cities theretofore valued at \$6,388,318.83; good will, trade-marks, and patents theretofore valued at \$6,634,501.90; and other assets valued at \$166,475.65. Moreover, the existence of the plan of reorganization, assented to by a vast majority of the security holders, gave assurance of at least one bidder for the entire property who had confidence that the business, if sold as an entirety as a going concern, possessed a value greater than its liquidating value, and would, if necessary to effectuate the plan, bid for the assets in cash more than the estimated liquidating value. The upset price and the sale price were grossly inadequate.¹⁵

*525 In justifying the action taken, the Court of Appeals called attention to the fact that the nonassenting creditors had not introduced any evidence to prove their contention that the sale should not be confirmed. In view of the undisputed facts stated above, the introduction of such evidence was not indispensable. The failure to secure an adequate price seems to have been due, not to lack of opposing evidence,

but to the mistaken belief that it was the duty of the court to aid in effectuating the plan of reorganization, since a very large majority of the debenture holders had assented to it. Moreover, the court stood in a position different from that which it occupies in ordinary litigation, where issues are to be determined solely upon such evidence as the contending parties choose to introduce. In receivership proceedings, as was held in [National Surety Co. v. Coriell](#), 289 U.S. 426, 436, 53 S.Ct. 678, 77 L.Ed. 1300, every important determination by the court calls for an informed, independent judgment; and special reasons exist for requiring adequate, trustworthy information where the jurisdiction rests wholly upon the consent of the defendant who joins in the prayers for relief. It would be *526 unreasonable to impose upon a few dissenting creditors the heavy financial burden of making an adequate appraisal supported by the testimony of competent experts, where, as here, the assets include extensive plants and equipment located in nine states.

The relief which the bank seeks is that sum in cash which it would have received if the property had been sold at a proper price. To this relief it is clearly entitled. The cause is remanded to the District Court for the purpose of ascertaining the sum. In making their determination, it must be borne in mind that the problem which was presented to the trial court upon the application for the receiver's sale of the assets of this manufacturing company, with its many far-flung plants and warehouses, was a very different one from that with which courts have been confronted upon applications for sale on foreclosure of railroad systems. In such cases, it is ordinarily necessary that the property be sold as an entirety. The unity of the system must be preserved in both the public and the private interest, and the large amount of cash required by the upset price renders the reorganization committee, which ordinarily controls a large majority of the outstanding securities, practically the only bidder.¹⁶ Compare **307 *527 [Kansas City Terminal R. Co. v. Central Union Trust Co.](#), 271 U.S. 445, 453, 454, 46 S.Ct. 549, 70 L.Ed. 1028. In the case at bar, preservation of the unity of the property was not essential. The sale of the assets in many parcels was possible, and perhaps desirable in the interest of all concerned.

A detailed appraisal must now be made of the corporation's assets as of the date of the sale, based upon then values and the possibility of disposing of them in parcels, as well as an entirety. The appraisal of the current assets will present little difficulty; and the experience gained since the

sale in collecting the receivables and in disposing of the inventory will be of aid. The appraisal of the property other than the current assets will require careful preparation and consideration. The inadequacy of the upset price seems to have resulted mainly from the assumption that the only alternatives were to continue to operate the properties as an entirety or to scrap all, and from a determination that the properties should not be scrapped. So far as appears, no consideration was then given to the possibility of selling the properties in such parcels as would permit of reconstituting as separate units some of the original independent concerns; or to the fact that a detailed valuation of the many items of which the assets, tangible and intangible, were composed was essential to intelligent bidding for the property in such parcels or as scrap; or to the fact that, if the sale was not made as an entirety, the appropriate markets for some of the parcels or lots might not be New Castle, Pa., where the sale was held. Moreover, no attempt appears to have been made then to secure bids from buyers of scrapped properties.

The history of the enterprise lends no support to the view that, unless all the property was to be scrapped, all had to be sold as an entirety. The losses of the corporation appear to have been due largely to the fundamental mistake of judgment committed in merging the several independent concerns. Before the consolidation, each of *528 the six independent concerns earned large profits. Their aggregate profits for each of the last three years before the merger had averaged \$3,455,642 a year. A few months after the merger the corporation entered upon a period of heavy losses which continued unbroken up to the time of the receivers' sale. The abrupt change from profit to loss was not the result of the general business depression. Although 1928 and 1929 were years of general business prosperity,¹⁷ the loss of the corporation (before payment of debenture interest) was \$587,123 in 1928 and \$490,371 in 1929.¹⁸ The heavy losses during 1928, 1929, and later years (including the period of the receivership) appear to have been due in large measure to the cost of carrying unused properties. During the receivership, only the Pennsylvania plants were in operation.¹⁹ For them there was still substantial business; and that business might then have been profitable if not burdened with the cost of carrying the many unused properties.²⁰ In valuing the assets, the appraisers should also bear in mind that, even if part of the properties should have been sold as scrap, the reorganization committee was a willing purchaser for the rest.

Fourth. The International Heater Company, the other petitioner in Nos. 62 and 63, holds three promissory notes

of the corporation of \$20,000 each, maturing, respectively, *529 on the last days of 1931, 1932, and 1933. It refused assent to the plan; but it does not question either that the District Court had equity jurisdiction of the cause, or that there was equity in the bill. It expressly concedes that the court could properly lend its aid to enable security holders of an unsuccessful corporation to find, through reorganization, a practical method of continuing the business. Its main objection is that, under the decree entered, it is denied payment in cash of the amount to which it is entitled. The heater company did not learn of the application for the order of sale until after the hearing thereon had closed. Then it filed a petition to intervene, was permitted to intervene as defendant, but only 'in subordination to, and recognition of, the propriety of the proceeding'; and it appealed **308 to the Circuit Court of Appeals from both the decree ordering the sale and from that confirming it and approving the plan. It seeks reversal of the decree on two entirely distinct and alternative grounds.

1. The heater company asks that, pursuant to the plan, these notes be paid in full by the new corporation. The plan provides that debts for merchandise or services shall be paid by the new corporation in full. These notes were part of the purchase price paid, in the latter part of 1927, for a minority interest in the stock of the Lincoln Radiator Company, the majority interest of which the corporation had previously acquired. The heater company contends that the notes, being a part of the current indebtedness of the old company, and having been given for personal property, are to be deemed merchandise debts within the meaning of the plan, but that, if the plan as drawn does not include them, it should be amended by the court, so as to provide for the payment of the notes in full.

The Court of Appeals rejected this contention. We think it was right, substantially for the reasons stated by it.

*530 2. The heater company contends that, if the notes are not to be paid in full, it should receive a sum much larger than its distributive share of the purchase price paid by the new corporation. Unlike the bank, it does not argue that the court was obliged to make an independent investigation into the value of the assets before fixing the upset price. Its contentions are that the heater company should not be prejudiced by its own failure to introduce evidence on that issue, since it had no notice or knowledge of the hearing; that, moreover, the gross inadequacy of the price paid was due to the fact that, instead of aiming to secure for nonassenting creditors the largest possible sum in cash, the court treated the receiver's sale as merely a necessary step in effectuating the plan of reorganization, and hence adopted a method of selling which excluded all bidders except the reorganization committee. We have no occasion to discuss this argument in detail. For the reasons stated in connection with the bank's claim, we think that the sale was made at a grossly inadequate price, and that it was invalid also as to the heater company. Like the bank, the heater company is entitled to receive in cash its distributive share of the amount which, upon the new appraisal, shall be found to have been the fair selling value of the assets.

In Nos. 62, 63, and 64, decree reversed as to petitioners.

In No. 65, decree modified, and, as modified, affirmed.

All Citations

290 U.S. 504, 54 S.Ct. 298, 78 L.Ed. 465, 90 A.L.R. 391

Footnotes

- 1 The corporation acquired by the merger ten plants. Two at Johnstown, Pa.; two at New Castle, Pa.; one at Framingham, Mass.; one at Trenton, N.J.; one at Chicago, Ill.; and one each at Utica, Dunkirk, and North Tonawanda, N.Y. One plant had been sold in 1927, and one was shut down. Two were closed early in 1929. In 1930 one plant was shut down because of the decline in business, and one in 1931 before the receivers were appointed.
- 2 On December 30, 1931, at which time Bankers' Trust Company, trustee for the debenture holders, recovered judgment for the entire principal outstanding, the amount had been further reduced to \$10,673,000.
- 3 Moreover, the existing debentures were entitled to be secured by a prior lien against any subsequent mortgage; the new debentures were entitled only to an equal lien with any subsequent mortgage. The committee later agreed with an opposition committee (see note 4) that the lien should be prior.

- 4 The opposition committee were to receive \$35,000 for fees and expenses of the members and counsel; and one of its members, to be designated by the reorganization committee, was to become a member of the latter and of the board of directors of the new company.
- 5 On the day of their appointment, the receivers had also \$1,494,327.22 in sound receivables and at least \$34,534.40 in securities convertible in cash.
- 6 The aggregate of other current liabilities (including amounts not then payable) was only \$157,511.89. There was besides the August 1, 1931, requirement for the sinking fund. But the debentures held by the corporation applicable for this purpose reduced the requirement of cash to \$43,918.50.
- 7 All the cases in which this Court appears to have exercised this power in aid of reorganization upon the ground of insolvency dealt with railroads or other public utilities where continued operation of the property and preservation of its unity seemed to be required in the public interest. [Milwaukee & Minnesota R. Co. v. Soutter](#), 2 Wall. 510, 17 L.Ed. 900; [Davis v. Gray](#), 16 Wall. 203, 21 L.Ed. 447; [Union Trust Co. v. Illinois Midland R. Co.](#), 117 U.S. 434, 6 S.Ct. 809, 29 L.Ed. 963; [Wallace v. Loomis](#), 97 U.S. 146, 24 L.Ed. 895; [Wood v. Guarantee Trust Co.](#), 128 U.S. 416, 9 S.Ct. 131, 32 L.Ed. 472; [Quincy, Missouri & Pacific R. Co. v. Humphreys](#), 145 U.S. 82, 12 S.Ct. 787, 36 L.Ed. 632; [Louisville Trust Co. v. Louisville R. Co.](#), 174 U.S. 674, 19 S.Ct. 827, 43 L.Ed. 1130; [In re Metropolitan Ry. Receivership](#), 208 U.S. 90, 28 S.Ct. 219, 52 L.Ed. 403; [Kansas City Terminal R. Co. v. Central Union Trust Co.](#), 271 U.S. 445, 46 S.Ct. 549, 70 L.Ed. 1028; compare [Sage v. Central R. Co.](#), 99 U.S. 334, 25 L.Ed. 394; [Shaw v. Little Rock & Ft. S.R. Co.](#), 100 U.S. 605, 25 L.Ed. 757. Moreover, in all those cases the sale was made upon foreclosure. In [Brown, B. & Co. v. Lake Superior Iron Co.](#), 134 U.S. 530, 10 S.Ct. 604, 33 L.Ed. 1021; and [Leadville Coal Co. v. McCreery](#), 141 U.S. 475, 12 S.Ct. 28, 35 L.Ed. 824, where the defendant corporation had allowed the receivership of a rolling mill to proceed nine months without answering and creditors did not object until after the decree of sale, this Court refused to decide whether originally the suit should have been allowed to proceed.

The Act of March 3, 1933, c. 204, s 77, 47 Stat. 1474, amending the Bankruptcy Act (11 USCA s 205(a), provides: 'Reorganization of railroads engaged in interstate commerce. (a) Any railroad corporation may file a petition stating that the railroad corporation is insolvent or unable to meet its debts as they mature and that it desires to effect a plan of reorganization.'

- 8 In [National Surety Co. v. Coriell](#), 289 U.S. 426, 435, 53 S.Ct. 678, 77 L.Ed. 1300, the question before this Court was not the equity of the bill, but the propriety of the procedure pursued by the District Court when approving the plan of reorganization. Compare [Michigan v. Michigan Trust Co.](#), 286 U.S. 334, 343, 52 S.Ct. 512, 76 L.Ed. 1136; [Shapiro v. Wilgus](#), 287 U.S. 348, 356, 53 S.Ct. 142, 77 L.Ed. 355, 85 A.L.R. 128; [Filene's Sons Co. v. Weed](#), 245 U.S. 597, 38 S.Ct. 211, 62 L.Ed. 497; [Riehle v. Margolies](#), 279 U.S. 218, 49 S.Ct. 310, 73 L.Ed. 669; [Munroe v. Raphael](#), 288 U.S. 485, 53 S.Ct. 424, 77 L.Ed. 910.
- 9 Unless all debenture holders assented to the plan, it could not be effectuated except through the medium of a judicial sale; for the indenture with the Bankers' Trust Company, trustee, provided that the property of the Radiator Corporation should not be sold as an entirety unless 'as a part of the purchase price for the sale of the property of the company as an entirety (the purchaser) expressly assumes in writing the due and punctual payment of the principal and interest of all the debentures,' whereas the main purpose of the plan was to cut in half the amount of the debenture liability and to eliminate all fixed charges through transferring the entire property to a new company.
- 10 Similarly, it has been held that an assignment made for the benefit of creditors, by one who is solvent, to avoid temporary embarrassment and sacrifice of assets, is a fraudulent conveyance as to those who have not consented, and that the conveyance will be set aside to the extent necessary to permit nonassenting creditors to levy execution. [Burt v. McKinstry](#), 4 Minn. 204 (Gil. 146), 77 Am.Dec. 507; [Gardner v. Commercial Nat. Bank](#), 95 Ill. 298.
- 11 'An execution sale under a consent judgment, where the consent is, in effect, not the act of the defendant, but that of the plaintiff prosecuting the action, is in reality merely a voluntary transfer. To give it any better standing would be the grossest sacrifice of substance to form.' [Title Ins. & Trust Co. v. California Development Co.](#), 171 Cal. 173, 210, 152 P. 542, 558. See, also, [Metcalf v. Moses](#), 35 App.Div. 596, 55 N.Y.S. 179; [Id.](#), 161 N.Y. 587, 56 N.E. 67; [Mechanics' Nat. Bank v. H. C. Burnet Mfg. Co.](#), 33 N.J. Eq. 486; [Atwater v. American Exchange Nat. Bank](#), 152 Ill. 605, 38 N.E. 1017;

Skinner v. J. I. Case Threshing Machine Co., 94 Ind.App. 651, 182 N.E. 99; *Hill v. Pioneer Lumber Co.*, 113 N.C. 173, 18 S.E. 107, 21 L.R.A. 560, 37 Am.St.Rep. 621.

- 12 See, also, *Metcalf v. Moses*, 35 App.Div. 596, 55 N.Y.S. 179; *Id.*, 161 N.Y. 587, 56 N.E. 67; *Johnston v. Straus* (C.C.) 26 F. 57.
- 13 The record does not show that all the debentures would not have been paid in due course under proper management, in the absence of the voluntary default made to effect the desired reorganization, and other proceedings to that end.
- 14 There, in a case of reorganization, the court said: 'The holders of the bonds secured by the senior mortgages and the other debenture bondholders of the Richmond Company had the opportunity to join the petitioner in his effort to recover property which he alleged had been taken from that on which they all relied for security. They refused to enter the contest, and accepted as full payment and satisfaction of their bonds the settlement offered in the reorganization. Thus the petitioner was left as the only bondholder who chose to avail himself of the reservation and make the contest, and it follows that he alone is entitled to receive the fruit of his effort. * * * All other creditors waived their rights, and were in the position of saying, either that there was no merit in petitioner's contention, or that they were unwilling to make any effort to bring under the security the property alleged to have been diverted. Evidently, under such conditions, the property which may be recovered or brought back as a part of the assets of the Richmond Company by petitioner's efforts and expense would be applicable to his bonds. The principle is well settled by authority. *Freedman's S. & T. Co. v. Earle*, 110 U.S. 710, 4 S.Ct. 226, 28 L.Ed. 301.' See, also, *In re American Candy Mfg. Co.* (C.C.A.) 256 F. 87, 88; *George v. St. Louis Cable & Western R. Co.* (C.C.) 44 F. 117, 120-124.
- 15 It seems to have been the aim of the reorganization committee to have the upset price fixed at a sum which would yield to nonassenting debenture holders not more than the then market value of their bonds. At one time it has made at one of its meetings a tentative suggestion of \$3,600,000. The gross inadequacy of the upset price is illustrated by the division of the \$2,500,000, as applied to the ten separate parcels in which, as a formality, the property was offered before selling it as an entirety to the reorganization committee. Parcel A for which the upset price of \$2,392,000 was set included, besides the plants and other real estate in Pennsylvania, all the personal property except that used in connection with the plants and other real estate located in the other eight states. Parcel B embraced the plant and appurtenant real and personal property in New Jersey (including 11 1/2 acres near Trenton and 14 dwelling houses), carried on the books at \$861,179.12. The upset price on this parcel was fixed at \$28,000. Parcel C embraced the plant and appurtenant real and personal property in Massachusetts (including 23 acres at Framingham), carried on the books at \$592,452.64. The upset price for this parcel was fixed at \$17,500. Parcel D embraced the plant and appurtenant real and personal property at North Tonawanda (including 10 acres) and Dunkirk, N.Y., valued on the books at \$1,318,373.60. The upset price for this parcel was fixed at \$37,500. Parcel E included 10 acres of land, the plants and appurtenant real and personal property and a warehouse at Chicago, Ill., carried on the books at \$605,149.43, and also the Edgewood Apartment Hotel, at Chicago, carried on the books at \$51,172.31. The upset price fixed for this parcel was \$17,500. Parcel F included the warehouse at Baltimore, Md., and the usual equipment, which was carried on the books at \$33,477.93. The upset price on this parcel was fixed at \$1,000. Parcel G included the warehouse equipment at Cincinnati, Ohio, which was carried on the books at \$48,632.84. The upset price on this parcel was fixed at \$2,250. Parcel H included the warehouse at Richmond, Va., which was carried on the books at \$26,045.42. The upset price on this parcel was fixed at \$1,000. Parcel I included two warehouses at Hempstead, N.Y., which was carried on the books at \$30,093.81. The upset price on this parcel was fixed at \$1,000. Parcel J included the warehouse at Washington, D.C., which was carried on the books at \$58,536.53. The upset price on this parcel was fixed at \$1,000.
- 16 By the decree, the purchaser was required to pay only \$300,000 in cash, presumably to cover the expenses and fees of the reorganization committee, the receivers, and counsel. The decree provided that on the balance of the purchase price 'The Purchaser shall be credited on account of his purchase price for Debentures and coupons and assigned claims finally established and allowed, turned over in part payment of the purchase price, with such sum as would be paid in respect of such Debentures, coupons and assigned claims out of the proceeds of sale, if the whole amount of the purchase price had been paid in cash.' By this provision, customary in decrees for sales of railroad systems on foreclosure, the reorganization committee was relieved of the necessity of raising a large sum in cash—a necessity which naturally would deter bidders not so situated.

- 17 The losses were doubtless due in part to the fact that already, at the end of 1927, the very lucrative 'direct to the consumer' business theretofore carried on by two of the theretofore independent concerns had to be discontinued, because incompatible with the selling methods of the other plants of the consolidated company.
- 18 The greater part of the products of these plants was used in the new buildings. In the year 1928, the new construction in America was said to have reached its all-time record.
- 19 See note 1, p. 300.
- 20 During the first four months of the receivership, the gross sales were \$1,300,000. For the first fifty days of the receivership an operating gain of \$31,917.77 was turned into a loss of \$14,630.44 by reason of maintenance expense of the nonoperating plants of \$46,548.21.

668 B.R. 505

United States Bankruptcy Court, S.D. Florida.

IN RE: [IVANKOVICH FAMILY LLC](#),

A&O Family LLC (Florida), A & O
Family LLC (Illinois), Atlas P2 Managing
Member, LLC., Debtors-In-Possession.

[Ivankovich Family LLC](#), A&O Family LLC
(Florida), A&O Family LLC (Illinois), Atlas
P2 Managing Member, LLC., Anthony
Ivankovich, and Olga Ivankovich, Plaintiffs,

v.

Jeanette Ivankovich, Schiller Ducanto & Fleck
LLP, and Steven Ivankovich, Defendants.

CASE NOS. 24-15755-LMI, 24-15762-
LMI, 24-15767-LMI, 24-15770-LMI

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Signed February 26, 2025

Synopsis

Background: Debtors, a group of related investment companies in substantively consolidated Chapter 11 cases, and their alleged founders brought adversary proceeding against debtors' manager, his wife, and her divorce counsel, objecting to wife's proofs of interest asserting undetermined share of equity in debtor-companies as marital property. Wife and counsel moved to abstain.

The Bankruptcy Court, [Laurel M. Isicoff](#), J., held that Bankruptcy Court would exercise its discretion to permissively abstain from hearing adversary proceeding.

Motion granted.

Procedural Posture(s): Motion to Abstain or for Abstention.

Attorneys and Law Firms

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A&O Family LLC (FL), Atlas P2 Managing Member, LLC, Ivankovich Family LLC, Anthony Ivankovich, Olga Ivankovich.

[Michael S. Budwick](#), Esq., Miami, FL, for Defendant Steven Ivankovich.

[Darrell Winston Payne](#), Stearns Weaver Miller, et al, Miami, FL, for Defendants Schiller Ducanto & Fleck, LLP, Jeanette Ivankovich.

[Patricia A. Redmond](#), Miami, FL, for Defendant, Jeanette Ivankovich.

Alexa Garcia Chinchilla, [David L. Rosendorf](#), Esq, Coral Gables, FL, for Plaintiff Anthony Ivankovich, Olga Ivankovich.

ORDER ON MOTION TO ABSTAIN FROM ADJUDICATING COUNTS II, IV, AND VI OF PLAINTIFFS' ADVERSARY COMPLAINT

[Laurel M. Isicoff](#), United States Bankruptcy Judge

This matter came before the Court for a hearing on January 29, 2025 and then again on February 11, 2025 for a further hearing (the "Hearings") upon the *Motion to Abstain from Adjudicating Counts II, IV, and VI of Plaintiffs' Adversary Complaint* (ECF #31) (the "Abstention Motion") filed by Defendants, Jeannette Ivankovich ("Jeannette") and Schiller Ducanto & Fleck LLP, ("Schiller") (collectively, the "Defendants"). The Court has reviewed the Complaint¹, Abstention Motion, the ***507** Joint Response and Joint Supplemental Response² filed by the Debtors Ivankovich Family LLC, A&O Family LLC (FL), A&O Family LLC (IL), and Atlas P2 Managing Member, LLC (collectively, the "Debtors") and Anthony and Olga Ivankovich (collectively, the "Doctors") (together, the "Plaintiffs"), the Defendants' Reply³, and considered argument of the parties at the Hearings. For the reasons set forth below, the Court will exercise its discretion and permissively abstain from adjudicating Counts II and VI of the Complaint pursuant to [28 U.S.C. § 1334\(c\)\(1\)](#).⁴

FACTUAL BACKGROUND AND PROCEDURAL HISTORY

The Debtors are a string of related investment companies whose ownership interests are in dispute. The Debtors were allegedly founded by the Doctors and managed by the Doctors' son, Steven Ivankovich ("Steven"). Steven is in the midst of a contentious divorce proceeding with his estranged wife – the Defendant Jeanette. The divorce is pending in the Circuit Court of Cook County, Illinois County Department, Domestic Relations Division as *In re: Marriage of Jeanette Ivankovich (Petitioner) and Steven Ivankovich (Respondent)*, Case Number 2021-D-9220 (the "Illinois Divorce Proceeding" or the "Illinois Divorce Court").

Jeanette initiated the Illinois Divorce Proceeding against Steven on October 22, 2021.⁵ On March 12, 2024, after an evidentiary hearing, the Illinois Divorce Court found that Jeanette has a clear protectable right in some of the Debtors' assets (by virtue of Steven's affiliation with them or control over them) because said assets are marital property and entered a preliminary injunction against Steven and his affiliates (the "Preliminary Injunction").⁶ The Preliminary Injunction enjoined Steven from dissipating, destroying, transferring, encumbering, concealing, or otherwise disposing of some of the Debtors' assets held in investment accounts at Celadon Financial Group ("Celadon"). Pursuant to the Preliminary Injunction, Celadon was ordered to pay Jeanette child support and spousal support in the amount of \$651,446.38 in satisfaction of unpaid support judgments entered in favor of Jeannette and against Steven. Celadon was also ordered to pay Jeanette's counsel, Schiller, \$400,000.00 for legal fees and \$25,000.00 for the appointment of a forensic accounting expert. The Preliminary Injunction also ordered that the Celadon accounts be frozen in order to preserve the Debtors' *508 assets until the Illinois Divorce Court had the opportunity to determine what interests Jeanette has in the Debtors' assets. Steven and the Debtors appealed the Preliminary Injunction to the First Judicial District in and for the Appellate Court of Illinois, Appellate Case Number 1-24-1118 (the "Appeal"); however, the Appeal is currently stayed as a result of the Debtors' bankruptcy.⁷

After the entry of the Preliminary Injunction and apparently prior to the Debtors' bankruptcy filing, the Illinois Divorce Court ruled that Ivankovich Family LLC, A&O Family LLC (Florida), A & O Family LLC (Illinois), and the Doctors are necessary parties to the Illinois Divorce Proceeding. The Doctors have been joined as necessary parties, but due to the bankruptcy cases, the Debtors have not been joined.

The Illinois Divorce Proceedings have been ongoing for over three years. Jeannette argues that the delay is due to Steven's bad faith and serial litigation habits and in support of this argument, attaches to her reply a sanctions order entered by the Illinois Divorce Court against Steven (the "Sanctions Order").⁸ The Sanctions Order sanctioned Steven \$420,000 and his counsel \$70,000 for delaying the proceedings and presenting facts that were not well grounded and were blatantly false.

While the Illinois Divorce Proceeding was pending, on November 13, 2023, Steven filed an action against Defendants in the Circuit Court of the 11th Judicial Circuit of Miami-Dade County, Florida seeking declaratory relief that assets of some of the Debtor LLCs were not assets of Steven and a declaration of marital rights of Jeanette, if any, to membership interests in the LLCs (the "Florida Action"). On December 26, 2023, the Florida Action was removed to United States District Court for the Southern District of Florida, Miami Division, Case Number 23-cv-24894-FAM. The district court dismissed Steven's complaint on July 1, 2024⁹ based in part on the *Colorado River*¹⁰ abstention doctrine finding that the Illinois Divorce Court is the proper court to determine whether Steven's interests in the LLCs constitute marital property and if so, to determine what interest Jeanette owns in those LLCs.¹¹

*509 On June 10, 2024 (the "Petition Date"), the Debtors filed separate voluntary petitions for relief under Chapter 11 of Title 11 of the United States Code (the "Bankruptcy Code"); the four bankruptcy cases were subsequently consolidated for joint administration (the "Main Case").¹² Jeanette filed proofs of interest in each of the Debtors' bankruptcies for an "unknown" interest "representing a yet to be determined share of the equity" of the Debtors as "marital property" (Proof of Interest No. 6-1 in Case No. 24-15755-LMI; Proof of Interest No. 8-1 in Case No. 24-15762-LMI; Proof of Interest No. 6-1 in Case No. 24-15767-LMI; Proof of Interest No. 7-1 in Case No. 24-15770-LMI) (the "Disputed Interests").

On October 17, 2024, the Plaintiffs initiated this adversary proceeding by filing the Complaint. On November 25, 2024, Defendants filed a *Motion to Dismiss Counts II, IV, and VI of Adversary Complaint* (ECF #10) (the "Motion to Dismiss") and subsequently filed the Abstention Motion on January 22, 2025. In the Abstention Motion, Defendants ask this Court to abstain from adjudicating Counts II and VI of the Complaint

(the “Counts”). Count II is an objection to the Disputed Interests brought by the Doctors against Jeanette and Count VI is brought by the Doctors against Jeanette and Steven for declaratory relief as to ownership of the Debtors. Defendants argue that mandatory abstention under [28 U.S.C. § 1334\(c\)\(2\)](#) applies to the Counts and alternatively, argues that the Court should permissively abstain from adjudicating the relief sought in the Counts pursuant to [28 U.S.C. § 1334\(c\)\(1\)](#).¹³

In their Joint Response, the Plaintiffs argued that the Abstention Motion was untimely pursuant to Local Rule 5011-2(A), which provides: “[a] motion to abstain from an adversary proceeding shall be filed not later than the date set for filing a response under Bankruptcy Rule 7012 and these local rules.” The deadline for filing a response to the Complaint was November 25, 2024¹⁴, which Defendants timely complied with by filing their Motion to Dismiss on that date. The Abstention Motion was not filed until January 22, 2025 and therefore, the Court ruled at the January 29 Hearing that the Abstention Motion was untimely.

However, because the Court has the authority to permissively abstain *sua sponte* from adjudicating the Counts, the Court continued the hearing to February 11 to allow the parties to submit further briefing on permissive abstention only.

ANALYSIS

A bankruptcy court may abstain “from hearing a particular proceeding arising under title 11 or arising in or related to cases under title 11” when to do so would be “in the interest of justice, or in the interest of comity with State courts or respect for State law.” [28 U.S.C. § 1334\(c\)\(1\)](#).

Any factors considered by a court in determining whether to exercise its discretion ***510** to abstain is governed by the three statutory factors – the interest of justice, interest of comity with state courts, and respect for state law. *AASI Creditor Liquidating Trust v. Peoplesoft, USA (In re All Am. Semiconductor, Inc.)*, 2010 WL 2854153, at *2 (Bankr. S.D. Fla. 2010).

In analyzing these three statutory factors, several courts, including this Court, have applied a list of non-exclusive factors a court should consider when deciding whether permissive abstention is appropriate.

- (1) The effect, or lack of effect, on the efficient administration of the bankruptcy estate if discretionary abstention is exercised;
- (2) The extent to which state law issues predominate over bankruptcy issues;
- (3) The difficulty or unsettled nature of the applicable state law;
- (4) The presence of related proceedings commenced in state court or other non-bankruptcy courts;
- (5) The jurisdictional basis, if any, other than [§ 1334](#);
- (6) The degree of relatedness or remoteness of the proceedings to the main bankruptcy case;
- (7) The substance rather than the form of an asserted “core” proceeding;
- (8) The feasibility of severing state law claims from core bankruptcy matters to allow judgments to be entered in state court with enforcement left to the bankruptcy court;
- (9) The burden on the bankruptcy court's docket;
- (10) The likelihood that the commencement of the proceedings in bankruptcy court involves forum shopping by one of the parties;
- (11) The existence of a right to jury trial;
- (12) The presence in the proceeding of non-debtor parties;
- (13) Comity; and
- (14) The possibility of prejudice to other parties in the action.

Id. (citing *E.S. Bankest, LLC v. United Beverage Florida, LLC (In re United Container LLC)*, 284 B.R. 162, 176 (Bankr. S.D. Fla. 2002)). No particular factor is controlling and it is within the discretion of the court how much weight, if any, should be given to any particular factor. *Id.* (internal citations omitted).

Plaintiffs first argue that permissive abstention should be denied because this Court has “core” jurisdiction and constitutional authority to finally adjudicate the disputed ownership interests in the Debtors under [28 U.S.C. § 157\(b\)](#), citing to cases that hold that the filing of a proof of interest and the resolution thereof constitute core proceedings within the equity jurisdiction of the bankruptcy court. *See In re AVN*

Corp., 235 B.R. 417 (W.D. Tenn. 1999); *In re Jordan River Resources, Inc.*, 455 B.R. 657 (Bankr. W.D. Mich. 2011). Defendants argue that the Counts are non-core, related to, matters because Jeanette's claims, which arise from unpaid support owed by Steven and her claimed equity interests are both issues that are squarely before the Illinois Divorce Court, and are state law marital issues.

The Plaintiffs also argue that the Court has core jurisdiction because the very structure of the bankruptcy plan that has been filed by the Debtors (the "Chapter 11 Plan")¹⁵ hinges on resolution of the ownership of the Debtors, since, under the Chapter 11 Plan, the equity interests in the *511 Debtors will be extinguished and new equity issued.

Whether the Counts constitute core matters is not outcome determinative of this Court's decision whether to permissively abstain from adjudicating the Counts. See *In re 160 Royal Palm, LLC*, 2020 WL 4792094 (Bankr. S.D. Fla. 2020) (permissively abstaining from a core matter); *In re Best Reception Sys., Inc.*, 220 B.R. 932, 955 (Bankr. E.D. Tenn. 1998) ("courts may abstain from hearing core proceedings under the authority of § 1334(c)(1)."); *In re Condra*, 212 B.R. 987, 992 (Bankr. M.D. Ala. 1997) ("Discretionary abstention is available in core and non-core proceedings. Even if this matter were a civil proceeding which is related to a case under Chapter 11, the court should abstain where the case was brought and should be timely heard in a state forum."). Regarding the argument that the resolution of the Chapter 11 Plan hinges on resolution of the ownership in the Debtors, the Court has already advised the parties that the Court will not set a confirmation hearing on the Chapter 11 Plan until the issue of Jeannette's interests in the Debtors has been resolved.

Applying the three statutory factors, with the overlay of the *United Container* factors, the Court finds that it is appropriate to abstain from adjudicating the relief sought in the Counts.

The first statutory factor is the "interest of justice." In applying the "interest of justice" factor to this case, the Court considers the likelihood that the commencement of the proceedings in bankruptcy court involves forum shopping by one of the parties.

In this case, forum shopping with respect to the relief sought in the Counts is clear. These issues have been pending in Illinois Divorce Court for over three years. On September 14, 2023, the Illinois Divorce Court issued a temporary restraining order (the "TRO") enjoining, with

some exceptions the disposition, etc. of certain assets held at Celadon. On November 6, 2023, the Illinois Divorce Court ruled that the TRO would stay in place until a final order regarding Jeannette's request for a Preliminary Injunction. Steven filed the Florida Action on November 13, 2023, only one week later. Steven appealed the dismissal of the Florida Action to the Eleventh Circuit Court of Appeals but voluntarily dismissed that appeal on September 3, 2024. This adversary proceeding was filed only a month later.

The second and third statutory factors are "comity" and "respect for state law." When state law issues predominate the proceedings, "[c]omity for the state courts and the general principle that cases arising under state law should generally be tried in the state court weigh in favor of permissive abstention." *United Container LLC*, 284 B.R. at 177. None of the parties dispute that the issues regarding whether and to what extent Steven has an interest in the Debtors, and to what extent Jeanette has a marital interest in Steven's interest in the Debtors is governed entirely by state law, with factors relating to Illinois family law bearing weight on that analysis. Thus, both comity and respect for state law warrant abstention.

Turning to some of the other factors outlined in *United Container* underscores the appropriateness of abstention. All of the parties involved in the Counts are non-debtors. The Counts are both brought by the Doctors against Jeanette and Steven and solely relate to a determination of ownership of the Debtors. These exact issues are currently pending in the Illinois Divorce Court in which the Doctors, Steven, and Jeanette (that is, *all* those claiming a legal or beneficial interest in the *512 Debtors' equity) are parties. As the Court reiterated at the October 30, 2024 hearing on Jeannette's Stay Relief Motion, the equity interests in the Debtors are not property of the estate and therefore not subject to the automatic stay. For those same reasons, a determination of ownership of the Debtors bears a limited connection to the Debtors' bankruptcy case, and only because of the provision in the Chapter 11 Plan impacting equity. "When a state court proceeding sounds in state law and bears a limited connection to a debtor's bankruptcy case, abstention is particularly compelling." *Id.*

Plaintiffs argue that the dispute over ownership of the equity interests in the Debtors cannot be timely adjudicated in the Illinois Divorce Proceeding given that the case has already been pending for over three years and the Illinois Divorce Proceeding was just transferred to a new judge. The Plaintiffs assert that interested parties will be prejudiced if

this bankruptcy case is effectively put on hold while awaiting final adjudication of the ownership issues in the Illinois Divorce Proceeding. Defendants counter that the only reason the Illinois Divorce Proceeding has been prolonged is due to Steven's bad faith and serial litigation habits, all as outlined in the Sanctions Order. Whether decided by this Court, or by the Illinois Divorce Court, the bankruptcy proceedings will be delayed until the ownership issue is resolved. Moreover, there is nothing preventing the Debtors in this surplus bankruptcy case from filing an amended bankruptcy plan that does not depend on resolution of the equity dispute.

The Court finds that requiring the parties to start the litigation anew in this Court would be a burden on the Court's docket and prejudice Jeanette who has been actively litigating the same issues before the Illinois Divorce Court for several years. Moreover, it is unnecessary for this Court to adjudicate the relief sought in the Counts when the Illinois Divorce Court has the most familiarity with the law impacting the resolution. Both comity and respect for the Illinois Divorce Court and Illinois marital law make clear the appropriateness of abstention.

CONCLUSION

Having considered the above relevant factors, the Court concludes that it should abstain from adjudicating the Counts pursuant to the permissive abstention provision of [28 U.S.C. § 1334\(c\)\(1\)](#) and that doing so is in the interest of justice, in the interest of comity with state courts, and respect for state law. Accordingly, it is hereby,

ORDERED AND ADJUDGED as follows: the Abstention Motion (ECF #31) is **GRANTED**.

ORDERED in the Southern District of Florida on February 26, 2025.

All Citations

668 B.R. 505

Footnotes

- 1** *Complaint for Objection to Claims and Interests of Jeanette Ivankovich and Schiller, Ducanto & Fleck LLP, and for Declaratory and Injunctive Relief* (ECF #1) (the "Complaint").
- 2** *Plaintiffs' Response to Defendants' JudgeMotion to Abstain from Adjudicating Counts II, IV, and VI of Plaintiff's Adversary Complaint* (ECF #36) (the "Joint Response"); *Joint Supplemental Response to Defendants' Motion to Abstain from Adjudicating Counts II, IV, and VI of Plaintiffs' [sic] Adversary Complaint* (ECF #48) (the "Joint Supplemental Response").
- 3** *Defendants' Reply in Support of Defendants' Motion to Abstain [ECF 31] and in Opposition to Plaintiffs' Joint Response to Defendants' Motion to Abstain from Adjudicating Counts II, IV, and VI Plaintiffs' Adversary Complaint [ECF 36] and Plaintiff's Supplemental Response [ECF 48]* (ECF #49) (the "Defendants' Reply").
- 4** At the Hearings, the Court granted Defendants' Motion to Dismiss (defined hereinafter) as to Count IV. Therefore, this opinion addresses the abstention arguments only as to the remaining Counts II and VI.
- 5** A copy of the Illinois Divorce Proceeding docket is attached to the Joint Supplemental Response (ECF #48).
- 6** The Preliminary Injunction is attached as Exhibit A to the *Debtors' Response in Opposition to Motion to Dismiss Count IV* (ECF #17-1).
- 7** Jeanette filed a *Motion for Determination that Automatic Stay Does Not Apply to State Court Divorce Proceeding or, Alternatively, for Relief from Automatic Stay to Allow State Court Divorce Proceeding to Determine Jeanette Ivankovich's Domestic Support Obligation Claim Including Any Attorney Fees Assessed and to Determine Ownership of Debtors* (ECF #123 in the Main Case) (the "Stay Relief Motion") requesting stay relief to allow the Appeal to go forward, which the Debtors opposed. The Court denied Jeanette's request.
- 8** See Sanctions Order, attached as Exhibit A to Defendants' Reply (ECF #49).

- 9 *Ivankovich v. Ivankovich*, 2024 WL 3251570 (S.D. Fla. 2024).
- 10 The *Colorado River* abstention doctrine applies in cases that involve substantially the same parties and substantially the same issues. *Colorado River Water Conservation Dist. v. United States*, 424 U.S. 800, 96 S.Ct. 1236, 47 L.Ed.2d 483 (1976). Upon establishing substantially similar parties and issues, the Court must engage in a six-factor analysis to analyze the permissibility of abstention. *Ambrosia Coal and Const. Co. v. Pages Morales*, 368 F.3 1320, 1330 (11th Cir. 2004). Those factors are as follows: (1) whether one of the courts has assumed jurisdiction over the property, (2) inconvenience of the federal forum, (3) the potential for piecemeal litigation, (4) the order in which the fora obtained jurisdiction, (5) whether state or federal law will be applied, and (6) the adequacy of the state court to protect the parties' rights. *Id.* (internal citations omitted).
- 11 Steven appealed the dismissal order on July 31, 2024 (USCA, 24-12480-F), but voluntarily dismissed the appeal on September 3, 2024.
- 12 Ivankovich Family LLC 24-15755-LMI; Atlas P 2 Managing Member LLC 24-15770-LMI; A&O Family LLC(Florida) 24-15762-LMI; and A&O Family LLC (Illinois) 24-15767-LMI.
- 13 As another alternative basis, Defendants argue that the *Younger* and *Colorado River* abstention doctrines support abstention. *Younger v. Harris*, 401 U.S. 37, 91 S.Ct. 746, 27 L.Ed.2d 669 (1971); *Colorado River*, 424 U.S. 800, 96 S.Ct. 1236. The Court does not need to determine whether either doctrine applies because the Court is permissively abstaining pursuant to 28 U.S.C. § 1334(c)(1).
- 14 See Order Granting Unopposed Motion to Extend Time to File Response to Adversary Complaint (ECF #8).
- 15 Debtors' Joint Plan of Reorganization (ECF #202 in the Main Case).

303 B.R. 539
United States Bankruptcy Court,
S.D. Georgia,
Brunswick Division.

In the Matter of Tommy
D. FUSSELL, Jr., Debtor.
Alice R. Edenfield, Plaintiff,
v.
Tommy D. Fussell, Jr., Defendant.

Bankruptcy No. 03–20622.
|
Adversary No. 03–2023.
|
Nov. 20, 2003.

Synopsis

Background: Creditor, Chapter 13 debtor's ex-wife, filed adversary complaint to determine the dischargeability of two financial obligations incurred by debtor in the parties' divorce decree.

Holdings: The Bankruptcy Court, [Lamar W. Davis, Jr., J.](#), held that:

creditor failed to establish that debtor's assumption of the pre-divorce credit card debt or his assumption of the second mortgage on the marital residence was a maintenance or support obligation, and

the bankruptcy court would abstain from determining if debtor's post-divorce, prepetition credit card obligations were in the nature of alimony, support, or maintenance, and would allow the state court to decide that issue.

Obligations held dischargeable.

Attorneys and Law Firms

*542 [John S. Myers](#), St. Marys, GA, for debtor.

M. Elaina Massey, Brunswick, GA, trustee.

MEMORANDUM AND ORDER

[LAMAR W. DAVIS, JR.](#), Bankruptcy Judge.

Before the Court is Plaintiff's Complaint to determine the dischargeability of debts. Debtor filed his Chapter 13 case on April 29, 2003, listing Plaintiff, his ex-wife, as a creditor. Plaintiff asserts that obligations Debtor incurred in their divorce decree are non-dischargeable pursuant to [11 U.S.C. § 523\(a\)\(5\)](#) or [\(a\)\(15\)](#). The Court has jurisdiction over this matter pursuant to 11 U.S.C. § 157. Based on the evidence, citations of authority and other applicable authority, I make the following Findings of Fact and Conclusions of Law in accordance with the directives of Bankruptcy Rule 7052.

FINDINGS OF FACT

Debtor and Plaintiff married in May 1998 and separated in September 2002. They were both previously married and both have children as a result of their prior marriages, but there are no children of this marriage and thus no issue of child support is presented in this proceeding. They were divorced on December 18, 2002 pursuant to a decree which incorporated a separation agreement signed by the parties on November 19, 2002, which contained the two financial obligations which are at issue in this adversary proceeding. The relevant provisions of the separation agreement read as follows:

The parties agree that they own real property located at 550 Marys Drive, Woodbine, Camden County, Georgia. The parties agree that the Husband shall retain permanent use and possession of said marital residence and the Wife shall Quitclaim her interest in the property to the Husband. The Husband shall be responsible for the first mortgage and the second mortgage, insurance and taxes on said residence and shall hold the Wife harmless thereon. The Husband agrees that he will refinance the first and second mortgages on said property as soon as possible following the entry of the Final Judgment and Decree in this case....

The Husband agrees to be solely responsible for the Bank One Visa account of \$8,700.00 and the Shell Mastercard of \$1,100.00 and shall hold the Wife harmless thereon. The Husband further agrees to obtain new credit cards solely in his name, pay these two accounts in full, and close them out within ninety (90) days of the entry of the Final Judgment

and Decree in this case. The Wife agrees to cease using said account and to return these credit cards to the Husband instanter.

Sep. Agreement ¶¶ 3, 6 (Nov. 19, 2002).

Prior to the marriage, Plaintiff owned a tract of land and a mobile home. When the parties married, she sold the mobile home, disposed of all her furnishings, and put the proceeds from the sale into the parties' joint account which they used to pay their expenses. Additionally, soon after the parties were married, Plaintiff received approximately \$14,000.00 in severance from her former employer which she placed in their joint account.

Prior to the marriage, Debtor's Camden County home, which was to become the marital home, was subject to a first mortgage *543 of approximately \$110,000.00 and a second mortgage of approximately \$20,000.00. After their marriage they refinanced the second mortgage, and they consolidated several bills with the pay off on the existing second mortgage into a new second mortgage which Debtor and Plaintiff co-signed. They obtained the new mortgage from Atlantic National Bank, where Plaintiff is currently employed. The proceeds of the refinancing and the funds from Plaintiff's severance package were applied as follows: They paid off the then existing balance on the second mortgage of approximately \$20,000.00, and they paid off an estimated \$7,000.00 of her personal debt and \$18,000.00 of his personal debt.

In the separation agreement Debtor retained the right to permanent use and possession of the marital residence and assumed responsibility for payment of the first and second mortgages. The agreement also provided that he would refinance the second mortgage as soon as possible with the obvious intent of removing Plaintiff as a co-obligor. Despite his best efforts to refinance, he was unable to do so, and Plaintiff remains indebted as a co-maker on this obligation. Debtor's obligation under the decree to pay the second mortgage is in issue in this proceeding. The other issue in this proceeding relates to Debtor's assumption of the balance on the Bank One Visa account in the amount of \$8,700.00. The balance on the Visa card has increased substantially as a result of his post-divorce, pre-bankruptcy charges totaling approximately \$7,200.00.

The fair market value of the Camden County house is insufficient to satisfy the obligations on both the first and second mortgages and in all likelihood will yield no more than

the current balance on the first mortgage. In fact, Debtor has attempted to sell the house for \$115,000.00 without success. Thus it is likely that the majority if not the entire balance of the second mortgage will remain a deficiency obligation of both Debtor and Plaintiff. At the time of the divorce Debtor intended to remain in the home, but he had a 75 mile daily commute to his job at the Federal Law Enforcement Training Center in Glynn County. After he was unable to refinance the second mortgage due to the loss of Plaintiff's income, he moved to Glynn County to reduce his commute and to make it more feasible to care for his minor daughter after work. As a result he incurred a rental obligation of approximately \$850.00 per month, and he provided in his plan that he would surrender the home to his creditors rather than attempt to retain it.

As to the credit cards, Debtor concedes that he made significant charges on the Visa card between the time of the divorce and the filing of the Chapter 13. Of those charges, \$850.00 was used to pay Plaintiff's attorney's fees from the divorce, \$1000.00 was used to pay Plaintiff's moving expenses as required by the divorce decree, and roughly \$900.00 was used to pay the Shell obligation which he assumed as part of Paragraph 6 of the divorce decree. The remainder of the post-divorce, pre-bankruptcy charges include purchases at a local florist, a jewelry store, visits to a tanning salon and extremely high cellular phone bills. Plaintiff did not use the Visa card after the separation. In the separation agreement, Debtor and Plaintiff agreed:

Neither the Wife nor the Husband may hereinafter incur any debts or obligations upon the credit of the other and the parties agree that each shall be responsible for all bills incurred by him/her and each shall indemnify, defend and hold the other harmless on any such debts or obligations.

Sep. Agreement ¶ 12 (Nov. 19, 2002).

At the time of the divorce Debtor's income exceeded Plaintiff's income by a significant *544 amount. In 2001, he earned approximately \$43,000.00 in contrast to her \$32,000.00. In the following year, he earned approximately \$46,000.00, and she earned \$35,000.00. Exh. P-11. Debtor's Schedule I indicates that he has a monthly net income of \$3,210.87, and his Schedule J lists his ordinary monthly expenses at \$2,658.00. In October 2003, this Court increased Debtor's monthly payment into the plan from \$553.00 to \$623.00. Additionally, Debtor has three dependent, minor children from a previous marriage. His twelve year old daughter lives with him, and his thirteen year old twins live with his ex-wife. Because of the split custody he neither pays

nor receives child support. Plaintiff's budget shows that she grosses approximately \$3,142.00 per month with a net income of \$2,191.00. Her ordinary living expenses total \$2,109.00 not including any payment toward the obligations for which she is jointly liable with Debtor but which he assumed in the divorce decree. Exh. P-9.

CONCLUSIONS OF LAW

A. The Second Mortgage and the Visa Card Balance at the Time of the Divorce.

1. 11 U.S.C. § 523(a)(5)

Generally, all individual debts are dischargeable in a Chapter 13 bankruptcy; however, 11 U.S.C. § 523(a) provides exceptions to dischargeability. 11 U.S.C. § 523(a)(5) provides that a Chapter 13 discharge:

(a) does not discharge an individual debtor from any debt—

(5) to a spouse, former spouse, or child of the debtor, for alimony to, maintenance for, or support of such spouse or child, in connection with a separation agreement, divorce decree or other order of a court of record, determination made in accordance with State or territorial law by a governmental unit, or property settlement agreement, but not to the extent that—

(B) such debt includes a liability designated as alimony, maintenance, or support, unless such liability is actually in the nature of alimony, maintenance, or support;

In *Smith v. Smith (In re Gene Kyle Smith)*, Adv. Nos. 96–2054 & 96–2085, Ch. 7 Case No. 95–20524 (Bankr.S.D.Ga. Dec. 30, 1997), this Court, relying extensively on *Harrell v. Sharp (In re Harrell)*, 754 F.2d 902 (11th Cir.1985), articulated the following legal framework for a § 523(a)(5) determination:

The burden of proof in establishing the Section 523(a)(5) exception is on the non-debtor spouse. However, although exceptions from discharge are normally construed strictly against the objecting creditor in order to provide the debtor with a “fresh start,” policy considerations require a bankruptcy court to construe domestic relations exceptions more liberally.

Under Section 523(a)(5), the non-debtor spouse must show that the obligation in issue is actually in the nature of support. If this burden is met, the burden of going forward shifts to the debtor to rebut the evidence that the provision

is actually in the nature of support under Section 523(a)(5). The ultimate burden remains with the creditor seeking to except the debt from discharge. The relevant time for making the Section (a)(5) analysis is the time of the decree.

.... [T]he bankruptcy court must independently assess the character of an obligation arising out of a divorce and determine whether it is in the nature of alimony. Section 523(a)(5) requires that the bankruptcy court determine nothing more than whether the payment obligation *545 is in the nature of “alimony, maintenance, or support.” No precise inquiry into the parties' present financial circumstances is required; only a simple inquiry into the nature of the obligation, liquidating known amounts and leaving any issue of future modifications to the applicable state court.

In determining whether a debtor's obligation is in the nature of support, the intent of the parties [or the trier of fact] at the time of the settlement agreement or trial is dispositive. While a label placed upon spousal obligation is not dispositive in determination of dischargeability, it is indicative of the parties' intent.

Id. slip op. at 10–12 (internal citations omitted).

The most critical factors to be considered in interpreting the parties' intent with respect to the provisions of a divorce settlement include: (1) any disparity in the parties' earning capacities; (2) parties' relative business or employment opportunities; (3) parties' physical condition; (4) parties' educational background; (5) parties' probable future financial needs; (6) benefits that each party would have received if marriage had continued. *Id.* at 12. (citing *Dennis v. Dennis (In re Dennis)*, 25 F.3d 274, 279 (5th Cir.1994)).

The separation agreement does not specifically provide for alimony payable to the Plaintiff; however, it provides that Debtor will assume the Visa debt of \$8,700.00 and the second mortgage on the house. It is well-established that debts payable to third parties may be viewed as maintenance or support obligations. See *Pauley v. Spong, (In re Spong)*, 661 F.2d 6, 10–11 (2nd Cir.1981); *Williams v. Holt (In re Holt)*, 40 B.R. 1009, 1012 (S.D.Ga.1984). Therefore, the protection afforded by debt assumption and hold harmless agreements arising in a divorce may provide essential maintenance or support so as to fall into § 523(a)(5). See, e.g., *Smith v. Smith (In re Smith)*, 218 B.R. 254, 260 (Bankr.S.D.Ga.1997); *Chapman v. Chapman (In re Chapman)*, 187 B.R. 573, 575 (Bankr.N.D. Ohio 1995); *Ferebee v. Ferebee (In re Ferebee)*, 129 B.R. 71, 73–74 (Bankr.E.D.Va.1991).

However, Plaintiff still bears the burden of proof of establishing that the obligation is actually in the nature of support. The separation agreement does not provide for alimony for Plaintiff, and Plaintiff presented no evidence which establishes that when Debtor assumed the second mortgage and credit card debt, the parties intended those sums to qualify as providing alimony and support to her. Therefore, Plaintiff failed to satisfy her burden of proof.

The house belonged to the Debtor prior to the marriage; therefore, the fact that he remained in possession of the house and assumed the second mortgage does not indicate that the parties intended his assumption of the second mortgage as providing support to her. Furthermore, in the separation agreement, Debtor assumed the Visa and Shell credit card debts and Plaintiff assumed the Belks, J.C. Penney and Sears credit card debts. The division of the credit card debts appears to be in the nature of a property settlement. In addition, the short duration of the marriage and the fact that there were no children of this marriage also indicate that the separation agreement was intended as a property settlement. See *Semler v. Semler (In re Semler)*, 147 B.R. 137, 140 (Bankr.N.D.Ohio 1992) (“The marriage of short duration produced no children which reflects little need for support provisions.”); *Boudakian v. Boudakian (In re Boudakian)*, 137 B.R. 89, 92–93 (Bankr.D.R.I.1992) (“Many Bankruptcy Court decisions *546 support the view that a marriage like this one, of short duration, without issue, and where the financial condition of the non-debtor spouse had not materially declined, would result in a finding of a property distribution, as opposed to alimony or support.”)

Finally, in applying the *In re Dennis* factors to determine intent, it does not appear that the parties intended for the obligations to be considered in the nature of support. Although Debtor currently has more income than Plaintiff, a large percentage of that income is retirement pay. Debtor works as a security guard whereas Plaintiff works in a corporate environment with advancement opportunity. Furthermore, Debtor has three minor children which impact his probable financial needs. The parties did not present evidence as to their respective physical conditions or educational backgrounds.

The court is aware that determining these obligations to be dischargeable will allow the creditors to pursue Plaintiff for collection of Debtor and Plaintiff's joint debts. If successful, Plaintiff's ability to provide for her own necessities may

be impacted. However, the intent of the parties at the time of the decree is dispositive. *Cummings v. Cummings*, 244 F.3d 1263, 1266 (11th Cir.2001) (noting that the touchstone for dischargeability under 523(a)(5) is intent of the parties). Plaintiff's inability to pay the obligations at this point is not a factor to be considered in a § 523(a)(5) case. See *Harrell v. Sharp (In re Harrell)*, 754 F.2d 902, 907 (11th Cir.1985) (holding that no precise inquiry into spouse's financial circumstances is necessary).

2. 11 U.S.C. § 523(a)(15)

Section 523(a)(15) is not applicable to this Chapter 13 case. Section 1328(a)(2) excepts § 523(a)(5) debts from discharge, but it does not except § 523(a)(15) debts from discharge. 11 U.S.C. § 1328(a)(2). See also *Williams v. Williams (In re Williams)*, Ch. 7 Case No. 98–40928, Adv. No. 98–4090, slip op. at 5 n. 1, 1998 WL 34064516 (Bankr.S.D.Ga. Sept. 30, 1998). So long as Debtor's Chapter 13 case remains pending and in the event it is successfully completed, his Chapter 13 discharge will include any unpaid balance owed on the mortgage and the pre-divorce credit card obligation. If for any reason his case is converted to Chapter 7, then a § 523(a)(15) issue will arise based on the then current ability of the parties to pay these debts.

B. The Post-divorce, Pre-bankruptcy Visa Balance

After the divorce, Debtor incurred substantial additional charges on the Visa card that he seeks to discharge. According to his testimony, he obtained cash advances to pay obligations to Plaintiff such as her attorney's fees and moving expenses, both of which he owed pursuant to the separation agreement. In addition, Debtor made purchases at a local florist, a jewelry store, and a tanning salon.

A bankruptcy court may, in its discretion, abstain from addressing a particular matter when concerns of comity and judicial convenience outweigh federal bankruptcy concerns. *In re Chadwick*, 296 B.R. 876, 883 (Bankr.S.D.Ga.2003). Specifically, 28 U.S.C. § 1334(c)(1), in pertinent part, provides,

Nothing in this section prevents a district court in the interest of justice, or in the interest of comity with State courts or respect for State law, from abstaining from hearing a particular proceeding arising under title 11 or arising in or related to cases under title 11.

*547 Although § 1334(c) refers to district courts, it applies to the bankruptcy court when the district court refers a case

or proceeding to the bankruptcy court. *Cash Currency Exch., Inc. v. Shine (In re Cash Currency Exch., Inc.)*, 37 B.R. 617, 620 n. 2 (N.D.Ill.1984).

The Eleventh Circuit noted that “it is appropriate for bankruptcy courts to avoid incursions into family law matters out of consideration of court economy, judicial restraint, and deference to our state court brethren and their established expertise in such matters.” *Carver v. Carver*, 954 F.2d 1573, 1579 (11th Cir.1992)(quoting *In re MacDonald*, 755 F.2d 715, 717 (9th Cir.1985)). Furthermore, the state court has concurrent jurisdiction with this Court to determine whether Debtor's obligations are in the nature of support for the purposes of § 523(a)(5). *Cummings v. Cummings*, 244 F.3d 1263, 1267 (11th Cir.2001).

In the interest of justice, comity and judicial convenience, this Court will abstain from determining if Debtor's post-divorce, pre-bankruptcy obligations on the Visa card are in the nature of alimony, support or maintenance. The post-divorce, pre-bankruptcy charges were prohibited by the separation agreement and unanticipated by the parties and the Camden County Superior Court; therefore, it is impossible for this Court to determine the intent of the parties or the state court at the time of the decree. Indeed, to attempt to do so would infringe on the prerogative of the state judicial system. It is for that court to determine the liability for Debtor's charges on the joint credit card made after the separation agreement was entered and their dischargeability in bankruptcy.

Further, because the state court has concurrent jurisdiction to determine dischargeability, the parties are granted relief from

the automatic stay under 11 U.S.C. § 362 in order to have the issue determined by the state court. See *Carver*, 954 F.2d at 1578 (noting that “such relief should be liberally granted in situations involving alimony, maintenance, or support in order to avoid entangling the federal court in family law matters best left to state court.”).

ORDER

Pursuant to the foregoing Findings of Fact and Conclusions of Law, IT IS THE ORDER OF THIS COURT that (1) Debtor's obligation to pay the second mortgage on the Camden County house is dischargeable in Chapter 13 and; (2) Debtor's obligation to pay the \$8,700.00 balance on the Visa card as of the date of the separation agreement is dischargeable in Chapter 13.

FURTHER ORDERED that this Court will abstain from determining if the post-divorce, pre-bankruptcy credit card charges are dischargeable due to their nature as alimony, maintenance or support.

FURTHER ORDERED that the parties are granted relief from the automatic stay in order to pursue an action in the state court to determine the dischargeability of the post-divorce, pre-bankruptcy credit card charges.

All Citations

303 B.R. 539

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26 B.R. 267

United States Bankruptcy Court,
W.D. Missouri, Western Division.

In the Matter of RIMPULL
CORPORATION, Alleged Debtor.
CASSCO MACHINING, INC., Payne
Manufacturing, Inc., and Marmon/
Keystone Corporation, Petitioners,

v.

RIMPULL CORPORATION, Defendant.

Bankruptcy No. 82-02474-3-11.

|
Nov. 10, 1982.

Synopsis

Minority creditors who dissented from alleged debtor's repayment arrangement which had been accepted by vast majority of debtor's creditors brought action to have debtor adjudicated as an involuntary debtor. The Bankruptcy Court, Dennis J. Stewart, J., held that abstention and consequent dismissal would be in best interests of debtor and creditors.

Dismissed.

Attorneys and Law Firms

*268 Michael R. Roser, Kansas City, Mo., for petitioners.

Mendel Small, Kansas City, Mo., for defendant.

FINDINGS OF FACT, CONCLUSIONS OF LAW AND
ORDER ABSTAINING FROM PROCEEDINGS UNDER
[SECTION 305](#) OF THE BANKRUPTCY CODE AND
ACCORDINGLY DISMISSING CASE

DENNIS J. STEWART, Bankruptcy Judge.

This is an action brought by the petitioners, who are creditors of the alleged debtor in varying amounts, to have the debtor adjudicated as an involuntary debtor under the provisions of section 303 of the Bankruptcy Code. In its answer to the involuntary petition, the debtor denies that it is "generally not paying such debtor's debts as such debts become due" within the meaning of section 303(h)(1) of the Bankruptcy Code and, further, requests abstention by the bankruptcy court from this case under the provisions of [section 305](#) of the Bankruptcy Code.

After joinder of the issues by the pleadings, a trial of the issues of whether the debtor is paying its debts as they become due and of the issues underlying the request for abstention came on before the bankruptcy court for hearing on October 22, 1982, in Kansas City, Missouri. Thereupon, the petitioners appeared by Michael R. Roser, Esquire, their counsel, and the alleged debtor corporation appeared by its counsel, Mendel Small, Esquire. A plenary evidentiary hearing was conducted, and, on the basis of the evidence which was then adduced, the following findings of fact are made.

Findings of Fact

Rimpull Corporation manufactures and sells bottom and rear-dump vehicles, and related parts, to the mining industry. It was organized in the year 1971 by Richard Manuel Davis, who since February 1971 has been the chief executive officer and major stockholder. As of the date of the hearing on October 22, 1982, Mr. Davis was holder of 99% of the outstanding stock, the only director and the president of Rimpull Corporation. Mr. Davis is responsible for all the business and operations of the organization. The business of Rimpull was not profitable during the years of its early existence. It first turned a profit in 1974 when its sales totaled \$2,800,000.00 for the year. Over the years which followed, sales continued to increase as follows:

1975.....	\$4,700,000.00
1976.....	\$4,900,000.00
1977.....	\$8,400,000.00
1978.....	\$12,200,000.00
1979.....	\$12,100,000.00

Beginning in 1980, apparently because of a decline in the mining industry generally, sales commenced to decline. In 1980, total sales were \$9,700,000.00. In 1981, they were \$5,700,000.00. And, to date in 1982, the total sales have been, according to the uncontradicted testimony of Mr. Davis, \$6,500,000.00 or \$6,600,000.00.

Accordingly, the last profitable year for Rimpull Corporation was the year 1979. The loss for 1980 was \$606,584.00. For 1981, it was \$1,510,322. For the first six months of 1982, the loss has been \$914,885.00. According to the testimony of Mr. *269 Davis, it is hoped that an additional loss of only \$50,000.00 will be suffered for the remaining months of 1982. The projected loss for the entire year 1982 is \$1,100,000.00.

Additionally, as of December 31, 1981, Rimpull Corporation was the debtor on several large notes. One of these was a note in the total sum of \$800,000.00, owed to the Commerce Bank of Kansas City. This note was a note originally issued by the General Capital Corporation, which had been the parent corporation of Rimpull Corporation but was merged into Rimpull. As a result of the merger, the obligations of General Capital Corporation became those of Rimpull. As to this particular obligation, it was secured by all the stock of Rimpull Corporation and a \$250,000.00 note of Rimpull Corporation, which note is said to represent a temporary working capital loan. Additionally, the note was guaranteed by Mr. Davis, the major stockholder and chief executive officer of Rimpull Corporation.

Another indebtedness to the Commerce Bank of Kansas City is represented by a demand note dated January 31, 1982, in the total principal sum of \$2,770,000.00. Rimpull Corporation has given no security for this loan.

A third large obligation is that owed to Mr. Davis, the major stockholder and chief executive officer, in the sum of \$1,015,000.00. This is an unsecured indebtedness which, according to Mr. Davis' uncontradicted testimony, represents loans of working capital over the last four to six years. He also states that the last payment on the loan was made on May 31, 1982, and consisted solely of an interest payment. No payment of principal has been made to Mr. Davis in the last twelve months. According also to Mr. Davis' testimony, Rimpull Corporation leases a building from him at 157th Street and highway 169. As of June 1982, he reduced the rent which Rimpull is to pay him from \$6900 per month to \$5,000 per month. He intends to forgive any indebtedness

for the difference "so long as Rimpull stays out of chapter proceedings." No other indebtedness for rent is currently owed by Rimpull to Mr. Davis.

All told, the indebtedness of Rimpull Corporation amounts to some \$6,504,000.00, including that to the "trade creditors," including the petitioners in this case. The indebtedness to the petitioner Cassco Machining, Inc., is \$24,280.70 plus interest. That to the petitioner Payne Manufacturing, Inc., is \$32,257.50 plus interest. And \$1,819.10 plus interest is owed to the third petitioner, Marmon-Keystone Corporation.

Between December 31, 1981, and June 30, 1982, the debt of Rimpull Corporation to its suppliers, the "trade creditors," increased from \$375,399.00 to \$1,919,768.00. Over the same period of time, the comparative ratio of current indebtedness to other indebtedness declined from 1.07 to .76. As of June 30, 1982, Rimpull Corporation had a negative net worth of \$1,265,218.00. And, as of July 31, 1982, Rimpull had debts to "trade creditors" of \$843,920 that had been owed for 90 days or more. According to the uncontradicted testimony of Mr. Davis, it is not unusual in the particular trade or business for accounts payable to be owed for 90 days or more.

The accounting firm of Arthur Andersen and Company issued an auditor's report on Rimpull Corporation as of December 31, 1981. *Inter alia*, the report stated as follows:

"As shown in the financial statements, the Company incurred net losses of \$606,584 and \$1,510,322 during the years ended December 31, 1980 and 1981, respectively. In addition, at December 31, 1981, the Company has a total of \$3,695,000 in demand notes. These factors indicate the Company may be unable to continue in existence. Realization of the investments in inventory of \$3,848,687 and equipment of \$200,221 is dependent upon the success of future operations. The financial statements do not include any adjustments relating to the realization of these investments that might be necessary should the Company be unable to continue in existence."

In order to contend with this financial situation, Rimpull Corporation has, according to the testimony of Mr. Davis, inaugurated *270 a "severe retrenchment program" to reduce costs and the scale of operations. Further, Rimpull sought to place in effect a plan for dealing with the great range of outstanding debt. As an initial step, Rimpull paid the \$800,000.00 debt to Commerce Bank. According to the testimony of Mr. Davis, Rimpull paid off these obligations

so that Commerce Bank could not use the Rimpull stock, which was the security for the \$800,000 debt, to control the debtor corporation and possibly cause it to be liquidated. Likewise, according to Mr. Davis' testimony, payment of this debt ensured autonomy by having the additional effect of preventing Commerce Bank from exercising control over him personally because of his personal guarantee of the loan. The indebtedness was paid in June 1982, a date within 90 days of the date of the filing of the petition for relief in this case. Accordingly, the petitioning creditors contend that this payment constitutes an avoidable preference within the meaning of section 547 of the Bankruptcy Code or possibly a fraudulent transfer within the meaning of section 548 of the Bankruptcy Code.

As to the remaining indebtedness of \$2,770,000 to Commerce Bank, the debtor proposed to pay Commerce Bank the sum of \$200,000 forthwith and to give Commerce Bank a note in the sum of \$1,770,000 which should not bear interest and which would have no maturity date, but would be secured by a security interest in inventory of Rimpull Corporation which is slow moving and which has significant value, according to the testimony of Mr. Davis, if Rimpull Corporation commences to manufacture off-road vehicles on a permanent basis. Otherwise, according to this arrangement, the alleged debtor would maintain with Commerce Bank an \$800,000.00 line of credit which would not be cancellable over a period of three years. This would be secured by a security interest in the cash, inventory, and accounts receivable of the Rimpull Corporation.

Under the date of July 16, 1982, the alleged debtor transmitted the following letter to its creditors:

"As you are aware, Rimpull Corporation has recently had difficulty paying invoices from your company within normal credit terms. We have been in existence for many years and have always felt an equal obligation to both suppliers and customers so be assured that this situation is as distressing to us as it has been for you. The purpose of this letter is to help you better understand our situation and outline our plan for corrective action.

"The dramatic downturn in the mining equipment industry has had a serious impact on our company over the past several months and has resulted in a sharp decline in new truck sales and a drop in parts sales as well. The new truck sales which the company has been able to get have been only marginally profitable. Also hurting Rimpull's liquidity is a heavy production inventory in the several

million dollar range consisting of parts which are used to make trucks operated primarily by the copper and iron ore industries which we estimate are unlikely to be sold in the near term. Most of the rest of the company's assets consist of inventory of service parts, specifically fabricated for our trucks, which can only be converted to cash when purchased by our customers—many of whose mines are currently either closed, or working short work turns.

"Despite these problems, Rimpull intends to continue to operate and stay in the mining equipment business, both as a manufacturer of trucks and a supplier of parts to its customers. In order for Rimpull to be successful in its efforts, we need the help of our customers, suppliers and lenders.

"We have already taken some positive steps in this direction and want to bring you up to date on them.

"(1) We have retained an investment banker with experience in our industry who has worked with us in developing a program to (a) significantly reduce operating costs, (b) generate a positive cash flow from operations going forward each month, and (c) to restructure our indebtedness with the bank and our suppliers.

***271** "(2) Our bank, the Commerce Bank of Kansas City, has agreed in principle to restructure its debt with us, assuming the trade restructuring program described below is successful. Specifically, the bank has agreed to restructure \$1,770,000 of its \$2,770,000 loan to a long term loan *payable only* out of the proceeds of approximately \$2,000,000 of slow and non-moving production inventory. In other words, if the inventory is not used or sold, the bank does not get paid. The bank has also agreed to restructure \$800,000 of the remaining \$1,000,000 as a three year revolving credit and be paid only \$200,000 in cash at the time the agreement is finalized. In the unlikely event that Rimpull does not continue to operate for the next three years, the total amount of the bank debt would have priority over the claims of the unsecured creditors. At the present time, our analysis indicates the liquidation value of all the company's assets would be less than the bank debt.

"This agreement with the bank frees up cash to pay trade debts which would not otherwise be available for that purpose, and we appreciate their confidence in Rimpull's ability to weather the current tough economic climate in the mining industry.

“We are therefore proposing to you, as an important supplier with whom we hope to continue to do business, the following restructuring plan, which is the same proposal that we are offering to all other unsecured trade creditors who are owed more than \$1,500.

“We are asking you to accept in lieu of your existing trade debt, a note equal to 100% of the debt, payable in ten equal installments at six month intervals over the next five years, without interest. The first payment of 10% would be made in cash upon your acceptance of this proposal.

“If our cash flow builds up faster than we anticipate, it would be our intent to accelerate the payment of the notes, but we cannot make any commitment to do so at this time.

“We are aware of the impact that this deferral may have on your business and are deeply sorry. We also understand that you may not wish to extend credit to us for this period of time so we have provided a second alternative. Under this alternative, in full settlement of all obligations owed by Rimpull to your firm Rimpull would pay you 40% in cash, 25% upon acceptance and 15% in four months. Again, this same proposal is being offered to all unsecured trade creditors over \$1,500.

“I hope that you will work with us on these proposals. I wish we had more money to be able to pay you more. All I can say is that we intend to be in business for a long time, and I hope that the benefits of our future business with you will help offset some of this problem.

“We feel that this plan is the best we can offer. We feel it is very important that we make commitments to you that we can meet under most reasonable projections of economic and business activity.

“We have consulted with our attorneys in reviewing the possible alternatives that exist for handling the claims of creditors. It appears that the only alternative to the plan of payment proposed above is the filing of an Arrangement Proceeding (Chapter XI) in the federal courts which would only further delay payment. In addition, the costs inherent in such a proceeding would undoubtedly result in payments significantly less and significantly later than those proposed above. We hope that our creditors will go along with our payment plan so that we will not be forced to seek temporary protection of the Court.

“Please do not hesitate to call if you have any questions. We have attached for your convenience an acceptance agreement form for either alternative above which we would appreciate your signing and returning to us as soon as possible. We will promptly make payment to you upon receipt of this form duly executed.

“We appreciate your cooperation in this difficult situation. With your patience and cooperation it will be corrected.”

***272** According to Mr. Davis' uncontradicted testimony, 67% of the number of the trade creditors and 76% in amount the trade creditors have to date indicated their acceptance of the arrangement described in the above quoted letter. But the petitioning creditors, who are among the trade creditors, have brought this suit for the entry of an involuntary order of relief under title 11, United States Code, for the Rimpull Corporation.

Conclusions of Law

Abstention

[Section 305](#) of the Bankruptcy Code provides that the court, “after notice and a hearing, may dismiss a case under this title ... at any time if ... the interests of creditors and the debtor would be better served by such dismissal or suspension.” According to the legislative history under that section, “(t)he court may dismiss or suspend ..., for example, if an arrangement is being worked out by creditors and the debtor out of court, there is no prejudice to the rights of creditors in that arrangement, and an involuntary case has been commenced by a few recalcitrant creditors to provide a basis for future threats to extract full payment.” Considered under these standards, the case at bar is a paradigm case for abstention by the court of bankruptcy. An arrangement has been worked out by the debtor with its creditors; it has been accepted by a vast majority of the creditors; the money is in place to fund a major part of the arrangement¹; and only a minority of creditors have dissented from the arrangement and have filed the petition at bar requesting an involuntary adjudication.

The petitioning creditors, however, assert that there are factors present in the case at bar which distinguish it from the exemplar case described in the legislative history to [section 305](#) of the Bankruptcy Code. They contend that, unless the involuntary order for relief is entered, the \$800,000 payment

to Commerce Bank, made within 90 days of the date of the filing of the involuntary petition, would be “insulate(d) ... from judicial scrutiny and probable avoidance.” But, in making the determination of the issue of abstention, the court must be mindful of the primary standard to be applied, i.e., whether abstention will be in the best interest of the creditors and of the debtor as well. According to the nonjudicial arrangement now offered the creditors, they all, at their option, can be paid 100% of the existing indebtedness, albeit without interest in the case of the “trade creditors.” Thus, even if the prepetition payment of \$800,000 is in fact “insulated from judicial scrutiny,” an unfair or undesirable result is not achieved thereby. It is still proposed, and with some degree of realism, that the creditors will be paid 100% of their principal. Therefore, the court cannot conclude that, for this reason, abstention would not be in the best interests of the creditors and the debtor.²

The petitioning creditors, however, next contend that the creditors would receive more in liquidation under the Bankruptcy *273 Code than they would in the arrangement which is now being offered them. In this regard, the analysis of the petitioning creditors is as follows:

“If the \$800,000 payment made to Commerce in June 1982 were avoided, Rimpull's cash position would be \$1,800,000. Rimpull's non-cash assets include accounts receivable (\$475,000), inventory (\$3,000,000 at cost), and machinery and equipment (\$158,000 net of depreciation). Rimpull's trade creditors would be limited to a 40% recovery only if liquidation of Rimpull's non-cash assets, less administration expenses, produced \$801,600. This represents 22% of the book value of Rimpull's non-cash assets.”

It must be remembered, however, as a signal point that the arrangement being offered to the trade creditors will grant them 100% payment, at their option, if they are willing to wait as much as five years for the full payment of their debt, which will be paid in six month intervals over that five-year period. They need be limited to 40% recovery only if, *at their option*, they elect to receive payment within four months. And, if the figures contained in the above analysis can be accepted as correct, payment through liquidation, even if the full “book value” referred to can be obtained, would result in far less than 100% payment to the “trade creditors.”³ Nor is it altogether likely that the time factor would be improved upon, when, according to the evidence, operations must continue for some time in order that much of the property can retain its present “book value.”

Next, however, the petitioning creditors contend that it is unlikely that the debtor corporation can long continue in business, in view of their continuing losses, their declining sales and the opinion of Arthur Andersen and Company that “the Company may be unable to continue in existence.” But there are factors which ameliorate this dim view, including the obtaining of new finance, a retrenchment program which will reduce overhead, the reduction of Mr. Davis' salary to zero and the proposed subordination of the corporation's indebtedness to him in part and the forgiveness of it in remaining part. Now that these principal factors have come into existence, the company can point with some justification to a possibility of minimizing losses for the remainder of 1982 and perhaps reversing the trend in the near future.

The petitioning creditors contend that the arrangement benefits Commerce Bank and Mr. Davis, but is detrimental to the other creditors. They state in this respect as follows:

“(T)he workout that Rimpull proposes would very nearly assure payment in full of the debt owed to Commerce. It would also require trade creditors to accept a 60% discount of the debts due them. In these Bankruptcy Code proceedings, Rimpull could propose a plan of reorganization that accorded differing treatment to the debt owed to Commerce and the debts owed to trade creditors. But, the plan of reorganization could not be confirmed unless each trade creditor received at least the amount that would be received in a liquidation proceeding. Bankruptcy Code section 1129(a)(7). It is reasonably likely that trade creditors would realize substantially more than 40% of the debts due them in a liquidation proceeding.”

As the court has previously pointed out, however, the trade creditors may elect to receive 100% of their debts under the arrangement being offered them. The entire indebtedness of Commerce Bank will be paid, albeit the bank also may have to sacrifice some interest, and it will be paid as a matter of priority over the debts of the trade creditors. But Commerce Bank, according to the evidence which has been adduced to this court, will provide the financing which is necessary to the continuation of the business and the potential of a *274 100% payout to all the trade creditors who elect it. Under these circumstances, the Bankruptcy Code recognizes that it would be fair to grant the financing creditor some priority in payment. And it must also be recognized as fair under the circumstances of this case.

According to the evidence which is before this court, it cannot be concluded that the arrangement favors Mr. Davis, the chief executive officer of Rimpull Corporation. It is true that it proposes to keep Rimpull Corporation in business and to impose some sacrifice upon the creditors in order to do this. But, according to the uncontradicted evidence before this court, Mr. Davis will also undergo some sacrifice, subordinating virtually all the corporate debt owed to him to all of the other indebtedness and continuing to serve as the chief executive officer of Rimpull Corporation without pay.

In view of the foregoing facts and considerations, this court cannot discern any significant distinction between the arrangement at bar and those which were approved and provided the basis for dismissal or abstention in the cases cited and relied upon by the petitioning creditors.⁴

For the foregoing reasons, this court concludes that abstention and consequent dismissal would be in the best interests of the debtor and the creditors within the meaning of [section 305](#) of the Bankruptcy Code. Having so concluded, the court need not treat of the issues presented under section 303 of the Bankruptcy Code.⁵

It is therefore, accordingly,

ORDERED that, as a matter of unreviewable abstention pursuant to [section 305](#) of the Bankruptcy Code, this case be, and it is hereby, dismissed.

All Citations

26 B.R. 267

Footnotes

- 1 According to the alleged debtor's uncontradicted claims in this regard, it currently has on hand "\$985,000 in cash or cash equivalents" with which it "can carry out the ... composition and extension and give all of its trade creditors at least 40¢ for each dollar of debt it owes to them." Brief in Support of Motion for Abstention Pursuant to [Section 305](#) of the Bankruptcy Code, filed October 28, 1982, p. 3.
- 2 It must be observed that, in circumstances like those at bar, when, even without recovery of the alleged preference, the creditors are proposed to be paid 100% (or at least as much as they would receive in liquidation if the preference were recovered), the preference statute cannot be said implacably to call for recovery. It is recognized in section 547(b)(5) of the Bankruptcy Code that a payment which is otherwise a preference need not be recovered if the creditor is not thereby accorded more than he would otherwise receive in [title 11](#) proceedings. According to the considerations stated in the text of this memorandum, it cannot be forecast at this point that Commerce Bank is receiving under the current arrangement any more than it would receive in [title 11](#) proceedings. And, further, under the terms of the fraudulent conveyance statute, section 548 of the Bankruptcy Code, it is recognized that antecedent debts may constitute such consideration as will ordinarily prevent a payment from being considered to be fraudulent. See section 548(d)(2).
- 3 According to the figures set out in the petitioning creditors' posthearing brief, the potential liquidation value of the alleged debtor's assets would be \$5,433,000. The outstanding debt is \$6,504,000. Even given the book values, therefore, over a million dollars worth of debt would be left unpaid by straight liquidation. And it must be further considered that the liquidation values, as observed by the auditor's report, may be vastly lower by reason of the discontinuance of operations by the debtor.
- 4 See, e.g., [Matter of Win-Sum Sports, Inc.](#), 14 B.R. 389 (Bkrtcy.D.Conn.1981), in which the fundamental operative fact, i.e., that the debtor proposed with some realism to pay all the outstanding debt, was the same as in the case at bar. The distinctions pointed out by the petitioning creditors in their brief are not material to this action. The same thing is essentially true of [Matter of Lufttek](#), 6 B.R. 539, 547 (Bkrtcy.E.D.N.Y.1980) ("(M)any of its creditors have consented to (abstention), ... it would lose a substantial amount of its receivables if it is forced out of business as a result of bankruptcy liquidation, ... the petition was joined by the subsidiary of one of its competitors, and ... it has entered into a commitment for a loan which would enable it to privately reorganize its debts and pay its creditors in full. Virtually all the same material points of agreement between this case and that of [In re Bailey's Beauticians Supply Co.](#), 671 F.2d 1063 (7th Cir.1982), can be noted. Full disclosure has been accomplished in the case at bar by means of the evidence adduced in the hearing of October 21, 1982. Nor can it be regarded as decisive that in the *Bailey's Beauticians* case, *supra*, the debtor's assets were being administered by an "independent third party," i.e., an assignee for the benefit of creditors. Even in cases

under the Bankruptcy Code, it is recognized in the concept of the debtor-in-possession that it is desirable, when it is in the interest of the debtor and creditors to do so, to allow a debtor to administer its own assets.

- 5 If the court were required to make a finding on this issue, it could not be said that there has been any clear showing that the debtor is not making its payments "as such debts become due." There was no showing of any maturity date of the outstanding and unforgiven debts. It was shown that there were some \$800,000 in aged trade debts of a vintage of 90 days or so. But it was also shown that payment in excess of 90 days was nothing unusual in the custom and usage of the trade. No contracts were adduced or otherwise evidenced which would permit a finding that the trade debts were past due. That debt of the petitioning creditors is alleged, as of the date of the filing of the petition, to be "immediately due and payable," but no evidence has been adduced to demonstrate any certain maturity date or due date of the indebtedness.

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594 B.R. 442

United States Bankruptcy Court, D. Utah.

IN RE: **GENERAL AERONAUTICS
CORPORATION**, Debtor.

Bankruptcy Number: 17-28510

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Signed December 4, 2018

Synopsis

Background: Purported debtor, a company that developed gyroplanes, moved to dismiss involuntary bankruptcy petition.

Holdings: The Bankruptcy Court, [R. Kimball Mosier](#), J., held that:

petitioning creditors' claims were not subject of bona fide dispute, as would disqualify creditors from filing involuntary petition;

purported debtor was generally not paying its debts as they become due;

involuntary petition was not filed in bad faith;

suspension of proceedings for 60 days was appropriate; and

award of purported debtor's attorney fees and costs was not warranted after suspension of involuntary bankruptcy case.

Ordered accordingly.

Procedural Posture(s): Motion to Convert or Dismiss Case.

Attorneys and Law Firms

*[447](#) [Kenneth L. Cannon, II](#), [Penrod W. Keith](#), Durham Jones & Pinegar, Salt Lake City, UT, for Debtor.

MEMORANDUM DECISION

[R. KIMBALL MOSIER](#), U.S. Bankruptcy Judge

General Aeronautics Corporation and other related companies have tried to build and market gyroplanes for over 30 years, but business has not been easy. Funding shortfalls have been common, and the company could not afford to pay employees their full compensation for significant stretches of time. When the last shortfall hit in early 2015, many of its remaining employees resigned or were laid off. The company received new funding in late 2016, and word spread among the former employees and creditors, who joined together to consider their options. On September 28, 2017, Jason Chen, Jacob van der Westhuizen, Robert Wilson, Howard Kent, William Scott Carron, and Henry Parry II filed an involuntary petition against General Aeronautics, asserting claims principally for unpaid rent, unpaid compensation, and loans made to the company.¹ They were joined by three additional creditors—Carolynn Taft, Martie Nadauld, and Lori Chigbrow—on June 25, 2018 (with the original six, the Petitioning Creditors).

General Aeronautics controverted the petition and filed a motion to dismiss it and a motion to require the Petitioning Creditors to post a bond. The Court conducted preliminary hearings on those matters *[448](#) and set a date for trial. Shortly thereafter, General Aeronautics filed a separate motion to dismiss the case under [11 U.S.C. § 305\(a\)](#).² The Court conducted trial on all of these matters on September 18, 19, 20, 24, 26, and 27. After thoroughly reviewing the evidence and assessing the credibility of witnesses; and having read the motions, memoranda, and briefs; and having heard the arguments of counsel and conducted its own independent research of applicable law, the Court issued its ruling from the bench on October 4, suspending proceedings for 60 days under [§ 305\(a\)](#). The Court reserved the right to enter a written decision memorializing that oral ruling without altering its substance or the Court's final judgment. In accordance with that reservation the Court issues the following Memorandum Decision.³

I. JURISDICTION

The Court's jurisdiction over this contested matter is properly invoked under [28 U.S.C. § 1334\(b\)](#) and [§ 157](#). This a core proceeding under [28 U.S.C. § 157\(b\)\(2\)\(O\)](#), and the Court may enter a final order. Venue is appropriate under [28 U.S.C. §§ 1408](#) and [1409](#).

II. FINDINGS OF FACT

A. The Debtor's History

David Groen, a former Army helicopter pilot who served in the Vietnam War and flew commercially afterward, founded Groen Brothers Aviation, Inc. (GBA) in the mid-1980s with the goal of developing and bringing to market the technology of sustained autorotative flight using gyroplanes and other similar aircraft. While gyroplane technology has existed for approximately a century—it was the brainchild of Juan de la Cierva in the years shortly after World War I—Groen used his knowledge of helicopters to make improvements, such as the addition of collective pitch control, to gyroplanes. GBA believed that these advances, along with the particular characteristics of gyroplanes that distinguish them from helicopters and airplanes,⁴ would allow it to carve out a niche in the aircraft market.

GBA grew sporadically. Its funding in the early days consisted of numerous investments from small shareholders, and it was often playing catch-up on its financial obligations. By 2001, it had not brought a product to market that generated any meaningful revenue. That same year, GBA received a \$5 million investment, which allowed it to begin a program to achieve FAA certification on an aircraft called the Hawk 4. But the ebb in the aviation industry after the 9/11 terrorist attacks caused GBA to lay off approximately 100 of its 135 employees. It weathered the downturn and secured a contract to begin *449 work on a project called the Heliplane for the Defense Advanced Research Projects Agency (DARPA) around 2005, and employment numbers rebounded. Even so, GBA frequently remained short of cash and required additional investment. Although GBA completed the first of four phases required under the DARPA program, the contract was not renewed. The loss of the contract combined with the Great Recession led to another bout of financial trouble. GBA asked employees to defer compensation and eventually accrued approximately \$1 million in unpaid wages and salary, which it later repaid, but it laid off 90 of 96 employees in 2007-08.

After those layoffs GBA stalled. Of the 20 engineers and 20 drafters it employed during the peak of the DARPA project, it retained only one of each after the layoffs. Its debt structure discouraged additional investment, and it produced nothing from 2008-12. GBA eventually changed its name to Groen Brothers Aviation USA, Inc. and developed a financial restructuring and recapitalization plan whereby it would

transfer its assets, employees, and operations to a new entity, Groen Brothers Aviation Global, Inc. (GBAG).⁵ As part of that plan, GBA's creditors would have their debt converted into equity in GBAG. Trade creditors, utilities, and employees were excluded from this conversion arrangement. After some delay, the transfer from GBA to GBAG was carried out in December 2012 (Transition).

Freed from the debt of GBA, GBAG was supposed to attract new investment from certain funds managed by Steven Stevanovich, who is currently one of two Executive Directors of the debtor. The expected funding did not materialize, however, and cash was acutely scarce pre- and post-Transition, which led to reductions in employee pay and, as before, the accrual of unpaid compensation.⁶ GBAG's finances were uncertain enough that it asked its landlord in December 2013 for some time to vacate the property in the event it could not pay rent.⁷ In addition, employment numbers had not recovered to prior levels. GBA had 47 employees on its payroll in January 2012, many of them part-time or temporary.⁸ Those numbers dropped to 13 at GBAG a year later,⁹ but later climbed to as high as 28 in November 2014.¹⁰

In early 2014, Jason Chen, who had previously worked for GBA as a fundraiser from 2004-08 and as an advisor for a shorter six-month period, was asked by GBAG to investigate and pursue a potential deal with Wuhai, a city in Inner Mongolia, China. That deal did not come to fruition. Though not formally appointed, Chen became de facto CEO, and at his insistence the company changed its name to General Aeronautics Corporation (GAC). With Chen's assistance, GAC negotiated with the Aviation Industry Corporation of China (AVIC) to form a joint venture to develop and produce a two-seat and a four-seat aircraft. While the parties signed a letter of intent in July 2014 and a cooperation agreement in December 2014, the deal was later terminated. Chen also provided *450 much-needed cash, which was used to fund payroll and other expenses. But when Chen left GAC the company ran out of money and in January 2015 it laid off nearly all of its employees (2015 Layoffs). Other employees, including executives Robert Wilson and Jacob van der Westhuizen, resigned.

As GBA had done in 2008, GAC entered a period of doldrums. Groen, who was restored as CEO shortly after the 2015 Layoffs, was one of five employees remaining, though GAC had no operations. By April 2015, it had \$205 left in its bank account. GAC received relatively modest

amounts of funding beginning around May 2016 and started to repay some amounts owed to former employees.¹¹ Then with Groen at the helm, GAC changed its name to Groen Aeronautics Corporation. In late 2016, Groen Aeronautics began conversations with West Mountain Partners, L.P. to fund the development of a new aircraft. The company believed it needed approximately \$13 million to complete the project or \$5 million to create a prototype, and in November 2016, West Mountain agreed to invest \$5 million with the option to invest up to \$8 million more.¹² The following month, \$4,993,290.77 was deposited into the bank account of GAC Unmanned Aircraft Systems, Inc.,¹³ the wholly-owned subsidiary of Groen Aeronautics. There is no evidence that West Mountain has invested funds beyond the original \$5 million.

Once Groen Aeronautics received those funds, Groen and the board grappled over authority to use them. Groen's apparent insistence on using a portion of that money to repay some of GAC's old debts led to the board ousting Groen as CEO and a board member in January 2017. By May 2017 Groen Aeronautics had changed its name to Skyworks Global, Inc. Since Groen's ouster Skyworks has spent substantial sums of money, but it has largely ignored the old unpaid debts accrued at GAC.¹⁴

GAC presently has three employees and outsources its engineering work. While developing an aircraft from design to production is an admittedly long and difficult process, GAC has not built a gyroplane. During its existence GBA only built ten, none of which received FAA certification. Like GBA before it, GAC has not generated meaningful revenue during its existence and is entirely dependent on equity investments or loans to fund its operations.

GAC is currently pursuing, to varying degrees, six projects for the application of its technology.¹⁵ Two projects—the Hawk 6e and the Gyroliner—are in the earliest stages of development and their potential for success is unclear. The Hawk 6e is a six-seat electric composite-body gyroplane that exists only in an artist's conception; the design process has not yet begun. But other aviation companies have started to explore the market for distributive electric propulsion, in which the Hawk 6e would compete. The Gyroliner is a passenger airplane fitted with a rotor—a modern analogue to the Fairey Rotodyne—and is intended *451 to serve the inner-city market in India. Brigadier General (Ret.) John Michel, the other Executive Director at GAC, testified that

the company is in early-stage discussions regarding the Gyroliner, but it is undisputed that it has not been built. The third project aims to resurrect the Heliplane with DARPA, whose “Red Team”—a group that evaluates and scrutinizes potential projects—was scheduled to review the Heliplane on October 15, 2018 to determine if it should move forward. The fourth project is a collaboration with FedTech whose goal is to develop the Precision Airdrop System, which has the stated capability of dropping up to a ton of material within a meter of its intended target. Potential applications for such technology include humanitarian aid organizations and the military, and GAC believes that a sizeable market will develop in the next few years. The fifth project is reenergizing the SparrowHawk line, a small, experimental two-seat gyrocopter. GAC intends to build an updated version called the SparrowHawk 4 and is attempting to sell the five SparrowHawks it has in inventory for \$50,000 each.

The sixth project, the Hawk 5, is the closest to realization and offers the best chance at producing revenue in the near term. The Hawk 5 is a five-seat gyroplane that is currently GAC's primary initiative. GAC has been in negotiations with the Serbian government and Jugoimport-SPDR J.P. (Jugoimport), a government conglomerate that includes Avio Industrija d.o.o. (UTVA), Jugoimport's operating subsidiary, to produce a Hawk 5 prototype. After trial, GAC supplemented the record with a contract signed with Jugoimport for the fabrication, assembly, and flight testing of a prototype. Gen. Michel testified that he hopes a prototype will be produced within six months. While a prototype is necessary to attract potential orders, whether the Hawk 5 will enter production and generate revenue is another matter. Gen. Michel believes GAC would receive thousands of orders for the Hawk 5, which would sell at \$650,000 to \$1,000,000, depending on the region to which it was sold and the aircraft's features and mission objectives. He also estimates that profit margins on the aircraft will be 20-30%. But these figures were not corroborated by additional evidence, and the commercial manufacture of the Hawk 5 is not a *fait accompli*. Even though Jugoimport has agreed to produce a prototype, the contract with GAC expressly states that further production of the Hawk 5 “will be the subject of a separate contract.”

B. The Market for Gyroplanes¹⁶

While gyroplane technology has existed for a century and predates that of helicopters, gyroplanes have not achieved the popularity or market share of other aircraft. For most of its history, the market for gyroplanes has been the province

of sport enthusiasts. There have been attempts at producing larger gyroplanes for commercial transportation—the Fairey Rotodyne, developed in the United Kingdom in the 1950s, is one notable example—but they have not brought sustained success. At present, there may be up to 32 companies building gyroplanes. One of the leaders in that group is AutoGyro, a German company that produces 300-400 aircraft per year and generates approximately \$40 million in annual revenue. AutoGyro also achieved FAA type certification on one of its models in 2016. Certification allows a company to sell an aircraft across ***452** a much broader range of applications; without it, the company is limited to experimental or sport craft applications. In addition to AutoGyro, certain large aircraft manufacturers, including Boeing and Airbus, are developing products that, while not gyroplanes themselves, have functionalities that could eat into the gyroplane market share.

C. Reductions in Pay

The lack of funding in 2012 caused GBA to tighten its belt. One cost-cutting measure was a request for all employees, executive and non-executive alike, to reduce their compensation around April 2012.¹⁷ It was not a mandatory reduction; employees were asked to do what they could, and while not all employees agreed to reduce their compensation, some did in varying amounts. Employees indicated their consent to a reduction in pay via email. As the Transition approached, GBA notified employees that “[i]nitially compensation levels in [GAC] will ... remain at the current reduced levels.”¹⁸ And although the company expressed optimism that it could restore employee pay to their former levels within 60 days after the Transition,¹⁹ those reduced rates persisted until the 2015 Layoffs.²⁰ GAC was unable to pay employees all of their compensation post-Transition at those lower amounts (Unpaid Compensation).

The parties have disputed whether GBA and, later, GAC promised to repay the difference between non-executive employees' former compensation levels and their reduced compensation levels (Deferred Compensation), along with a 25% bonus to incentivize employees to take a pay cut (Bonus Compensation).²¹ But there is no dispute. Numerous former non-executive employees separately testified that GBA and GAC promised them Deferred and Bonus Compensation, and though the promise was an oral one, their testimony on that point was credible. In particular, the voluntary nature of the reduction supports the employees' version of events.

If non-executive employees were not offered Deferred or Bonus Compensation, but also did not have to reduce their compensation, it seems unlikely that many of them would opt for the reduction. But 10 of the 41 non-executive employees on GBA's payroll on May 12, 2012 chose to take a pay cut in some amount.²² A year later, 11 of the 18 non-executive employees on GAC's payroll continued to take a pay cut.²³ It is unlikely that they would have made that choice and stuck with it, knowing that some of their peers who chose not to reduce their compensation were being paid in full while company executives were accruing Deferred and Bonus Compensation, if they did not also expect to be repaid at some point in the future. Moreover, at least two previous times during its existence GBA asked employees to reduce their compensation, and both times GBA eventually ***453** paid back the difference to its employees. But GAC never explained why many of the same employees who had gone through those previous rounds of pay cuts and repayments would agree to a third pay cut without at least a promise of repayment. It simply is not credible, given past practice at GBA, that they would have agreed to such an arrangement.

In addition, two pieces of documentary evidence support the Petitioning Creditors' contention. The first is Wilson's December 2012 letter, which was written to all employees, not merely executive employees, to inform them of the imminent Transition and to outline certain HR matters related to the Transition. One such matter is employee compensation. Wilson's letter carefully distinguishes between two categories of compensation. The first is the difference between pre- and post-May 2012 levels of compensation and the incentive bonus accrued after transition to GAC. The second is the difference between pre- and post-May 2012 levels of compensation and the incentive bonus accrued prior to GBA's transition to GAC.

As you may recall, David [Groen] indicated in an October meeting with staff that it should be possible to reinstate pay to pre-May levels within 60 days of closing. The difference between pre- and post-May levels accrued after transition within [GAC], along with a 25% incentive for those still working at [GAC], should follow soon thereafter.

Separately, we must address the difference, and incentive bonus, between pre- and post-May levels, that has been accrued prior to transition within [GBA]. We remain committed to making these payments as soon as possible.²⁴ The references to these categories show that GBA initially offered, and GAC continued to offer, Deferred and Bonus

Compensation to all of its employees, not just executives. Importantly, Wilson's letter states that Deferred and Bonus Compensation accrued post-Transition would be paid soon after GAC returned employee pay to pre-May 2012 levels. In other words, GAC not only acknowledged its obligation to repay Deferred and Bonus Compensation, but also tentatively scheduled a time to do so.

The second piece of documentary evidence is the means by which GAC would know exactly how much to repay: an Excel spreadsheet maintained by Lori Chigbrow, who was the accounting manager for GBA and GAC. Created at the direction of company executives, the spreadsheet tracked payroll payments for individual pay periods from January 7, 2012 to January 31, 2015. And once the reduced pay rates began in April 2012, it also tracked Unpaid, Deferred, and Bonus Compensation both pre- and post-Transition.²⁵ And that spreadsheet tracked those categories of compensation for executive and non-executive employees alike. The statements in Wilson's letter and the tab in Chigbrow's spreadsheet tracking Deferred and Bonus Compensation would not exist if GBA and GAC had not offered Deferred and Bonus Compensation to all of their employees.

GAC's evidence on this issue is not compelling. Groen explained that, after consultation with company leadership in 2012, he asked all employees to take a cut in pay, but executives alone would receive Deferred and Bonus Compensation. The asserted rationale for that disparate treatment was concern over potential investment *454 in GBA or GAC. Groen stated that Wilson would not have permitted non-executive Deferred and Bonus Compensation because an investor would be less likely to put money into GBA or GAC if it saw those obligations on its books.

This explanation has two faults. First, the assertion that Wilson would not approve non-executive Deferred and Bonus Compensation is directly contradicted by his December 2012 letter, where he acknowledged that all employees are entitled to Deferred and Bonus Compensation. Second, the concern that non-executive Deferred and Bonus Compensation would scare away investors is belied by the fact that GBA and GAC offered such compensation to its executives in amounts that dwarfed any potential non-executive Deferred and Bonus Compensation. While non-executives who reduced their pay outnumbered executives who did so by more than 2-to-1, the executives earned more and reduced their salaries by far greater amounts than non-executives, so they accounted for over 98% of all post-Transition Deferred Compensation.²⁶

GAC has argued that payment of executive Deferred and Bonus Compensation was contingent on approval by GBA's and, later, GAC's board, and has implied, albeit without justification, that this condition might mollify potential investors. But GAC never explained why it could not also have attached the same condition to non-executive Deferred and Bonus Compensation. Based on the substantial amount of executive Deferred and Bonus Compensation, it is not plausible that an investor would be frightened by the marginal addition of non-executive Deferred and Bonus Compensation.

D. The Labor Commission Claimants

Three of the Petitioning Creditors—Parry, Nadauld, and Carron—filed claims for Unpaid Compensation with the Utah Labor Commission. All three received judgments in their favor, including a 100% penalty and attorney's fees, which collectively totaled \$69,549.73.²⁷ GAC entered into a payment agreement with the state to repay that amount and began making monthly payments of \$2,250 in July 2016, which continued through the filing date.²⁸ As of that date GAC had paid \$33,750 towards those judgments, leaving a balance of \$35,799.73.²⁹ A claim with the Labor Commission for unpaid wages is limited to either the unpaid wages in the year prior to the claim or \$10,000.³⁰ All three of the employees who filed claims with the Labor Commission had Unpaid Compensation in excess of \$10,000.

E. The Payment Plan

When GAC received additional funding around May 2016, Groen directed that a portion of it be used to pay unpaid wages to former employees (Payment Plan).³¹ *455 GAC rehired Chigbrow as a contractor from May 2016 to April 2017 to track the Payment Plan. At Groen's request, she created an Excel spreadsheet listing the amounts owing and those paid.³² Based on those exhibits, GAC appears to be repaying Unpaid Compensation as well as unpaid wages earned pre-Transition at GBA under the Payment Plan.³³ The Court will address the issue of whether GAC is paying certain debts of GBA in greater detail in Section II.F, *infra*. But for purposes of accounting for payments under the Payment Plan, there was no evidence on whether those payments would be allocated first to unpaid wages accrued pre-Transition at GBA or Unpaid Compensation accrued post-Transition at GAC. For the purposes of this decision, the Court will allocate the

payments to Unpaid Compensation accrued post-Transition at GAC.

The Payment Plan began in May 2016 and, based on testimony from some of the Petitioning Creditors, has continued uninterrupted at least through approximately June 2018. It appears that executives were excluded from the Payment Plan,³⁴ and certain former employees who went back to work for GAC, such as Terry Brandt and Jehan Khan, were removed from the Payment Plan once they resumed work for the company. While GAC paid a total of \$12,454 to former employees under the Payment Plan in May 2016,³⁵ it typically paid \$4,200 per month from June 2016 through September 2017.³⁶ By the filing date GAC had paid at least \$67,831.11 under the Payment Plan.³⁷

F. Responsibility for GBA's Debts

GAC disclaims any responsibility to pay GBA's debts, particularly compensation that employees earned but did not receive from their time at GBA. According to Groen, these debts were never GAC's obligation, though their repayment ultimately hinged on GAC's success. Once GAC had sufficient cash it planned to buy back the \$1.5 million in stock GBA held, thereby providing GBA with funds to pay off its delinquent debts.

Despite Groen's testimony, the evidence suggests that GAC is paying some of GBA's debts under the Payment Plan, and Groen wanted to pay more of these debts when GAC received funding from West Mountain in late 2016. In addition, Wilson's *456 December 2012 letter appears at first glance to convey GAC's willingness to repay GBA's debts. The letter states that “[w]e remain committed to [paying certain categories of unpaid compensation accrued pre-Transition] as soon as possible,” and that all of GBA's debt “will be an important priority” and “will be handled appropriately after [the] [T]ransition.”³⁸ Critically, however, on whose behalf Wilson spoke in the context of that letter is not clear: “we” could refer to GBA, GAC, or simply management, and the use of “we” elsewhere in the letter evinces a similar ambiguity. The letter stops short of obligating GAC on GBA's debts and is ultimately consistent with Groen's contention that GBA's debts would be repaid once GAC bought back its stock.

Ultimately, these pieces of evidence do not establish GAC's responsibility for GBA's debts. Groen's desire to repay those debts with GAC funds does not create an obligation, and

in any event GAC's board overruled Groen on that point. Similarly, mere payment of unpaid compensation under the Payment Plan does not establish liability for those amounts.

G. GAC's Board of Directors

GAC had a five-person board post-Transition which consisted of Groen, who served as the chairman, Wilson, John Carter, George Rudman, and Masoud Emami.³⁹ The board members were scattered around the country and the globe, so the board never conducted a meeting between the Transition and the time of trial. Instead, it would use email or phone calls to discuss matters that required board approval in an attempt to reach written unanimous consent. Among the matters that purportedly required board approval were expense reports, loans, issuance of stock, and appointment to executive positions.

The overwhelming weight of the evidence, however, shows that GAC's board frequently abdicated, if not entirely ignored, its oversight responsibilities regarding these matters. The only two documented board actions from 2013 to the 2015 Layoffs were its approval of the name change from GBAG to GAC and its acceptance of Chen's resignation as CEO.⁴⁰ In addition, the board never formally appointed Wilson as an officer of GAC even though he performed essential executive functions, including managing the company's cash flow. Nor did it approve Chen as CEO, even though he held himself out as such during his time with the company.

More troubling is the board's apparent lack of oversight and knowledge regarding GAC's finances. The board never approved any expense reimbursements from 2013 to the 2015 Layoffs even though employees were incurring expenses during that time. Groen testified that while he was supposed to be actively involved in the company as chairman, there were many things of which he was not aware. As an illustrative and astonishing example, Groen did not know that GAC had no money after the 2015 Layoffs—this following a year in which GAC required frequent cash infusions from Chen and his contacts totaling hundreds of thousands of dollars just to make payroll.

GAC has argued that the asserted loans and expenses that make up some of the *457 Petitioning Creditors' claims are in bona fide dispute because the board did not authorize those amounts. But there is a glaring incongruity between the board's assertion of fastidious and rigid adherence to company protocol in this case and how the board functioned

in practice. The board's failure to discharge its oversight responsibilities during the events in question leads to only one reasonable conclusion: GAC's board, either by decision or inaction, essentially let the executives run the company at their discretion. Perhaps this was a necessary step. GAC faced funding emergencies on a regular basis, which were particularly acute in the 2013-14 period. The widely-dispersed board may have been too slow to respond to these crises as they arose, while company executives had the ability to react quickly and decisively.

H. Claims of the Petitioning Creditors

1. Howard Kent

Howard Kent personally owned commercial real estate located on West California Avenue in Salt Lake City, UT, and, as landlord, entered into a five-year lease agreement dated January 3, 1997 with GBA for the lease of suites A-E at that location.⁴¹ The lease was subsequently amended, with GBA increasing its footprint in the building to include suites F-H.⁴² The fourth amendment, dated December 14, 2011, reduced the leased space to the original suites A-E and provided that monthly rent would consist of a base rent of \$9,072.50 plus \$2,745.63 in monthly building operating costs (or CAM) for a total of \$11,818.13 per month.⁴³ The term of the fourth amendment ran from September 12, 2011 until September 30, 2012.⁴⁴

While there were no subsequent amendments to the lease, it is undisputed that GBA continued to occupy the space and GAC occupied the space post-Transition until Kent sold the West California Avenue property sometime in late 2014. It is also undisputed that Kent continued to assess rent in precisely the same amounts as he did under the fourth amendment.⁴⁵ From January 2013 through October 2014, Kent assessed monthly rent of \$12,409.04, consisting of a base rent of \$9,072.50, \$2,745.63 in CAM, and \$590.91 in late fees. In November 2014, Kent assessed only the base rent and CAM for a total of \$11,818.13. Therefore, from January 2013 to November 2014, Kent assessed \$284,817.01 in rent. GAC made over \$94,000 in payments that were allocated to rent owing from January 2013 forward.⁴⁶ After deducting those payments, the balance owing was \$190,172.65, the same amount Kent asserted in the amended involuntary petition. GAC's Accounts Payable Aging Summary dated January 15, 2015 lists the amount owing to Kent as \$177,763.61,⁴⁷ which is \$12,409.04—or one month's rent—lower than the amount

due in Kent's invoice. Although that discrepancy was not explained at trial, the Court surmises that GAC believes it made an extra month's rent that is not reflected in the invoice. Kent has not been paid any of the amount listed in the aging summary.

2. Lori Chigbrow

Lori Chigbrow began working for GBA in 2002, became a part-time employee in *458 2008, and continued in that capacity post-Transition at GAC until she lost her job as part of the 2015 Layoffs. Chigbrow agreed to a 25% reduction in pay effective as of the pay period ending on June 9, 2012,⁴⁸ which carried over to her time at GAC. Chigbrow accrued \$6,575.43 in Unpaid Compensation, \$5,550.60 in Deferred Compensation, and \$1,387.65 in Bonus Compensation for a total of \$13,513.68.⁴⁹ Chigbrow received \$4,627.77 under the Payment Plan through September 2017,⁵⁰ reducing her claim to \$8,885.91 as of the filing date.

3. Carolynn Taft

Carolynn Taft, then known as Carolynn Schmidtke, began working for GBA in October 2007 and continued with GAC post-Transition. Taft agreed to reduce her compensation by 15% in May 2012,⁵¹ which continued post-Transition at GAC. She accrued \$6,688.63 in Unpaid Compensation,⁵² \$554.94 in Deferred Compensation, and \$138.74 in Bonus Compensation,⁵³ and has a \$43.60 expense claim.⁵⁴ GAC paid Taft \$4,709.72 under the Payment Plan prior to the filing date.⁵⁵ As a result, Taft has a total claim of \$2,716.19.

4. Henry Parry

Henry Parry began working for GBA in 1989 and continued at GAC after the Transition. He took a 20% reduction in pay in May 2012,⁵⁶ which remained in effect until July 2014, when his former pay level was restored.⁵⁷ GAC did not always pay Parry what he was owed at either level, and he later filed a claim with the Labor Commission for \$9,570.69, which included wages of \$9,175.13 owed to him after March 1, 2014, plus expense reimbursements of \$395.56.⁵⁸ Parry also kept a detailed account of the Unpaid Compensation owed to him until March 1, 2014.⁵⁹ Excluding the unpaid wages from Parry's time at GBA, Parry's calculation shows that he accrued \$27,739.30 in Unpaid Compensation at GAC.⁶⁰ He also accrued \$12,602.18 in Deferred Compensation, and

\$3,150.55 in Bonus *459 Compensation.⁶¹ Subtracting from those sums the \$2,357 Parry received under the Payment Plan⁶² leaves a claim of \$41,135.03.

5. Martie Nadauld

Martie Nadauld began working for GBA in 2008 and continued with GAC post-Transition. She agreed to a 20% reduction in pay at GBA, but only for a couple of pay periods.⁶³ She did not reduce her pay at GAC and therefore did not accrue Deferred or Bonus Compensation. But Nadauld did accrue \$20,081.52 in Unpaid Compensation.⁶⁴ She filed a claim with the Labor Commission for \$6,510.46,⁶⁵ and received \$1,295 under the Payment Plan.⁶⁶ Deducting those amounts from Nadauld's Unpaid Compensation leaves a claim of \$12,276.06.

6. Scott Carron

Scott Carron had previously worked at GBA from 2006 to 2008, left, then was hired by GAC in June 2014. As part of his agreement to work at GAC, he was guaranteed a salary of \$115,050, or \$4,425 per pay period,⁶⁷ and did not agree to defer any compensation. The last pay check Carron received from GAC was for the pay period ending December 20, 2014, and he was laid off in January 2015. At the time he was laid off, \$59,737.50 of Carron's guaranteed salary remained unpaid. He later submitted a \$10,000 claim to the Labor Commission, which comprised four weeks of unpaid salary for the pay periods ending January 3 and 17, 2015 as well as two weeks of paid time off. Carron deducted that \$10,000 from the balance of his unpaid salary and added a \$65.38 expense reimbursement claim to arrive at \$49,802.88, the claim he asserted in the amended involuntary petition.

Carron also applied for unemployment compensation, which began about two months after the 2015 Layoffs. The amount of unemployment compensation Carron received was not introduced into evidence, but Carron made clear that he did not deduct it from his \$49,802.99 claim. Even so, such a deduction may not be necessary; there was no evidence suggesting that Carron's receipt of unemployment compensation would reduce GAC's liability, and his claim could be \$49,802.99. Assuming, for the sake of argument, that Carron would have to deduct any unemployment compensation he received from his claim, there was still a two-month period from mid-January to mid-March for which he was not compensated through either the Labor

Commission or unemployment benefits. Pay periods ending January 31, February 14 and 28, and March 14 would have come due during that period. Multiplying four unpaid pay periods by Carron's compensation of \$4,425 per pay period yields \$17,700. Adding the \$65.38 expense reimbursement claim,⁶⁸ but deducting the \$567 which Carron received under the Payment Plan,⁶⁹ results in a claim of \$17,198.38.

*460 7. Jacob van der Westhuizen

Jacob van der Westhuizen began working at GBA in April 2000. He held various executive positions in GBA, and he continued as an executive with GAC post-Transition, where he was the Senior Vice President and CTO. Pre- and post-Transition, van der Westhuizen's salary was \$130,000 or \$5,000 gross pay per pay period.⁷⁰ He agreed to reduce his pay 35% beginning in April 2012.⁷¹ That reduction became more drastic at GAC: van der Westhuizen took an 89% pay cut, receiving \$550 per pay period.⁷² GAC did not pay van der Westhuizen all of his salary at the reduced rate, and he accumulated \$23,850 in Unpaid Compensation.⁷³ And because he reduced his salary substantially, van der Westhuizen is owed \$201,800 in Deferred Compensation and \$50,450 in Bonus Compensation.⁷⁴

8. Robert Wilson

Robert Wilson joined GBA in September 2001 as an executive and eventually attained the position of Executive Vice President and COO, which he held at GAC until he left as part of the 2015 Layoffs. Wilson received a \$140,000 salary at GBA,⁷⁵ which continued at GAC. He agreed to a 50% reduction in salary in April 2012,⁷⁶ which changed to 94% post-Transition at GAC.⁷⁷ Wilson did not receive all of his salary at the reduced rate, and GAC owes him \$13,569.30 in Unpaid Compensation.⁷⁸ As with van der Westhuizen, Wilson substantially reduced his salary and accrued \$256,872.86 in Deferred Compensation and \$64,218.22 in Bonus Compensation.⁷⁹ In addition to those amounts, GAC owes Wilson at least \$69,099.95 for expenses and loans he made to the company.⁸⁰

*461 9. Jason Chen

Jason Chen has asserted a claim of \$694,236.50 in the amended petition which consists of three categories: funding he provided to GAC during his time as de facto CEO, unpaid

salary, and expenses. With respect to the first category, the evidence is clear that Chen provided substantial funding to GAC.⁸¹ The parties vigorously dispute, however, whether that funding was in the form of loans or equity. Chen wired \$516,770 to GAC during 2014,⁸² \$130,000 of which was an equity investment made by three of Chen's associates, and \$20,000 of which was repaid. The remaining sum, \$366,770, is the amount Chen alleges that GAC owes him in unpaid loans.

There is conflicting evidence on whether Chen's funds were loans or equity. Chen's and Stevanovich's testimony disagree on this point and so does the documentary evidence. On October 20, 2014, Carolyn Taft sent a brief email to Henry Parry regarding Chen's "stock numbers." The email states that \$326,770, which was the amount Chen had wired to GAC prior to that date,⁸³ was the equivalent of 48,410 shares at \$6.75 per share.⁸⁴ In addition, Chen wrote an email to Wilson and Taft on November 17, 2014 that stated:

Slight change of plan. Instead of having all of my investments as equity investment[s] as discussed, Lisa [Chen's wife] and I had a discussion with Steve [Stevanovich] and he promised that the money will be paid back once we are funded. So, for now, would you please just issue me \$130,000 as equity and leave the rest as a personal loan.

Also, do you have a standard loan document that I can sign just to formally note the amount [that] is being loaned to

GAC. A very simple loan would be perfect.⁸⁵

A handwritten note on the printed email deducts \$130,000 in "shares" from \$456,770, the amount which Chen had wired to GAC up to that date,⁸⁶ leaving a balance of \$326,770. In apparent response to that email and without Stevanovich's knowledge, the next day GAC drafted a promissory note in the amount of \$326,770, payable on demand to Chen.⁸⁷ Although Wilson signed the note on behalf of GAC, Chen did not sign it because he believed the amount of the note should have been higher, which seems to contradict the figures in Chen's email and the list of wired payments in Exhibit LL. Chen testified that he later signed an amended note, but he could not find a copy of it, and no amended note was produced at trial. These documents suggest that Chen and GAC were negotiating the status of his advances to the company, and it does not appear that the parties resolved that issue before Chen left GAC.

As regards the second category, Chen asserts that Stevanovich promised him a \$280,000 salary with GAC. While Chen worked at GAC for approximately ten months, he and GAC never executed a written employment agreement. On December 14, 2014, after some back-and-forth negotiations with Stevanovich, Chen emailed a proposed employment agreement *462 to Stevanovich, which included a \$300,000 salary payable once GAC could raise \$5 million in equity.⁸⁸ Stevanovich rejected the proposal because it was "not the deal that [they had] discussed."⁸⁹ Chen was never paid for his work with GAC.

As regards the third category, Chen claims \$94,133.17 in unreimbursed expenses. While GAC has argued that Chen never submitted expense reports or receipts to support this amount, GAC acknowledged in a January 2015 letter that it had received "expense records that we recognize as business expenses and an obligation of the Company" totaling \$70,581.74, which GAC owed to Chen and his wife.⁹⁰ That amount, however, does not appear on GAC's Accounts Payable Aging Summary dated January 15, 2015.

III. CONCLUSIONS OF LAW

A. Section 303

Section 303 imposes two requirements on petitioning creditors seeking entry of an order for relief. First, § 303(b)(1) requires the Petitioning Creditors to show that at least three of them—since GAC has twelve or more creditors—hold claims that are not contingent as to liability or the subject of a bona fide dispute as to liability or amount, and which together aggregate at least \$15,775 in unsecured claims. Second, § 303(h)(1) requires the Petitioning Creditors to show that GAC is generally not paying its debts as they come due unless they are the subject of a bona fide dispute as to liability or amount.

1. Section 303(b)(1): Numerosity of Creditors and Dollar Threshold

Section 303(b)(1) states:

An involuntary case against a person is commenced by the filing with the bankruptcy court of a petition under chapter 7 or 11 of this title—by three or more entities, each of which is either a holder of a claim against such person that is not contingent as to liability or the subject of a bona fide dispute as to liability or amount ... if such noncontingent, undisputed claims aggregate at least \$15,775 more than the

value of any lien on property of the debtor securing such claims held by the holders of such claims.

GAC has consistently challenged the Petitioning Creditors' standing under § 303(b)(1) by arguing that their claims are either contingent as to liability or the subject of a bona fide dispute as to liability or amount. In pursuing this challenge, GAC has argued that a bona fide dispute as to any amount of a claim would render a creditor ineligible. By contrast, the Petitioning Creditors have taken the position that a creditor has standing under § 303(b)(1) as long as some portion of its claim remains undisputed. The opposing sides of this argument mirror the divergence in case law occasioned by an amendment to § 303(b)(1) under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA). The Court addressed this dispute in an oral ruling on the Debtor's Motion to Dismiss, and the Court now incorporates that ruling into this decision.

Section 303(b)(1) has undergone two revisions relevant to this case since it was enacted as part of the Bankruptcy Reform Act of 1978. When first enacted, it lacked the requirement that a creditor's claim not be the subject of a bona fide dispute.⁹¹ *463 Congress added that requirement through the Bankruptcy Amendments and Federal Judgeship Act of 1984.⁹² The purpose of the 1984 amendment was straightforward: "to prevent creditors from using involuntary bankruptcy as a club to coerce a debtor to pay debts as to which the debtor, in good faith, had legitimate defenses."⁹³ The proponent of the change, Senator Max Baucus, elaborated on the bona fide dispute requirement as follows:

The problem can be explained simply. Some courts have interpreted section 303's language on a debtor's general failure to pay debts as allowing the filing of involuntary petitions and the granting of involuntary relief even when the debtor's reason for not paying is a legitimate and good-faith dispute over his or her liability. This interpretation allows creditors to use the Bankruptcy Code as a club against debtors who have bona fide questions about their liability, but who would rather pay up than suffer the stigma of involuntary bankruptcy proceedings.

My amendment would correct this problem. Under my amendment, the original filing of an involuntary petition could not be based on debts that are the subject of a good-faith dispute between the debtor and his or her creditors. In the same vein, the granting of an order of relief could not

be premised solely on the failure of a debtor to pay debts that were legitimately contested as to liability or amount.

I believe this amendment, although a simple one, is necessary to protect the rights of debtors and to prevent misuse of the bankruptcy system as a tool of coercion. I also believe it corrects a judicial misinterpretation of existing law and congressional intent as to the proper basis for granting involuntary relief.⁹⁴

The amendment did not define "bona fide dispute," however, so courts set about articulating a standard for determining whether a claim is in bona fide dispute, sometimes resulting in disagreement.⁹⁵ In time, courts "more or less settled on finding a bona fide dispute when 'there is either a genuine issue of material fact that bears upon the debtor's liability or a meritorious contention as to the application of *464 law to undisputed facts.'"⁹⁶ Pre-BAPCPA, these analyses "focused principally on liability issues" regarding the underlying claim.⁹⁷ But courts had also developed a rule whereby a bona fide dispute as to a portion of a petitioning creditor's claim would not disqualify the creditor under § 303(b)(1) if a portion of that claim was undisputed.⁹⁸

Against the backdrop of these developments, Congress amended § 303(b)(1) again in 2005 as part of BAPCPA by adding "as to liability or amount" after "bona fide dispute." The interpretation of that amendment divided courts into two roughly equal camps.⁹⁹ On one side, some courts have concluded that the BAPCPA amendment substantively changed § 303(b)(1) and have held that the plain meaning of the statute now requires that a bona fide dispute as to any amount of a petitioning creditor's claim, no matter how small the amount in dispute, strips the creditor of standing under § 303(b)(1).¹⁰⁰ On the other, courts have viewed the amendment as clarifying prior legislative intent, though not affecting the pre-BAPCPA operation of the statute.¹⁰¹ This Court agrees with the latter group of cases for two reasons.

First, certain interpretive principles require departure from a strict plain meaning reading of the statute. It is an unquestioned maxim that "interpretation of the Bankruptcy Code starts 'where all such inquiries must begin: with the language of the statute itself,'"¹⁰² and it is also true that where the language of the statute is clear, "the sole function of the courts is to enforce it according to its terms."¹⁰³ But "[w]hen Congress enacts *465 legislation,

it is presumed to act with knowledge of the existing law and judicial concepts,”¹⁰⁴ and “[w]hen Congress amends the bankruptcy laws, it does not write on a clean slate.”¹⁰⁵ In particular, “[p]re-BAPCPA bankruptcy practice is telling because [courts] ‘will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure.’”¹⁰⁶ As applied to § 303(b)(1), these interpretive principles suggest that BAPCPA did not alter the operation of the statute.

When Congress amended § 303(b)(1) in 1984, it struck a balance between the ability of petitioning creditors to have access to the bankruptcy courts and the interest of would-be debtors to remain free from involuntary petitions filed by creditors whose claims were legitimately disputed. To read the BAPCPA amendment as disqualifying a creditor where any amount of its claim is disputed would be to noticeably shift that balance by dramatically restricting creditors' access to the bankruptcy courts through an involuntary petition.¹⁰⁷ This would amount to a significant change in pre-BAPCPA practice, but there is simply no “clear indication that Congress intended such a departure.” As one court observed:

With the dearth of committee comments and legislative history available to interpret BAPCPA, this Court cannot presume that Congress added the phrase “as to liability [or] amount” with the intent that the claims of involuntary petitioners must now be fully liquidated either by agreement or judgment so that no dispute exists as to any portion of such claims. Without clear legislative intent, this Court cannot presume such a change in the law and declines to do so.¹⁰⁸

Because there is not a clear indication that Congress intended to institute a change that would significantly shift the debtor-creditor balance existing in pre-BAPCPA practice, the Court agrees with *DemirCo*, *Collier's*, and other similar authorities that “the better view is that the 2005 amendments do not change the analysis.”¹⁰⁹

Second, to the extent that these interpretive principles do not require departure from a strict plain meaning reading of the statute, viewing the BAPCPA amendment as disqualifying a petitioning creditor if even a small portion of its claim is disputed would lead to an absurd result—one “so bizarre that Congress could not have intended it.”¹¹⁰ To illustrate such a result, a court posed the following hypothetical: suppose a petitioning creditor had a claim of \$100,000 and of that amount, \$99,900 was undisputed and only \$100 was

*466 subject to a bona fide dispute.¹¹¹ The court stated that disqualifying such a creditor would be absurd,¹¹² and while this Court recognizes the rarity with which the absurdity doctrine should be invoked,¹¹³ this appears to be an instance where “the literal application of a statute will produce a result demonstrably at odds with the intentions of its drafters.”¹¹⁴ To be sure, the example in *In re 3 Man Corp.* is extreme, but it is the logical and necessary conclusion of reading the statute literally. A strict plain meaning interpretation of § 303(b)(1) would disqualify many petitioning creditors, including those whose claims were undisputed except for a small, inconsequential amount. *Collier's* puzzled over why Congress could intend such a result:

Why would Congress want to disqualify a creditor whose claim is noncontingent and at least partially undisputed? Section 303's requirements regarding type and number of claims are an attempt to balance a debtor's interest in staying out of bankruptcy with the interest of creditors in putting a debtor into bankruptcy. Why shouldn't the undisputed, noncontingent portion of a petitioning creditor's claim count? Why disqualify the creditor in toto? Why effectively bar that creditor's access to the bankruptcy forum?¹¹⁵

Because it does not appear that Congress intended to significantly limit the availability of an involuntary petition, the Court will not read the BAPCPA amendment to effect that change. A bona fide dispute as to some amount of a creditor's claim will not disqualify the creditor so long as there is some portion of its claim that is not in bona fide dispute and which, along with the other undisputed portions of the other petitioning creditors' claims, meets the statutory dollar threshold of § 303(b)(1).

Having addressed the effect of a bona fide dispute, the Court next turns to how one is determined. Tenth Circuit precedent requires that there be an “objective basis for either a factual or legal dispute as to the validity of [the] debt” in order to conclude that the debt is the subject of a bona fide dispute.¹¹⁶ “The court need not determine the probable outcome of the dispute, but merely whether one exists.”¹¹⁷ But “[t]his does not mean that the bankruptcy court is totally prohibited from addressing the legal merits of the alleged dispute; indeed, the bankruptcy court may be required to conduct a limited analysis of the legal issues in order to ascertain whether an objective legal basis for the dispute exists.”¹¹⁸ “Once the petitioning creditor establishes a prima facie case that its claim is not subject to a bona fide dispute, the burden shifts to

the debtor to present evidence of a bona fide dispute. Under this objective approach, the debtor's subjective intent does not control ^{*467} whether a claim is considered to be subject to a bona fide dispute.”¹¹⁹

GAC has disputed many aspects of the Petitioning Creditors' claims but based on the findings of fact, the Court concludes that many of these disputes are not bona fide. With respect to whether GAC owes Deferred and Bonus Compensation, the Court concludes that the Petitioning Creditors carried their burden based on testimony and documentary evidence that non-executive employees were entitled to such compensation. But after viewing the evidence objectively, GAC did not carry its burden to demonstrate a bona fide dispute on this issue. Accordingly, the Court will count Deferred and Bonus Compensation for purposes of § 303.

In addition, GAC has argued that choosing to file a claim with the Labor Commission is an election of remedies and that Carron, Nadauld, and Parry have waived any entitlement to the balance of Unpaid Compensation over the amounts they received in the Labor Commission judgments. GAC relies on [Utah Code Ann. § 34-28-9.5](#) for its election of remedies argument. In brief, that provision informs employees whether they can file an action for unpaid wages in district court or whether they must use the Labor Commission. Employees with wage claims less than or equal to \$10,000 must first pursue administrative remedies, while those with claims above \$10,000—and those with claims under that amount subject to certain exceptions—may file in the district court in the first instance. But the statute does not preclude employees with claims over \$10,000 from filing with the Labor Commission, and it does not bar recovery of amounts over that threshold. Carron's judgment from the Labor Commission likewise does not support GAC's election of remedies argument. It states that Carron filed a wage claim “for work that he performed for [GAC] during the period of December 21, 2014 to January 20, 2015.”¹²⁰ The judgment expressly circumscribes Carron's claim with the Labor Commission to a defined time period, but it does not mention wages he might have earned outside those dates. Nor does it state that a wage claimant forgoes wages not pursued with the Labor Commission. The judgment's language, along with that of the statute, suggests a wage claimant is free to pursue wages not within the Labor Commission's purview. Accordingly, Carron, Nadauld, and Parry are not limited to the amounts sought through the Labor Commission, and [Utah Code Ann. § 34-28-9.5](#) does not create a bona fide dispute regarding their claims.

With respect to GAC's liability for the debts of GBA: The Petitioning Creditors did not carry their prima facie burden to show the absence of a bona fide dispute on this point. GAC is a separate legal entity and did not assume the debts of GBA. Evidence that GAC has likely been paying some of GBA's unpaid compensation under the Payment Plan does not establish GAC's liability for those debts. Accordingly, the Court finds that there is a bona fide dispute on this issue and, as a result, none of GBA's debts, including compensation earned but unpaid from an employee's time at GBA, will be counted for purposes of § 303.

GAC has also argued that many of the Petitioning Creditors' claims are the subject of a bona fide dispute because they were not approved by its board of directors. The Court has found, however, ^{*468} that the board effectively ceded authority over the approval of loans and expenses and other matters to the company's executives. Having ceded such authority, GAC's attempt to stand on ceremony and dispute its obligation to repay amounts simply because the board did not approve those amounts is unavailing. The Court concludes that the board's failure to approve a loan or expense does not render it subject to a bona fide dispute.

As regards Kent's claim, GAC has maintained that it is subject to a bona fide dispute as to liability and amount based on the following grounds: first, GAC and Kent never entered into a lease; second, GAC never assumed or received the lease as part of the Transition; third, GBA, which remained in existence after the Transition, continued to use space in the leased premises; and fourth, some of the rent charges in Kent's claim predate GAC's occupancy of the property.¹²¹ The Court does not find any of these grounds compelling because GAC was responsible for rent payments, and the charges allocable to GAC's occupancy can be readily determined.

When the fourth amendment to the lease expired on September 30, 2012 and Kent continued to accept rent payments, GBA became a tenant at will,¹²² just as it had when the third amendment expired without extension on December 1, 2010.¹²³ After the Transition, GAC continued the operations of GBA in the same space, with the same employees, and with the same corporate mission. While GBA existed as a legal entity and held shares of GAC stock, it had no operations post-Transition. This arrangement suggests that GAC, as the operating corporate entity, in effect became a tenant at will and took over the responsibility to make rent payments. And that is precisely what happened.

Groen testified that GAC paid rent for the West California Avenue property, which is supported by GAC's records and course of conduct. The clearest piece of evidence is GAC's Accounts Payable Aging Summary dated January 15, 2015, which lists a debt owing to Kent of \$177,763.61.¹²⁴ It is not credible to maintain that GAC does not owe rent when its own aging summary lists that very same rent obligation. In addition, GAC wrote Kent a letter in December 2014 after it had moved out of the West California Avenue property, which provided GAC's updated address, phone number, and website and informed Kent that GBAG had changed its name to GAC. Critically, the letter stated that despite the name change, "[a]ny outstanding obligations by GBAG remain the responsibility of GAC."¹²⁵ If GAC owed no rent, there would be little reason to send a letter to Kent that essentially told him that he could seek payment of GBAG's debts from GAC at a new address. After viewing the evidence objectively, the Court concludes that there is no bona fide dispute regarding GAC's liability for post-Transition rent to Kent. The fact that GAC did not have a signed lease agreement with Kent does not create an objective basis to dispute Kent's claim because GAC was a tenant in the premises and had assumed responsibility for rent.

***469** There is also no objective basis to dispute the amount of Kent's claim. While the amounts GAC paid to Kent were initially credited against delinquent rent owed by GBA, it appears that GBA's outstanding balance was paid off around October 2014. That month GAC sent a letter to Kent informing him that the security deposit paid by GBA under the 1997 lease could be "applied toward payment of rent due."¹²⁶ There would be no need to clarify that funds deposited by GBA could be used to satisfy debts of GAC if GBA still owed rent. This suggests that the amount owing to Kent in GAC's aging summary—which is dated after the letter—consists entirely of post-Transition rent. And that's corroborated by Kent's invoice. Kent assessed \$284,817.01 in post-Transition rent, and GAC made over \$94,000 in payments that were allocated solely against that sum, leaving a balance of \$190,172.65 in post-Transition rent. Because the amount listed in the aging summary is lower than that in the invoice, the Court concludes that there is no bona fide dispute that GAC owes at least \$177,763.61 in post-Transition rent to Kent. That amount is not contingent as to liability.

The Court concludes that the claims of van der Westhuizen and Wilson are also not in bona fide dispute. GBA and GAC carefully recorded the amounts they were owed, and there is no objective factual or legal basis to vary from those numbers.

Based on GAC's Excel spreadsheet, the Court concludes that van der Westhuizen's undisputed claim is \$276,100. As for Wilson, his undisputed claim is \$403,760.33, composed of \$334,660.38 in Unpaid, Deferred, and Bonus Compensation, and \$69,099.95 in expenses and loans. GAC has asserted that Wilson's and van der Westhuizen's compensation should not be counted under § 303(b)(1) because reimbursement of executives is contingent on GAC obtaining sufficient cash flow to pay those claims, as determined by GAC's board. In response, the Petitioning Creditors have argued that such an arrangement runs afoul of *Utah Code Ann. § 34-28-3(6)(b)*, which requires that an employee expressly authorize any withholding of wages in writing, and it is undisputed that Wilson and van der Westhuizen did not execute such a writing. The Court does not need to resolve this legal issue or the factual issue regarding board approval because the Petitioning Creditors can satisfy § 303(b)(1) with other creditors whose non-contingent, undisputed, unsecured claims exceed \$15,775. The Court does conclude, however, that Wilson's \$69,099.95 expense and loan claim is non-contingent and not in bona fide dispute and should be counted in the § 303(b)(1) analysis.

The Court concludes that all three categories of Chen's claim are in bona fide dispute. The evidence on whether his contributions were loans or equity is conflicting, and there is an objective basis to dispute if GAC is obligated to repay Chen for his contributions. Chen's salary claim is not supported by a signed employment agreement, and he and Stevanovich appear to have disagreed on the terms of his employment, so there is an objective basis to dispute what he was owed in salary. And Chen's expense claim, while partially documented in a letter, does not appear in GAC's aging summary, in contrast to other expense claims. Accordingly, there is an objective basis to dispute that claim.

Based on the foregoing findings of fact and conclusions of law, the Court concludes that these Petitioning Creditors have unsecured claims in at least the following amounts that are not contingent as ***470** to liability and not the subject of a bona fide dispute as to liability or amount:

1. Howard Kent: \$177,763.61.
2. Lori Chigbrow: \$8,885.91.
3. Carolynn Taft: \$2,716.19.
4. Henry Parry: \$41,135.03.
5. Martie Nadauld: \$12,276.06.

6. Scott Carron: \$17,198.38.

7. Robert Wilson: \$69,099.95.

Because there are at least three petitioning creditors whose non-contingent, undisputed, unsecured claims exceed \$15,775, the Court concludes that the Petitioning Creditors have satisfied the requirements of § 303(b)(1).

2. Section 303(h)(1): Generally Not Paying Debts as They Come Due

Having found that the Petitioning Creditors have met the numerosity and dollar threshold requirements of § 303(b)(1), the Court turns to § 303(h). Under that subsection, the Petitioning Creditors bear the burden to show by a preponderance of the evidence that the debtor is generally not paying its debts as they become due.¹²⁷ That determination is made as of the filing date.¹²⁸ If the Petitioning Creditors carry their burden, “the burden shifts to the debtor to show that the debts in question are subject to a bona fide dispute.”¹²⁹ Importantly, and unlike § 303(b)(1), § 303(h) contains no provision that excludes consideration of contingent debts.

Though it doesn't endorse a specific set of factors, *Bartmann* prescribes a totality of the circumstances test under § 303(h)(1), and the 10th Circuit BAP has characterized this test as a “flexible case-by-case approach” that permits a bankruptcy court “to receive and consider all admissible evidence presented, the demeanor and credibility of the witnesses, and argument of counsel [in determining] whether the creditor has met its burden.”¹³⁰ In addition, the BAP stated that the use of the word “generally” in § 303(h)(1) was meant to indicate that courts should use a totality of the circumstances test and eschew mechanical tests.¹³¹ The Court notes, however, that some decisions involving § 303(h)(1) have begun with or included what is characterized as a mechanical or mathematical test, which can be supplemented with other factors or analyzed in conjunction with a broader totality test.¹³²

***471** This is the approach the Court will take. While the BAP has counseled against mechanical tests, that proscription appears aimed more at rigid mathematical formulas that fail to account for the particular circumstances of a case.¹³³ What some courts have characterized as a “mechanical” test in fact falls well within the broad *Bartmann* framework, which permits the Court to “consider all admissible evidence

presented.” A good amalgamation of the totality and so-called mechanical tests, which this Court adopts, is found in *In re Quinto & Wilks, P.C.*:

Generally not paying debts includes regularly missing a significant number of payments to creditors or regularly missing payments that are significant in amount in size to the debtor's operation. Where the debtor has few creditors, the number which will be significant will be fewer than when the debtor has a large number of creditors. Also the amount of debts being paid is important. If the amounts missed are not substantial in comparison to the magnitude of the debtor's operation, involuntary relief would be improper. Determining that a debtor is generally not paying his debts requires a more general showing of the debtor's financial condition and debt structure than merely establishing the existence of a few unpaid debts. A court must compare the number of debts unpaid each month to those paid, the amount of the delinquency, the materiality of the nonpayment, and the nature of the debtor's conduct of its financial affairs. A starting point in the inquiry is to employ what is termed the mechanical test which is composed of five factors: the timeliness of payments on past due obligations; the amount of debts long overdue; the length of time during which the debtor has been unable to meet large debts; any reduction in the debtor's assets, and the debtor's financial situation. In the final analysis, the determination whether an alleged debtor is generally not paying his or her debts as they become due is a flexible one which admits no hard and fast rules, and requires a careful balancing of both the number and amount of the unpaid debts, in proportional terms, viewed in the light of the alleged debtor's total financial picture.¹³⁴

Whether a debtor defers payment on certain debts, such as employee salaries or wages, in order to pay other debts is a relevant consideration.¹³⁵ In addition, the length of time debts have gone unpaid is also relevant,¹³⁶ but the fact that a petitioning creditor has not demanded payment or pursued collection before joining the involuntary petition is not.¹³⁷

***472** A company's accounts payable aging reports are a good place to begin the § 303(h)(1) inquiry.¹³⁸ But GAC claims not to have kept traditional accounting records after the 2015 Layoffs, and no accounts payable aging reports contemporaneous with the filing date were introduced into evidence. Instead, GAC tracked its expenses and payments using invoices and bank statements.¹³⁹ GAC's bank statements and those of GAC Unmanned Aircraft

Systems, Inc., its wholly-owned subsidiary, were introduced into evidence,¹⁴⁰ as were contemporaneous invoices,¹⁴¹ though neither side elicited testimony regarding the invoices. Importantly, Exhibit SG54 appears to be a selection of invoices rather than a comprehensive collection of them, so it is not possible on this record to develop a complete picture of GAC's invoice payments around the filing date. Nevertheless, a comparison of the selected invoices and the relevant bank statements shows that GAC was, for the most part, paying its invoices in full on average roughly 30 days after the date of the invoice around the time the involuntary petition was filed.¹⁴² The lone conspicuous exception appears to be the City of Buckeye, AZ, in which GAC rented a hangar. An invoice dated September 15, 2017 lists a past due balance of \$11,418.47, which includes a current charge of \$871.25.¹⁴³ It is not clear whether the current charge represented a monthly obligation, but the evidence suggests that the past due balance accumulated over several months. As far back as March 2017, GAC was already repaying a portion of a past due balance, which it continued to do in April and June.¹⁴⁴ Even so, the past due balance owing to the City of Buckeye around the filing date was not a significant unpaid debt within the context of GAC's operations in September 2017; during that month GAC spent \$212,942.28. In addition to the invoices, the bank statements show that GAC was paying wages to employees as well as employment taxes, though it is not clear whether these amounts were being paid in full. While the picture is perhaps incomplete, it appears that GAC was generally paying its current debts as they came due at the time this case was filed.¹⁴⁵

***473** But GAC has substantial, years-old debt owing to at least 19 current and former employees, including some of the Petitioning Creditors, as well as debt owing to Kent. GAC owes \$258,708.54 in post-Transition Unpaid Compensation,¹⁴⁶ at least \$67,831.11 of which was paid before this case was filed under the Payment Plan,¹⁴⁷ as well as \$2,301,694.73 in Deferred Compensation and \$575,423.68 in Bonus Compensation, none of which has been paid.¹⁴⁸ In addition, GAC's Accounts Payable Aging Summary dated January 15, 2015, which excluded wages and salary owed to employees, shows that GAC had \$1,036,563.74 in outstanding expenses as of that date.¹⁴⁹ It is not clear how much, if any, GAC has paid of that amount, but it is clear that the \$177,763.61 owed to Kent, the \$48,228.31 owed to Groen, the \$69,099.95 owed to Wilson, and the small expense claims of Taft and Carron have not been paid. GAC also

owed \$35,799.73 on the Labor Commission judgments and \$4,456.21 in unpaid COBRA and FSA plan administration fees from 2015.¹⁵⁰ Adding those amounts to the total Unpaid, Deferred, and Bonus Compensation shows that GAC owed approximately \$3.4 million in aged debt when this case was filed.

Most of this debt started accruing in December 2012 as a result of austerity measures that began at GBA and continued post-Transition at GAC until the 2015 Layoffs. And except for paying a portion of Unpaid Compensation under the Payment Plan and some of the Labor Commission judgments pursuant to an agreement with the state, GAC appears to have devoted no resources towards its repayment between the 2015 Layoffs and the filing date. Admittedly, GAC foundered after the 2015 Layoffs and was not immediately able to repay any of these debts. Its bank account stood at \$1,800 by the end of January 2015 and declined to \$205 in April.¹⁵¹ But when GAC received approximately \$5 million in funding in December 2016, it largely continued to ignore these obligations. Instead, GAC used this funding to make substantial and regular payments to a variety of entities during 2017. For example, GAC made at least seven pre-petition payments totaling \$141,355 to Mungo Creative Group, Inc., a social media company whose duties include composing press releases for GAC, handling its Twitter feed, and keeping up its social media presence; three payments totaling \$113,000 to Seven Ply Maple, a media company hired to make computer-generated videos of GAC's designs; and seven payments totaling \$91,868.70 to Albright Stonebridge, a Washington, DC law firm used to find contacts in the aviation industry.¹⁵² Payments to these and other ***474** entities constitute a significant portion of GAC's expenses, but there was no evidence that such payments were reasonably calculated to bring gyroplanes to market.¹⁵³

The bank statements belonging to GAC and its wholly-owned subsidiary provide a more complete view of GAC's spending and total financial picture. In December 2016, \$4,993,290.77 was deposited into GAC Unmanned Aircraft Systems, Inc.'s bank account, which GAC uses as a holding account. GAC started receiving transfers from that account in January 2017, and it received a total of \$2,138,592.80 during 2017, an average of \$178,216.06 per month. Those transfers left \$2,854,697.97 in the subsidiary's bank account by the end of that year. Through the first four months of 2018, GAC received \$835,724.81 from its subsidiary, or \$208,931.20 per month.¹⁵⁴ For the 16-month period from January 2017 to

April 2018, GAC received an average of \$185,894.85 per month, and it appears to have consumed that cash at a roughly equivalent rate. At the beginning of January 2017, prior to the first transfer from the subsidiary, GAC's bank account balance was \$120,413.54. At the end of April 2018 it was \$134,213.03, suggesting that nearly all of the cash transferred to it by the subsidiary was spent in the operation of the business.¹⁵⁵

These numbers show that the \$3.4 million in aged debt was significant relative to the size of GAC's operation around the filing date. No other debt was a fraction as large, but GAC devoted far less to it than its current debts. While GAC was spending \$185,894.85 per month on average in 2017, it allotted just \$4,214 to the repayment of Unpaid Compensation and \$2,250 to Labor Commission claims in September 2017.¹⁵⁶ And even though the Payment Plan was in effect for 17 months prior to the filing date, GAC paid \$67,831.11, or approximately 2% of the total \$3.4 million in debt.

These numbers also show a significant reduction in GAC's assets. Although GAC's expenditures continued, it was not generating any revenue at the time this case was filed to offset its outlays. By the end of April 2018, the most recent month for which a bank statement was introduced into evidence, the subsidiary's bank account *475 was down to \$2,018,973.16.¹⁵⁷ Stevanovich testified that the subsidiary had about \$1.5-\$2.0 million in its bank account at the time of trial, but the account was already at the upper limit of that estimate five months earlier. Assuming transfers to GAC continued through September 2018 in the same average amount of \$185,894.85 per month, the subsidiary's account would be down to \$1,089,498.91 by the end of September 2018. There was no evidence that new funds have been placed in the subsidiary's bank account.

In sum, as of the petition date GAC was expending substantial amounts of money but it had largely deferred payment on \$3.4 million in long-overdue debt, which it had not significantly reduced in the over two-and-a-half years between the 2015 Layoffs and the filing date. Moreover, GAC's expenditures were steadily depleting its cash reserves, which were not being replenished with new revenue. Despite paying its current debts on time, GAC placed \$3.4 million in aged debt on the back burner, and this choice leads the Court to conclude that GAC was generally not paying its debts as they came due when the case was filed. That conclusion shifts the burden to GAC to demonstrate that the debts at issue are the subject

of a bona fide dispute, but because the Court has already concluded that they are not, it is not necessary to repeat that analysis. Having met their burden under § 303(h)(1), the Court concludes that the Petitioning Creditors have satisfied the statutory requirements of § 303.

B. GAC's Motion to Dismiss for Bad Faith

The Court will now address GAC's motion to dismiss the involuntary petition because it was filed in bad faith.¹⁵⁸ The Tenth Circuit has not ruled on the legal issue of whether an involuntary petition can be dismissed on bad faith grounds even if the requirements of § 303 have been met, but a handful of other courts, including one circuit court, have held that it can be so dismissed.¹⁵⁹ The Court does not need to decide that legal issue, however, because even if it followed the rule of *Forever Green*, the Court concludes that the petition was not filed in bad faith.

At the outset, an involuntary petition enjoys a presumption of good faith, and the debtor bears the burden to show by a preponderance of the evidence that the filing was in bad faith.¹⁶⁰ While courts have created a panoply of tests to evaluate whether an involuntary petition was filed in bad faith,¹⁶¹ the Court agrees with *Forever Green* that the proper test to use in evaluating bad faith is the totality of the circumstances. Not only is it “most suitable for evaluating the myriad ways in which creditors filing an involuntary petition *476 could act in bad faith,”¹⁶² it also is the test that the Tenth Circuit applies to other bankruptcy questions involving good or bad faith and would likely adopt in this context.¹⁶³

In conducting this fact-intensive review, courts may consider a number of factors, including, but not limited to, whether: the creditors satisfied the statutory criteria for filing the petition; the involuntary petition was meritorious; the creditors made a reasonable inquiry into the relevant facts and pertinent law before filing; there was evidence of preferential payments to certain creditors or of dissipation of the debtor's assets; the filing was motivated by ill will or a desire to harass; the petitioning creditors used the filing to obtain a disproportionate advantage for themselves rather than to protect against other creditors doing the same; the filing was used as a tactical advantage in pending actions; the filing was used as a substitute for customary debt-collection procedures; and the filing had suspicious timing.¹⁶⁴

GAC's bad faith argument is based on the improper purpose and improper use tests,¹⁶⁵ which are two of the six bad faith tests mentioned in *Collier's*. Those tests are not contrary to the totality test, but instead have been incorporated into it through the factors regarding the motivation for the filing and whether the petitioning creditors are taking a disproportionate advantage for themselves.¹⁶⁶ Because those two tests are now reduced to factors, however, they alone do not determine the Petitioning Creditors' good or bad faith. Moreover, although the filing of an involuntary petition without first pursuing non-bankruptcy collection remedies was generally regarded as a species of improper use of the Code that would support a finding of ***477** bad faith,¹⁶⁷ that too is now just one factor among many. In its motion, GAC has emphasized that the Petitioning Creditors have largely bypassed normal collection procedures and has argued that Chen had improper motives and the remaining Petitioning Creditors had different, but also improper, motives. But because the Court is applying the totality test, the evidence regarding these claims must be viewed against a broader set of facts and circumstances.

Regarding Chen's motivations, GAC's theory of the case is that Chen orchestrated this involuntary petition with the nefarious aim of forcing GAC into bankruptcy, depressing its value, and acquiring its assets at rock-bottom prices or, at the very least, using the threat of bankruptcy to leverage a settlement of his claim.¹⁶⁸ GAC also asserts that Chen paid or guaranteed the other Petitioning Creditors' legal fees, implying that he persuaded them to join the petition solely as pawns to clear the **§ 303** statutory hurdle, after which time he would pursue his asset-acquisition scheme. These allegations directly implicate the factors of whether the petition was motivated by ill will or a desire to harass and whether Chen used the filing to obtain a disproportionate advantage for himself.¹⁶⁹

The evidence supports neither allegation against Chen, however. During cross-examination GAC's counsel asked Chen point-blank whether, if GAC's assets were liquidated in bankruptcy, he or someone connected to him would be interested in purchasing them. Without hesitation, Chen responded that he had absolutely no interest in purchasing GAC's assets because he does not believe the company's technology is still competitive. The Court finds this testimony credible, and GAC did not impeach it.

Notwithstanding Chen's testimony, CAG attempted to prove his motivations circumstantially through his involvement in

prior bankruptcy cases where, GAC alleged, he engaged in similar attempts to acquire assets or leverage settlement. The Court concludes that the evidence advanced in support of this argument was unconvincing. The evidence showed that Chen became a director and co-CEO of a company called AirFastTickets, Inc. in December 2014 after making a bridge loan to it. The Delaware Court of Chancery appointed a receiver for the company in July 2015 and, six days after that appointment, certain of AirFast's creditors filed an involuntary petition against it.¹⁷⁰ Chen was not among the petitioning creditors. During that bankruptcy, AirTourist, Inc., a company of which Chen was the CEO, bought substantially all of AirFast's intellectual property, software, and certain related assets.¹⁷¹ AirTourist later changed its name to Travana, Inc., and Chen was one of six petitioning creditors who filed an involuntary petition against it in April 2017.¹⁷² An attachment to the petition showed that Chen alleged two claims: \$697,219.00 for severance under an employment contract and \$1,926.79 in unreimbursed expenses.¹⁷³ Further facts ***478** about these cases were not introduced into evidence. Nowhere in these facts is any proof that Chen has previously attempted to use an involuntary petition to seize corporate control of a debtor or leverage a settlement. Importantly, there is no allegation that the Travana case was dismissed on bad faith grounds, which suggests that Chen's actions as a petitioning creditor were not deemed improper. At most, these facts show that Chen perhaps has some familiarity with purchasing assets in a **§ 363** sale and filing an involuntary petition. They do not create an inference that Chen is using this bankruptcy to take control of GAC.

The fee arrangements between Chen and the other Petitioning Creditors also do not create such an inference. While Chen did contact some of the Petitioning Creditors to ask whether they would like to join the petition and did guarantee the payment of their legal fees,¹⁷⁴ the evidence was clear that he is not paying their legal fees. The original six Petitioning Creditors testified, some with a resigned grimace, that they are paying their own way, each sharing in the fees in proportion to his or her claim asserted in the petition.¹⁷⁵ This is consistent with the retention letter from their firm.¹⁷⁶ While Chen's actions suggest that he occupies a leadership role among the Petitioning Creditors, that alone is insufficient to support GAC's takeover allegation, particularly considering a dearth of corroborating evidence that Chen aims to acquire GAC.

GAC also failed to present evidence supporting its allegation that Chen used this bankruptcy to leverage a settlement of his

claims. Chen's testimony indicates that his goal in this case is to receive payment of his claim either through a plan of reorganization or the appointment of a trustee and liquidation of GAC's assets. There is a critical distinction between using an involuntary petition as a cudgel to extort a settlement on the one hand and seeing an involuntary petition through all the way to repayment on the other, and the Court concludes that GAC has not shown that Chen's actions fall on the bad faith side of that ledger.

As with Chen, the other Petitioning Creditors are animated by a simple desire to get paid. They admitted, almost uniformly, that they wanted to receive what they believed was owed to them. And while the Petitioning Creditors did not, with the exception of the former employees who filed claims with the Labor Commission, pursue customary debt-collection procedures before filing this case, that fact does not deserve the weight normally accorded to it given GAC's history and current financial situation.

This is not an instance where petitioning creditors have forced an otherwise healthy company into bankruptcy for the simple purpose of debt collection. GAC is not a typical business with regular operations and a steady stream of revenue. Instead, it is principally dependent on the intermittent largesse of investors to continue its work and pay its bills. GAC, like GBA, operated in fits and starts, alternating between periods marked by progress and ^{*479} high employment and those marked by layoffs and lack of funding. Through all of that, neither company was able to bring a product to market in over 30 years that provided sustained success and generated stable revenues. All of the Petitioning Creditors, who, with the exception of Kent, had worked for GAC and GBA during various times over the years, were well aware of those companies' cyclical nature, but also their incipient potential, to which many of them hitched their hopes not only of repayment, but also a career.

Although GBA had laid off and rehired employees in the past, the 2015 Layoffs at GAC seemed to represent something more than just another trough in the cycle. Whereas prior layoffs had stripped GBA down to an essential core of employees, the 2015 Layoffs prompted the resignation of even long-tenured executives, such as Wilson and van der Westhuizen. More importantly, the 2015 Layoffs were preceded by a multi-year period marked by an apparent lack of productivity, low employment, and financial stress. GBA and GAC had struggled with cash flow both pre- and post-Transition even though company executives were optimistic about funding

being just around the corner. The first year post-Transition—2013—was particularly lean, and 2014 might have been just as bad or worse if Chen had not provided much-needed cash to the company. When Chen left, and his capital along with him, GAC ground to a halt. As mentioned previously, GAC only had \$205 in its bank account by the end of April 2015.

It would have been rational to wonder, at that point, whether GAC could ever pay what the Petitioning Creditors claim is owed to them, much less realize its long-held dream of successfully bringing sustained autorotative flight to market. When Chigbrow called certain former employees to inform them that they would be receiving some money under the Payment Plan around May 2016, many had already given up hope of getting paid. And when some Petitioning Creditors discovered that GAC had received funding in late 2016, a reasonable person in their shoes would naturally view this as perhaps their best chance to get paid, a chance that might not return for some time, if at all. Chen testified that people were excited when they heard of the funding; it was as if rain had come after a long drought.

But the Petitioning Creditors soon found that the rain wasn't falling on them. During 2017, GAC burned through cash at a steady rate, which, other than relatively small amounts paid toward Unpaid Compensation and the Labor Commission claims, was not being paid to the Petitioning Creditors and other similarly situated former employees. In other words, other creditors were being preferred at the Petitioning Creditors' expense. And, based on GBA's and GAC's performance history, one could reasonably question whether the sums spent on getting the business running again would bear fruit before they were exhausted. Accordingly, the Petitioning Creditors' motivation can be seen as a desire to protect themselves against other creditors obtaining a disproportionate share of GAC's assets as well as a desire to prevent dissipation of those assets before this round of funding ran out. Both are proper reasons to file an involuntary petition.¹⁷⁷ Viewed subjectively and objectively, the Court concludes that the Petitioning Creditors' motivations do not evince bad faith. At bottom, they simply ^{*480} wanted to get paid before the next drought returned.

To summarize, many of the factors in the totality test favor the Petitioning Creditors. They have satisfied the statutory criteria of § 303, and the petition is meritorious. The petition's timing was not suspicious, nor was it used to gain a tactical advantage in other actions. While GAC has questioned the Petitioning Creditors' motives, it is clear that they did not

file the petition to obtain a disproportionate advantage for themselves or to harass or embarrass the debtor. To the contrary, they were the ones being disadvantaged and simply wanted to collect on years-old debt. The only factor that cuts in GAC's favor is that the Petitioning Creditors have not pursued customary debt-collection remedies before arriving in bankruptcy court. But given the weight of the other factors and the circumstances surrounding GAC's history and financial situation, this is insufficient to carry GAC's burden to show that the petition was filed in bad faith. Accordingly, the Court will deny GAC's motion to dismiss the involuntary petition.

C. GAC's Motion to Dismiss Under Section 305(a)

The parties also tried GAC's separate motion under § 305(a) to dismiss this case or, in the alternative, suspend proceedings for four months.¹⁷⁸ When petitioning creditors prevail at trial on an involuntary petition, the Code obliges courts to enter an order for relief.¹⁷⁹ Despite satisfaction of the statutory requirements of § 303, however, § 305(a) provides that a court may dismiss a case or suspend all proceedings in a case,¹⁸⁰ but only if it finds that the interests of creditors and the debtor would be better served by dismissal or suspension. Dismissal or suspension is an “extraordinary remedy of narrow breadth,”¹⁸¹ and a mere balancing of harm to the debtor and creditors will not suffice to satisfy § 305(a).¹⁸² The party seeking relief under § 305(a) bears the burden to show that dismissal or suspension would benefit both parties.¹⁸³

Courts employ a totality of the circumstances test to evaluate § 305(a) motions,¹⁸⁴ and modern decisions typically look at seven factors:

- (1) the economy and efficiency of administration; (2) whether another forum is available to protect the interests of both parties or there is already a pending proceeding in state court; (3) whether federal proceedings are necessary to reach a just and equitable solution; (4) whether there is an alternative means of achieving an equitable distribution of assets; (5) whether the debtor and the creditors are able to work out a less *481 expensive out-of-court arrangement which better serves all interests in the case; (6) whether a non-federal insolvency has proceeded so far in those proceedings that it would be costly and time consuming to start afresh with the federal bankruptcy process; and (7) the purpose for which bankruptcy jurisdiction has been sought.¹⁸⁵

These factors are not exclusive, and while “no one factor is more important than another,”¹⁸⁶ they may be given different weight depending on the case.¹⁸⁷ “A bankruptcy court is not bound by a prescriptive template; it may consider any factors it deems relevant to the determination of whether it is in the best interests of the parties to the suit to seek dismissal. Reasoned judgment based on articulated facts is the only test which the statute itself requires.”¹⁸⁸

In addition to these factors, GAC has argued that the Court should consider the extent to which the case presents unsettled issues of non-bankruptcy law. GAC asserts that there are two unsettled issues under Utah law: first, whether [Utah Code Ann. § 34-28-3\(6\)\(b\)](#)'s requirement that an employee must authorize the withholding of wages in writing applies to officers and to future income; and second, whether [Utah Code Ann. § 34-28-1 et seq.](#) precludes Carron, Parry, and Nadauld from asserting claims in excess of the amounts claimed with the Labor Commission.¹⁸⁹ While some courts have relied on this factor under § 305(a),¹⁹⁰ the Court does not give it any weight in this case. Although few authorities appear to have addressed the legal questions GAC has raised, the Court has already determined that they either do not create a bona fide dispute as to the Petitioning Creditors' claims or do not need to be resolved to reach a conclusion under § 303. Since there is no need for a state court to decide an intractable issue of state law, this factor does not weigh in favor of dismissal.

The remaining factors tend to fall on opposing sides of the ledger. On the one hand, other forums exist to adjudicate the parties' disputes and federal proceedings may not be necessary to reach a just and equitable solution. On the other hand, this case does not impinge on an already-begun non-federal insolvency proceeding, and while the Petitioning Creditors filed this case to receive payment, that was not an improper purpose under the facts of this case. In short, this dispute could proceed in bankruptcy court but could exist comfortably outside it. The most pertinent factor in deciding between those two options is whether the parties will be able to achieve a less expensive out-of-court workout that serves all of their interests. While § 305(a)(1) reflects a congressional policy to encourage workouts over bankruptcy,¹⁹¹ the Court must be satisfied that a debtor and its creditors would in fact be better off pursuing such a course.

GAC's amenability to settlement favors an out-of-court workout. Even though *482 GAC ousted Groen over the repayment of old debts, it now believes it can reach

settlements with at least six of the Petitioning Creditors outside of bankruptcy. Its offer to repay what Carron, Parry, Nadauld, Chigbrow, and Taft have asserted in the involuntary petition appears to be a good faith effort to act on that belief, though it is not without controversy, as the parties have disputed whether GAC's settlement offers in the case have been furtive attempts to undermine the standing of the non-settling Petitioning Creditors.¹⁹² GAC has indicated its willingness to use mediation, arbitration, and, as a last resort, litigation to resolve unsettled claims. It also believes that it is on the verge of generating enough revenue to pay the claims of Wilson and van der Westhuizen. This optimism stops when GAC speaks of Chen's claim, however. GAC hotly disputed his claim throughout trial and readily admits that it is not willing to resolve it "without substantial litigation."¹⁹³

While it appears that Chen's claim will be litigated whether this dispute ends up in bankruptcy or not, an order for relief would likely subject the remaining Petitioning Creditors' claims to litigation as well. The Funds and West Mountain threatened fierce claim litigation, which would no doubt diminish any advantage a bankruptcy proceeding would have in economy and efficiency of administration over a non-bankruptcy action, which would have to begin from scratch. In addition, claim litigation would drive up costs relative to a potential out-of-court settlement.

Bankruptcy would likely be costly for GAC as well. The funding it has received and the contracts it has negotiated might evaporate, possibly removing reorganization as an option. If GAC were liquidated, odds are low that creditors would receive a substantial dividend. While GAC has patents of unknown worth, its assets essentially consist of its bank accounts, which may have had slightly more than \$1 million left in them as of September 2018, assuming a cash burn rate of \$185,894.85 per month. The Petitioning Creditors asserted claims totaling \$1,587,212.07, which is already above identifiable assets, and administrative costs and the claims of other creditors would further diminish potential returns. So even if the Petitioning Creditors' claims survived litigation, there would be little chance of meaningful repayment.

In some ways, the question becomes whether GAC can return more to creditors inside bankruptcy or outside it. Based on the facts of this case, the Court concludes that the best chance for creditors to be paid a meaningful return is outside of bankruptcy. Many of the Petitioning Creditors would avoid the costs of claim litigation and the prospect of

sharing with other creditors in a pool of limited assets. At the same time, GAC would have a better chance of obtaining cash for settlements of creditors' claims. But for creditors to be better off outside of bankruptcy, GAC would have to deliver on its promises. After reviewing GAC's and GBA's history, the Court shares the Petitioning Creditors' well-founded skepticism regarding GAC's promises that funding or contracts are right around the corner. Over the course of three decades those companies have repeatedly approached the threshold of potential *483 success, only to linger briefly and turn away empty-handed. Moreover, GAC operates in an industry, the apparent progress of AutoGyro notwithstanding, where sustained success seems elusive.

Even so, GAC has provided enough evidence to be given a chance to prove that this time is different. While GAC emphasized its many *irons* in the fire, some of those projects may be years, if not decades, away from realization. The crucial development is GAC's contract with Jugointport to build and flight test a Hawk 5 prototype. Commercial production is admittedly not guaranteed, but according to Gen. Michel this collaboration could yield revenue within months after a prototype is produced. In the meantime, GAC is attempting to generate revenue through the sale of SparrowHawk inventory.

Accordingly, after considering the good faith efforts of GAC to settle some of the Petitioning Creditors' claims, the expense of bankruptcy and the harm it could cause to GAC, and the likelihood that GAC will achieve success on the Hawk 5 or another project, and after assessing the possibility for meaningful recovery for creditors in a liquidation and outside of bankruptcy, the Court concludes that the interests of creditors and GAC would be better served by suspension of these proceedings for 60 days. After that time, the Court will evaluate GAC's progress on the Hawk 5 and other projects, obtaining funding from investors, and its efforts to settle the Petitioning Creditors' claims. Depending on the level of progress on those fronts, the Court will consider extending the suspension, dismissing the case, or entering an order for relief.

D. GAC's Motion for a Bond Under Section 303(e)

GAC requested that the Petitioning Creditors be required to post a bond under § 303(e) to compensate it, in the event the petition is dismissed, for the damage it has allegedly suffered as a result of the involuntary petition.¹⁹⁴ Section 303(e) permits a court to order that a petitioning creditor "file

a bond to indemnify the debtor for such amounts as the court may later allow under subsection (i) of this section.” In turn, § 303(i) allows a court, upon dismissal of the petition, to grant judgment against a petitioning creditor for the debtor's costs and fees and, if the court finds that the petitioner filed the petition in bad faith, for any damages proximately caused by the filing or punitive damages. Since the Court has concluded that the Petitioning Creditors did not file this petition in bad faith, damages under § 303(i)(2) would not be available, but “[b]ad faith is not a prerequisite to an award of costs and attorney's fees under § 303(i)(1).”¹⁹⁵

Even if the Court dismissed the case under § 305(a) after the 60-day suspension or some longer period, it would not grant judgment under § 303(i)(1). While § 305(a) dismissals have supported the imposition of fees and costs,¹⁹⁶ the Court concludes that the facts of this case do not warrant such a result. Section 303(i)(1) gives a court discretion to award fees and costs, and that discretion is guided by a totality of the circumstances test, which considers “(1) the merits of the involuntary *484 petition; (2) the role of any improper conduct on the part of the alleged debtor; (3) the reasonableness of the actions taken by the petitioning creditors; and (4) the motivation and objectives behind the filing of the petition.”¹⁹⁷ While GAC does not appear to have engaged in improper conduct, the Court has already

concluded that the petition is meritorious and the Petitioning Creditors' motivations in filing the petition were proper. And because the Court has concluded that this dispute could proceed in bankruptcy court, the Petitioning Creditors' actions in filing and pursuing this petition have been reasonable. The Court declines to require the Petitioning Creditors to pay for GAC's fees and costs under these circumstances, so a bond is not necessary. The Court will deny GAC's motion under § 303(e).

IV. CONCLUSION

The Petitioning Creditors have satisfied the statutory requirements of § 303, and the petition was not filed in bad faith. But because of the circumstances of this case, the Court declines to enter an order for relief at this time. After the 60-day suspension, the Court will examine GAC's progress and reevaluate what course of action is in GAC's and its creditors' best interests. A separate Order and Judgment will be entered in accordance with this Memorandum Decision.

All Citations

594 B.R. 442

Footnotes

- 1 The involuntary petition was subsequently amended on April 10, 2018.
- 2 All subsequent statutory references are to Title 11 of the United States Code unless otherwise indicated.
- 3 This Memorandum Decision constitutes the Court's findings of fact and conclusions of law pursuant to Fed. R. Civ. P. 52(a), made applicable in contested matters by Fed. R. Bankr. P. 9014(c). Any of the findings of fact herein are deemed, to the extent appropriate, to be conclusions of law, and any conclusions of law are similarly deemed, to the extent appropriate, to be findings of fact, and they shall be equally binding as both.
- 4 The most critical distinction between a helicopter and a gyroplane is that the former's top rotor is powered during flight, while the latter's is not. A powered rotor requires a transmission and other complex systems, which increase aircraft weight and require extensive and frequent maintenance. In addition, helicopters are more difficult to fly, particularly in the event of engine failure. By contrast, the gyroplane's non-powered rotor makes it easier to fly, while at the same time reducing maintenance costs. In addition, gyroplanes do not need the long runways that airplanes do, and they can fly low and at speeds that would be dangerous for airplanes.
- 5 GBA continues to exist as a corporate entity but has no current operations. Its only asset is approximately \$1.5 million in stock in the new, post-Transition company.
- 6 See *infra*, Section II.C.
- 7 Ex. H. GBAG had also proposed a plan for the payment of delinquent rent.

- 8 Ex. WWW, at PPE 01-07-12 tab.
- 9 *Id.* at PPE 01-05-13 Reduced Rates tab.
- 10 *Id.* at PPE 11-22-14 Reduced Rates tab.
- 11 See *infra*, Section II.E.
- 12 Ex. QQ, at SKYWORKS000193-94.
- 13 Ex. SS, at SKYWORKS000709.
- 14 The name of the debtor on the petition is General Aeronautics Corporation, Skyworks's name when some of the Petitioning Creditors worked for it. GBAG, GAC, Groen Aeronautics Corp., and Skyworks all refer to the same corporate entity. For simplicity's sake, and unless specified otherwise, the Court will use GAC—the name used on the petition—to refer to the debtor regardless of whether the debtor's name was something different at the time of the event under discussion.
- 15 See Ex. SG71.
- 16 The parties did not present extensive evidence on the gyroplane market, but there were enough snippets that can be pieced together to form an impression of the market that will be helpful in evaluating GAC's [§ 305](#) motion.
- 17 It is unclear whether all employees were asked to do this at the same time, but the evidence suggests that pay reductions took effect for three executives—Groen, Wilson, and van der Westhuizen—on April 15, 2012, while for all other employees who opted to reduce their pay, the reductions began on April 29, 2012. See Ex. WWW, 2012 Accr Payroll-Reduced Rates tab.
- 18 Ex. AAA.
- 19 *Id.*
- 20 See Ex. WWW, 2012 Accr Payroll-Reduced Rates tab.
- 21 Groen made clear that executives would receive Deferred and Bonus Compensation.
- 22 Ex. WWW, PPE 05-12-12 Reduced Rates tab.
- 23 *Id.* at PPE 05-11-13 Reduced Rates tab.
- 24 Ex. AAA.
- 25 See Ex. WWW. Unpaid Compensation is summarized in the Detail Unpaid Payroll tab, while Deferred and Bonus Compensation are found in the 2012 Accr Payroll-Reduced Rates tab.
- 26 See *id.*, at 2012 Accr Payroll-Reduced Rates tab.
- 27 Ex. SG55.
- 28 *Id.*
- 29 Ex. BBBB, a table prepared by GAC for this litigation which lists its outstanding liabilities as of September 30, 2017, shows a \$58,400 balance owing to the Utah Office of State Debt Collection. The discrepancy between that amount and the amount remaining in Ex. SG55 was not explained at trial. The evidence indicated that GAC was making payments towards the Labor Commission judgments as shown in Ex. SG55, so the Court will view the \$35,799.73 pre-petition balance remaining as correct.
- 30 See [Utah Code Ann. § 34-28-9\(1\)\(a\)\(d\)-\(e\) \(2017\)](#).

- 31 The Court excludes regular payments to the Labor Commission from the Payment Plan, but Parry, Nadauld, and Carron each received a single payment in May 2016 which was not part of the Labor Commission payments. See Ex. VVV, at Unpaid Payroll tab. Those single payments will be counted as part of the Payment Plan in determining their claims.
- 32 Ex. VVV, at Unpaid Payroll tab. That spreadsheet tracks payments through February 2017. Ex. SG55 tracks payments to a smaller subset of employees, but through December 2017.
- 33 The amounts to be repaid to non-Labor Commission employees in column C of the Unpaid Payroll tab of Ex. VVV match the amounts in column BM of the Detail Unpaid Payroll tab of Exhibit WWW. Column BM is the grand total of unpaid wages accrued pre-Transition at GBA and post-Transition at GAC.
- 34 Terry Brandt was at one time listed as Vice President of Flight Operations, see Ex. SG39, but was not considered an executive for purposes of compensation, see Ex. WWW, at Detail Unpaid Payroll tab, or the Payment Plan.
- 35 Ex. VVV, at Unpaid Payroll tab.
- 36 See *id.* & Ex. SG55. The monthly totals in Ex. SG55 appear to be lower because there are some employees omitted from that spreadsheet who are included in Ex. VVV. Ex. SG55 also appears to omit GAC's payment of employment taxes on amounts paid to employees.
- 37 See Ex. SG55. This figure is likely higher because Ex. SG55 undercounts payments compared to Ex. VVV. But Ex. VVV cannot be used for this calculation since it only runs through February 2017.
- 38 Ex. AAA.
- 39 See Ex. HH. That exhibit lists the board members as of January 2015. Groen, Wilson, and Carter had been on the board since the Transition. It is unclear whether anyone preceded Rudman and Emami in their seats on the board, but that is not material to this decision.
- 40 See Exs. GG & HH.
- 41 Ex. B.
- 42 See Ex. C.
- 43 *Id.*
- 44 *Id.*
- 45 See Exs. D & E.
- 46 See Ex. D.
- 47 Ex. A.
- 48 Ex. WWW, at PPE 06-09-12 Reduced Rates tab.
- 49 *Id.* at Detail Unpaid Payroll and 2012 Accr Payroll-Reduced Rates tabs.
- 50 See Ex. SG55.
- 51 Ex. WWW, at PPE 05-12-12 Reduced Rates tab.
- 52 *Id.* at Detail Unpaid Payroll tab. This amount is corroborated by an email Taft sent to Groen at the time of the 2015 Layoffs stating GAC owed her \$6,688.63. Ex. CCC.
- 53 Ex. WWW, at 2012 Accr Payroll-Reduced Rates tab.

- 54 Ex. A.
- 55 See Ex. SG55.
- 56 Ex. WWW, at PPE 05-12-12 tab.
- 57 *Id.* at PPE 07-05-14 tab.
- 58 Ex. S. The expense reimbursement Parry claimed with the Labor Commission matches the amount owed to him on GAC's Accounts Payable Aging Summary dated January 15, 2015. See Ex. A. Because Parry received or is being paid that amount through the Labor Commission, the expense amount showing on the aging summary will not be considered for purposes of calculating Parry's claim under § 303.
- 59 Ex. R. Parry's account includes \$2,287.69 in unpaid wages during his time at GBA. That amount will be excluded from the § 303 analysis.
- 60 This is largely consistent with GAC's records, which show \$27,511.40 in Unpaid Compensation owing to Parry through March 1, 2014. See Ex. WWW, at Detail Unpaid Payroll tab. The difference appears to come from a discrepancy between GAC's records and Parry's accounting concerning the pay periods ending January 4 and 18, 2014, but the Court does not view the difference as material to the resolution of this case.
- 61 Ex. WWW, at Detail Unpaid Payroll and 2012 Accr Payroll-Reduced Rates tabs.
- 62 Ex. VVV, at Unpaid Payroll tab.
- 63 Ex. WWW, at PPE 05-12-12 and PPE 06-09-12 tabs.
- 64 *Id.* at Detail Unpaid Payroll tab.
- 65 Ex. SG55.
- 66 Ex. VVV, at Unpaid Payroll tab.
- 67 Ex. I.
- 68 Ex. A.
- 69 Ex. VVV, at Unpaid Payroll tab. This is consistent with Carron testimony that he received a check for approximately \$500 more than a year after the 2015 Layoffs.
- 70 See Ex. WWW, at PPE 01-07-12 and PPE 01-05-13 Reduced Rates tabs; Ex. Z, at 44 & 53 of 89.
- 71 Ex. WWW, at PPE 04-28-12 tab; Ex. Z, at 36 of 89.
- 72 Ex. Z, a spreadsheet van der Westhuizen prepared to track amounts owed to him, suggests that his pay remained at 65% of his salaried rate through the 2015 Layoffs. But that is not supported by GAC's Excel spreadsheets. They show a post-Transition reduction to 11% of van der Westhuizen's original rate, see Ex. WWW, at PPE 01-05-13 Reduced Rates tab, which is consistent with the payment of \$550 per pay period documented in van der Westhuizen's pay stubs. See Ex. Z, at 53 of 89. More importantly, the 2012 Accr Payroll-Reduced Rates tab of Ex. WWW documents a change in van der Westhuizen's Deferred Compensation from \$1,750 for the pay period ending 11/24/12 to \$4,450 for the pay period ending 01/05/13. If van der Westhuizen's pay rate remained at 65% post-Transition but he was only getting paid \$550 per pay period, he would be accruing \$2,700 in Unpaid Compensation per pay period. But the Detail Unpaid Payroll tab does not show that amount in any post-Transition pay period. Instead, on the occasions when van der Westhuizen was not paid, he accrued \$550 in Unpaid Compensation per pay period. The Court finds that Ex. WWW records the correct division between van der Westhuizen's Unpaid and Deferred Compensation.

- 73 Ex. WWW, at Detail Unpaid Payroll tab.
- 74 *Id.* at 2012 Accr Payroll-Reduced Rates tab.
- 75 See *id.* at PPE 01-07-12 tab. Wilson's salary of \$5,384.61 per bi-weekly pay period comes out to \$139,999.86 per year.
- 76 *Id.* at PPE 04-28-12 tab.
- 77 *Id.* at PPE 01-05-13 tab.
- 78 *Id.* at Detail Unpaid Payroll tab.
- 79 *Id.* at 2012 Accr Payroll-Reduced Rates tab.
- 80 Ex. A. The amounts on Ex. A exclude wages and salaries owed to employees. Wilson has not been paid any of the \$69,099.95 listed on Ex. A.
- 81 See Ex. MM. GAC's bank account records show numerous transfers from Chen during 2014.
- 82 Ex. LL.
- 83 See Ex. LL.
- 84 Ex. SG35.
- 85 Ex. SG36.
- 86 See Ex. LL.
- 87 Ex. KK.
- 88 Ex. SG32.
- 89 *Id.*
- 90 Ex. RRR.
- 91 The 1979 text of § 303(b)(1) read:
- An involuntary case is commenced by the filing with the bankruptcy court of a petition under chapter 7 or 11 of this title —by three or more entities, each of which is either a holder of a claim against such person that is not contingent as to liability or an indenture trustee representing such a holder, if such claims aggregate at least \$5,000 more than the value of any lien on property of the debtor securing such claims held by the holders of such claims.
- 92 *Key Mech. Inc. v. BDC 56 LLC (In re BDC 56 LLC)*, 330 F.3d 111, 117 (2d Cir. 2003), *overruled on other grounds by Adams v. Zarnel (In re Zarnel)*, 619 F.3d 156 (2d Cir. 2010).
- 93 *In re Tikijian*, 76 B.R. 304, 314 (Bankr. S.D.N.Y. 1987); see also *Fustolo v. 50 Thomas Patton Drive, LLC*, 816 F.3d 1, 7 (1st Cir. 2016) (“The self-evident purpose of the no bona fide dispute requirement, as courts have repeatedly recognized, is to prevent creditors from using involuntary bankruptcy to coerce a debtor to satisfy a judgment even when substantial questions may remain concerning the liability of the debtor.”) (citations and internal quotation marks omitted).
- 94 *In re Henry*, 52 B.R. 8, 9-10 (Bankr. S.D. Ohio 1985) (quoting 130 Cong. Rec. S7618 (daily ed. June 19, 1984) (remarks of Sen. Baucus)).
- 95 See, e.g., *In re Lough*, 57 B.R. 993, 996-97 (Bankr. E.D. Mich. 1986) (rejecting two other courts' bona fide dispute standards and fashioning its own). The *Lough* standard became the progenitor of the objective standard adopted by

certain circuit courts of appeal, including the Tenth Circuit. See *Rimell v. Mark Twain Bank (In re Rimell)*, 946 F.2d 1363, 1365 (8th Cir. 1991) (adopting the objective test and noting its adoption by other courts).

- 96 *Fustolo*, 816 F.3d at 6-7 (quoting *In re BDC 56 LLC*, 330 F.3d at 117).
- 97 *In re Fustolo*, 503 B.R. 206, 223 (Bankr. D. Mass. 2013), *aff'd* 2015 WL 4876075 (D. Mass. Feb. 17, 2015), *aff'd* 816 F.3d 1 (1st Cir. 2016).
- 98 E.g., *IBM Credit Corp. v. Compuhouse Sys., Inc.*, 179 B.R. 474, 479 (W.D. Pa. 1995) (“[I]t is clear that if at least a portion of the debt that is the subject of the petition is undisputed, the undisputed portion is sufficient to create a debt under Section 303(b)(1) not subject to bona fide dispute.”), *aff'd* 85 F.3d 612 (3d Cir. 1996); *In re Hentges*, 351 B.R. 758, 776 (Bankr. N.D. Okla. 2006) (“[C]ourts widely held that a dispute as to a portion of a petitioning creditor’s claim did not disqualify the creditor as a petitioning creditor under Section 303 of the Bankruptcy Code.”).
- 99 *Fustolo*, 816 F.3d at 9.
- 100 See *Montana Dep’t of Revenue v. Blixseth*, 581 B.R. 882, 903 (D. Nev. 2017) (“I find that § 303(b), as amended under the BAPCPA in 2005, unambiguously disqualifies a creditor whose claim is the subject of any bona fide dispute as to amount.”), *appeal docketed*, No. 18-15064 (9th Cir. Jan. 16, 2018); *In re Vicor Techs., Inc.*, No. 12-39329-EPK, 2013 WL 1397460, at *5 (Bankr. S.D. Fla. Apr. 5, 2013) (“[A] dispute as to any portion of a claim, even if some dollar amount would be left undisputed, means there is a bona fide dispute as to the amount of the claim and such claim cannot be counted to satisfy § 303(b)(1).”).
- 101 See *In re Miller*, 489 B.R. 74, 82 (Bankr. E.D. Tenn. 2013) (“[T]he court does not agree that post-BAPCPA § 303(b) requires an all-or-nothing analysis: that the statutory language ‘as to liability or amount’ should be read as meaning that any dispute as to any portion of the amount of a claim owed disqualifies a creditor from being a petitioning creditor.”); *In re Tucker*, No. 5:09-bk-914, 2010 WL 4823917, at *6 (Bankr. N.D. W. Va. Nov. 22, 2010) (“The better reasoned authority suggests that a petitioning creditor is not disqualified even if a bona fide dispute exists regarding a *portion* of its claim.”).
- 102 *Ransom v. FIA Card Servs., N.A.*, 562 U.S. 61, 69, 131 S.Ct. 716, 178 L.Ed.2d 603 (2011) (quoting *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 241, 109 S.Ct. 1026, 103 L.Ed.2d 290 (1989)).
- 103 *Ron Pair Enters., Inc.*, 489 U.S. at 241, 109 S.Ct. 1026 (citation and internal quotation marks omitted).
- 104 *In re VistaCare Grp., LLC*, 678 F.3d 218, 226 (3d Cir. 2012) (citation and internal quotation marks omitted).
- 105 *Dewsnup v. Timm*, 502 U.S. 410, 419, 112 S.Ct. 773, 116 L.Ed.2d 903 (1992) (citation and internal quotation marks omitted).
- 106 *Hamilton v. Lanning*, 560 U.S. 505, 517, 130 S.Ct. 2464, 177 L.Ed.2d 23 (2010) (quoting *Travelers Cas. & Sur. Co. of Am. v. Pac. Gas & Elec. Co.*, 549 U.S. 443, 454, 127 S.Ct. 1199, 167 L.Ed.2d 178 (2007)).
- 107 See 2 Collier on Bankruptcy ¶ 303.11[1] (Richard Levin & Henry J. Sommer eds., 16th ed.) (“[D]isqualifying a creditor because a *portion* of its debt is in dispute could curtail the ability of creditors to resort to a remedy Congress intended them to have.”).
- 108 *In re DemirCo Holdings, Inc.*, No. 06-70122, 2006 WL 1663237, at *3 (Bankr. C.D. Ill. June 9, 2006).
- 109 2 Collier on Bankruptcy ¶ 303.11[2].
- 110 *Robbins v. Chronister*, 435 F.3d 1238, 1241 (10th Cir. 2006) (quoting *Demarest v. Manspeaker*, 498 U.S. 184, 190-91, 111 S.Ct. 599, 112 L.Ed.2d 608 (1991)).
- 111 *In re 3 Man Corp.*, No. 5-12-bk-00879-JJT, 2014 WL 4346747, at *4 (Bankr. M.D. Pa. Aug. 29, 2014) (quoting 2 Bankruptcy Litigation § 11:10).

- 112 *Id.*
- 113 See *Robbins*, 435 F.3d at 1241-43 (providing an overview of the application of the absurdity doctrine).
- 114 *Ron Pair Enters., Inc.*, 489 U.S. at 242, 109 S.Ct. 1026 (quoting *Griffin v. Oceanic Contractors, Inc.*, 458 U.S. 564, 571, 102 S.Ct. 3245, 73 L.Ed.2d 973 (1982)).
- 115 2 Collier on Bankruptcy ¶ 303.11[2].
- 116 *Bartmann v. Maverick Tube Corp.*, 853 F.2d 1540, 1544 (10th Cir. 1988).
- 117 *Id.*
- 118 *In re Rimell*, 946 F.2d at 1365; see also *In re TPG Troy, LLC*, 492 B.R. 150, 159 (Bankr. S.D.N.Y. 2013) (“[T]he court may address the merits of the dispute” in determining the presence of a bona fide dispute.), *aff’d*, 793 F.3d 228 (2d Cir. 2015).
- 119 *Bartmann*, 853 F.2d at 1544 (citations omitted).
- 120 Ex. N.
- 121 Dkt. No. 145, at 6.
- 122 See *Evershed v. Berry*, 20 Utah 2d 203, 436 P.2d 438, 440 (1968) (“If nothing more is shown than payment and receipt of rent, the result at common law is the creation either of a tenancy at will or at most of one from year to year.”).
- 123 See Ex. C.
- 124 Ex. A. The entry in the aging summary is “California Ave,” which refers to the property GAC rented from Kent.
- 125 Ex. G.
- 126 Ex. F. T
- 127 *Id.* at 1546.
- 128 *Id.*
- 129 *Soc’y at Lloyd’s v. Harmsen (In re Harmsen)*, 320 B.R. 188, 197 (10th Cir. BAP 2005).
- 130 *Id.* at 198. While the BAP approved of the bankruptcy court’s consideration of certain factors in applying the totality of the circumstances test, it did not expressly endorse such factors for use in future cases.
- 131 See *id.* (citing *In re All Media Properties, Inc.*, 5 B.R. 126, 143 (Bankr. S.D. Tex. 1980)).
- 132 See *In re Agrawal*, 562 B.R. 510, 515-18 (Bankr. W.D. Okla. 2016) (applying the mathematical and totality of the circumstances tests); *In re ELRS Loss Mitigation, LLC*, 325 B.R. 604, 630-33 (Bankr. N.D. Okla. 2005) (same). The labels courts have affixed to the mathematical and totality tests are not consistent, however. In fact, some courts have described the same test as a totality inquiry while others have called it mechanical. Compare *In re Huggins*, 380 B.R. 75, 83 (Bankr. M.D. Fla. 2007) (“The courts apply a flexible totality of the circumstances test in determining whether a debtor is ‘generally not paying’ his debts, which focuses on the number of unpaid claims, the amount of the claims, the materiality of nonpayment and the overall conduct of the debtor’s financial affairs.”), with *In re Agrawal*, 562 B.R. at 515 (“[T]he second step of the [mechanical] inquiry ... requires the court to compare the number and amount of unpaid debts with the number and amount of paid debts. That comparison is to take into account the materiality of that nonpayment as well as a debtor’s general conduct of its financial affairs.”). The Court does not need to resolve this semantic argument, however.
- 133 See 2 Collier on Bankruptcy ¶ 303.31 (“There is no single mathematical formula that can be used to determine whether the [‘generally not paying’] standard has or has not been met.”).

- 134 *In re Quinto & Wilks, P.C.*, 531 B.R. 594, 609 (Bankr. E.D. Va. 2015) (citations and internal quotation marks omitted).
- 135 See *In re CorrLine Int'l, LLC*, 516 B.R. 106, 160 (Bankr. S.D. Tex. 2014).
- 136 2 Collier on Bankruptcy ¶ 303.31[2] (citing *In re Everett*, 178 B.R. 132, 139 (Bankr. N.D. Ohio 1994)).
- 137 *In re Int'l Oil Trading Co.*, 545 B.R. 336, 358 (Bankr. S.D. Fla. 2016); see also *In re West Side Cmty. Hosp., Inc.*, 112 B.R. 243, 256 (Bankr. N.D. Ill. 1990) ("Mere failure of a creditor to demand payment of a debt does not excuse failure to pay it."); *In re Win-Sum Sports, Inc.*, 14 B.R. 389, 392-93 (Bankr. D. Conn. 1981) ("A debt is no less due because a creditor has seen fit for a time to forebear in collecting it.").
- 138 See *In re CorrLine Int'l, LLC*, 516 B.R. at 159 (starting the § 303(h)(1) inquiry by looking at the debtor's accounts payable aging report).
- 139 The Petitioning Creditors note that Stevanovich alluded to a spreadsheet during his cross-examination, which, they argue, shows the existence of more detailed accounting records that were not produced during discovery. But Stevanovich's testimony only indicated that the spreadsheet was used to keep track of its outstanding debts, and there was no indication that it was anything more complex than that.
- 140 Exs. TT & SS, respectively.
- 141 Ex. SG54.
- 142 Some creditors were paid more quickly while others took longer to receive payment. For example, among creditors with multiple invoices in Ex. SG54, General Michel's three invoices were paid on average 12 days after the invoice date. By contrast, GAC paid two invoices for Nathan W. Drage, P.C. on average 66 days after the invoice date. This disparity in payment time is not material to the Court's analysis, however.
- 143 Ex. SG54, at SKYWORKS000060.
- 144 Ex. TT, at SKYWORKS000715, 000721, 000728.
- 145 Ex. BBBB is not to the contrary. The table shows \$247,000.27 in outstanding liabilities, but GAC's bank statements indicate that most of those debts were paid in full or in substantial part during the following month. Accordingly, the table supports the conclusion that GAC was generally paying its current debts as they came due. The Petitioning Creditors have focused on \$4,456.21 in unpaid COBRA and FSA plan administration fees from 2015 as well as \$58,400 owing to the Utah Office of State Debt Collection as evidence that GAC was generally not paying its debts as they came due. Since these debts were incurred long before the filing date, they do not change the Court's conclusion regarding GAC's payment of current debts. But those unpaid debts will be considered in the next portion of the Court's analysis.
- 146 See Ex. WWW, at Detail Unpaid Payroll tab.
- 147 See Section II.E.
- 148 See *id.* at 2012 Accr Payroll-Reduced Rates tab. Over 98% of the Deferred and Bonus Compensation is attributable to executive salaries, the payment of which, GAC has argued, is subject to the approval of its board. But as mentioned previously, contingent debts are included in the § 303(h)(1) analysis.
- 149 Ex. A.
- 150 Ex. BBBB.
- 151 Ex. TT, at SKYWORKS000605 & 000613.
- 152 *Id.* at SKYWORKS000688-765. Ex. CCCC, a demonstrative exhibit prepared by the Petitioning Creditors, summarizes these payments and payments to other entities, including post-petition payments.

153 GAC has essentially argued that it was necessary to spend money in this way—that is, it had to use its finite resources in such a way as to maximize the chances that the company would become operationally viable, and devoting those resources to the repayment of old debts would diminish those chances. This “necessity” argument is not an express factor in the § 303(h)(1) analysis, and perhaps with good reason—if the debtor is in such financial difficulty that it must rob Peter to pay Paul, it’s likely that the debtor is generally not paying its debts as they come due. But because the totality test is flexible, looks at the debtor’s total financial picture, and considers all admissible evidence presented, the Court will not preclude the possibility that this defense could be considered in exceptional cases.

This argument would have to arise as part of a burden-shifting framework, however. If a petitioning creditor has carried its burden to show that the debtor was generally not paying its debts as they came due, it would then be the debtor’s burden to prove that the allocation of resources was necessary. Even if this were an exceptional case, GAC did not carry its burden to show that it was necessary to spend the amount of money it did on the services it purchased. Accordingly, the Court will not consider this argument in its § 303(h)(1) analysis.

154 See Ex. ZZZ.

155 A review of GAC’s bank statements shows that it does not appear to have had material sources of funding during this time other than the transfers from its subsidiary’s bank account.

156 Ex. SG55.

157 Ex. ZZZ, at SKYWORKS000844.

158 GAC’s motion to dismiss alleges a number of other grounds to dismiss the petition, including that the Petitioning Creditors lack standing and their claims are the subject of bona fide disputes. Because the Court has addressed those issues in the context of § 303(b) and (h), only the bad faith argument remains. See Docket Nos. 40, 71, and 89.

159 See *In re Forever Green Athletic Fields, Inc.*, 804 F.3d 328, 334 (3d Cir. 2015) (collecting cases). But see *Marciano v. Chapnick (In re Marciano)*, 708 F.3d 1123, 1129 (9th Cir. 2013) (“The Bankruptcy Code does not expressly provide for dismissal of an otherwise proper involuntary petition because of the subjective ‘bad faith’ of the filers.”).

160 *Id.* at 335 (citations omitted); see also 2 Collier on Bankruptcy ¶ 303.16.

161 See 2 Collier on Bankruptcy ¶ 303.16[1] (listing six developed tests).

162 *In re Forever Green Athletic Fields, Inc.*, 804 F.3d at 336.

163 See, e.g., *Anderson v. Cranmer (In re Cranmer)*, 697 F.3d 1314, 1318 (10th Cir. 2012) (using a totality of the circumstances test to determine if a chapter 13 plan has been proposed in good faith); *Gier v. Farmers State Bank of Lucas, Kan. (In re Gier)*, 986 F.2d 1326, 1329 (10th Cir. 1993) (“[I]n determining whether a Chapter 13 petition has been filed in bad faith under § 1307(c), the bankruptcy court must consider the ‘totality of the circumstances.’”).

164 *In re Forever Green Athletic Fields, Inc.*, 804 F.3d at 336.

165 See Alleged Debtor’s Trial Brief, Dkt. No. 145, at 9.

166 See *Gen. Trading Inc. v. Yale Materials Handling Corp.*, 119 F.3d 1485, 1501 (11th Cir. 1997) (“Some courts have established an ‘improper purpose test,’ under which bad faith exists where the filing of the petition was motivated by ill will, malice or the purpose of embarrassing or harassing the debtor.”); *In re Basil St. Partners, LLC*, 477 B.R. 846, 852 (Bankr. M.D. Fla. 2012) (“[T]he ‘improper purpose’ test [asks whether] the petitioning creditors were motivated to file the petition out of ill will or malice, or in order to harass or embarrass the debtor.”); 2 Collier on Bankruptcy ¶ 303.16[1] (“[The] ‘improper use’ test ... looks at whether the creditor’s conduct takes disproportionate advantage of other creditors.”); *In re Smith*, 243 B.R. 169, 194 (Bankr. N.D. Ga. 1999) (“The ‘improper use’ test finds bad faith when a petitioning creditor uses involuntary bankruptcy procedures in an attempt to obtain a ‘disproportionate advantage’ for itself, rather than to protect

against other creditors obtaining disproportionate advantages, particularly when the petitioner could have advanced its own interests in a different forum.”) (citation omitted).

Collier's describes the totality test as a combination of the improper purpose and improper use tests, 2 *Collier on Bankruptcy* ¶ 303.16[1], but *Forever Green's* totality test is broader, combining the improper purpose, improper use, subjective, and objective tests. *In re Forever Green Athletic Fields, Inc.*, 804 F.3d at 335-36.

167 *E.g.*, *In re Basil St. Partners, LLC*, 477 B.R. at 852.

168 Dkt. No. 145, at 14.

169 The latter factor encompasses creditor action to use “the bankruptcy to acquire corporate control.” See 2 *Collier on Bankruptcy* ¶ 303.16[1].

170 Ex. SG17, at 2-8.

171 Ex. SG20, at 7.

172 Ex. SG25.

173 *Id.* at 7.

174 Ex. SG65, at 3-4.

175 Carolyn Taft, Martie Nadauld, and Lori Chigbrow—the three creditors who joined the involuntary petition in June 2018—are not participating in this fee-sharing arrangement. The other Petitioning Creditors are paying for their legal fees. See Exs. 66, 67, & 68. These three creditors' combined claims constitute 2.4% of the total claims asserted by the Petitioning Creditors, however, so the original six Petitioning Creditors are paying a *de minimis* additional amount to cover Taft's, Nadauld's, and Chigbrow's pro rata share of fees.

176 *Id.* at 3.

177 See *Gen. Trading Inc.*, 119 F.3d at 1502; *In re Forever Green Athletic Fields, Inc.*, 804 F.3d at 336.

178 Dkt. No. 103. Westford Global Holdings Inc., SGS Global Holdings Inc., Lake Zurich Holdings Ltd. (Funds), and West Mountain Partners, L.P. filed joinders in the motion. Dkt. Nos. 129 & 132.

179 See § 303(h).

180 *Wechsler v. Macke Int'l Trade, Inc. (In re Macke Int'l Trade, Inc.)*, 370 B.R. 236, 246 (9th Cir. BAP 2007) (“[N]otwithstanding a bankruptcy court's jurisdiction over an involuntary case pursuant to § 303, § 305(a) provides that the bankruptcy court may dismiss an involuntary case, or suspend all proceedings in that case, and thereby decline to exercise that jurisdiction.”).

181 *Id.* at 247 (internal quotation marks omitted).

182 *In re Monitor Single Lift I, Ltd.*, 381 B.R. 455, 462 (Bankr. S.D.N.Y. 2008).

183 *Id.* at 462-63.

184 *In re Northshore Mainland Servs., Inc.*, 537 B.R. 192, 203 (Bankr. D. Del. 2015).

185 *In re Monitor Single Lift I, Ltd.*, 381 B.R. at 464-65.

186 *In re EB Holdings II, Inc.*, 589 B.R. 704, 727 n.73 (Bankr. D. Nev. 2017).

187 *In re Monitor Single Lift I, Ltd.*, 381 B.R. at 465.

- 188 *In re Naartjie Custom Kids, Inc.*, 534 B.R. 416, 425 (Bankr. D. Utah 2015) (quoting *In re First Assured Warranty Corp.*, 383 B.R. 502, 530 (Bankr. D. Colo. 2008)).
- 189 Dkt. No. 103, at 6-9.
- 190 See *In re St. Marie Dev. Corp. of Mont.*, 334 B.R. 663, 671-72 (Bankr. D. Mont. 2005).
- 191 *In re Colonial Ford, Inc.*, 24 B.R. 1014, 1015 (Bankr. D. Utah 1982).
- 192 Compare Dkt. No. 144, at 2-5, with Dkt. No. 145, at 17-18. GAC later filed a motion to approve settlement agreements with Nadauld, Chigbrow, and Taft, see Dkt. No. 163, and at the hearing on that motion counsel for GAC clarified that the settlements would have no effect on the Petitioning Creditors' standing under § 303.
- 193 Dkt. No. 135, at 2.
- 194 Dkt. No. 51.
- 195 *Crest One Spa v. TPG Troy, LLC (In re TPG Troy, LLC)*, 793 F.3d 228, 235 (2d Cir. 2015).
- 196 *In re Macke Int'l Trade, Inc.*, 370 B.R. at 248-53.
- 197 *Crest One Spa*, 793 F.3d at 235 (quoting *In re Taub*, 438 B.R. 761, 775 (Bankr. E.D.N.Y. 2010)).

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2025 WL 419414

Only the Westlaw citation is currently available.

United States Bankruptcy Court, N.D. Iowa.

IN RE: [PURE PRAIRIE POULTRY, INC.](#) f/k/a Pure Prairie Farms, Inc., Debtor

Bankruptcy No. 24-01098

|

Signed February 5, 2025

Attorneys and Law Firms

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Opinion and Order on Motions to Dismiss

[Thad J. Collins](#), Chief Bankruptcy Judge

*1 The matters before the Court are Community Bank & Trust's ("CBT") Motion to Dismiss (Doc. 12) and Motion for Relief from Stay (Doc. 23), Michael Helgeson's Motion for Relief from Stay (Doc. 38), and Pure Prairie Poultry, Inc.'s ("Pure Prairie" or the "Alleged Debtor") Motion to Dismiss (Doc. 39). Interested Party Growers (the "Growers") and Helgeson joined CBT's Motion to Dismiss (Doc. 29, Doc. 38). A telephonic hearing was held on December 13, 2024. The following appearances were entered: Clinton E. Cutler on behalf of CBT; Krystal Mikkilineni and Erik Ahlgren on behalf of the Growers; Jeffrey D. Goetz and Elissa Holman on behalf of Pure Prairie Poultry, Inc.; Alexandria Quinn-Hanse on behalf of the United States Trustee; Joseph Peiffer on behalf of Tri-State Poultry, LLC, Ekelr, LLC, Lee Frie, and Larry Falk (the "Petitioning Creditors"); Jeffrey D. Klobucar on behalf of Tri-State Poultry, LLC, and Ekelr, LLC; Kristina M. Stanger and Jaden Banks on behalf of First Cooperative Association (d/b/a AgState); Collin M. Davison on behalf of Henkel Construction Company; Jacob Larson on behalf of the Iowa Department of Agriculture and Land Stewardship; Charles E. Nelson on behalf of Michael Helgeson. The Court heard argument and took the matters under advisement on the

papers submitted. This is a core proceeding under [28 U.S.C. §§ 157 and 1334](#).

I. Background/Statement of the Case

On November 7, 2024, the Petitioning Creditors filed a Chapter 7 Involuntary Petition against Pure Prairie. On November 19, 2024, CBT filed its Motion to Dismiss, in which the Growers and Michael Helgeson later joined. On December 12, 2024, Pure Prairie filed its own Motion to Dismiss.

II. Findings of Fact

Pure Prairie is a Minnesota-based poultry producer with a production plant located in Charles City, Iowa. Pure Prairie purchases pullet chicks from a breeding stock company and contracts for the care and feeding of those chicks until they are twenty weeks old. At twenty weeks, the chicks are transferred to breeder barns where they become laying hens for approximately forty-five weeks. Those eggs are then taken to a custom hatchery. Once those chicks hatch, they are taken to barns to be raised for six weeks. At that time, Pure Prairie picks up the birds and delivers them to its processing plant, where they are processed and later sold as whole chickens or chicken parts packaged in retail tray packs or boxes for sale to food service. At all relevant times, Pure Prairie is the owner of the birds and eggs. It pays for the use of facilities, labor, feed, vaccines, and utility costs related to the raising of birds and hatching of eggs.

Pure Prairie filed a Chapter 11 petition in the United States Bankruptcy Court for the District of Minnesota on September 20, 2024. See In re Pure Prairie Poultry, Inc., No. 24-32426 (Bankr. D. Minn. Sept. 20, 2024). This was short-lived, however, as the case was dismissed on Pure Prairie's own emergency motion on September 27, 2024. The motion, filed just two days prior to dismissal, argued that dismissal was necessary for a number of reasons: (1) Pure Prairie lacked sufficient cash collections to pay ongoing expenses and would incur \$10,800,000 in negative cash flow during the first six weeks of the case; (2) it could not obtain post-petition financing on terms acceptable to its secured lenders; (3) it experienced production disruptions and vendor delays causing negative impacts on operations; and (4) it lacked the resources or cash to continue operations while seeking restructuring through the Chapter 11 process. None of the

Petitioning Creditors appeared at the hearing or objected to dismissal, nor did any other party in interest. The United States Trustee did not oppose dismissal, acknowledging that there appeared to be no equity in the assets for unsecured creditors and that a Chapter 7 trustee would likely abandon the assets.

*2 Following dismissal of the Chapter 11 case, Pure Prairie made an assignment for the benefit of creditors (the “Assignment”) in the Fifth Judicial District in Nicollet County, Minnesota, pursuant to Chapter 577 of the Minnesota Statutes and a general receivership was established pursuant to Chapter 576. As part of the Assignment, Pure Prairie assigned its assets to Lighthouse Management Group. As of the date of the Assignment, Pure Prairie had ceased operations and terminated the majority of its employees, retaining only a limited number necessary to protect and preserve the existing assets. Community Bank has agreed to fund the ongoing expenses of the Assignment, including payment of utilities, insurance, and security of the plant.

This involuntary proceeding was filed on November 7, 2024, against Pure Prairie by four of its unsecured creditors; Larry Falk, Tri-State Poultry, LLC, Ekelr, LLC, and Lee Frie. Their claims amount to approximately \$2,635,561.28. The total debt, both secured and unsecured, amounts to over \$113 million.

III. Conclusions of Law/Discussion

The Board of Directors asks the Court to dismiss this involuntary proceeding under 11 U.S.C. §§ 303(a) and 707(a). The Board argues that Pure Prairie is a “farmer” as defined in 11 U.S.C. § 101(20) and is therefore ineligible to be a debtor in an involuntary bankruptcy under section 303(a). For this reason, it argues that cause exists for dismissal under section 707(a). CBT also asks the Court to dismiss this case, arguing that cause exists under section 305(a)(1), which provides that a court may dismiss an involuntary proceeding at any time if dismissal would better serve the interests of creditors and the debtor. The Petitioning Creditors argue that neither the Board nor CBT have standing to challenge the involuntary petition, that Pure Prairie is not a “farmer,” and that dismissal would not better serve the interests of the creditors and the Alleged Debtor.

A. Standing

1. The Board of Directors

The Petitioning Creditors first argue that the Board of Directors lacks standing to challenge the involuntary petition. In support of this argument, the Creditors cite to [Federal Rule of Bankruptcy Procedure 1011\(a\)](#), which limits those who may contest the involuntary petition to the named debtor only. [Fed. R. Bankr. P. 1011\(a\)](#) (“A debtor may contest an involuntary petition filed against it.”). Because parties in interest are expressly permitted to make a motion to dismiss “at a later time and in different circumstances,” they assert that “[w]here Congress places an express requirement in one part of a statute but leaves it out of another, courts should not ‘add[] that term’ where it was ‘conspicuously absent.’” While the Court agrees with this assertion, the Creditors fail to account for the fact that the Alleged Debtor in this case is a corporation and the Board of Directors is not merely a party in interest.

[Federal Rule of Bankruptcy Procedure 9001\(b\)\(5\)\(A\)](#) provides that “if the debtor is a corporation, and if the court so designates,” the term “debtor” includes “[a]ny or all of its officers, directors, trustees, or members of a similar controlling body.” [Fed. R. Bankr. P. 9001\(b\)\(5\)\(A\)](#). It may also include controlling stockholders or members, or [a]ny other person in control.” *Id.* See also [In re Best Home Performance of CT, LLC](#), No. 19-20688, 2020 WL 6192977, at *—, 2019 Bankr. LEXIS 3682 at *20 (Bankr. D. Conn. Dec. 2, 2019) (“[T]he underlying purpose of the statute would be thwarted in favor of manipulation and abuse if no one was to have a voice for the corporation.”). Under this Rule, the Court finds the Board of Directors to be a suitable designee to represent the Alleged Debtor in this proceeding. The Board thus has standing to contest the petition and prosecute its Motion of behalf of the Alleged Debtor.

2. Community Bank & Trust

*3 The Petitioning Creditors make the same argument in response to CBT's motion to dismiss, asserting that it does not have standing to contest the petition as the senior secured creditor. CBT has moved for dismissal under 11 U.S.C. § 305(a)(1), which allows a court to abstain and dismiss the proceeding if the dismissal would better serve the interests of

creditors and the debtor. “Unlike [section 303](#) and [Rule 1011](#) ... [section 305\(a\)](#) ... contain[s] no language limiting who may file a motion to dismiss such that any party in interest may file and prosecute such motions.” [In re Jr. Food Mart, Inc.](#), 234 B.R. 420, 421–22 (Bankr. E.D. Ark. 1999). See also [In re Cink](#), No. 06-40019, 2007 WL 601585, at *2, 2007 Bankr. LEXIS 649 at *6 (Bankr. S.D. Feb. 21, 2007) (“Any party in interest, including the debtor, may move for dismissal of a case—any chapter—under [11 U.S.C. § 305\(a\)\(1\)](#).”); 2 Collier on Bankruptcy ¶ 303.35 (16th ed. 2024) (“[Section 305](#) permits any party to seek dismissal.”). “Prohibiting a creditor or other party in interest from seeking dismissal of an involuntary case would permit abusive filings without restraint.” [In re Jr. Food Mart](#), 234 B.R. at 422. CBT is therefore not precluded from filing or prosecuting its motion to dismiss under [section 305\(a\)\(1\)](#).

B. “Farmer” Status

[Section 303\(a\) of the Bankruptcy Code](#) provides that an involuntary Chapter 7 case may be commenced “only against a person, except a farmer[.]”¹ “Farmer” is defined in [11 U.S.C. § 101\(20\)](#) as:

[A] person that received more than 80 percent of such person's gross income during the taxable year of such person immediately preceding the taxable year of such person during which the case under this title concerning such person was commenced from a farming operation owned or operated by such person.

The term “farming operation” includes “farming, tillage of soil, dairy farming, ranching, production or raising of crops, poultry, or livestock, and production of poultry or livestock products in an unmanufactured state.” [11 U.S.C. § 101\(21\)](#). The Court must determine whether more than 80% of Pure Prairie's 2023 Gross Income was derived from a “farming operation.”

This case has similarities to [In re Dakota Lay'd Eggs](#), 57 B.R. 648 (Bankr. N.D. 1986). In that case, the alleged debtor was an egg producer. Like Pure Prairie, the debtor owned flocks of laying hens and contracted with outside farmers, who then provided shelter and the labor necessary for maintaining the chickens. [Id.](#) at 650. The debtor provided feed and medication for the animals but was otherwise uninvolved until it picked up and transported the eggs to its processing facility. [Id.](#) The court was careful to note that while the legislative history of the relevant Code provisions suggests that the definitions

of “farmer” and “farming operation” should be liberally construed, the provisions “cannot be so broadly applied as to bring in operations clearly outside the nature or practices one normally associates with farming.” [Id.](#) at 653. These definitions were intended to “include those activities normally done by persons engaged in the initial stages of production.” [Id.](#) The court found that the income derived from the sale of the eggs fell within the definition of “poultry production,” and thus constituted income derived from a “farming operation,” citing primarily to the fact that the hens were owned by the alleged debtor. [Id.](#) at 656.

This case differs from the [Dakota Lay'd Eggs](#) case in one important respect, however. Pure Prairie generates only a small portion of its income from the sale of eggs—the vast majority of this income comes from the sale of poultry that has undergone “primary” or “secondary processing.” As noted in the Declaration of George Peichel (Doc. 55-3), “primary processing” refers to the process of receiving, staging, slaughtering, scolding, de-feathering, eviscerating, and chilling whole birds for further packaging and sale. “Secondary processing” can include portioning, deboning, marinating, forming, cooking, and packaging ready-to-eat poultry. The Petitioning Creditors argue that the income derived from the processed poultry products cannot be considered income from a farming operation because the products are no longer in an “unmanufactured state.”

1. Unmanufactured State

*4 “Unmanufactured” is not defined in [section 101](#), or anywhere else in the Bankruptcy Code. When interpreting a word not defined in the relevant statute, the Court first looks to the word's plain meaning. [Perrin v. United States](#), 444 U.S. 37, 42, 100 S.Ct. 311, 62 L.Ed.2d 199 (1979) (“A fundamental canon of statutory construction is that, unless otherwise defined, words will be interpreted as taking their ordinary, contemporary, common meaning.”). The Oxford English Dictionary defines “unmanufactured” as “[n]ot manufactured; in a raw or unprocessed state or condition.” Unmanufactured, [Oxford English Dictionary](#), https://www.oed.com/dictionary/unmanufactured_adj (last updated July 2023). The eggs sold by the Alleged Debtor clearly fit this definition. They may be washed and packaged prior to sale, but they are otherwise raw and unprocessed. The same cannot be said about the chicken products, however. While some of the chicken products produced by the Alleged Debtor may be “raw” when sold,

the Court cannot conclude they are “unprocessed” after undergoing what is specifically referred to as primary or secondary processing.

This conclusion and supporting rationale are in accordance with an earlier case before this Court involving a sawmill operation. [In re Miller](#), 122 B.R. 360 (Bankr. N.D. Iowa 1990). In that case, the debtors owned land on which they grew and harvested timber. [Id.](#) at 362. After harvesting, the logs were processed in the debtors’ sawmill and sold commercially. [Id.](#) The debtors argued that this was a “nontraditional farming operation” that should be recognized as such under the Bankruptcy Code. [Id.](#) The Court took issue with this “expansive view of farming,” stating the following:

[A]ssuming arguendo, that logging can constitute a farming activity, the operation of a sawmill is one further step removed from that logging activity and is beyond even an expansive view of a farming operation. The definition of a farming operation makes specific reference to the growing and cultivation of farm commodities in their unmanufactured state. The sawing, planing, and drying of

Income

40000 – Revenue from Operations

40005 – Revenue from Chicken Products	\$38,368,909.82
40010 – Revenue – Eggs	\$1,247,392.50
40015 – Revenue – Bi-Products	\$3,842.92
40020 – Discounts	(\$227,317.62)
40100 – Freight Revenue	\$616,638.38
Total – 40000 – Revenue from Operations	\$40,009,466.00

Based on these amounts, the Court has calculated that approximately 3.1% of Pure Prairie's income from 2024 came from the sale of unmanufactured farm products (eggs). This is a far cry from the 80% required for it to be classified as a “farmer” for [section 303\(a\)](#) purposes. Because the movants have not shown that at least 80% of Pure Prairie's 2023 income came from the sale of eggs—or other farm products in an “unmanufactured state”—the Court concludes that Pure Prairie is not a “farmer” and may be the subject of an involuntary proceeding.

lumber to be sold commercially, is clearly a manufacturing activity.

[Id.](#) at 365. Much like in [Miller](#), the processing activity here is far removed from the farming aspect and clearly constitutes a manufacturing activity. Any income derived from the sale of those products in their manufactured state thus cannot be considered income from a farming operation.

2. Percentage of Gross Income

The Court has not been provided with the specifics of Pure Prairie's income from taxable year 2023, only that “approximately 100% of [Pure Prairie's] gross income was derived from poultry operations” that year. This was also the case in 2024, up until Pure Prairie ceased operations. The Court is left to assume that the 2023 income was derived in substantially the same way as 2024—the majority being derived from manufactured “chicken products.” The income statement for January 2024 through October 2024 provides as follows:

C. Abstention

CBT argues that that the Court should abstain and dismiss this case because the pending state court Assignment protects the interests of all parties and provides for an economic and efficient administration of the Alleged Debtor's liquidation. Starting fresh in this involuntary proceeding, it argues, would be costly and time consuming. In addition, CBT points out that the Alleged Debtor already sought relief in a bankruptcy case and concluded that it was not in its best interest, later moving to dismiss the case. The Petitioning Creditors did

not object to dismissal in that case, and the court granted the motion. In opposition, the Petitioning Creditors argue that abstention would be improper in this case for a number of reasons: (1) there is no opportunity for creditors to conduct discovery into claims against the Alleged Debtor; (2) the Minnesota Receivership Statute does not contain rights for the benefit of creditors to the same extent of the Bankruptcy Code; (3) creditors do not have the right to prosecute claims against the Alleged Debtor without leave of the Minnesota Court and additional expense and motion practice; (4) creditors are not sure what assets have been transferred to the Assignee as part of the Assignment; and (5) the Assignment has not proceeded in such a way and to such an extent that prejudice would occur if the case continued in the Bankruptcy Court.

***5** As the parties acknowledge in their respective motions, “[a]bstention is an extraordinary power that should be used only in extraordinary circumstances.” [Pennino v. Evergreen Presbyterian Ministries](#) (*In re Pennino*), 299 B.R. 536, 538 (B.A.P. 8th Cir. 2003).² This power is governed by [section 305 of the Bankruptcy Code](#), which provides, in relevant part:

(a) The court, after notice and a hearing, may dismiss a case under this title, or may suspend all proceedings in a case under this title, at any time if—

(1) The interests of creditors and the debtor would be better served by such dismissal or suspension ...

[11 U.S.C. § 305\(a\)\(1\)](#). In determining whether the interests of the parties would be better served by dismissal, courts must focus on the unique facts of each case. See [In re Iowa Trust](#), 135 B.R. 615, 622 (Bankr. N.D. Iowa 1992). “[A] bankruptcy court is not bound by a prescriptive template,” and “may consider any factors it deems relevant to the determination.” [Profutures Special Equity Fund, L.P. v. Spade](#) (*In re Spade*), 269 B.R. 225, 228 (D. Colo. 2001) (citing [In re Iowa Coal Mining Co.](#), 242 B.R. 661, 671 (Bankr. S.D. Iowa 1999)). Courts undertaking this analysis have considered a number of factors, including the following:

1. The economy and efficiency of administration;
2. The availability of another forum, or the actual pendency of an insolvency proceeding in one;
3. The essentiality of federal jurisdiction to a just and equitable resolution;
4. The availability of alternative means for an equitable distribution of assets and value;

5. The lesser cost of a non-bankruptcy process that would serve all interests as well;

6. The possibility that commencing administration in bankruptcy would duplicate previous effort toward a workout in a non-bankruptcy setting; and

7. The purpose for which bankruptcy jurisdiction was sought by the petitioners.

[In re NRG Energy, Inc.](#), 294 B.R. 71, 80 (Bankr. D. Minn. 2003) (citing [In re Fax Station, Inc.](#), 118 B.R. 176, 177 (Bankr. D. R.I. 1990); [In re 801 South Wells St. L.P.](#), 192 B.R. 718, 723 (Bankr. N.D. Ill. 1996); [In re Trina Assoc.](#), 128 B.R. 858, 867 (Bankr. E.D. N.Y. 1991)). Notably, after considering these factors, “courts generally dismiss an involuntary case under [§ 305\(a\)\(1\)](#) where the debtor has made an assignment for the benefit of creditors.” [In re Cincinnati Gear Co.](#), 304 B.R. 784, 785–86 (Bankr. S.D. Ohio 2003) (citing [In re Bailey's Beauticians Supply Co.](#), 671 F.2d 1063 (7th Cir. 1982); [In re Artists' Outlet, Inc.](#), 25 B.R. 231 (Bankr. D. Mass. 1982); [In re M. Egan Co., Inc.](#), 24 B.R. 189 (Bankr. W.D. N.Y. 1982)).³ Those decisions are bolstered by the legislative history of [section 305](#), which indicates that Congress likely contemplated abstention under similar circumstances:

[I]f an arrangement is being worked out by creditors and the debtor out of court, there is no prejudice to the rights of creditors in that arrangement, and an involuntary case has been commenced by a few recalcitrant creditors to provide a basis for future threats to extract full payment. The less expensive out-of-court workout may better serve the interests in the case.

[H.R. REP. NO. 95-595](#), 95th Cong. 1st Sess. 325 (1977); [S.R. REP. NO. 95-989](#), 95th Cong. 2d Sess. 36 (1978).

***6** The facts of this case align closely with the scenario Congress considered and intended [§ 305](#) to address. The Alleged Debtor has executed an assignment for the benefit of creditors in Minnesota state court. While not necessarily “recalcitrant,” the Petitioning Creditors here are few in number and hold a small fraction of the total claims against Pure Prairie. They argue that bankruptcy better serves the interests in this case because it provides procedural and substantive benefits that would otherwise be unavailable to the creditors in state court. The Court is not persuaded by this argument and finds that abstention is proper in this case for the reasons that follow.

1. The Assignment adequately protects interests of all parties at a lesser cost.

The Petitioning Creditors assert that the Assignment does not provide transparency, litigation protections, or jurisdiction for creditors to have their claims adjudicated to the same extent that bankruptcy does. They point out that the Assignment does not provide them with an opportunity to conduct discovery into claims against the Alleged Debtor, that a trustee in bankruptcy would have more expansive powers to pursue claims related to prepetition transfers than the Assignee, and that creditors do not have a right to prosecute claims against the Alleged Debtor without leave of the Minnesota court. While the Court acknowledges this to be the case under the Assignment, it cannot conclude that creditors are prejudiced here merely because they are not afforded exactly the same rights as they would be in bankruptcy or are required to seek leave of court to exercise them. Their interests are still adequately protected by the Assignment for their benefit. Under Minnesota law, the Assignee represents the creditors, not the Alleged Debtor. [Boyum v. Jordan](#), 146 Minn. 66, 72–73, 178 N.W. 158 (1920). In its role, the Assignee has a duty to act in good faith and exercise its due diligence in managing the Assignment assets. See 4 Dunnell Minn. Digest, [Assignments for Benefit of Creditors](#) § 2.01 (2024). Part of this duty is an obligation to pursue actions to set aside fraudulent conveyances and unlawful preferences. Minn. Stat. § 577.07. See also [Swedish-American Nat'l Bank of Minneapolis v. First Nat'l Bank of Gardner](#), 89 Minn. 98, 108–09, 94 N.W. 218 (1903). If questions arise about the property subject to the Assignment, the creditors may ask the court to order the Assignee to file a schedule of all the assigned property or to conduct appraisals if appropriate. Minn. Stat. § 576.33. The Assignee may also be required to prepare and file interim reports detailing its activities, receipts, disbursements, and other relevant matters. *Id.* § 576.36. While the Assignee may not have the same powers as a bankruptcy trustee, its powers are expansive enough to protect the creditors in this case without the additional layer of expenses that bankruptcy would entail.

The additional expense of bankruptcy is particularly important to note here. Based on the record before the Court, all of the Alleged Debtor's assets are encumbered and no equity exists in the property. As the United States Trustee noted in the earlier Minnesota proceeding, if the case were to proceed in bankruptcy, the assets would likely be abandoned by the trustee and it would proceed as a no-asset case.

Unsecured creditors stand to recover very little, if anything, in any scenario. The expense of bankruptcy would eat away at what already stands to be a measly recovery for all creditors involved.

2. Proceeding with this case would serve no real bankruptcy purpose.

Involuntary proceedings are intended to serve as a means “to secure an equitable distribution of the assets of the alleged debtor among all his creditors.” [In re Arker](#), 6 B.R. 632, 636 (E.D.N.Y. 1980) (citing [In re Blount](#), 142 F. 263 (E.D. Ark. 1906); [Pirie v. Chicago Title & Trust Co.](#), 182 U.S. 438, 21 S.Ct. 906, 45 L.Ed. 1171 (1901)). “Such a remedy exists as an avenue of relief for the benefit of the overall creditor body ... [it] was not intended to redress the special grievances, no matter how legitimate, of particular creditors.” [In re Brooklyn Resource Recovery](#), 216 B.R. 470, 486 (Bankr. E.D.N.Y. 1997). As such, involuntary petitions require “a reasonable prospect for some distribution to creditors.” Frank R. Kennedy, [The Report of the Bankruptcy Commission: The First Five Chapters of the Proposed New Bankruptcy Act](#), 49 Ind. L.J. 422, 430 (1974). See also [Arker](#), 6 B.R. at 637 (“To grant an order for relief in a case where there are no assets to be liquidated for the benefit of creditors would not be in comport with this long standing policy underlying involuntary proceedings.”). This is particularly true in a corporate Chapter 7 case, such as this one. Corporations are not granted a discharge in Chapter 7. 11 U.S.C. § 727(a)(1) (“The court shall grant the debtor a discharge, unless ... the debtor is not an individual.”). “The limited purpose of a corporate Chapter 7 case is the fair and orderly liquidation of corporate assets.” [In re Lang](#), 398 B.R. 1, 4 (Bankr. N.D. Iowa 2008) (citing [In re Int'l Zinc Coatings & Chem. Corp.](#), 355 B.R. 76, 85 (Bankr. N.D. Ill. 2006)). Where there are no assets available for distribution, the case serves no bankruptcy purpose. [In re Int'l Zinc Coatings & Chem. Corp.](#), 355 B.R. at 85.

*7 As noted, there will be nothing for the trustee to distribute in this case and little prospect of acquiring funds, even if costly preference and avoidance actions were pursued. This case would thus serve no real purpose except to increase costs and provide the Petitioning Creditors with a forum to pursue potential claims against the Alleged Debtor that may instead be brought in state court.

Based on the totality of the circumstances in this case, the Court finds that the interests of both the Alleged Debtor and its creditors would be better served by abstention under [section 305\(a\)\(1\)](#).

2. The alternate motions for dismissal are **DENIED**, as moot.

3. The alternate motions for relief from the automatic stay are **DENIED**, as moot.

IV. Conclusion/Order

Ordered: February 5, 2025

IT IS THEREFORE ORDERED:

1. Pursuant to [11 U.S.C. § 305\(a\)](#), this Court abstains from exercising jurisdiction over this case, which is hereby **DISMISSED**.

All Citations

Not Reported in B.R. Rptr., 2025 WL 419414

Footnotes

- 1 "Person" includes an individual, partnership, or corporation. [11 U.S.C. § 101\(41\)](#).
- 2 Courts often avoid application of [section 305\(a\)](#) because the resulting order is not reviewable on appeal. [11 U.S.C. § 305\(c\)](#).
- 3 See also Mike C. Buckley & Gregory Sterling, [What Banks Need to Know About ABCs](#), 120 Banking L.J. 48, 54 (2003) ("Reluctant creditors will find it difficult to attack an [assignment for the benefit of creditors ("ABC")]. Creditors who file an involuntary bankruptcy case after the ABC will usually be faced with a motion by the Assignee or other interested parties to dismiss or abstain from the bankruptcy case on the grounds that the pending ABC is a more than adequate substitute for an involuntary bankruptcy case. Replacing one professional fiduciary with another would generally be a waste of resources and time, and most such involuntary bankruptcies are dismissed, or the bankruptcy court abstains in deference to the existing ABC.").

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51 F.3d 562

United States Court of Appeals,
Fifth Circuit.

In The Matter of Irma J. WALKER, Debtor.

Irma J. WALKER, Appellee,

v.

The CADLE COMPANY, Appellant,

v.

Denise D. LINDSEY and Stan Svara
d/b/a SKS Enterprises, Appellees.

No. 94–30256.

|

May 9, 1995.

Synopsis

Chapter 7 debtor brought action against mortgagee to recover damages for willful stay violation, and mortgagee brought third-party claims for contribution. The United States Bankruptcy Court for the Eastern District of Louisiana held for debtor and for mortgagee of third-party claim, and appeal was taken. The District Court, [Martin L.C. Feldman, J.](#), 168 B.R. 114, affirmed in part and reversed in part, and mortgagee appealed. The Court of Appeals, [King](#), Circuit Judge, held that: (1) mortgagee had no right of contribution from third party, and (2) bankruptcy court lacked subject matter jurisdiction over mortgagee's contribution claim.

Affirmed.

Procedural Posture(s): On Appeal.**Attorneys and Law Firms**

*563 [Mark C. Landry](#), Newman, Mathis, Brady, Wakefield & Spedale, Metairie, LA, for appellant.

[Phillip K. Wallace](#), New Orleans, LA, for Walker.

[Lawrence Robert Anderson, Jr.](#), Seale, Smith, Zuber & Barnette, Baton Rouge, LA, for Svara.

Denise D. Lindsey, Slidell, LA, pro se.

Appeal from the United States District Court for the Eastern District of Louisiana.

Before [KING](#), [EMILIO M. GARZA](#) and [DeMOSS](#), Circuit Judges.

Opinion[KING](#), Circuit Judge:

In this case, we are confronted with questions surrounding the scope of bankruptcy jurisdiction. Irma J. Walker filed an adversary proceeding in bankruptcy court against the Cadle Company alleging violations of the automatic stay provisions of the Bankruptcy Code. The Cadle Company, seeking contribution and indemnity for any damages assessed against it, initiated third-party actions against Stan Svara and an attorney retained by the Cadle Company, Denise Lindsey. Although the bankruptcy court determined that Lindsey could not be charged with any liability for violations of the automatic stay, it did find that the Cadle Company and Svara had violated the automatic stay, and it awarded Walker damages and attorney's fees. Both the Cadle Company and Svara appealed to the district court which affirmed the judgment against the Cadle Company and in favor of Walker. See *Walker v. Cadle Co. (In re Walker)*, 168 B.R. 114 (E.D.La.1994). The district also found, however, that neither it nor the bankruptcy court had subject matter jurisdiction over the Cadle Company's claim for contribution and indemnity against Svara, and accordingly, it reversed the bankruptcy court's award against Svara. The Cadle Company now appeals. Finding no reversible error in the district court's decision, we affirm.

I. BACKGROUND

In December of 1979, Walker purchased a mobile home from a Louisiana mobile home dealer. The purchase was financed and secured with a chattel mortgage in favor of Capital Bank & Trust Company. In 1990, the Cadle Company ("Cadle") bought the mortgage from the Federal Deposit Insurance Company, which acquired the mortgage when Capital Bank & Trust Company became insolvent.

The next year, Walker became delinquent in her payments on the mortgage, and Jeff Joseph, the Cadle account officer in charge of Walker's file, hired an attorney, Denise Lindsey, to pursue the debt. Eventually, Cadle sued Walker on the loan and received a default judgment against Walker for \$11,810.74 plus interest, costs, and attorney's fees.

On July 26, 1991, Walker sought the protection of Chapter 7 of the Bankruptcy Code. Walker filed a B-2 schedule itemizing her personal property and estimating its value at just over \$1000. Walker also signed a statement of intent, proclaiming that she would voluntarily surrender the trailer within forty-five days as required by [11 U.S.C. § 521\(2\)\(b\)](#). In early August, Lindsey was notified of Walker's bankruptcy filings, and *564 she in turn advised Joseph of Walker's bankruptcy. One week later, on August 12, 1991, Cadle filed a proof of claim (which was signed by Joseph) in the bankruptcy court for \$14,421.88.

Around the same time, Joseph told a business associate, Stan Svava, that he might have a trailer available, and he gave Svava Walker's telephone number. Svava called Walker about the trailer, but Walker informed Svava that she had filed for bankruptcy and she told Svava to contact her attorney, Jonathan May, about the trailer. Svava then relayed his conversation with Walker back to Joseph, telling him to contact Svava when Joseph got "matters straight."

Near August 23, 1991, Lindsey sent May a voluntary release and surrender form which was to be executed at a creditor's meeting. When Lindsey arrived at that September 3 meeting, she found that the form had not been signed and that Walker's attorney, May, had passed away. Lindsey gave another copy of the release form to Walker's new attorney, James Moorman. Lindsey testified that Moorman advised her that he would look over the release and "have [Walker] sign it if everything was in order." Additionally, Walker informed Lindsey that she was planning to give up the trailer, but would need until the end of the week to remove her property from the trailer. Walker, however, did not sign a voluntary release and surrender form.

Lindsey sent a letter to Joseph on September 4, 1991, informing Joseph that, "Mrs. Walker should be out of the trailer by Saturday, 9/7/91. She will surrender the trailer at any time after that, but I must confirm with her attorney at the end of this week." Five days later, the bankruptcy court granted the bankruptcy trustee's petition of disclaimer and abandonment of the trailer.

Sometime after the September 3 creditors' meeting, Cadle, through Joseph, began negotiating with Svava for the purchase of the trailer. On September 6, Joseph informed Svava that Walker would vacate the trailer over the next few days and instructed Svava to inspect the trailer to determine whether Svava would consider purchasing it. After Svava looked at

the trailer, he reported to Joseph that the trailer was in poor condition. Moreover, Svava told Joseph that he did not think that Walker still lived in the trailer as the mobile home's door was open, animals were roaming around, and evidence of rodent and insect infestation was present.

After Svava described the condition of the trailer to Joseph, they agreed that Svava would purchase the trailer for \$1750. Later, on September 11, Joseph spoke to Lindsey about the trailer. Lindsey, however, did not give Joseph permission to sell the trailer, but informed Joseph that additional authorization from Walker's attorney was needed.¹

Nevertheless, a few weeks later, on September 25, 1991, Joseph called Lindsey and informed her that he was selling the trailer and that he needed the Voluntary Surrender Form. Lindsey then sent another form to Walker's attorney. The next day, Cadle sold the mobile home to Svava's fiancée, Joni Davis, and several days later, on September 30, 1991, Svava and some associates went to retrieve the trailer. Svava again found the trailer disheveled, but he and his men added to the mess by throwing Walker's personal property on the lot when they removed the mobile home.

Walker, meanwhile, had been hospitalized with [pneumonia](#) and heart failure for approximately two weeks after she filed for bankruptcy protection in August. After her release, Walker lived with her parents. On October 7, 1991, Walker returned to the mobile home park, finding the trailer gone and her personal property strewn about the lot. Evidently, because of exposure to the elements, none of the property could be salvaged.

Walker filed an adversary proceeding against Cadle for violating the automatic stay imposed by [11 U.S.C. § 362](#), seeking recovery *565 for damage to her personal property. Cadle instituted a counter-claim seeking to revoke Walker's discharge from bankruptcy (which had been granted on May 18, 1992). Cadle alleged that the discharge should be revoked because of a discrepancy between the value of the property as stated in Walker's B-2 schedules and the value stated in her complaint. Walker amended her complaint to conform to her bankruptcy schedules. Cadle also brought a third-party demand against Lindsey and Svava, seeking contribution and/or indemnity for any damages assessed against Cadle.

After a trial on the merits in late October of 1992, the bankruptcy court issued findings of fact and conclusions of law. Specifically, the court found that Cadle and Svava had

violated the automatic stay by selling the trailer and, in doing so, had caused \$2000 of damage to Walker. The bankruptcy court also awarded Walker attorney's fees. On the other hand, the bankruptcy court found that, "Lindsey did not violate the automatic stay against the debtor's property as she did not take any action or control over the debtor's property [,] ... and [she] cannot be charged with any liability as the result of Cadle's violation of the automatic stay."

After the parties submitted additional materials, the bankruptcy court issued supplemental findings of fact and conclusions of law, and awarded Walker attorney's fees in the amount of \$4800 and costs of \$361.76. Following additional proceedings, the bankruptcy court found that Svava was fifty percent responsible for the amounts owed to Walker.

Svava and Cadle appealed to the district court. The district court found that Cadle had no cause of action against Svava under the Bankruptcy Code. Moreover, the district court determined that it (and the bankruptcy court) did not have subject matter jurisdiction over Cadle's third-party claim, and accordingly, the court reversed the bankruptcy court's judgment against Svava. Additionally, the district court affirmed the bankruptcy court's finding that Cadle violated the automatic stay, as well as the bankruptcy court's computation of the amount of the fees, costs, and damages owed to Walker.

Cadle now appeals to this court, arguing that the district court erred in affirming the bankruptcy court's: finding that Cadle violated the automatic stay; determination that Walker proved that she was damaged; dismissal of the cause of action against Lindsey; computation of the amount of costs and attorney's fees; and dismissal of Cadle's third-party complaint against Lindsey. Further, Cadle complains that the district court erred in concluding that Cadle did not have a cause of action against Svava under bankruptcy law and in holding that it lacked subject matter jurisdiction to hear and dispose of Cadle's third-party claim against Svava. We, however, disagree with all of Cadle's contentions.

II. STANDARD OF REVIEW

We review the bankruptcy court's findings of fact for clear error, and we will reverse "only if, on the entire evidence, we are left with the definite and firm conviction that a mistake has been made." *Allison v. Roberts (In re Allison)*, 960 F.2d 481, 483 (5th Cir.1992); see also *Henderson v. Belknap (In re Henderson)*, 18 F.3d 1305, 1307 (5th Cir.), cert. denied, 513

U.S. 1014, 115 S.Ct. 573, 130 L.Ed.2d 490 (1994); *Haber Oil Co. v. Swinehart (In re Haber Oil Co.)*, 12 F.3d 426, 434 (5th Cir.1994). By contrast, we review issues of law de novo. *In re Henderson*, 18 F.3d at 1307; *In re Haber Oil Co.*, 12 F.3d at 426; *In re Allison*, 960 F.2d at 483.

III. DISCUSSION

A. Bankruptcy Contribution Claim

Cadle argues that the district court erred in concluding that there was no cause of action for contribution under § 362 of the Bankruptcy Code. Additionally, Cadle contends that the bankruptcy court had jurisdiction over its third-party claim against Svava through federal question jurisdiction, apparently based on the notion that its contribution claim is based on federal law. More specifically, Cadle asserts that the entire case, including the third-party demand against Svava, revolved around the application of 11 U.S.C. § 362. According to Cadle, "[i]f this third-party demand were brought as an independent indemnity action, it could be *566 brought in federal court, as the primary issue to be determined would be whether a violation of § 362 occurred." Therefore, Cadle posits that the district court had federal question jurisdiction under 28 U.S.C. § 1331. Cadle's contention, however, is misplaced, as there is no contribution action in § 362 of the Bankruptcy Code.

The Supreme Court has concluded that "a right to contribution may arise in either of two ways: first, through the affirmative creation of a right of action by Congress, either expressly or by clear implication; or, second, through the power of federal courts to fashion a federal common law of contribution." *Texas Indus. v. Radcliff Materials*, 451 U.S. 630, 638, 101 S.Ct. 2061, 2066, 68 L.Ed.2d 500 (1981).

There is no express right to contribution in § 362 of the Bankruptcy Code. *Wieboldt Stores, Inc. v. Schottenstein*, 111 B.R. 162, 167 (N.D.Ill.1990) ("Nowhere does the Bankruptcy Code expressly provide for a right to contribution."); *Barber v. Riverside Int'l Trucks, Inc. (In re Pearson Indus.)*, 142 B.R. 831, 848 (Bankr.C.D.Ill.1992) (same); see also Edward M. Fox & James Gadsden, *Rights of Indemnification and Contribution among Persons Liable for Fraudulent Conveyances*, 23 Seton Hall L.Rev. 1600, 1602-03 ("[I]t is quite clear that no right of contribution exists under the Bankruptcy Code"). Thus, as the Supreme Court noted, if a right to contribution exists, "it must be by implication." *Texas Indus.*, 451 U.S. at 639, 101 S.Ct. at 2066. The Court

instructs that in discerning such an implication by Congress “[o]ur focus ... is on the intent of Congress.” *Id.* Moreover, we may divine congressional intent by looking at “the legislative history and other factors: e.g., the identity of the class for whose benefit the statute was enacted, the overall legislative scheme, and the traditional role of the states in providing relief.” *Id.*

Cadle cites no legislative history indicating congressional intent to create a cause of action for contribution. On the other hand, the purpose of the automatic stay provisions are clear. As the legislative history of § 362 notes, the automatic stay is designed to protect debtors from creditors and creditors from each other. S.Rep. No. 989, 95th Cong., 2d Sess. 49–55 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5835–41 (“The automatic stay ... provides creditor protection.... The automatic stay is one of the fundamental protections provided by the bankruptcy laws.”); *see also* *Hunt v. Bankers Trust Co.*, 799 F.2d 1060, 1069 (5th Cir.1986) (discussing the goal of the automatic stay to prevent a “chaotic and uncontrolled scramble for the debtor’s assets” (internal quotation omitted)); *In re Prairie Trunk Ry.*, 112 B.R. 924, 928 (Bankr.N.D.Ill.1990) (noting that “[t]he intent behind section 362 is principally to protect a debtor by giving him relief from creditors in accordance with the policy of the Bankruptcy Code of affording the debtor an effective fresh start.”). There is nothing in the legislative history of § 362 or in the case law interpreting that history to indicate that § 362(h) is designed to protect creditors who ignore the automatic stay. *Cf. Wieboldt Stores*, 111 B.R. at 168 (noting, in the fraudulent conveyance context, that third-party plaintiffs “are not members of the class for whose benefit the Bankruptcy Code was enacted”). It is clear that here, as was evident for the petitioner in *Texas Industries*, Cadle “is a member of the class whose activities Congress intended to regulate for the protection and benefit of an entirely distinct class.” *Texas Indus.*, 451 U.S. at 639, 101 S.Ct. at 2066 (internal quotation omitted).

The combination of these two factors—the absence of legislative history mentioning contribution and the fact that § 362(h) was not enacted to protect violators of the automatic stay—indicates that Congress did not intend to create a cause of action for contribution in § 362 of the Bankruptcy Code. As the Supreme Court made clear in deciding whether the antitrust law included an implied cause of action for contribution, “[t]he absence of any reference to contribution in the legislative history or of any possibility that Congress was concerned with softening the blow on joint wrongdoers in

this setting makes examination of other factors unnecessary.” *Texas Indus.*, 451 U.S. at 639, 101 S.Ct. at 2066. We, as other courts examining this issue, agree, and, consequently, we find no implied *567 right of contribution in the Bankruptcy Code. *See, e.g., Wieboldt Stores*, 111 B.R. at 168; *In re Pearson Indus.*, 142 B.R. at 848; *Neill v. Borreson (In re John Peterson Motors)*, 56 B.R. 588, 591 n. 5 (Bankr.D.Minn.1986).

If, as in the instant case, a right to contribution is not affirmatively created by the statute, then such a right may exist only through federal common law. *Texas Indus.*, 451 U.S. at 640, 101 S.Ct. at 2066. We do not wantonly use our power to fashion common-law remedies, for the Supreme Court has cautioned us to invoke the power of the “federal common law” only when either “a federal rule of decision is necessary to protect uniquely federal interests, [or] ... Congress has given the courts the power to develop substantive law.” *Id.* (internal quotation and citations omitted). This grant of power is very narrow, and although bankruptcy might seem to be a “uniquely federal interest,” the Court has stated that, “the existence of congressional authority under Art. I [does not] mean that federal courts are free to develop a common law to govern those areas until Congress acts.” *Id.* at 641, 101 S.Ct. at 2067. Instead, the Court has declared that “absent some congressional authorization to formulate substantive rules of decision, federal common law exists only in such narrow areas as those concerned with the rights and obligations of the United States, interstate and international disputes implicating the conflicting rights of States or impairing our relations with foreign nations, and admiralty cases.” *Id.* Simply put, bankruptcy is not an area where the courts have wide discretion to fashion new causes of action. As one lower court noted, “in enacting the Bankruptcy Code Congress created a comprehensive legislative program providing for no right to contribution.” *Wieboldt Stores*, 111 B.R. at 168. The Supreme Court spoke similarly, noting that, “[t]he presumption that a remedy was deliberately omitted from a statute is strongest when Congress has enacted a comprehensive legislative scheme.” *Northwest Airlines, Inc. v. Transport Workers Union*, 451 U.S. 77, 97, 101 S.Ct. 1571, 1583–84, 67 L.Ed.2d 750 (1981). Accordingly, like the court in *Wieboldt Stores*, we “refuse[] to fashion a new remedy that might disturb this carefully considered legislative scheme.” *Wieboldt Stores*, 111 B.R. at 168; *see also In re John Peterson*, 56 B.R. at 591 n. 5 (finding that third-party contribution claim was based in state law because federal common law did not provide for such a claim in Title 11); *Fox & Gadsden*, *supra*,

at 1605 (concluding that “there is simply no basis on which a right of indemnification or contribution can be found under federal common law”).

Cadle correctly notes that the Supreme Court recognized a cause of action for contribution under § 10–b of the Securities Exchange Act of 1934. See *Musick, Peeler & Garrett v. Employers Ins.*, 508 U.S. 286, 113 S.Ct. 2085, 124 L.Ed.2d 194 (1993). That case, however, is readily distinguishable from the case at bar. First, in *Employers Insurance*, the Court noted that because the “private right of action under Rule 10b–5 was implied by the judiciary [,] ... [t]he federal courts have accepted and exercised the principal responsibility for the continuing elaboration of the scope of the 10b–5 right and the definition of the duties it imposes.” *Id.* at —, 113 S.Ct. at 2089. The Court also mentioned that its power to shape the contours of the 10b–5 cause of action was reinforced by “obvious legislative consideration” of that power in federal legislation. *Id.* Thus, the Court in *Employers Insurance* found that Congress had implicitly given courts the ability to develop 10b–5 law. That is not the situation under the automatic stay provisions; the remedies under 362(h) are not judicially created, and Cadle cites nothing to indicate congressional intent for courts to develop the cause of action for violations of the automatic stay.²

***568** Second, in *Employers Insurance*, the Court was persuaded by the existence of a right of contribution in parallel securities actions. Specifically, the Court found that “these explicit provisions for contribution are an important, not an inconsequential, feature of the federal securities law and that consistency requires us to adopt a like contribution rule for the right of action existing under Rule 10b–5.” *Id.* at —, 113 S.Ct. at 2091. In the instant case, however, Cadle cites no bankruptcy provisions recognizing a third-party right of contribution. Accordingly, *Employers Insurance* does not support the creation of a cause of action for contribution under § 362 of the Bankruptcy Code.

B. Bankruptcy Jurisdiction

Cadle next argues that the district court erred in failing to recognize bankruptcy jurisdiction over its third-party claim against Svava. This contention, however, is misplaced. Jurisdiction for bankruptcy cases is rooted in the provisions of 28 U.S.C. § 1334. See *Celotex Corp. v. Edwards*, 514 U.S. 300, —, 115 S.Ct. 1493, 1498, 131 L.Ed.2d 403 (U.S.1995) (stating that “[t]he jurisdiction of the bankruptcy courts ... is grounded in and limited by statute”); *FDIC v. Majestic*

Energy Corp. (In re Majestic Energy Corp.), 835 F.2d 87, 90 (5th Cir.1988) (noting that “whether federal jurisdiction over bankruptcy cases and proceedings exists is determined under § 1334(b)”; *Wood v. Wood (In re Wood)*, 825 F.2d 90, 92 (5th Cir.1987) (describing § 1334 as the “starting point” for analyzing federal court’s subject matter jurisdiction over bankruptcy claims); see also S.Rep. No. 989, 95th Cong., 2d Sess. 153–54 (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5939–41 (discussing how the Bankruptcy Reform Act of 1978 amended § 1334’s provisions “relating to the jurisdiction of the U.S. district courts over bankruptcy proceedings”); H.R.Rep. No. 595, 95th Cong., 2d Sess. 48–52 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6010–13 (same). Section 1334 provides that, with one exception, “the district court shall have original and exclusive jurisdiction of all cases under title 11.” 28 U.S.C. § 1334(a). The exception, stated in subsection (b) of § 1334, explains that “[n]otwithstanding any Act of Congress that confers exclusive jurisdiction on a court or courts other than the district courts, the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11.” 28 U.S.C. § 1334(b).

Through this section, district courts, along with their bankruptcy units, are empowered to hear “cases under title 11” (i.e. the bankruptcy petition itself). *Celotex*, 514 U.S. at —, 115 S.Ct. at 1498; *Querner v. Querner (In re Querner)*, 7 F.3d 1199, 1201 (5th Cir.1993); *In re Wood*, 825 F.2d at 92; see also S.Rep. No. 989, 153–54, reprinted in 1978 U.S.C.C.A.N. 5787, 5939–41. Additionally, § 1334(b) gives the district courts original, but not exclusive, jurisdiction over “proceedings arising under title 11”; “proceedings ‘arising in’ a case under title 11”; and “proceedings ‘related to’ a case under title 11.” *In re Wood*, 825 F.2d at 92; accord *Celotex*, 514 U.S. at —, 115 S.Ct. at 1498; *In re Querner*, 7 F.3d at 1199. As the Supreme Court recently announced, § 1334(b) gives bankruptcy courts jurisdiction over “more than the simply proceedings involving the property of the estate, [but] a bankruptcy court’s ‘related to’ jurisdiction is not limitless.” *Celotex*, 514 U.S. at —, 115 S.Ct. at 1498.

In determining the scope of the jurisdictional provisions of § 1334(b), we have noted that it is not necessary to distinguish their meanings because they “operate conjunctively to define the scope of jurisdiction.” *In re Wood*, 825 F.2d at 93; accord *In re Majestic Energy Corp.*, 835 F.2d at 90; see also *Celotex*, 514 U.S. at —, 115 S.Ct. at 1498 (noting the Supreme Court’s agreement with the conclusion in *Pacor* that, “Congress intended to grant comprehensive jurisdiction

to the bankruptcy courts so that they might deal efficiently and expeditiously with all *569 matters connected with the bankruptcy estate.” (internal quotations omitted)). Instead, to ascertain whether jurisdiction exists, “it is necessary only to determine whether a matter is at least ‘related to’ the bankruptcy.” *In re Wood*, 825 F.2d at 93. Although the Bankruptcy Code does not define “related matters,” in *In re Wood*, we adopted the Third Circuit’s formulation, and we determined that a matter is related for § 1334 purposes when “ ‘the outcome of that proceeding could conceivably have any effect on the estate being administered in bankruptcy.’ ” *Id.* (quoting *Pacor, Inc. v. Higgins*, 743 F.2d 984, 994 (3d Cir.1984)). As we later more specifically stated, “ ‘[a]n action is related to bankruptcy if the outcome could alter the debtor’s rights, liabilities, options, or freedom of action (either positively or negatively) and which in any way impacts upon the handling and administration of the bankrupt estate.’ ” *In re Majestic Energy Corp.*, 835 F.2d at 90 (quoting *Pacor*, 743 F.2d at 994) (alteration in original). Conversely, “bankruptcy courts have no jurisdiction over proceedings that have no effect on the debtor.” *Celotex*, 514 U.S. at —n. 6, 115 S.Ct. at 1499 n. 6.

As several courts have observed, “a vast majority of cases find that ‘related to’ jurisdiction is lacking in connection with third-party complaints.” *Official Committee of Unsecured Creditors ex rel. Summit Airlines v. Ganz (In re Summit Airlines)*, 160 B.R. 911, 922 (Bankr.E.D.Pa.1993) (listing cases); accord *In re Schwamb*, 169 B.R. 601, 604 (E.D.La.1994), *aff’d*, No. 94–30427, 48 F.3d 530, 1995 U.S.App. LEXIS 4456 (5th Cir.1995). This too is such a case. Even under the broadest meaning of the term, Cadle’s third-party claim against Svava does not “relate to” the bankruptcy claim so as to confer bankruptcy jurisdiction.

In the instant case, Cadle’s claim against Svava has no “conceivable effect on the administration of the estate” nor would the outcome of that claim “alter the debtor’s rights, liabilities, options, or freedom of action.” Cadle’s third-party action against Svava claimed that Svava, and not Cadle, was responsible for any damage to Walker’s property. It is difficult to imagine that whether Svava should be required to reimburse Cadle for any money Cadle pays to Walker could somehow affect the estate. See *Official Creditors’ Comm. v. International Ins. Co. (In re Pettibone)*, 135 B.R. 847 (Bankr.N.D.Ill.1992) (finding cross-claim which would “merely determine which party will ultimately be responsible in the event that [the first-party defendant] is found liable

in the underlying [a]dversary actions,” was not “related to” bankruptcy action under § 1334).

Cadle’s claim that § 157 of the Code gave the bankruptcy court jurisdiction over its claim against Svava is also incorrect. Section 157 does not give bankruptcy courts power beyond that granted in 28 U.S.C. § 1334; rather, § 157 allows district courts to assign cases to the bankruptcy courts.³ See 3 David G. Epstein et al., *Bankruptcy* § 12–1 (1992) (describing the operation of § 157 and noting that in enacting that provision “Congress was saying the district court had jurisdiction, but that the district court in one way or another could delegate some parts of this to the bankruptcy judges.” (footnote omitted)). Specifically, § 157 describes the bankruptcy court’s power in various types of cases. Under this section, a bankruptcy judge may decide “ ‘all core proceedings arising under title 11, or arising in a case under title 11’ and ... enter appropriate orders and judgments.”⁴ *In re Wood*, 825 F.2d at 95 (quoting 28 U.S.C. § 157(b)(1)); see also *Citizens Bank & Trust v. Case (In re Case)*, 937 F.2d 1014, 1019 (5th Cir.1991). For “non-core proceedings” otherwise related to a case under title 11, a bankruptcy judge may only “submit findings of fact and conclusions of law to the district court, subject *570 to de novo review.”⁵ *In re Wood*, 825 F.2d at 95; accord *In re Case*, 937 F.2d at 1019. Thus, while § 157 gives bankruptcy courts the power to hear some cases, and the power to decide certain cases, it does not give those courts the power to hear cases that the district court could not hear. As noted above, there was no federal jurisdiction over Cadle’s third-party claim, and accordingly, the district court did not err in refusing to find that the bankruptcy court had jurisdiction over that claim through § 157.

C. Supplemental Jurisdiction

Cadle further asserts that the bankruptcy court had jurisdiction to hear the third-party claim against Svava under the principle of supplemental jurisdiction. Cadle argues that, “when the jurisdiction granted the district court under § 1334 [conferring bankruptcy jurisdiction] is combined with the grant of § 1367 [supplemental jurisdiction], there can be no doubt about the capacity of the bankruptcy court to hear the third-party demand.”⁶ Notably, Cadle does not assert that the district court should have exercised its supplemental jurisdiction to hear its third party claim against Svava. Accordingly, we do not address the difficult question of whether a *district court* may address claims that are supplemental to its bankruptcy jurisdiction. See generally Susan Block–Lieb, *The Case Against Supplemental*

Jurisdiction: A Constitutional, Statutory, and Policy Analysis, 62 Fordham L.Rev. 721 (1994) (discussing arguments against district court's exercising jurisdiction supplemental to their bankruptcy jurisdiction and describing cases). Nevertheless, even assuming, *arguendo*, that a district court could reach a third-party claim under its supplemental jurisdiction, we find that a bankruptcy court does not have supplemental jurisdiction to reach such claims.

Several bankruptcy courts have concluded that they had jurisdiction supplemental to their bankruptcy jurisdiction. For example, the court in *In re Eads* determined that it had supplemental jurisdiction. See *Hawkins v. Eads (In re Eads)*, 135 B.R. 387 (Bankr.E.D.Cal.1991). In *In re Eads*, the bankruptcy court concluded, without much analysis on the interaction between § 157 and § 1334, that “the supplemental jurisdiction statute applies in bankruptcy adversary proceedings and, subject to the court's discretion to decline to exercise such jurisdiction, permits defendants to assert third-party claims on theories of ancillary and pendent jurisdiction, which are components of supplemental jurisdiction.” *Id.* at 390. After conducting a traditional supplemental jurisdiction analysis, the court found that there was a “close logical and factual nexus between the pendent claim and the impleader claims,” and held that there was pendent jurisdiction over a state-law fraud claim. *Id.* at 397. The court, however, specifically limited its finding, stating that its determination of supplemental jurisdiction was “limited to a statement of the subject-matter jurisdiction of the district court, of which the bankruptcy court is a unit, over third-party claims. It does not address whether a bankruptcy judge may preside over the trial.” *Id.* at 390 (emphasis added).

Other bankruptcy courts, however, have gone further. In *571 *Jones v. Woody (In re W.J. Servs., Inc.)*, 139 B.R. 824, 826 (Bankr.S.D.Tex.1992), the court noted that under § 1367, district courts could exercise jurisdiction over “claims that involve the joinder or intervention of additional parties” and observed that “[p]ursuant to 28 U.S.C. § 151, the bankruptcy court is a unit of the district court.” Thus, the court concluded that, “[u]nder 28 U.S.C. § 1367(a), the bankruptcy court has supplemental jurisdiction over claims that form the same case or controversy.” *In re W.J. Servs.*, 139 B.R. at 826; cf. *National Westminster Bankcorp v. ICS Cybernetics, Inc. (In re ICS Cybernetics)*, 123 B.R. 467, 472–73 (Bankr.N.D.N.Y.1989) (finding, in a pre-section 1367 case, that a bankruptcy court had ancillary jurisdiction over compulsory counter-claims that the court also found to be core proceedings), *aff'd*, 123 B.R. 480 (N.D.N.Y.1990). In light of the Supreme Court

admonishments in *Finley v. United States*, 490 U.S. 545, 109 S.Ct. 2003, 104 L.Ed.2d 593 (1989) and our reading of the statutes we find the bankruptcy courts' reasoning unpersuasive, and we conclude that bankruptcy courts may not exercise supplemental jurisdiction.

The Supreme Court discussed the limitations of supplemental and pendent jurisdiction in *Finley v. United States*, 490 U.S. 545, 109 S.Ct. 2003, 104 L.Ed.2d 593 (1989). In that case, the Court noted that:

It remains rudimentary law that as regards all courts of the United States inferior to this tribunal, two things are necessary to create jurisdiction.... The Constitution must have given to the court the capacity to take it, and an act of Congress must have supplied it.... To the extent that such action is not taken, the power lies dormant.

Finley, 490 U.S. at 547–48, 109 S.Ct. at 2006 (internal quotation omitted). Applying this rule to pendent-party jurisdiction, the Court stated “we will not assume that the full constitutional power has been congressionally authorized, and will not read jurisdictional statutes broadly.” *Id.* at 549, 109 S.Ct. at 2007.

In interpreting the Supreme Court's decision, we noted that “pendent-party jurisdiction does not exist, unless Congress has expressly spoken to allow it. Accordingly, this Court along with others, has read *Finley* as sounding the death knell for pendent-party jurisdiction.” *Sarmiento v. Texas Bd. of Veterinary Medical Examiners*, 939 F.2d 1242, 1247 (5th Cir.1991); see also *Iron Workers Mid-South Pension Fund v. Terotechnology*, 891 F.2d 548, 551 (5th Cir.) (“The Supreme Court held in *Finley* that while pend[e]nt-party jurisdiction may pass constitutional muster, it has not been congressionally authorized.”), *cert. denied*, 497 U.S. 1024, 110 S.Ct. 3272, 111 L.Ed.2d 782 (1990).

Much of the force of the *Finley* decision was lost with Congress's actions in the Judicial Improvements Act of 1990, 104 Stat. 5089, 5113. In that Act, Congress stated that:

Except as provided in subsections (b) and (c) or as expressly provided otherwise by Federal statute, in any civil action of which the district courts have original jurisdiction, the district courts shall have supplemental jurisdiction over all other claims that are so related to claims in the action within such original jurisdiction that they form part of the same case or controversy under Article III of the United States Constitution. Such

supplemental jurisdiction shall include claims that involve the joinder or intervention of additional parties.

28 U.S.C. 1367(a). By virtue of this Act, Congress conferred a broad grant of jurisdiction upon the district courts, indicating a congressional desire that, “supplemental jurisdiction at least in the first instance ... go to the constitutional limit, to which it appeared to be carried in ... [*United Mine Workers v. Gibbs*, 383 U.S. 715, 86 S.Ct. 1130, 16 L.Ed.2d 218 (1966)]”⁷ *Rodriguez v. Pacificare* *572 of *Texas*, 980 F.2d 1014 (5th Cir.) (quoting David D. Seigel, *Commentary on 1990 Revision*, 28 U.S.C.A. § 1367, at 831 (1993)), *cert. denied*, 508 U.S. 956, 113 S.Ct. 2456, 124 L.Ed.2d 671 (1993); *see also* Charles Alan Wright et al., 13B *Federal Practice and Procedure* § 3567.2 (2d ed. Supp.1994) (describing the teachings of *Finley* as, “for the most part, a matter of unhappy history,” and noting that under § 1367 supplemental “jurisdiction extends to the limits of Article III”).

While § 1367 addressed the power of the *district courts* to exercise supplemental jurisdiction, it did not discuss the power of the bankruptcy courts to reach pendent parties. As noted above, *Finley* requires courts not to “assume that the full constitutional power has been congressionally authorized,” and not to “read jurisdictional statutes broadly.” *Finley*, 490 U.S. at 549, 109 S.Ct. at 2007. Because there is no Congressional statute conferring upon the *bankruptcy courts* the power to exercise supplemental jurisdiction, we find no error in the district court's conclusion that the bankruptcy court did not have the power to hear Cadle's contribution claim against Svara. *See Fisher v. Federal Nat'l Mortgage Ass'n (In re Fisher)*, 151 B.R. 895, 898–99 (Bankr.N.D.Ill.1993) (noting that § 1367 “confers authority only upon the district court”).

The district and circuit court case law in this area, although sparse, is not inapposite. In the only circuit court decision found that discussed jurisdiction supplemental to bankruptcy jurisdiction, the Second Circuit concluded that the operation of § 1334(b)'s bankruptcy jurisdiction and § 1367's supplemental jurisdiction gave the *district court* power to approve a settlement “forming part of the same case before it.”⁸ *Publicker Indus. v. United States (In re Cuyahoga Equip. Corp.)*, 980 F.2d 110, 114–15 (2d Cir.1992) (emphasis added). In that case, the court did not imply that a bankruptcy court had the same power.

Similarly, in the only district court decision recognizing supplemental jurisdiction, the court invoked ancillary jurisdiction to hear a contribution claim that it determined to

be “logically entwined” to the bankruptcy trustee's fraudulent conveyance claims. *Wieboldt Stores, Inc. v. Schottenstein*, 111 B.R. 162, 166 (N.D.Ill.1990). In reaching its conclusion, the court noted that it “ha[d] not found any legal authority supporting the notion that the bankruptcy jurisdiction statute limits *this court's* otherwise legitimate exercise of ancillary jurisdiction.” *Id.* at 167. *But cf. Southtrust Bank v. Alpha Steel Co. (In re Alpha Steel Co.)*, 142 B.R. 465, 471 (M.D.Ala.1992) (intimating that bankruptcy courts lacked supplemental jurisdiction). Notably, however, the court in *Wieboldt*, just as the court in *In re Cuyahoga Equipment Corp.*, did not indicate that the *bankruptcy court* had the power to exercise supplemental jurisdiction.

Examination of the bankruptcy jurisdiction statute itself also counsels against extending supplemental jurisdiction to the bankruptcy courts. As several courts have commented, “[t]here are ... strong ... arguments to support the position that the ‘relate to’ and ‘arising in’ jurisdictional components of § 1334(b) already allow bankruptcy courts to hear, to the extent Congress intended, all supplemental claims that have a logical relationship to an underlying bankruptcy proceeding.” *Wilcox v. Houghton (In re Houghton)*, 164 B.R. 146, 148 (Bankr.W.D.Wash.1994) (quoting *In re Alpha Steel Co.*, 142 B.R. at 471); *accord In re Fisher*, 151 B.R. at 899.

Analysis of the statutory language empowering district courts to refer certain cases to the bankruptcy courts yields a similar result. As described above, 28 U.S.C. § 157 governs the types of cases that a district court may *573 refer to a bankruptcy court, stating in part that, “[e]ach district court may provide that any or all cases under title 11 and any or all proceedings arising under title 11 or arising in or related to a case under title 11 shall be referred to the bankruptcy judges for the district.” 28 U.S.C. § 157(a). Additionally, § 157 distinguishes core and non-core cases, providing that bankruptcy courts may “hear and determine” core cases, but noting that bankruptcy courts may only submit findings of fact and conclusions of law to the district court in non-core cases. *See* 28 U.S.C. § 157(b), (c). Absent from this grant of jurisdiction is any indication that district courts may refer to bankruptcy courts any cases that were before the district courts only on the basis of supplemental jurisdiction. As one commentator describes:

[Section] 157(c)(1) speaks only of “a proceeding that is not a core proceeding but that is otherwise related to a case under title 11.” It is silent with regard to the power of a bankruptcy court to “hear” or “determine” a supplemental

claim—a proceeding that is neither core nor related to the title 11 case.

Block–Lieb, *supra*, at 810 (footnote omitted). Simply put, even assuming that a district court could exercise jurisdiction supplemental to its bankruptcy jurisdiction described in 28 U.S.C. § 1334, there is nothing in the jurisdictional statutes to indicate that the district court could refer such a case to a bankruptcy court.

Congress has gone to great lengths to determine what proceedings may be tried by bankruptcy courts, and “the exercise of ancillary and pendent jurisdiction by bankruptcy courts could subsume the more restrictive ‘relate to’ and ‘arising in’ jurisdiction, such that the latter would be rendered substantially, if not entirely, superfluous.” *In re Alpha Steel, Inc.*, 142 B.R. at 471; accord *In re Houghton*, 164 B.R. at 148. Thus, it would be somewhat incongruous to gut this careful system by allowing bankruptcy courts to exercise supplemental jurisdiction to pull into bankruptcy courts matters Congress excluded in its specific jurisdictional grants. See *In re Houghton*, 164 B.R. at 148; *In re Fisher*, 151 B.R. at 899; *In re Alpha Steel, Inc.*, 142 B.R. at 471.

Additionally, even if supplemental jurisdiction were thought to “supplement [] rather than supplant[] ‘related to’ and ‘arising in’ jurisdiction, a bankruptcy court exercising the former could hear claims which in effect, merely relate to claims which themselves have only a relate-to connection with the primary case.” *In re Alpha Steel, Inc.*, 142 B.R. at 471 (internal quotation omitted). It seems unlikely that

Congress would have intended such a result, especially after carefully delimiting bankruptcy jurisdiction in § 157. Moreover, as noted above, such a result would contravene the Supreme Court’s directive in *Finley* instructing courts not to “read jurisdictional statutes broadly.” *Finley*, 490 U.S. at 549, 109 S.Ct. at 2007. Thus, we find that the district court correctly concluded that the bankruptcy court could not exercise supplemental jurisdiction over Cadle’s third-party claim.

D. Other Claims

Cadle’s remaining claims are meritless. In short, based on our review of the record in this case, we find that the bankruptcy court did not err in concluding that Cadle violated the automatic stay, in finding that Cadle was responsible for the damages to Walker, or in determining the amount of damages and costs that Walker is entitled to receive.⁹

IV. CONCLUSION

For the foregoing reasons, the decision of the district court is AFFIRMED.

All Citations

51 F.3d 562, 63 USLW 2722, 33 Collier Bankr.Cas.2d 1136, Bankr. L. Rep. P 76,499

Footnotes

- 1 There is some dispute about what Lindsey told Joseph. In their brief, Cadle notes that “Lindsey informed [Joseph] during this conversation [that] Cadle has sufficient legal grounds to pick up the mobile home.” The bankruptcy court disagreed. As the district court noted, “[t]he bankruptcy court found that Lindsey did not authorize the recovery of the trailer. Lindsey testified that she did not tell Joseph that Cadle could pick up the mobile home....”
- 2 Cadle cites several cases for the proposition that “[s]everal courts recognized well in advance of the 1984 enactment [of § 362(h)] a private right of action for individuals injured by a stay violation.” These cases, however, do not recognize a private right of action for violations of the automatic stay. Instead, in the cases cited by Cadle, the debtors sought damages from the courts through civil contempt proceedings, not through a judicially created cause of action. See, e.g., *Miller v. Savings Bank (In re Miller)*, 22 B.R. 479, 480 (D.Md.1982) (affirming bankruptcy court’s finding of contempt and awarding damages); *Walters v. Hatcher (In re Walters)*, 41 B.R. 511, 513, 516 (W.D.Mo.1984) (describing the civil contempt award); *DePoy v. Kipp (In re DePoy)*, 29 B.R. 471, 478–80 (Bankr.N.D.Ind.1983) (noting that the damages awarded were in conjunction with civil contempt); *Cusanno v. Fidelity Bank (In re Cusanno)*, 17 B.R. 879, 882 (Bankr.E.D.Pa.1982) (awarding damages for violation of the automatic stay and noting that “[s]uch action will not be sanctioned by this court” (emphasis added)).

- 3 The section states, in part, “[e]ach district court may provide that any or all cases under [title 11](#) and any or all proceedings arising under [title 11](#) or arising in or related to a case under [title 11](#) shall be referred to the bankruptcy judges for the district.” [28 U.S.C. § 157\(a\)](#).
- 4 Subsection (b)(1) provides that “Bankruptcy judges may hear and determine all cases under [title 11](#) and all core proceedings arising under [title 11](#), or arising in a case under [title 11](#) ... and may enter appropriate orders and judgments.” [28 U.S.C. § 157\(b\)\(1\)](#).
- 5 [Section 157](#) states:
- A bankruptcy judge may hear a proceeding that is not a core proceeding but that is otherwise related to a case under [title 11](#). In such proceeding, the bankruptcy judge shall submit proposed findings of fact and conclusions of law to the district court, and any final order or judgment shall be entered by the district judge after considering the bankruptcy judge's proposed findings and conclusions and after reviewing de novo those matters to which any party has timely and specifically objected.
- [28 U.S.C. § 157\(c\)\(1\)](#). If the parties consent, however, the district court may grant the bankruptcy court power to hear noncore, but related, proceedings. See [28 U.S.C. 157\(c\)\(2\)](#) (stating that “the district court, with the consent of all the parties to the proceeding, may refer a proceeding related to a case under [title 11](#) to a bankruptcy judge to hear and determine and to enter appropriate judgments....”).
- 6 We construe Cadle's argument to mean that even if no cause of action for contribution or indemnity exists in the Bankruptcy Code, the district court erred in finding that the bankruptcy court could not hear Cadle's state law third-party claim under its supplemental jurisdiction. We express no view on whether Louisiana law recognizes such a claim.
- 7 Under *Gibbs*, “state claims against a defendant in a federal forum could be adjudicated if they were appended to a federal claim against that defendant, and derived from the same nucleus of operative facts.” *Rodriguez v. Pacificare of Texas*, 980 F.2d 1014, 1019 (5th Cir.), cert. denied, 508 U.S. 956, 113 S.Ct. 2456, 124 L.Ed.2d 671 (1993). From this reasoning, known as pendent claim jurisdiction, pendent party jurisdiction developed. Through pendent party jurisdiction, federal courts exercised jurisdiction over state law claims involving non-diverse defendants as long as the factual basis of the state law claim was sufficiently intertwined with the federal claim. *Id.*; see generally Charles Alan Wright et al., [13B Federal Practice and Procedure § 3567.2](#) (2d ed. Supp.1994).
- 8 The Second Circuit did not rest on [§ 1367](#) alone, noting that “[t]he district court did not need to rely solely on its supplemental jurisdiction to approve the settlement, because additional authority arises from CERCLA's jurisdictional grant....” *Publicker Indus. v. United States (In re Cuyahoga Equip. Corp.)*, 980 F.2d 110, 115 (2d Cir.1992).
- 9 Although not expressly addressed by the district court, we find that it implicitly affirmed the district court's dismissal of the cause of action against Lindsey. We find no error in this conclusion.

29 F.3d 88

United States Court of Appeals,
Second Circuit.In re **The LIONEL CORPORATION**

and Lionel Leisure, Inc., Debtors.

Murray KLEIN, Stanley Zabar, and **Saul Zabar**,
as Tenants in Common, Plaintiffs–Appellees,

v.

CIVALE & TROVATO,
INC., Defendant–Appellant,
Lionel Leisure, Inc., Defendant–Appellee,
J. United Electrical
Contracting Corp., Defendant.

No. 1235, Docket 93–5085.

|
Argued March 7, 1994.|
Decided July 12, 1994.**Synopsis**

Lessors and Chapter 11 debtor lessee brought adversary proceeding for declaration that contractor's mechanics' lien was invalid. The Bankruptcy Court, **Burton R. Lifland**, Chief Judge, ordered that lien be discharged, and contractor appealed. The United States District Court for the Southern District of New York, **John F. Keenan**, J., affirmed, **159 B.R. 410**, and contractor appealed. The Court of Appeals, **Walker**, Circuit Judge, held that: (1) contractor's failure to obtain stay did not moot appeal; (2) postpetition perfection of mechanics' lien did not violate automatic stay; and (3) mechanics' lien was statutory lien that was not avoidable as preferential transfer.

Reversed and remanded.

Procedural Posture(s): On Appeal.**Attorneys and Law Firms**

***89** **John S. Wojak, Jr.**, Ross & Cohen, New York City, for defendant-appellant.

Paul H. Aloe, New York City (**Craig Weiner**, Lawrence Devine, Rubin Baum Levin Constant & Friedman, of counsel), for plaintiffs-appellees.

Kevin Toole, New York City (**Jonathan Drucker**, Angel & Frankel, P.C., of counsel), for defendant-appellee.

***90** Before: **WALKER** and **JACOBS**, Circuit Judges, and **CARMAN**, Judge.*

Opinion**WALKER**, Circuit Judge:

Civale & Trovato, Inc. (“CTI”) is a construction company that performed work for Lionel Leisure, Inc. (“Lionel”) on a large retail space in New York City that Lionel leased from Messrs. Murray Klein, Stanley Zabar, and Saul Zabar (the “Owners”). CTI filed a mechanic's lien against the premises one week before Lionel filed a petition for Chapter 11 bankruptcy. CTI now appeals from a judgment of the United States District Court for the Southern District of New York (John F. Keenan, *Judge*) affirming the order of the United States Bankruptcy Court for the Southern District of New York (Burton R. Lifland, *Bankruptcy Judge*) which held that CTI's attempts to perfect its lien after the bankruptcy petition was filed violated the Bankruptcy Code's automatic stay provision and that the filing of the lien constituted an impermissible preferential transfer. We reverse.

BACKGROUND

Between May and October of 1990, CTI performed construction work for Lionel on a large retail space that Lionel leased from the Owners to operate a toy store. CTI claims that Lionel owes it approximately \$168,000 for labor and materials expended on the job. On June 7, 1991, CTI filed a Notice of Mechanic's Lien (the “Notice”) against the premises in order to secure its claim. This filing complied with the time constraints specified in **§ 10 of New York Lien Law**, which provides in relevant part that:

Notice of lien may be filed at any time during the progress of the work and the furnishing of the materials, or, within eight months after the completion of the contract, or the final performance of the work, or the final furnishing of the materials, dating from the last item of work performed or materials furnished....

N.Y.Lien Law § 10(1).

Section 11 of New York Lien Law required CTI to follow this filing by serving a copy of the Notice on the owner within thirty days and by filing proof of such service with the county clerk within thirty-five days. See N.Y.Lien Law § 11. Accordingly, CTI served a copy of the Notice on Lionel on June 10, 1991. Four days later, on June 14th, Lionel filed a petition for relief and reorganization pursuant to Chapter 11 of the Bankruptcy Code. On July 5, 1991, CTI served a copy of the Notice on the Owners. On July 11, 1991, CTI filed an affidavit of proof of service with the Clerk of the County of New York.

On October 1, 1991, the Owners and Lionel commenced an action in the bankruptcy court that sought, among other things, an order declaring CTI's mechanic's lien invalid. On cross-motions for summary judgment, the bankruptcy court determined that CTI's post-petition service of notice and filing of proof of service were acts to enforce a lien against property of the debtor's estate and thus violated the automatic stay imposed by § 362 of the Bankruptcy Code. See 11 U.S.C. § 362(a)(4) and (6). The bankruptcy court ruled that because these acts could not be given effect due to the automatic stay, CTI's lien had expired. In addition, the bankruptcy court stated that the Bankruptcy Code's preferential transfer provisions, 11 U.S.C. § 547, "seem to form an insurmountable hurdle for the putative lien creditors blocking the sustenance of vitality of their lien." The bankruptcy court therefore ordered that CTI's lien be "vacated, with prejudice, extinguished and without any further force and effect." Its order directed the Clerk of the County of New York "to take all necessary steps to have ... the [CTI] Notice removed from all records maintained by said Clerk for the recording of mechanics liens."

CTI appealed to the district court. The district court affirmed the bankruptcy court's determination that the service of the notice and filing of proof of service were invalid because they occurred after the automatic stay arose, 159 B.R. 410. In addition, the *91 district court rejected CTI's argument that its lien is exempt from the bankruptcy trustee's avoidance powers because it qualifies as a "statutory lien" under § 547(c)(6). The district court reasoned that because CTI did not file in time to obtain the benefit of the relation-back provision contained in § 13(5) of the New York Lien Law, which permits a mechanic's lien filed within four months after completion of an improvement to "relate-back" and gain priority over any interest created after commencement of the

improvement but before the filing of lien, CTI's filing fell within the ninety-day preference period prior to the filing of Lionel's bankruptcy petition. CTI appealed to this court.

DISCUSSION

I. Is This Case Moot?

As an initial matter, appellees argue that this case is moot because CTI did not obtain a stay of the bankruptcy court's decision and the New York County Clerk discharged CTI's notice of lien from its records in accordance with the court's order. Appellees reason that once a lien lapses in the State of New York, it cannot be judicially resurrected. However, each of the cases cited by appellees for this proposition pertains to a situation where the lien expired because of the lienor's failure to comply with the Lien Law's statutory requirements for preserving or continuing the lien. See *In re LoPriore*, 115 B.R. 462 (Bankr.S.D.N.Y.1990); *Dittmar Explosives, Inc. v. A.E. Ottaviano, Inc.*, 20 N.Y.2d 498, 285 N.Y.S.2d 55, 231 N.E.2d 756 (N.Y.1967); *Paolangeli v. Sopp*, 145 Misc.2d 259, 546 N.Y.S.2d 322 (N.Y.Sup.Ct.1989); *Hanson Heating & Plumbing, Inc. v. Stout*, 88 Misc.2d 241, 388 N.Y.S.2d 558 (N.Y.Sup.Ct.1976); *American Bridge Co. v. T.A. Larsen Co.*, 204 Misc. 131, 116 N.Y.S.2d 700 (N.Y.Sup.Ct.1952); *Bretzfelder v. Froman*, 76 Misc.2d 1063, 352 N.Y.S.2d 549 (Westchester County Ct.1973). These cases hold only that where a lien has lapsed by operation of law, it cannot be revived by a lienor's tardy attempt to comply with statutory requirements for maintaining or continuing the lien.

We are persuaded by CTI's argument that a lien that has been vacated because a court erroneously determined that the lienor had not complied with the Lien Law may be reinstated upon reversal of that vacatur, regardless of whether the lienor obtained a stay. For support, CTI cites to five New York cases where a lower court has vacated a mechanic's lien, only to have that decision reversed and the lien reinstated by an appellate court. See *Fane v. Armani Plumbing & Mechanical, Inc.*, 168 A.D.2d 143, 571 N.Y.S.2d 133 (1991); *Dember Constr. Corp. v. P & R Elec. Corp.*, 76 A.D.2d 540, 431 N.Y.S.2d 586 (1980); *Brusca v. Maschino*, 61 A.D.2d 973, 402 N.Y.S.2d 452 (1978); *Nimke v. Inta-State, Inc.*, 34 A.D.2d 675, 310 N.Y.S.2d 462 (1970); *Kim Kevin Corp. v. A. & A. Gibel Co.*, 20 A.D.2d 807, 248 N.Y.S.2d 741 (1964). In four of the cases the lower court had ordered the lien discharged or cancelled from the county clerk records and there is no indication in any of them that a stay of the vacatur was obtained.

Appellees argue that reinstating CTI's lien will prejudice creditors who created an interest in the premises subsequent to the vacatur. However, apart from the fact that we have been informed that there have been no conveyances, mortgages, or other interests in the premises recorded subsequent to the vacatur of CTI's lien on October 30, 1992, the records of the New York County Clerk clearly reflect that CTI's lien was vacated by order of the United States Bankruptcy Court. As such, any intervening creditor would have been on notice that a lien in favor of CTI once existed and had been judicially discharged and thus that his own interest was subject to the risk that the court order discharging the lien might be reversed on appeal. Because we think that appellate courts may reinstate liens that have been wrongly terminated by lower courts even where intervening creditors have acquired an interest in the subject property, we reject appellees' mootness argument.

II. The Applicability of the Automatic Stay

Before turning to the merits, we address CTI's argument that its lien should not be subject to the automatic stay provision of the Bankruptcy Code because the stay only protects property of the debtor, Lionel, and *92 its lien was filed against property of the Owners. Appellees respond that CTI waived this argument by not presenting it to either the bankruptcy court or the district court. Although we retain discretion to decide questions not raised initially in the court below, the general rule is that “ ‘a federal appellate court does not consider an issue not passed upon below.’ ” *Austin v. Healey*, 5 F.3d 598, 601 (2d Cir.1993) (quoting *Singleton v. Wulff*, 428 U.S. 106, 120, 96 S.Ct. 2868, 2877, 49 L.Ed.2d 826 (1976)).

CTI contends that we should hear its argument regarding the non-applicability of the automatic stay because failure to consider its claim “will result in a possible miscarriage of justice,” *Radix Org., Inc. v. Mack Trucks, Inc.*, 602 F.2d 45, 48 (2d Cir.1979); see also *Republic Nat'l Bank v. Eastern Airlines, Inc.*, 815 F.2d 232, 240 (2d Cir.1987), and, alternatively, that its argument cannot be waived because it calls into question the bankruptcy court's subject matter jurisdiction, see *John B. Hull, Inc. v. Waterbury Petroleum Prods., Inc.*, 588 F.2d 24, 27 (2d Cir.1978), cert. denied, 440 U.S. 960, 99 S.Ct. 1502, 59 L.Ed.2d 773 (1979); Fed.R.Civ.P. 12(h)(3). We reject both contentions.

Failure to consider CTI's argument will not lead to a manifest injustice because it is not the only means by which CTI can achieve success. CTI can still prevail by showing that

it did not violate the automatic stay and that its lien does not constitute a preferential transfer. CTI cannot excuse its failure to use a potential weapon in its arsenal simply by asking for a second chance to wage its battle. A contrary rule would unfairly prejudice its adversaries and contravene the purpose of having circuit courts sit as a forum of appellate review. See *Anschutz Land & Livestock Co. v. Union Pac. R.R. Co.*, 820 F.2d 338, 344 n. 5 (10th Cir.), cert. denied, 484 U.S. 954, 108 S.Ct. 347, 98 L.Ed.2d 373 (1987). This is especially true here where appellees have raised a substantial response to CTI's argument, namely that the automatic stay does apply because CTI impermissibly attempted to recover a claim against Lionel and/or to obtain Lionel's property, in violation of § 362(a)(1) and (3).

CTI's argument also does not call into question the bankruptcy court's jurisdiction, which was clearly established under 28 U.S.C. §§ 157 and 1334 and 11 U.S.C. § 105(a). The Owners' suit against Lionel sought to enforce Lionel's obligation under the lease to cause any mechanic's lien filed against the premises to be discharged by payment, deposit, bond, order of court, or otherwise. As such, it was a core proceeding which the bankruptcy court was authorized to hear and determine under 28 U.S.C. § 157(b)(2)(G). The bankruptcy court had jurisdiction over the Owners' claims against CTI under principles of supplemental jurisdiction. See 28 U.S.C. § 1367.

For the foregoing reasons, we decline to address the merits of CTI's argument regarding the non-applicability of the automatic stay for the first time on appeal. See *Truck Drivers Local 807 v. Carey Transp. Inc.*, 816 F.2d 82, 90 (2d Cir.1987) (refusing to consider argument in a bankruptcy appeal not raised in courts below); see also *In re Marvin Properties, Inc.*, 854 F.2d 1183, 1187 (9th Cir.1988) (same); *In re Modern Boats, Inc.*, 775 F.2d 619, 621 (5th Cir.1985) (per curiam) (same).

III. Did CTI Violate the Automatic Stay?

We now turn to the merits of whether CTI violated the automatic stay by serving notice upon the Owners and filing proof of such service after Lionel filed for bankruptcy. Because our review of the district court's decision is plenary, we independently examine the bankruptcy court's decision, applying the clearly erroneous standard to findings of fact and *de novo* review to conclusions of law. See *In re Brody*, 3 F.3d 35, 38 (2d Cir.1993); *In re G.S.F. Corp.*, 938 F.2d 1467, 1474 (1st Cir.1991) (collecting cases).

The bankruptcy court held that CTI's post-petition actions were acts to enforce its lien in violation of the automatic stay that protected Lionel's property. [Section 362\(a\)\(4\) of the Bankruptcy Code](#) specifically applies the stay to "any act to create, perfect, or enforce any lien against property of the estate." CTI argues that its post-petition activity fits *93 within the automatic stay exception found in [§§ 362\(b\)\(3\) and 546\(b\)](#). [Section 362\(b\)\(3\)](#) provides that "the filing of a petition ... does not operate as a stay ... of any act to perfect an interest in property to the extent that the trustee's rights and powers are subject to such perfection under [Section 546\(b\)](#) of this title." [Section 546\(b\)](#) provides that "[t]he rights and powers of a trustee under sections 544, 545 [avoidance of pre-petition statutory liens] and 549 [avoidance of post-petition transactions] of this title are subject to any generally applicable law that permits perfection of an interest in property to be effective against an entity that acquires rights in such property before the date of such perfection." The more narrow question thus becomes whether the New York Lien Law would permit CTI to perfect its lien by serving notice of the lien and filing proof of service where another entity had acquired rights to the property after CTI had filed its notice of lien.

Appellees claim that CTI cannot take advantage of this exception absent a specific provision of law permitting the perfection to "relate-back" to an earlier time. Appellees argue that because CTI filed too late to take advantage of New York Lien Law's relation-back provision, CTI cannot be saved by [§ 546\(b\)](#). This analysis was adopted by both the bankruptcy court and the district court. We take a different view.

We see nothing in [§ 546\(b\)](#) indicating that it applies only when the lienor fits within a "relation-back" statute. As long as an "applicable law" authorizes perfection after another party has acquired interests in the property, a lienor fits within the exception. We think that the New York Lien Law provides such authorization. While we recognize that no provision of the New York Lien Law specifically states that a superior lienor may serve its notice and file its proof of claim after another party has acquired its interest, the right to do so is reasonably inferred from [§§ 3, 11, and 13\(1\)](#).

[Section 3 of the Lien Law](#) provides that a mechanic's lien arises "from the time of filing a notice of such lien." [Section 13\(1\)](#) provides that a mechanic's lien "shall have priority over a conveyance ... not recorded, docketed or filed at the time of the filing of the notice of such lien." Under these two provisions, CTI's lien was created at the time it filed its notice

of lien and, as of that date, took priority over any subsequently filed interest. CTI achieved this superior status even before it complied with [§ 11](#)'s requirement that it serve its notice of lien and file proof of such service. We know this because [§ 11](#) explicitly states that failure to follow its requirements "shall terminate the notice as a lien." If non-compliance with [§ 11](#) terminates the lien, then the lien must exist prior to such non-compliance. In other words, while complying with [§ 11](#) is necessary to keep a lien alive, it is not a prerequisite to establishing the lien's initial validity, and hence, priority.

It is thus apparent that CTI's lien would have been superior to an interest in the premises acquired by a creditor after CTI filed its notice of lien but before it complied with [§ 11](#). Similarly, CTI's lien was prior to and therefore superior to the subsequently created interest of a hypothetical bankruptcy trustee. Because of this superiority, CTI was permitted to perfect its lien by complying with [§ 11](#), even after Lionel filed its bankruptcy petition. We therefore conclude that CTI's post-petition conduct fits within the exception created by [§§ 362\(b\)\(3\) and 546\(b\)](#) and should not have been declared invalid by the bankruptcy court as a violation of the automatic stay.

IV. Is CTI's Lien Voidable as a Preferential Transfer?

The final issue is whether CTI's lien constitutes an impermissible preferential transfer. The Bankruptcy Code gives trustees in bankruptcy the authority to avoid any preferential transfer to a creditor of an interest of the debtor made during the ninety days prior to the petition date. *See* [11 U.S.C. § 547\(b\)](#). CTI claims that this avoidance scheme does not apply to its lien because of [§ 547\(c\)\(6\) of the Bankruptcy Code](#), which provides that "[t]he trustee may not avoid under this section a transfer ... that is the fixing of a statutory lien that is not avoidable under section 545 of this title." *94 Although [§ 545](#) enumerates various conditions under which the trustee may avoid the fixing of a statutory lien, appellees do not assert that any of them are applicable.

Instead, appellees vigorously argue that CTI's filing of a notice of lien does not qualify as "the fixing of a statutory lien." The Bankruptcy Code defines a statutory lien as a

lien arising solely by force of a statute on specified circumstances or conditions, or lien of distress for rent, whether or not statutory, but does not include security interest or judicial lien, whether or not such interest or lien is provided by or is dependent on a statute and whether or not such interest or lien is made fully effective by statute.

11 U.S.C. § 101(53). In contrast, the Code defines a security interest as a “lien created by an agreement,” 11 U.S.C. § 101(51), and a judicial lien as a “lien obtained by judgment, levy, sequestration, or other legal or equitable process or proceeding,” 11 U.S.C. § 101(36). The Code thus contemplates that liens created consensually (such as mortgage liens or UCC security interests) or by judicial action (such as judgment liens, attachments, equitable liens or levies) are not “statutory liens,” while liens that come into being as a result of statutory operation, without consent or judicial action, are “statutory liens.” Given this scheme, we believe that mechanic's liens qualify as statutory liens. The legislative history to § 101(53) confirms this conclusion. It states that a statutory lien is “one that arises automatically, and is not based on an agreement to give a lien or on judicial action. Mechanics', materialmen's, and warehousemen's liens are examples.” H.R.Rep. No. 595, 95th Cong., 1st Sess. 314 (1978); S.Rep. No. 989, 95th Cong., 2d Sess. 27 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5813, 6271.

Our decision is in accord with other courts that have addressed this issue. In *In re Severson Acres Development Corp.*, 142 B.R. 59 (Bankr.N.D.N.Y.1992), the court rejected a trustee's argument that a post-petition filing of a mechanic's lien in accordance with New York Lien Law constituted a preferential transfer:

Section 547(c)(6) provides ... that a trustee may not avoid the fixing of a statutory lien that is not avoidable under section 545. Mechanics' liens duly filed pursuant to state law are not avoidable under section 545. Consequently, this court disagrees with the trustee's position.

Id. at 60. Although the lien in that case received the benefit of New York's “relation-back” provision, the court's preference decision did not rely on that fact. The court looked instead to whether the lienor had filed his notice of lien within the statutory time period. *See also In re Wisner*, 77 B.R. 395, 397–98 (Bankr.N.D.N.Y.1987) (holding that mechanic's lien arising under New York Lien Law is “statutory lien” as opposed to “judicial lien”).

In *In re APC Construction, Inc.*, 132 B.R. 690 (D.Vt.1991), the lienor filed his notice of lien under Vermont's lien law within the ninety-day period prior to the debtor's filing of bankruptcy. The district court determined that the lien was a statutory lien because it took effect when the notice of lien was filed and thus existed independently of any judicial process. *Id.* at 694. The district court found insignificant that the lienor was required by law to obtain a judicial writ of attachment

within three months after filing his lien because this step was required only to keep the lien in effect. The court reasoned that

the Bankruptcy Code categorizes a lien by the way it is *established*, not by how it is preserved. A statutory lien is a lien “arising” because of “specified circumstances or conditions” laid out in the statute.

Id. (quoting 11 U.S.C. § 101(47) (1986), now found at § 101(53)).

Several other courts have also observed that mechanic's liens are statutory liens because they arise strictly by operation of statute and not by agreement between the parties or judicial action. *See, e.g., In re WWG Indus., Inc.*, 772 F.2d 810, 812 (11th Cir.1985); *In re Minton Group, Inc.*, 28 B.R. 789, 791 (Bankr.S.D.N.Y.1983); *In re Seel*, 22 B.R. 692, 695–96 (Bankr.D.Kan.1982); *95 *In re Ribeiro*, 7 B.R. 359, 361 (Bankr.D.Mass.1980); *In re Saberman*, 3 B.R. 316, 318 (Bankr.N.D.Ill.1980).

We reject appellees' argument that a mechanic's lien qualifies as a statutory lien only when the lienor files within a “relation-back” period. Appellees reason that the retroactive dating will usually mean that the lien becomes effective as of a date before the preference period. However, this would not be true in every case. For example, where the lienor's work was completed in the ninety days prior to bankruptcy, the lien would not have an effective date prior to the preference period. Thus, relating back to a time before the preference period cannot be dispositive of whether a lien qualifies as a statutory lien. *Accord Minton Group*, 28 B.R. at 791 (“If the defendant is correct in its assertion that the attachments are statutory liens, it would be of no significance whether the efficacy of the liens related back to a point beyond the 90–day period prior to the filing of the bankruptcy petition or commenced from some point within the 90–day period.”).

Appellees also argue that filing within a relation-back period is necessary because it is only under these circumstances that the lien is fixed by force of statute rather than by the physical filing of a notice. However, this argument improperly shifts the focus of our inquiry from the nature of the lien in question (statutory or non-statutory) to how the lien's effective date is established. Appellees appear to have confused “the fixing of a statutory lien” with the statutory fixing of a lien. Since appellees have cited no authority for the proposition that a mechanic's lien can only be a statutory lien when its effective date is established by a relation-back provision, we reject their view as having no basis in the language or legislative history of § 547(c)(6).

Accordingly, we conclude that CTI's pre-petition filing of its notice of lien qualifies as "the fixing of a statutory lien" under § 547(c)(6) and cannot be avoided as a preferential transfer.

For the foregoing reasons, we reverse the judgment of the district court and remand for further proceedings in the bankruptcy court.

All Citations

CONCLUSION

29 F.3d 88, 31 Collier Bankr.Cas.2d 1090, 25 Bankr.Ct.Dec. 1440, Bankr. L. Rep. P 75,986

Footnotes

* Honorable Gregory W. Carman, Judge of the United States Court of International Trade, sitting by designation.

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11 U.S. Code § 362 - Automatic stay

U.S. Code Notes Authorities (CFR)

(a) Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title, or an application filed under section 5(a)(3) of the Securities Investor Protection Act of 1970, operates as a stay, applicable to all entities, of—

(1) the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title;

(2) the enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the case under this title;

(3) any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate;

(4) any act to create, perfect, or enforce any lien against property of the estate;

(5) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title;

(6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title;

(7) the setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor; and

(8) the commencement or continuation of a proceeding before the United States Tax Court concerning a tax liability of a debtor that is a corporation for a taxable period the bankruptcy court may determine or concerning the tax liability of a debtor who is an individual for a taxable period ending before the date of the order for relief under this title.

(b) The filing of a petition under section 301, 302, or 303 of this title, or of an application under section 5(a)(3) of the Securities Investor Protection Act of 1970, does not operate as a stay—

(1) under subsection (a) of this section, of the commencement or continuation of a criminal action or proceeding against the debtor;

(2) under subsection (a)—

(A) of the commencement or continuation of a civil action or proceeding —

(i) for the establishment of paternity;

(ii) for the establishment or modification of an order for domestic support obligations;

(iii) concerning child custody or visitation;

(iv) for the dissolution of a marriage, except to the extent that such proceeding seeks to determine the division of property that is property of the estate; or

(v) regarding domestic violence;

(B) of the collection of a domestic support obligation from property that is not property of the estate;

(C) with respect to the withholding of income that is property of the estate or property of the debtor for payment of a domestic support obligation under a judicial or administrative order or a statute;

(D) of the withholding, suspension, or restriction of a driver's license, a professional or occupational license, or a recreational license, under State law, as specified in section 466(a)(16) of the Social Security Act;

(E) of the reporting of overdue support owed by a parent to any consumer reporting agency as specified in section 466(a)(7) of the Social Security Act;

(F) of the interception of a tax refund, as specified in sections 464 and 466(a)(3) of the Social Security Act or under an analogous State law; or

(G) of the enforcement of a medical obligation, as specified under title IV of the Social Security Act;

(3) under subsection (a) of this section, of any act to perfect, or to maintain or continue the perfection of, an interest in property to the extent that the trustee's rights and powers are subject to such perfection under section 546(b) of this title or to the extent that such act is accomplished within the period provided under section 547(e)(2)(A) of this title;

(4) under paragraph (1), (2), (3), or (6) of subsection (a) of this section, of the commencement or continuation of an action or proceeding by a governmental unit or any organization exercising authority under the Convention on the Prohibition of the Development, Production, Stockpiling and Use of Chemical Weapons and on Their Destruction, opened for signature on January 13, 1993, to enforce such governmental unit's or organization's police and regulatory power, including the enforcement of a judgment other than a money judgment, obtained in an action or proceeding by the governmental unit to enforce such governmental unit's or organization's police or regulatory power;

[(5)] Repealed. Pub. L. 105–277, div. I, title VI, § 603(1), Oct. 21, 1998, 112 Stat. 2681–866;]

(6) under subsection (a) of this section, of the exercise by a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency of any contractual right (as defined in section 555 or 556) under any security agreement or arrangement or other credit enhancement forming a part of or related to any commodity contract, forward contract or securities contract, or of any contractual right (as defined in section 555 or 556) to offset or net out any termination value, payment amount, or other transfer obligation arising under or in connection with 1 or more such contracts, including any master agreement for such contracts;

(7) under subsection (a) of this section, of the exercise by a repo participant or financial participant of any contractual right (as defined in section 559) under any security agreement or arrangement or other credit enhancement forming a part of or related to any repurchase agreement, or of any contractual right (as defined in section 559) to offset or net out any termination value, payment amount, or other transfer obligation arising under or in connection with 1 or more such agreements, including any master agreement for such agreements;

(8) under subsection (a) of this section, of the commencement of any action by the Secretary of Housing and Urban Development to foreclose a mortgage or deed of trust in any case in which the mortgage or deed of trust held by the Secretary is insured or was formerly insured under the National Housing Act and covers property, or combinations of property, consisting of five or more living units;

(9) under subsection (a), of—

(A) an audit by a governmental unit to determine tax liability;

(B) the issuance to the debtor by a governmental unit of a notice of tax deficiency;

(C) a demand for tax returns; or

(D) the making of an assessment for any tax and issuance of a notice and demand for payment of such an assessment (but any tax lien that would otherwise attach to property of the estate by reason of such an assessment shall not take effect unless such tax is a debt of the debtor that

will not be discharged in the case and such property or its proceeds are transferred out of the estate to, or otherwise revested in, the debtor).

(10) under subsection (a) of this section, of any act by a lessor to the debtor under a lease of nonresidential real property that has terminated by the expiration of the stated term of the lease before the commencement of or during a case under this title to obtain possession of such property;

(11) under subsection (a) of this section, of the presentment of a negotiable instrument and the giving of notice of and protesting dishonor of such an instrument;

(12) under subsection (a) of this section, after the date which is 90 days after the filing of such petition, of the commencement or continuation, and conclusion to the entry of final judgment, of an action which involves a debtor subject to reorganization pursuant to chapter 11 of this title and which was brought by the Secretary of Transportation under section 31325 of title 46 (including distribution of any proceeds of sale) to foreclose a preferred ship or fleet mortgage, or a security interest in or relating to a vessel or vessel under construction, held by the Secretary of Transportation under chapter 537 of title 46 or section 109(h) of title 49, or under applicable State law;

(13) under subsection (a) of this section, after the date which is 90 days after the filing of such petition, of the commencement or continuation, and conclusion to the entry of final judgment, of an action which involves a debtor subject to reorganization pursuant to chapter 11 of this title and which was brought by the Secretary of Commerce under section 31325 of title 46 (including distribution of any proceeds of sale) to foreclose a preferred ship or fleet mortgage in a vessel or a mortgage, deed of trust, or other security interest in a fishing facility held by the Secretary of Commerce under chapter 537 of title 46;

(14) under subsection (a) of this section, of any action by an accrediting agency regarding the accreditation status of the debtor as an educational institution;

(15) under subsection (a) of this section, of any action by a State licensing body regarding the licensure of the debtor as an educational institution;

(16) under subsection (a) of this section, of any action by a guaranty agency, as defined in section 435(j) of the Higher Education Act of 1965 or the

Secretary of Education regarding the eligibility of the debtor to participate in programs authorized under such Act;

(17) under subsection (a) of this section, of the exercise by a swap participant or financial participant of any contractual right (as defined in section 560) under any security agreement or arrangement or other credit enhancement forming a part of or related to any swap agreement, or of any contractual right (as defined in section 560) to offset or net out any termination value, payment amount, or other transfer obligation arising under or in connection with 1 or more such agreements, including any master agreement for such agreements;

(18) under subsection (a) of the creation or perfection of a statutory lien for an ad valorem property tax, or a special tax or special assessment on real property whether or not ad valorem, imposed by a governmental unit, if such tax or assessment comes due after the date of the filing of the petition;

(19) under subsection (a), of withholding of income from a debtor's wages and collection of amounts withheld, under the debtor's agreement authorizing that withholding and collection for the benefit of a pension, profit-sharing, stock bonus, or other plan established under section 401, 403, 408, 408A, 414, 457, or 501(c) of the Internal Revenue Code of 1986, that is sponsored by the employer of the debtor, or an affiliate, successor, or predecessor of such employer—

(A) to the extent that the amounts withheld and collected are used solely for payments relating to a loan from a plan under section 408(b)(1) of the Employee Retirement Income Security Act of 1974 or is subject to section 72(p) of the Internal Revenue Code of 1986; or

(B) a loan from a thrift savings plan permitted under subchapter III of chapter 84 of title 5, that satisfies the requirements of section 8433(g) of such title;

but nothing in this paragraph may be construed to provide that any loan made under a governmental plan under section 414(d), or a contract or account under section 403(b), of the Internal Revenue Code of 1986 constitutes a claim or a debt under this title;

(20) under subsection (a), of any act to enforce any lien against or security interest in real property following entry of the order under subsection (d)(4) as to such real property in any prior case under this title, for a period of 2 years after the date of the entry of such an order, except that the debtor, in a subsequent case under this title, may move for relief from such order based

upon changed circumstances or for other good cause shown, after notice and a hearing;

(21) under subsection (a), of any act to enforce any lien against or security interest in real property—

(A) if the debtor is ineligible under section 109(g) to be a debtor in a case under this title; or

(B) if the case under this title was filed in violation of a bankruptcy court order in a prior case under this title prohibiting the debtor from being a debtor in another case under this title;

(22) subject to subsection (l), under subsection (a)(3), of the continuation of any eviction, unlawful detainer action, or similar proceeding by a lessor against a debtor involving residential property in which the debtor resides as a tenant under a lease or rental agreement and with respect to which the lessor has obtained before the date of the filing of the bankruptcy petition, a judgment for possession of such property against the debtor;

(23) subject to subsection (m), under subsection (a)(3), of an eviction action that seeks possession of the residential property in which the debtor resides as a tenant under a lease or rental agreement based on endangerment of such property or the illegal use of controlled substances on such property, but only if the lessor files with the court, and serves upon the debtor, a certification under penalty of perjury that such an eviction action has been filed, or that the debtor, during the 30-day period preceding the date of the filing of the certification, has endangered property or illegally used or allowed to be used a controlled substance on the property;

(24) under subsection (a), of any transfer that is not avoidable under section 544 and that is not avoidable under section 549;

(25) under subsection (a), of—

(A) the commencement or continuation of an investigation or action by a securities self regulatory organization to enforce such organization's regulatory power;

(B) the enforcement of an order or decision, other than for monetary sanctions, obtained in an action by such securities self regulatory organization to enforce such organization's regulatory power; or

(C) any act taken by such securities self regulatory organization to delist, delete, or refuse to permit quotation of any stock that does not meet applicable regulatory requirements;

(26) under subsection (a), of the setoff under applicable nonbankruptcy law of an income tax refund, by a governmental unit, with respect to a taxable period that ended before the date of the order for relief against an income tax liability for a taxable period that also ended before the date of the order for relief, except that in any case in which the setoff of an income tax refund is not permitted under applicable nonbankruptcy law because of a pending action to determine the amount or legality of a tax liability, the governmental unit may hold the refund pending the resolution of the action, unless the court, on the motion of the trustee and after notice and a hearing, grants the taxing authority adequate protection (within the meaning of section 361) for the secured claim of such authority in the setoff under section 506(a);

(27) under subsection (a) of this section, of the exercise by a master netting agreement participant of any contractual right (as defined in section 555, 556, 559, or 560) under any security agreement or arrangement or other credit enhancement forming a part of or related to any master netting agreement, or of any contractual right (as defined in section 555, 556, 559, or 560) to offset or net out any termination value, payment amount, or other transfer obligation arising under or in connection with 1 or more such master netting agreements to the extent that such participant is eligible to exercise such rights under paragraph (6), (7), or (17) for each individual contract covered by the master netting agreement in issue;

(28) under subsection (a), of the exclusion by the Secretary of Health and Human Services of the debtor from participation in the medicare program or any other Federal health care program (as defined in section 1128B(f) of the Social Security Act pursuant to title XI or XVIII of such Act); and

(29) under subsection (a)(1) of this section, of any action by—

(A) an amateur sports organization, as defined in section 220501(b) of title 36, to replace a national governing body, as defined in that section, under section 220528 of that title; or

(B) the corporation, as defined in section 220501(b) of title 36, to revoke the certification of a national governing body, as defined in that section, under section 220521 of that title.

The provisions of paragraphs (12) and (13) of this subsection shall apply with respect to any such petition filed on or before December 31, 1989.

(c) Except as provided in subsections (d), (e), (f), and (h) of this section—

(1) the stay of an act against property of the estate under subsection (a) of this section continues until such property is no longer property of the estate;

(2) the stay of any other act under subsection (a) of this section continues until the earliest of—

(A) the time the case is closed;

(B) the time the case is dismissed; or

(C) if the case is a case under chapter 7 of this title concerning an individual or a case under chapter 9, 11, 12, or 13 of this title, the time a discharge is granted or denied;

(3) if a single or joint case is filed by or against a debtor who is an individual in a case under chapter 7, 11, or 13, and if a single or joint case of the debtor was pending within the preceding 1-year period but was dismissed, other than a case refiled under a chapter other than chapter 7 after dismissal under section 707(b)—

(A) the stay under subsection (a) with respect to any action taken with respect to a debt or property securing such debt or with respect to any lease shall terminate with respect to the debtor on the 30th day after the filing of the later case;

(B) on the motion of a party in interest for continuation of the automatic stay and upon notice and a hearing, the court may extend the stay in particular cases as to any or all creditors (subject to such conditions or limitations as the court may then impose) after notice and a hearing completed before the expiration of the 30-day period only if the party in interest demonstrates that the filing of the later case is in good faith as to the creditors to be stayed; and

(C) for purposes of subparagraph (B), a case is presumptively filed not in good faith (but such presumption may be rebutted by clear and convincing evidence to the contrary)—

(i) as to all creditors, if—

(I) more than 1 previous case under any of chapters 7, 11, and 13 in which the individual was a debtor was pending within the preceding 1-year period;

(II) a previous case under any of chapters 7, 11, and 13 in which the individual was a debtor was dismissed within such 1-year period, after the debtor failed to—

(aa) file or amend the petition or other documents as required by this title or the court without substantial excuse (but mere inadvertence or negligence shall not be a substantial excuse unless the dismissal was caused by the negligence of the debtor's attorney);

(bb) provide adequate protection as ordered by the court; or

(cc) perform the terms of a plan confirmed by the court; or

(III) there has not been a substantial change in the financial or personal affairs of the debtor since the dismissal of the next most previous case under chapter 7, 11, or 13 or any other reason to conclude that the later case will be concluded—

(aa) if a case under chapter 7, with a discharge; or

(bb) if a case under chapter 11 or 13, with a confirmed plan that will be fully performed; and

(ii) as to any creditor that commenced an action under subsection (d) in a previous case in which the individual was a debtor if, as of the date of dismissal of such case, that action was still pending or had been resolved by terminating, conditioning, or limiting the stay as to actions of such creditor; and

(4)

(A)

(i) if a single or joint case is filed by or against a debtor who is an individual under this title, and if 2 or more single or joint cases of the debtor were pending within the previous year but were dismissed, other than a case refiled under a chapter other than chapter 7 after

dismissal under section 707(b), the stay under subsection (a) shall not go into effect upon the filing of the later case; and

(ii) on request of a party in interest, the court shall promptly enter an order confirming that no stay is in effect;

(B) if, within 30 days after the filing of the later case, a party in interest requests the court may order the stay to take effect in the case as to any or all creditors (subject to such conditions or limitations as the court may impose), after notice and a hearing, only if the party in interest demonstrates that the filing of the later case is in good faith as to the creditors to be stayed;

(C) a stay imposed under subparagraph (B) shall be effective on the date of the entry of the order allowing the stay to go into effect; and

(D) for purposes of subparagraph (B), a case is presumptively filed not in good faith (but such presumption may be rebutted by clear and convincing evidence to the contrary)—

(i) as to all creditors if—

(I) 2 or more previous cases under this title in which the individual was a debtor were pending within the 1-year period;

(II) a previous case under this title in which the individual was a debtor was dismissed within the time period stated in this paragraph after the debtor failed to file or amend the petition or other documents as required by this title or the court without substantial excuse (but mere inadvertence or negligence shall not be substantial excuse unless the dismissal was caused by the negligence of the debtor's attorney), failed to provide adequate protection as ordered by the court, or failed to perform the terms of a plan confirmed by the court; or

(III) there has not been a substantial change in the financial or personal affairs of the debtor since the dismissal of the next most previous case under this title, or any other reason to conclude that the later case will not be concluded, if a case under chapter 7, with a discharge, and if a case under chapter 11 or 13, with a confirmed plan that will be fully performed; or

(ii) as to any creditor that commenced an action under subsection (d) in a previous case in which the individual was a debtor if, as of the date

of dismissal of such case, such action was still pending or had been resolved by terminating, conditioning, or limiting the stay as to such action of such creditor.

(d) On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay—

(1) for cause, including the lack of adequate protection of an interest in property of such party in interest;

(2) with respect to a stay of an act against property under subsection (a) of this section, if—

(A) the debtor does not have an equity in such property; and

(B) such property is not necessary to an effective reorganization;

(3) with respect to a stay of an act against single asset real estate under subsection (a), by a creditor whose claim is secured by an interest in such real estate, unless, not later than the date that is 90 days after the entry of the order for relief (or such later date as the court may determine for cause by order entered within that 90-day period) or 30 days after the court determines that the debtor is subject to this paragraph, whichever is later—

(A) the debtor has filed a plan of reorganization that has a reasonable possibility of being confirmed within a reasonable time; or

(B) the debtor has commenced monthly payments that—

(i) may, in the debtor's sole discretion, notwithstanding section 363(c) (2), be made from rents or other income generated before, on, or after the date of the commencement of the case by or from the property to each creditor whose claim is secured by such real estate (other than a claim secured by a judgment lien or by an unmatured statutory lien); and

(ii) are in an amount equal to interest at the then applicable nondefault contract rate of interest on the value of the creditor's interest in the real estate; or

(4) with respect to a stay of an act against real property under subsection (a), by a creditor whose claim is secured by an interest in such real property, if the

court finds that the filing of the petition was part of a scheme to delay, hinder, or defraud creditors that involved either—

- (A)** transfer of all or part ownership of, or other interest in, such real property without the consent of the secured creditor or court approval; or
- (B)** multiple bankruptcy filings affecting such real property.

If recorded in compliance with applicable State laws governing notices of interests or liens in real property, an order entered under paragraph (4) shall be binding in any other case under this title purporting to affect such real property filed not later than 2 years after the date of the entry of such order by the court, except that a debtor in a subsequent case under this title may move for relief from such order based upon changed circumstances or for good cause shown, after notice and a hearing. Any Federal, State, or local governmental unit that accepts notices of interests or liens in real property shall accept any certified copy of an order described in this subsection for indexing and recording.

(e)

(1) Thirty days after a request under subsection (d) of this section for relief from the stay of any act against property of the estate under subsection (a) of this section, such stay is terminated with respect to the party in interest making such request, unless the court, after notice and a hearing, orders such stay continued in effect pending the conclusion of, or as a result of, a final hearing and determination under subsection (d) of this section. A hearing under this subsection may be a preliminary hearing, or may be consolidated with the final hearing under subsection (d) of this section. The court shall order such stay continued in effect pending the conclusion of the final hearing under subsection (d) of this section if there is a reasonable likelihood that the party opposing relief from such stay will prevail at the conclusion of such final hearing. If the hearing under this subsection is a preliminary hearing, then such final hearing shall be concluded not later than thirty days after the conclusion of such preliminary hearing, unless the 30-day period is extended with the consent of the parties in interest or for a specific time which the court finds is required by compelling circumstances.

(2) Notwithstanding paragraph (1), in a case under chapter 7, 11, or 13 in which the debtor is an individual, the stay under subsection (a) shall terminate on the date that is 60 days after a request is made by a party in interest under subsection (d), unless—

(A) a final decision is rendered by the court during the 60-day period beginning on the date of the request; or

(B) such 60-day period is extended—

(i) by agreement of all parties in interest; or

(ii) by the court for such specific period of time as the court finds is required for good cause, as described in findings made by the court.

(f) Upon request of a party in interest, the court, with or without a hearing, shall grant such relief from the stay provided under subsection (a) of this section as is necessary to prevent irreparable damage to the interest of an entity in property, if such interest will suffer such damage before there is an opportunity for notice and a hearing under subsection (d) or (e) of this section.

(g) In any hearing under subsection (d) or (e) of this section concerning relief from the stay of any act under subsection (a) of this section—

(1) the party requesting such relief has the burden of proof on the issue of the debtor's equity in property; and

(2) the party opposing such relief has the burden of proof on all other issues.

(h)

(1) In a case in which the debtor is an individual, the stay provided by subsection (a) is terminated with respect to personal property of the estate or of the debtor securing in whole or in part a claim, or subject to an unexpired lease, and such personal property shall no longer be property of the estate if the debtor fails within the applicable time set by section 521(a)(2)—

(A) to file timely any statement of intention required under section 521(a)(2) with respect to such personal property or to indicate in such statement that the debtor will either surrender such personal property or retain it and, if retaining such personal property, either redeem such personal property pursuant to section 722, enter into an agreement of the kind specified in section 524(c) applicable to the debt secured by such personal property, or assume such unexpired lease pursuant to section 365(p) if the trustee does not do so, as applicable; and

(B) to take timely the action specified in such statement, as it may be amended before expiration of the period for taking action, unless such

statement specifies the debtor's intention to reaffirm such debt on the original contract terms and the creditor refuses to agree to the reaffirmation on such terms.

(2) Paragraph (1) does not apply if the court determines, on the motion of the trustee filed before the expiration of the applicable time set by section 521(a)(2), after notice and a hearing, that such personal property is of consequential value or benefit to the estate, and orders appropriate adequate protection of the creditor's interest, and orders the debtor to deliver any collateral in the debtor's possession to the trustee. If the court does not so determine, the stay provided by subsection (a) shall terminate upon the conclusion of the hearing on the motion.

(i) If a case commenced under chapter 7, 11, or 13 is dismissed due to the creation of a debt repayment plan, for purposes of subsection (c)(3), any subsequent case commenced by the debtor under any such chapter shall not be presumed to be filed not in good faith.

(j) On request of a party in interest, the court shall issue an order under subsection (c) confirming that the automatic stay has been terminated.

(k)

(1) Except as provided in paragraph (2), an individual injured by any willful violation of a stay provided by this section shall recover actual damages, including costs and attorneys' fees, and, in appropriate circumstances, may recover punitive damages.

(2) If such violation is based on an action taken by an entity in the good faith belief that subsection (h) applies to the debtor, the recovery under paragraph (1) of this subsection against such entity shall be limited to actual damages.

(l)

(1) Except as otherwise provided in this subsection, subsection (b)(22) shall apply on the date that is 30 days after the date on which the bankruptcy petition is filed, if the debtor files with the petition and serves upon the lessor a certification under penalty of perjury that—

(A) under nonbankruptcy law applicable in the jurisdiction, there are circumstances under which the debtor would be permitted to cure the

entire monetary default that gave rise to the judgment for possession, after that judgment for possession was entered; and

(B) the debtor (or an adult dependent of the debtor) has deposited with the clerk of the court, any rent that would become due during the 30-day period after the filing of the bankruptcy petition.

(2) If, within the 30-day period after the filing of the bankruptcy petition, the debtor (or an adult dependent of the debtor) complies with paragraph (1) and files with the court and serves upon the lessor a further certification under penalty of perjury that the debtor (or an adult dependent of the debtor) has cured, under nonbankruptcy law applicable in the jurisdiction, the entire monetary default that gave rise to the judgment under which possession is sought by the lessor, subsection (b)(22) shall not apply, unless ordered to apply by the court under paragraph (3).

(3)

(A) If the lessor files an objection to any certification filed by the debtor under paragraph (1) or (2), and serves such objection upon the debtor, the court shall hold a hearing within 10 days after the filing and service of such objection to determine if the certification filed by the debtor under paragraph (1) or (2) is true.

(B) If the court upholds the objection of the lessor filed under subparagraph (A)—

(i) subsection (b)(22) shall apply immediately and relief from the stay provided under subsection (a)(3) shall not be required to enable the lessor to complete the process to recover full possession of the property; and

(ii) the clerk of the court shall immediately serve upon the lessor and the debtor a certified copy of the court's order upholding the lessor's objection.

(4) If a debtor, in accordance with paragraph (5), indicates on the petition that there was a judgment for possession of the residential rental property in which the debtor resides and does not file a certification under paragraph (1) or (2)—

(A) subsection (b)(22) shall apply immediately upon failure to file such certification, and relief from the stay provided under subsection (a)(3) shall

not be required to enable the lessor to complete the process to recover full possession of the property; and

(B) the clerk of the court shall immediately serve upon the lessor and the debtor a certified copy of the docket indicating the absence of a filed certification and the applicability of the exception to the stay under subsection (b)(22).

(5)

(A) Where a judgment for possession of residential property in which the debtor resides as a tenant under a lease or rental agreement has been obtained by the lessor, the debtor shall so indicate on the bankruptcy petition and shall provide the name and address of the lessor that obtained that pre-petition judgment on the petition and on any certification filed under this subsection.

(B) The form of certification filed with the petition, as specified in this subsection, shall provide for the debtor to certify, and the debtor shall certify—

(i) whether a judgment for possession of residential rental housing in which the debtor resides has been obtained against the debtor before the date of the filing of the petition; and

(ii) whether the debtor is claiming under paragraph (1) that under nonbankruptcy law applicable in the jurisdiction, there are circumstances under which the debtor would be permitted to cure the entire monetary default that gave rise to the judgment for possession, after that judgment of possession was entered, and has made the appropriate deposit with the court.

(C) The standard forms (electronic and otherwise) used in a bankruptcy proceeding shall be amended to reflect the requirements of this subsection.

(D) The clerk of the court shall arrange for the prompt transmittal of the rent deposited in accordance with paragraph (1)(B) to the lessor.

(m)

(1) Except as otherwise provided in this subsection, subsection (b)(23) shall apply on the date that is 15 days after the date on which the lessor files and

serves a certification described in subsection (b)(23).

(2)

(A) If the debtor files with the court an objection to the truth or legal sufficiency of the certification described in subsection (b)(23) and serves such objection upon the lessor, subsection (b)(23) shall not apply, unless ordered to apply by the court under this subsection.

(B) If the debtor files and serves the objection under subparagraph (A), the court shall hold a hearing within 10 days after the filing and service of such objection to determine if the situation giving rise to the lessor's certification under paragraph (1) existed or has been remedied.

(C) If the debtor can demonstrate to the satisfaction of the court that the situation giving rise to the lessor's certification under paragraph (1) did not exist or has been remedied, the stay provided under subsection (a)(3) shall remain in effect until the termination of the stay under this section.

(D) If the debtor cannot demonstrate to the satisfaction of the court that the situation giving rise to the lessor's certification under paragraph (1) did not exist or has been remedied—

(i) relief from the stay provided under subsection (a)(3) shall not be required to enable the lessor to proceed with the eviction; and

(ii) the clerk of the court shall immediately serve upon the lessor and the debtor a certified copy of the court's order upholding the lessor's certification.

(3) If the debtor fails to file, within 15 days, an objection under paragraph (2) (A)—

(A) subsection (b)(23) shall apply immediately upon such failure and relief from the stay provided under subsection (a)(3) shall not be required to enable the lessor to complete the process to recover full possession of the property; and

(B) the clerk of the court shall immediately serve upon the lessor and the debtor a certified copy of the docket indicating such failure.

(n)

(1) Except as provided in paragraph (2), subsection (a) does not apply in a case in which the debtor—

(A) is a debtor in a small business case pending at the time the petition is filed;

(B) was a debtor in a small business case that was dismissed for any reason by an order that became final in the 2-year period ending on the date of the order for relief entered with respect to the petition;

(C) was a debtor in a small business case in which a plan was confirmed in the 2-year period ending on the date of the order for relief entered with respect to the petition; or

(D) is an entity that has acquired substantially all of the assets or business of a small business debtor described in subparagraph (A), (B), or (C), unless such entity establishes by a preponderance of the evidence that such entity acquired substantially all of the assets or business of such small business debtor in good faith and not for the purpose of evading this paragraph.

(2) Paragraph (1) does not apply—

(A) to an involuntary case involving no collusion by the debtor with creditors; or

(B) to the filing of a petition if—

(i) the debtor proves by a preponderance of the evidence that the filing of the petition resulted from circumstances beyond the control of the debtor not foreseeable at the time the case then pending was filed; and

(ii) it is more likely than not that the court will confirm a feasible plan, but not a liquidating plan, within a reasonable period of time.

(o) The exercise of rights not subject to the stay arising under subsection (a) pursuant to paragraph (6), (7), (17), or (27) of subsection (b) shall not be stayed by any order of a court or administrative agency in any proceeding under this title.

(Pub. L. 95-598, Nov. 6, 1978, 92 Stat. 2570; Pub. L. 97-222, § 3, July 27, 1982, 96 Stat. 235; Pub. L. 98-353, title III, §§ 304, 363(b), 392, 441, July 10, 1984, 98 Stat. 352, 363, 365, 371; Pub. L. 99-509, title V, § 5001(a), Oct. 21, 1986, 100 Stat. 1911; Pub. L. 99-554,

[title II, §§ 257\(j\), 283\(d\), Oct. 27, 1986, 100 Stat. 3115, 3116; Pub. L. 101-311, title I, § 102, title II, § 202, June 25, 1990, 104 Stat. 267, 269; Pub. L. 101-508, title III, § 3007\(a\)\(1\), Nov. 5, 1990, 104 Stat. 1388-28; Pub. L. 103-394, title I, §§ 101, 116, title II, §§ 204\(a\), 218\(b\), title III, § 304\(b\), title IV, § 401, title V, § 501\(b\)\(2\), \(d\)\(7\), Oct. 22, 1994, 108 Stat. 4107, 4119, 4122, 4128, 4132, 4141, 4142, 4144; Pub. L. 105-277, div. I, title VI, § 603, Oct. 21, 1998, 112 Stat. 2681-886; Pub. L. 109-8, title I, § 106\(f\), title II, §§ 214, 224\(b\), title III, §§ 302, 303, 305\(1\), 311, 320, title IV, §§ 401\(b\), 441, 444, title VII, §§ 709, 718, title IX, § 907\(d\), \(o\)\(1\), \(2\), title XI, § 1106, title XII, § 1225, Apr. 20, 2005, 119 Stat. 41, 54, 64, 75, 77, 79, 84, 94, 104, 114, 117, 127, 131, 176, 181, 182, 192, 199; Pub. L. 109-304, § 17\(b\)\(1\), Oct. 6, 2006, 120 Stat. 1706; Pub. L. 109-390, § 5\(a\)\(2\), Dec. 12, 2006, 120 Stat. 2696; Pub. L. 111-327, § 2\(a\)\(12\), Dec. 22, 2010, 124 Stat. 3558; Pub. L. 116-189, § 9, Oct. 30, 2020, 134 Stat. 970; Pub. L. 119-27, § 11\(c\), July 18, 2025, 139 Stat. 457.\)](#)



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LII > U.S. Code > Title 11 > CHAPTER 5 > SUBCHAPTER III > **§ 541**

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Title

Section

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11 U.S. Code § 541 - Property of the estate

U.S. Code Notes

(a) The commencement of a case under section [301](#), [302](#), or [303](#) of this title creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:

(1) Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case.

(2) All interests of the debtor and the debtor's spouse in community property as of the commencement of the case that is—

(A) under the sole, equal, or joint management and control of the debtor;
or

(B) liable for an allowable claim against the debtor, or for both an allowable claim against the debtor and an allowable claim against the debtor's spouse, to the extent that such interest is so liable.

(3) Any interest in property that the trustee recovers under section 329(b), 363(n), 543, 550, 553, or 723 of this title.

(4) Any interest in property preserved for the benefit of or ordered transferred to the estate under section 510(c) or 551 of this title.

(5) Any interest in property that would have been property of the estate if such interest had been an interest of the debtor on the date of the filing of the petition, and that the debtor acquires or becomes entitled to acquire within 180 days after such date—

(A) by bequest, devise, or inheritance;

(B) as a result of a property settlement agreement with the debtor's spouse, or of an interlocutory or final divorce decree; or

(C) as a beneficiary of a life insurance policy or of a death benefit plan.

(6) Proceeds, product, offspring, rents, or profits of or from property of the estate, except such as are earnings from services performed by an individual debtor after the commencement of the case.

(7) Any interest in property that the estate acquires after the commencement of the case.

(b) Property of the estate does not include—

(1) any power that the debtor may exercise solely for the benefit of an entity other than the debtor;

(2) any interest of the debtor as a lessee under a lease of nonresidential real property that has terminated at the expiration of the stated term of such lease before the commencement of the case under this title, and ceases to include any interest of the debtor as a lessee under a lease of nonresidential real property that has terminated at the expiration of the stated term of such lease during the case;

(3) any eligibility of the debtor to participate in programs authorized under the Higher Education Act of 1965 (20 U.S.C. 1001 et seq.; 42 U.S.C. 2751 et seq.),^[1] or any accreditation status or State licensure of the debtor as an educational institution;

(4) any interest of the debtor in liquid or gaseous hydrocarbons to the extent that—

(A)

(i) the debtor has transferred or has agreed to transfer such interest pursuant to a farmout agreement or any written agreement directly related to a farmout agreement; and

(ii) but for the operation of this paragraph, the estate could include the interest referred to in clause (i) only by virtue of section 365 or 544(a)(3) of this title; or

(B)

(i) the debtor has transferred such interest pursuant to a written conveyance of a production payment to an entity that does not participate in the operation of the property from which such production payment is transferred; and

(ii) but for the operation of this paragraph, the estate could include the interest referred to in clause (i) only by virtue of section 365 or 542 of this title;

(5) funds placed in an education individual retirement account (as defined in section 530(b)(1) of the Internal Revenue Code of 1986) not later than 365 days before the date of the filing of the petition in a case under this title, but—

(A) only if the designated beneficiary of such account was a child, stepchild, grandchild, or stepgrandchild of the debtor for the taxable year for which funds were placed in such account;

(B) only to the extent that such funds—

(i) are not pledged or promised to any entity in connection with any extension of credit; and

(ii) are not excess contributions (as described in section 4973(e) of the Internal Revenue Code of 1986); and

(C) in the case of funds placed in all such accounts having the same designated beneficiary not earlier than 720 days nor later than 365 days before such date, only so much of such funds as does not exceed \$5,000; ^[2]

(6) funds used to purchase a tuition credit or certificate or contributed to an account in accordance with section 529(b)(1)(A) of the Internal Revenue Code of 1986 under a qualified State tuition program (as defined in section 529(b)(1) of such Code) not later than 365 days before the date of the filing of the petition in a case under this title, but—

(A) only if the designated beneficiary of the amounts paid or contributed to such tuition program was a child, stepchild, grandchild, or stepgrandchild of the debtor for the taxable year for which funds were paid or contributed;

(B) with respect to the aggregate amount paid or contributed to such program having the same designated beneficiary, only so much of such amount as does not exceed the total contributions permitted under section 529(b)(6) of such Code with respect to such beneficiary, as adjusted beginning on the date of the filing of the petition in a case under this title by the annual increase or decrease (rounded to the nearest tenth of 1 percent) in the education expenditure category of the Consumer Price Index prepared by the Department of Labor; and

(C) in the case of funds paid or contributed to such program having the same designated beneficiary not earlier than 720 days nor later than 365 days before such date, only so much of such funds as does not exceed \$5,000;²

(7) any amount—

(A) withheld by an employer from the wages of employees for payment as contributions—

(i) to—

(I) an employee benefit plan that is subject to title I of the Employee Retirement Income Security Act of 1974 or under an employee benefit plan which is a governmental plan under section 414(d) of the Internal Revenue Code of 1986;

(II) a deferred compensation plan under section 457 of the Internal Revenue Code of 1986; or

(III) a tax-deferred annuity under section 403(b) of the Internal Revenue Code of 1986;

except that such amount under this subparagraph shall not constitute disposable income as defined in section 1325(b)(2); or

(ii) to a health insurance plan regulated by State law whether or not subject to such title; or

(B) received by an employer from employees for payment as contributions—

(i) to—

(I) an employee benefit plan that is subject to title I of the Employee Retirement Income Security Act of 1974 or under an employee benefit plan which is a governmental plan under section 414(d) of the Internal Revenue Code of 1986;

(II) a deferred compensation plan under section 457 of the Internal Revenue Code of 1986; or

(III) a tax-deferred annuity under section 403(b) of the Internal Revenue Code of 1986;

except that such amount under this subparagraph shall not constitute disposable income, as defined in section 1325(b)(2); or

(ii) to a health insurance plan regulated by State law whether or not subject to such title;

(8) subject to subchapter III of chapter 5, any interest of the debtor in property where the debtor pledged or sold tangible personal property (other than securities or written or printed evidences of indebtedness or title) as collateral for a loan or advance of money given by a person licensed under law to make such loans or advances, where—

(A) the tangible personal property is in the possession of the pledgee or transferee;

(B) the debtor has no obligation to repay the money, redeem the collateral, or buy back the property at a stipulated price; and

(C) neither the debtor nor the trustee have exercised any right to redeem provided under the contract or State law, in a timely manner as provided under State law and section 108(b);

(9) any interest in cash or cash equivalents that constitute proceeds of a sale by the debtor of a money order that is made—

(A) on or after the date that is 14 days prior to the date on which the petition is filed; and

(B) under an agreement with a money order issuer that prohibits the commingling of such proceeds with property of the debtor (notwithstanding that, contrary to the agreement, the proceeds may have been commingled with property of the debtor),

unless the money order issuer had not taken action, prior to the filing of the petition, to require compliance with the prohibition; or

(10) funds placed in an account of a qualified ABLE program (as defined in section 529A(b) of the Internal Revenue Code of 1986) not later than 365 days before the date of the filing of the petition in a case under this title, but—

(A) only if the designated beneficiary of such account was a child, stepchild, grandchild, or stepgrandchild of the debtor for the taxable year for which funds were placed in such account;

(B) only to the extent that such funds—

(i) are not pledged or promised to any entity in connection with any extension of credit; and

(ii) are not excess contributions (as described in section 4973(h) of the Internal Revenue Code of 1986); and

(C) in the case of funds placed in all such accounts having the same designated beneficiary not earlier than 720 days nor later than 365 days before such date, only so much of such funds as does not exceed \$6,225.²

Paragraph (4) shall not be construed to exclude from the estate any consideration the debtor retains, receives, or is entitled to receive for transferring an interest in liquid or gaseous hydrocarbons pursuant to a farmout agreement.

(c)

(1) Except as provided in paragraph (2) of this subsection, an interest of the debtor in property becomes property of the estate under subsection (a)(1), (a)(2), or (a)(5) of this section notwithstanding any provision in an agreement, transfer instrument, or applicable nonbankruptcy law—

(A) that restricts or conditions transfer of such interest by the debtor; or

(B) that is conditioned on the insolvency or financial condition of the debtor, on the commencement of a case under this title, or on the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement, and that effects or gives an option to effect a forfeiture, modification, or termination of the debtor's interest in property.

(2) A restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title.

(d) Property in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest, such as a mortgage secured by real property, or an interest in such a mortgage, sold by the debtor but as to which the debtor retains legal title to service or supervise the servicing of such mortgage or interest, becomes property of the estate under subsection (a)(1) or (2) of this section only to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold.

(e) In determining whether any of the relationships specified in paragraph (5)(A) or (6)(A) of subsection (b) exists, a legally adopted child of an individual (and a child who is a member of an individual's household, if placed with such individual by an authorized placement agency for legal adoption by such individual), or a foster child of an individual (if such child has as the child's principal place of abode the home of the debtor and is a member of the debtor's household) shall be treated as a child of such individual by blood.

(f) Notwithstanding any other provision of this title, property that is held by a debtor that is a corporation described in section 501(c)(3) of the Internal Revenue Code of 1986 and exempt from tax under section 501(a) of such Code may be transferred to an entity that is not such a corporation, but only under the same conditions as would apply if the debtor had not filed a case under this title.

(Pub. L. 95-598, Nov. 6, 1978, 92 Stat. 2594; Pub. L. 98-353, title III, §§363(a), 456, July 10, 1984, 98 Stat. 363, 376; Pub. L. 101-508, title III, §3007(a)(2), Nov. 5, 1990, 104 Stat.

[1388–28](#); [Pub. L. 102–486, title XXX, § 3017\(b\)](#), Oct. 24, 1992, [106 Stat. 3130](#); [Pub. L. 103–394, title II, §§ 208\(b\), 223](#), Oct. 22, 1994, [108 Stat. 4124, 4129](#); [Pub. L. 109–8, title II, § 225\(a\)](#), title III, § 323, title XII, §§ 1212, 1221(c), 1230, Apr. 20, 2005, [119 Stat. 65, 97, 194, 196, 201](#); [Pub. L. 111–327, § 2\(a\)\(22\)](#), Dec. 22, 2010, [124 Stat. 3560](#); [Pub. L. 113–295, div. B, title I, § 104\(a\)](#), Dec. 19, 2014, [128 Stat. 4063](#); [Pub. L. 116–260, div. FF, title X, § 1001\(a\)](#), Dec. 27, 2020, [134 Stat. 3216](#); [Pub. L. 119–27, § 11\(e\)](#), July 18, 2025, [139 Stat. 458](#).)



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United States Code Annotated

Title 28. Judiciary and Judicial Procedure (Refs & Annos)

Part IV. Jurisdiction and Venue (Refs & Annos)

Chapter 85. District Courts; Jurisdiction (Refs & Annos)

28 U.S.C.A. § 1367

§ 1367. Supplemental jurisdiction

Currentness

(a) Except as provided in subsections (b) and (c) or as expressly provided otherwise by Federal statute, in any civil action of which the district courts have original jurisdiction, the district courts shall have supplemental jurisdiction over all other claims that are so related to claims in the action within such original jurisdiction that they form part of the same case or controversy under [Article III of the United States Constitution](#). Such supplemental jurisdiction shall include claims that involve the joinder or intervention of additional parties.

(b) In any civil action of which the district courts have original jurisdiction founded solely on [section 1332](#) of this title, the district courts shall not have supplemental jurisdiction under subsection (a) over claims by plaintiffs against persons made parties under [Rule 14](#), [19](#), [20](#), or [24 of the Federal Rules of Civil Procedure](#), or over claims by persons proposed to be joined as plaintiffs under Rule 19 of such rules, or seeking to intervene as plaintiffs under Rule 24 of such rules, when exercising supplemental jurisdiction over such claims would be inconsistent with the jurisdictional requirements of [section 1332](#).

(c) The district courts may decline to exercise supplemental jurisdiction over a claim under subsection (a) if--

- (1) the claim raises a novel or complex issue of State law,
- (2) the claim substantially predominates over the claim or claims over which the district court has original jurisdiction,
- (3) the district court has dismissed all claims over which it has original jurisdiction, or
- (4) in exceptional circumstances, there are other compelling reasons for declining jurisdiction.

(d) The period of limitations for any claim asserted under subsection (a), and for any other claim in the same action that is voluntarily dismissed at the same time as or after the dismissal of the claim under subsection (a), shall be tolled while the claim is pending and for a period of 30 days after it is dismissed unless State law provides for a longer tolling period.

(e) As used in this section, the term “State” includes the District of Columbia, the Commonwealth of Puerto Rico, and any territory or possession of the United States.

CREDIT(S)

(Added [Pub.L. 101-650, Title III, § 310\(a\)](#), Dec. 1, 1990, 104 Stat. 5113.)

[Notes of Decisions \(1895\)](#)

O’CONNOR’S CROSS REFERENCES

O’Connor’s Federal Rules Civil Trials:

See *O’Connor’s Federal Rules*, “Supplemental jurisdiction,” ch. 2-F, §6.

28 U.S.C.A. § 1367, 28 USCA § 1367

Current through P.L. 119-99. Some statute sections may be more current, see credits for details.

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United States Code Annotated

Title 28. Judiciary and Judicial Procedure (Refs & Annos)

Part IV. Jurisdiction and Venue (Refs & Annos)

Chapter 89. District Courts; Removal of Cases from State Courts (Refs & Annos)

28 U.S.C.A. § 1452

§ 1452. Removal of claims related to bankruptcy cases

Currentness

(a) A party may remove any claim or cause of action in a civil action other than a proceeding before the United States Tax Court or a civil action by a governmental unit to enforce such governmental unit's police or regulatory power, to the district court for the district where such civil action is pending, if such district court has jurisdiction of such claim or cause of action under [section 1334](#) of this title.

(b) The court to which such claim or cause of action is removed may remand such claim or cause of action on any equitable ground. An order entered under this subsection remanding a claim or cause of action, or a decision to not remand, is not reviewable by appeal or otherwise by the court of appeals under [section 158\(d\)](#), [1291](#), or [1292](#) of this title or by the Supreme Court of the United States under [section 1254](#) of this title.

CREDIT(S)

(Added [Pub.L. 98-353, Title I, § 103\(a\)](#), July 10, 1984, 98 Stat. 335; amended [Pub.L. 101-650, Title III, § 309\(c\)](#), Dec. 1, 1990, 104 Stat. 5113.)

Notes of Decisions (272)

O'CONNOR'S CROSS REFERENCES

O'Connor's Federal Rules Civil Trials:

See *O'Connor's Federal Rules*, "Removal & Remand," ch. 4-A, §1 et seq.

28 U.S.C.A. § 1452, 28 USCA § 1452

Current through P.L. 119-99. Some statute sections may be more current, see credits for details.

United States Code Annotated

Title 28. Judiciary and Judicial Procedure (Refs & Annos)

Part IV. Jurisdiction and Venue (Refs & Annos)

Chapter 85. District Courts; Jurisdiction (Refs & Annos)

28 U.S.C.A. § 1334

§ 1334. Bankruptcy cases and proceedings

Effective: October 17, 2005

[Currentness](#)

(a) Except as provided in subsection (b) of this section, the district courts shall have original and exclusive jurisdiction of all cases under title 11.

(b) Except as provided in subsection (e)(2), and notwithstanding any Act of Congress that confers exclusive jurisdiction on a court or courts other than the district courts, the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11.

(c)(1) Except with respect to a case under chapter 15 of title 11, nothing in this section prevents a district court in the interest of justice, or in the interest of comity with State courts or respect for State law, from abstaining from hearing a particular proceeding arising under title 11 or arising in or related to a case under title 11.

(2) Upon timely motion of a party in a proceeding based upon a State law claim or State law cause of action, related to a case under title 11 but not arising under title 11 or arising in a case under title 11, with respect to which an action could not have been commenced in a court of the United States absent jurisdiction under this section, the district court shall abstain from hearing such proceeding if an action is commenced, and can be timely adjudicated, in a State forum of appropriate jurisdiction.

(d) Any decision to abstain or not to abstain made under subsection (c) (other than a decision not to abstain in a proceeding described in subsection (c)(2)) is not reviewable by appeal or otherwise by the court of appeals under [section 158\(d\)](#), [1291](#), or [1292](#) of this title or by the Supreme Court of the United States under [section 1254](#) of this title. Subsection (c) and this subsection shall not be construed to limit the applicability of the stay provided for by [section 362 of title 11, United States Code](#), as such section applies to an action affecting the property of the estate in bankruptcy.

(e) The district court in which a case under title 11 is commenced or is pending shall have exclusive jurisdiction--

(1) of all the property, wherever located, of the debtor as of the commencement of such case, and of property of the estate; and

(2) over all claims or causes of action that involve construction of [section 327 of title 11, United States Code](#), or rules relating to disclosure requirements under [section 327](#).

CREDIT(S)

(June 25, 1948, c. 646, 62 Stat. 931; [Pub.L. 95-598, Title II, § 238\(a\)](#), Nov. 6, 1978, 92 Stat. 2667; [Pub.L. 98-353, Title I, § 101\(a\)](#), July 10, 1984, 98 Stat. 333; [Pub.L. 99-554, Title I, § 144\(e\)](#), Oct. 27, 1986, 100 Stat. 3096; [Pub.L. 101-650, Title III, § 309\(b\)](#), Dec. 1, 1990, 104 Stat. 5113; [Pub.L. 103-394, Title I, § 104\(b\)](#), Oct. 22, 1994, 108 Stat. 4109; [Pub.L. 109-8, Title III, § 324\(a\)](#), [Title VIII, § 802\(c\)\(2\)](#), [Title XII, § 1219](#), Apr. 20, 2005, 119 Stat. 98, 145, 195.)

[Notes of Decisions \(1683\)](#)

28 U.S.C.A. § 1334, 28 USCA § 1334

Current through P.L. 119-99. Some statute sections may be more current, see credits for details.

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United States Code Annotated

Title 28. Judiciary and Judicial Procedure (Refs & Annos)

Part I. Organization of Courts (Refs & Annos)

Chapter 6. Bankruptcy Judges (Refs & Annos)

28 U.S.C.A. § 157

§ 157. Procedures

Currentness

(a) Each district court may provide that any or all cases under title 11 and any or all proceedings arising under title 11 or arising in or related to a case under title 11 shall be referred to the bankruptcy judges for the district.

(b)(1) Bankruptcy judges may hear and determine all cases under title 11 and all core proceedings arising under title 11, or arising in a case under title 11, referred under subsection (a) of this section, and may enter appropriate orders and judgments, subject to review under [section 158](#) of this title.

(2) Core proceedings include, but are not limited to--

(A) matters concerning the administration of the estate;

(B) allowance or disallowance of claims against the estate or exemptions from property of the estate, and estimation of claims or interests for the purposes of confirming a plan under chapter 11, 12, or 13 of title 11 but not the liquidation or estimation of contingent or unliquidated personal injury tort or wrongful death claims against the estate for purposes of distribution in a case under title 11;

(C) counterclaims by the estate against persons filing claims against the estate;

(D) orders in respect to obtaining credit;

(E) orders to turn over property of the estate;

(F) proceedings to determine, avoid, or recover preferences;

(G) motions to terminate, annul, or modify the automatic stay;

(H) proceedings to determine, avoid, or recover fraudulent conveyances;

- (I) determinations as to the dischargeability of particular debts;
 - (J) objections to discharges;
 - (K) determinations of the validity, extent, or priority of liens;
 - (L) confirmations of plans;
 - (M) orders approving the use or lease of property, including the use of cash collateral;
 - (N) orders approving the sale of property other than property resulting from claims brought by the estate against persons who have not filed claims against the estate;
 - (O) other proceedings affecting the liquidation of the assets of the estate or the adjustment of the debtor-creditor or the equity security holder relationship, except personal injury tort or wrongful death claims; and
 - (P) recognition of foreign proceedings and other matters under chapter 15 of title 11.
- (3) The bankruptcy judge shall determine, on the judge's own motion or on timely motion of a party, whether a proceeding is a core proceeding under this subsection or is a proceeding that is otherwise related to a case under title 11. A determination that a proceeding is not a core proceeding shall not be made solely on the basis that its resolution may be affected by State law.
- (4) Non-core proceedings under section 157(b)(2)(B) of title 28, United States Code, shall not be subject to the mandatory abstention provisions of [section 1334\(c\)\(2\)](#).
- (5) The district court shall order that personal injury tort and wrongful death claims shall be tried in the district court in which the bankruptcy case is pending, or in the district court in the district in which the claim arose, as determined by the district court in which the bankruptcy case is pending.
- (c)(1) A bankruptcy judge may hear a proceeding that is not a core proceeding but that is otherwise related to a case under title 11. In such proceeding, the bankruptcy judge shall submit proposed findings of fact and conclusions of law to the district court, and any final order or judgment shall be entered by the district judge after considering the bankruptcy judge's proposed findings and conclusions and after reviewing de novo those matters to which any party has timely and specifically objected.
- (2) Notwithstanding the provisions of paragraph (1) of this subsection, the district court, with the consent of all the parties to the proceeding, may refer a proceeding related to a case under title 11 to a bankruptcy judge to hear and determine and to enter appropriate orders and judgments, subject to review under [section 158](#) of this title.
- (d) The district court may withdraw, in whole or in part, any case or proceeding referred under this section, on its own motion or on timely motion of any party, for cause shown. The district court shall, on timely motion of a party, so withdraw a proceeding

if the court determines that resolution of the proceeding requires consideration of both title 11 and other laws of the United States regulating organizations or activities affecting interstate commerce.

(e) If the right to a jury trial applies in a proceeding that may be heard under this section by a bankruptcy judge, the bankruptcy judge may conduct the jury trial if specially designated to exercise such jurisdiction by the district court and with the express consent of all the parties.

CREDIT(S)

(Added [Pub.L. 98-353, Title I, § 104\(a\)](#), July 10, 1984, 98 Stat. 340; amended [Pub.L. 99-554, Title I, §§ 143, 144\(b\)](#), Oct. 27, 1986, 100 Stat. 3096; [Pub.L. 103-394, Title I, § 112](#), Oct. 22, 1994, 108 Stat. 4117; [Pub.L. 109-8, Title VIII, § 802\(c\)\(1\)](#), Apr. 20, 2005, 119 Stat. 145.)

VALIDITY

<The United States Supreme Court has held that certain provisions of this section, as added by section 104(a) of [Pub.L. 98-353](#) (28 U.S.C.A. § 157(b)(2)(C)), are unconstitutional as applied to certain core, noncore and related proceedings. [Stern v. Marshall](#), U.S. 2011, 564 U.S. 462, 131 S.Ct. 2594, 180 L.Ed.2d 475.>

[Notes of Decisions \(2188\)](#)

28 U.S.C.A. § 157, 28 USCA § 157

Current through P.L. 119-99. Some statute sections may be more current, see credits for details.

115 S.Ct. 1493

Supreme Court of the United States

CELOTEX CORPORATION, Petitioner,

v.

Bennie EDWARDS et ux.

No. 93–1504.

|

Argued Dec. 6, 1994.

|

Decided April 19, 1995.

Synopsis

In Chapter 11 case, after bankruptcy court issued order staying all proceedings against debtor including proceedings where matter was on appeal and supersedeas bond had been posted by debtor, judgment creditors in asbestos litigation moved in district court to enforce supersedeas bond against surety after debtor lost appeal for which bond was posted. The United States District Court for the Northern District of Texas, [David O. Belew, Jr., J.](#), granted execution against surety on bond. Debtor appealed. The Court of Appeals for the Fifth Circuit, [6 F.3d 312](#), affirmed. Debtor petitioned for writ of certiorari. The Supreme Court granted certiorari in part, [114 S.Ct. 2099](#), and dismissed certiorari in part, [114 S.Ct. 2120](#), and, in an opinion delivered by Chief Justice [Rehnquist](#), held that: (1) whether judgment creditors were entitled to immediate execution on bond against debtor's surety was at least question "related to" debtor's bankruptcy case and was within bankruptcy court's jurisdiction, and (2) judgment creditors were required to obey bankruptcy court injunction until it was modified or reversed, even if they had proper grounds to object to injunction, and they could not collaterally attack injunction on motion to execute.

Reversed.

Justice [Stevens](#) dissented and filed opinion in which Justice [Ginsburg](#) joined.

Procedural Posture(s): On Appeal.****1495** *Syllabus**

***300** The United States District Court for the Northern District of Texas entered a judgment in favor of respondents

and against petitioner Celotex Corp. To stay execution of the judgment pending appeal, petitioner posted a supersedeas bond, with an insurance company (Northbrook) serving as surety. After the Fifth Circuit affirmed the judgment, Celotex filed for Chapter 11 bankruptcy in the Bankruptcy Court for the Middle District of Florida. Exercising its equitable powers under [11 U.S.C. § 105\(a\)](#), the Bankruptcy Court issued an injunction, which, in pertinent part, prohibited judgment creditors from proceeding against sureties without the Bankruptcy Court's permission. Respondents thereafter filed a motion pursuant to [Federal Rule of Civil Procedure 65.1](#) in the Northern District of Texas seeking permission to execute against Northbrook on the bond. The District Court granted the motion. The Fifth Circuit affirmed and later denied Celotex's petition for rehearing, rejecting the argument that its decision allowed a collateral attack on the Bankruptcy Court order.

Held: Respondents must obey the Bankruptcy Court's injunction. The well-established rule that "persons subject to an injunctive order issued by a court with jurisdiction are expected to obey that decree until it is modified or reversed, even if they have proper grounds to object to the order," [GTE Sylvania, Inc. v. Consumers Union of United States, Inc.](#), [445 U.S. 375, 386, 100 S.Ct. 1194, 1201, 63 L.Ed.2d 467](#), applies to bankruptcy cases, [Oriol v. Russell](#), [278 U.S. 358, 49 S.Ct. 173, 73 L.Ed. 419](#). A bankruptcy court has jurisdiction over proceedings "arising under," "arising in," or "related to" a Chapter 11 case. [28 U.S.C. §§ 1334\(b\) and 157\(a\)](#). The "related to" language must be read to grant jurisdiction over more than simply proceedings involving the debtor's property or the estate. Respondents' immediate execution on the bond is at least a question "related to" Celotex's bankruptcy. While the proceeding against Northbrook does not directly involve Celotex, the Bankruptcy Court found that allowing respondents and other bonded judgment creditors to execute immediately on the bonds would have a direct and substantial adverse effect on Celotex's ability to undergo a successful Chapter 11 reorganization. The fact that [Federal Rule of Civil Procedure 65.1](#) provides an expedited procedure for executing on supersedeas bonds does not mean that such a procedure cannot be stayed by a lawfully ***301** entered injunction. [Board of Governors, FRS v. MCorp Financial, Inc.](#), [502 U.S. 32, 112 S.Ct. 459, 116 L.Ed.2d 358](#), distinguished. The issue whether the Bankruptcy Court properly issued the injunction need not be addressed here. Since it is for the court of first instance to determine the question of the validity of the law, and since its orders are to be respected until its decision is reversed, respondents should have challenged the injunction

in the Bankruptcy Court rather than collaterally attacking the injunction in the Texas federal courts. Pp. 1498–1501.

6 F.3d 312, reversed.

REHNQUIST, C.J., delivered the opinion of the Court, in which O'CONNOR, SCALIA, KENNEDY, SOUTER, THOMAS, and BREYER, JJ., joined. STEVENS, J., filed a dissenting opinion, in which GINSBURG, J., joined, *post*, p. 1501.

Attorneys and Law Firms

Jeffrey W. Warren, Tampa, FL, for petitioner.

Brent M. Rosenthal, Dallas, TX, for respondents.

Opinion

Chief Justice REHNQUIST delivered the opinion of the Court.

The United States Court of Appeals for the Fifth Circuit held that respondents should be allowed to execute against petitioner's surety on a supersedeas bond posted by petitioner where the judgment which occasioned the bond had become final. It so held even though the United States Bankruptcy Court for the Middle District of Florida previously had issued an injunction prohibiting respondents *302 from executing on the bond without the Bankruptcy Court's permission. We hold that respondents were obligated to obey the injunction issued by the Bankruptcy Court.

I

In 1987 respondents Bennie and Joann Edwards filed suit in the United States District Court for the Northern District of Texas against petitioner Celotex Corporation (and others) alleging asbestos-related injuries. In April 1989 the District Court entered a \$281,025.80 judgment in favor of respondents and against Celotex. To stay execution of the judgment pending appeal, Celotex posted a supersedeas bond in the amount of \$294,987.88, with Northbrook Property and Casualty Insurance Company serving as surety on the bond. As collateral for the bond, Celotex allowed Northbrook to retain money owed to Celotex under a settlement agreement resolving insurance coverage disputes between Northbrook and Celotex.

The United States Court of Appeals for the Fifth Circuit affirmed, issuing its mandate on October 12, 1990, and thus rendering “final” respondents' judgment against Celotex. *Edwards v. Armstrong World Industries, Inc.*, 911 F.2d 1151 (1990). That same day, Celotex filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the Middle District of Florida.¹ The filing of the petition automatically stayed both the continuation of “proceeding[s] against” Celotex and the commencement of “any act to obtain possession of property” of Celotex.² 11 U.S.C. §§ 362(a)(1) and (3).

*303 On October 17, 1990, the Bankruptcy Court exercised its equitable powers under 11 U.S.C. § 105(a) and issued an injunction (hereinafter *Section 105 Injunction*) to augment the protection afforded Celotex by the automatic stay. In pertinent part, the *Section 105 Injunction* stayed all proceedings involving Celotex “regardless of ... whether the matter is on appeal and a supersedeas bond has been posted by [Celotex].” App. to Pet. for Cert. A–28.³ Respondents, whose bonded judgment against Celotex had already been affirmed on appeal, filed a motion pursuant to *Federal Rule of Civil Procedure 65.1* in the District Court seeking permission to execute against Northbrook on the supersedeas bond. Both Celotex and Northbrook opposed this motion, asserting that all proceedings to enforce the bonds had been enjoined by the Bankruptcy Court's *Section 105 Injunction*. Celotex brought to the District Court's attention the fact that, since respondents had filed their *Rule 65.1* motion, the Bankruptcy Court had reaffirmed the **1497 *Section 105 Injunction* and made clear that the injunction prohibited judgment creditors like respondents from proceeding against sureties without the Bankruptcy Court's permission:

“Where at the time of filing the petition, the appellate process between Debtor and the judgment creditor had been concluded, the judgment creditor is precluded from proceeding against any supersedeas bond posted by Debtor without first seeking to vacate the *Section 105* *304 stay entered by this Court.” *In re Celotex*, 128 B.R. 478, 485 (1991) (*Celotex I*).

Despite the Bankruptcy Court's reaffirmation and clarification of the *Section 105 Injunction*, the District Court allowed respondents to execute on the bond against Northbrook.⁴

*305 Celotex appealed, and the Fifth Circuit affirmed. *Edwards v. Armstrong World Industries, Inc.*, 6 F.3d 312 (1993) (*Edwards II*). It first held that, because the appellate

process for which the supersedeas bond was posted had been completed, Celotex no longer had a property interest in the bond and the automatic stay provisions of 11 U.S.C. § 362 therefore did not prevent respondents from executing against Northbrook. 6 F.3d, at 315–317. The court then acknowledged that “[t]he jurisdiction of bankruptcy courts has been extended to include stays on proceedings involving third parties under the auspices of 28 U.S.C. § 1334(b),” *id.*, at 318, and that the Bankruptcy Court itself had ruled that the Section 105 Injunction enjoined respondents’ proceeding against Northbrook to execute on the supersedeas bond. *Ibid.* The Fifth Circuit nevertheless disagreed with the merits of the Bankruptcy Court’s Section 105 Injunction, holding that “the integrity of the estate is not implicated in the present case because the debtor has no present or future interest in this supersedeas bond.” *Id.*, at 320. The court reasoned that the Section 105 Injunction was “manifestly unfair” and an “unjust result” because the supersedeas bond was posted “to cover precisely the type of eventuality which occurred in this case, insolvency of the judgment debtor.” *Id.*, at 319. In concluding that the Section 105 Injunction was improper, the Fifth Circuit expressly disagreed with the reasoning and result of *Willis v. Celotex Corp.*, 978 F.2d 146 (1992), cert. denied, 507 U.S. 1030, 113 S.Ct. 1846, 123 L.Ed.2d 470 (1993), where the Court of Appeals for the Fourth Circuit, examining the same **1498 Section 105 Injunction, held that the Bankruptcy Court had the power under 11 U.S.C. § 105(a) to stay proceedings against sureties on the supersedeas bonds. 6 F.3d, at 320.

Celotex filed a petition for rehearing, arguing that the Fifth Circuit’s decision allowed a collateral attack on an *306 order of the Bankruptcy Court sitting under the jurisdiction of the Court of Appeals for the Eleventh Circuit. The Fifth Circuit denied the petition, stating in part that “we have not held that the bankruptcy court in Florida was necessarily wrong; we have only concluded that the district court, over which we do have appellate jurisdiction, was right.” *Id.*, at 321. Because of the conflict between the Fifth Circuit’s decision in this case and the Fourth Circuit’s decision in *Willis*, we granted certiorari. 511 U.S. 1105, 114 S.Ct. 2099, 128 L.Ed.2d 661 (1994). We now reverse.

II

Respondents acknowledge that the Bankruptcy Court’s Section 105 Injunction prohibited them from attempting to execute against Northbrook on the supersedeas bond posted

by Celotex. Brief in Opposition 6, n. 2 (recognizing that the Section 105 Injunction “was intended to, and did, enjoin collection attempts like those made by [respondents] against Northbrook in this case”). In *GTE Sylvania, Inc. v. Consumers Union of United States, Inc.*, 445 U.S. 375, 386, 100 S.Ct. 1194, 1201, 63 L.Ed.2d 467 (1980), we reaffirmed the well-established rule that “persons subject to an injunctive order issued by a court with jurisdiction are expected to obey that decree until it is modified or reversed, even if they have proper grounds to object to the order.” In *GTE Sylvania*, we went on to say:

“There is no doubt that the Federal District Court in Delaware had jurisdiction to issue the temporary restraining orders and preliminary and permanent injunctions. Nor were those equitable decrees challenged as only a frivolous pretense to validity, although of course there is disagreement over whether the District Court erred in issuing the permanent injunction. Under these circumstances, the CPSC was required to obey the injunctions out of respect for judicial process.” *Id.*, at 386–387, 100 S.Ct., at 1201–1202 (internal quotation marks, citations, and footnote omitted).

*307 This rule was applied in the bankruptcy context more than 60 years ago in *Oriel v. Russell*, 278 U.S. 358, 49 S.Ct. 173, 73 L.Ed. 419 (1929), where the Court held that turnover orders issued under the old bankruptcy regime could not be collaterally attacked in a later contempt proceeding. Respondents acknowledge the validity of the rule but contend that it has no application here. They argue that the Bankruptcy Court lacked *jurisdiction* to issue the Section 105 Injunction, though much of their argument goes to the correctness of the Bankruptcy Court’s decision to issue the injunction rather than to its jurisdiction to do so.

The jurisdiction of the bankruptcy courts, like that of other federal courts, is grounded in, and limited by, statute. Title 28 U.S.C. § 1334(b) provides that “the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11.” The district courts may, in turn, refer “any or all proceedings arising under title 11 or arising in or related to a case under title 11 ... to the bankruptcy judges for the district.” 28 U.S.C. § 157(a). Here, the Bankruptcy Court’s jurisdiction to enjoin respondents’ proceeding against Northbrook must be based on the “arising under,” “arising in,” or “related to” language of §§ 1334(b) and 157(a).

Respondents argue that the Bankruptcy Court had jurisdiction to issue the Section 105 Injunction only if their proceeding to

execute on the bond was “related to” the Celotex bankruptcy. Petitioner argues the Bankruptcy Court indeed had such “related to” jurisdiction. Congress did not delineate the scope of “related to”⁵ jurisdiction, **1499 but its choice *308 of words suggests a grant of some breadth. The jurisdictional grant in § 1334(b) was a distinct departure from the jurisdiction conferred under previous Acts, which had been limited to either possession of property by the debtor or consent as a basis for jurisdiction. See *S.Rep. No. 95–989*, 2nd Sess., pp. 153, 154 (1978) U.S.Code Cong. & Admin.News 1978, pp. 5787, 5939, 5940. We agree with the views expressed by the Court of Appeals for the Third Circuit in *Pacor, Inc. v. Higgins*, 743 F.2d 984 (1984), that “Congress intended to grant comprehensive jurisdiction to the bankruptcy courts so that they might deal efficiently and expeditiously with all matters connected with the bankruptcy estate,” *id.*, at 994; see also *H.R.Rep. No. 95–595*, pp. 43–48 (1977), and that the “related to” language of § 1334(b) must be read to give district courts (and bankruptcy courts under § 157(a)) jurisdiction over more than simple proceedings involving the property of the debtor or the estate. We also agree with that court’s observation that a bankruptcy court’s “related to” jurisdiction cannot be limitless. See *Pacor, supra*, at 994; cf. *Board of Governors, FRS v. MCorp Financial, Inc.*, 502 U.S. 32, 40, 112 S.Ct. 459, 464, 116 L.Ed.2d 358 (1991) (stating that Congress has vested “limited authority” in bankruptcy courts).⁶

*309 We believe that the issue whether respondents are entitled to immediate execution on the bond against Northbrook is at least a question “related to” Celotex’s bankruptcy.⁷ Admittedly, a proceeding **1500 by respondents against Northbrook on the supersedeas bond does not directly involve Celotex, except to satisfy the judgment against it secured by the bond. But to induce Northbrook to serve as surety on the bond, *310 Celotex agreed to allow Northbrook to retain the proceeds of a settlement resolving insurance coverage disputes between Northbrook and Celotex. The Bankruptcy Court found that allowing respondents—and 227 other bonded judgment creditors—to execute immediately on the bonds would have a direct and substantial adverse effect on Celotex’s ability to undergo a successful reorganization. It stated:

“[I]f the [Section 105](#) stay were lifted to enable the judgment creditors to reach the sureties, the sureties in turn would seek to lift the [Section 105](#) stay to reach Debtor’s collateral, with corresponding actions by Debtor to preserve its

rights under the settlement agreements. Such a scenario could completely destroy any chance of resolving the prolonged insurance coverage disputes currently being adjudicated in this Court. The settlement of the insurance coverage disputes with all of Debtor’s insurers may well be the linchpin of Debtor’s formulation of a feasible plan. Absent the confirmation of a feasible plan, Debtor may be liquidated or cease to exist after a carion feast by the victors in a race to the courthouse.” *In re Celotex*, 140 B.R. 912, 915 (1992) (*Celotex II*).

In light of these findings by the Bankruptcy Court, it is relevant to note that we are dealing here with a reorganization under Chapter 11, rather than a liquidation under Chapter 7. The jurisdiction of bankruptcy courts may extend more broadly in the former case than in the latter. Cf. *Continental Ill. Nat. Bank & Trust Co. v. Chicago, R.I. & P.R. Co.*, 294 U.S. 648, 676, 55 S.Ct. 595, 606, 79 L.Ed. 1110 (1935). And we think our holding—that respondents’ immediate execution on the supersedeas bond is at least “related to” the Celotex bankruptcy—is in accord with representative recent decisions of the Courts of Appeals. See, e.g., *American Hardwoods, Inc. v. Deutsche Credit Corp.*, 885 F.2d 621, 623 (CA9 1989) (finding “related to” jurisdiction where enforcement of state-court judgment *311 by creditor against debtor’s guarantors would affect administration of debtor’s reorganization plan); cf. *MacArthur Co. v. Johns–Manville Corp.*, 837 F.2d 89, 93 (CA2) (noting that a bankruptcy court’s injunctive powers under § 105(a) allow it to enjoin suits that “might impede the reorganization process”), cert. denied, 488 U.S. 868, 109 S.Ct. 176, 102 L.Ed.2d 145 (1988); *In re A.H. Robins Co.*, 828 F.2d 1023, 1024–1026 (CA4 1987) (affirming Bankruptcy Court’s § 105(a) injunction barring products liability plaintiffs from bringing actions against debtor’s insurers because such actions would interfere with debtor’s reorganization), cert. denied *sub nom.*, 485 U.S. 969, 108 S.Ct. 1246, 99 L.Ed.2d 444 (1988).⁸

Respondents, relying on our decision in *Board of Governors, FRS v. MCorp Financial, Inc.*, 502 U.S. 32, 112 S.Ct. 459, 116 L.Ed.2d 358 (1991), contend that § 1334(b)’s statutory grant of jurisdiction must be reconciled and harmonized with [Federal Rule of Civil Procedure 65.1](#), which provides an expedited procedure for executing on supersedeas bonds. In *MCorp*, we held that the grant of jurisdiction in § 1334(b) to district courts sitting in bankruptcy did not authorize an injunction against a regulatory proceeding, but there we relied on “the specific preclusive language” of [12 U.S.C. § 1818\(i\) \(1\)](#), which stated that “no court shall have jurisdiction to affect by injunction or otherwise the issuance or enforcement

of any [Board] notice or order.’ ” 502 U.S., at 39, 42, 112 S.Ct., at 463, 465. There is no analogous statutory prohibition against enjoining the maintenance of a proceeding under Rule 65.1. That Rule provides:

“Whenever these rules ... require or permit the giving of security by a party, and **1501 security is given in the form *312 of a bond or stipulation or other undertaking with one or more sureties, each surety submits to the jurisdiction of the court and irrevocably appoints the clerk of the court as the surety's agent upon whom any papers affecting the surety's liability on the bond or undertaking may be served. The surety's liability may be enforced on motion without the necessity of an independent action....”

This Rule outlines a streamlined *procedure* for executing on bonds. It assures judgment creditors like respondents that they do not have to bring a separate action against sureties, and instead allows them to collect on the supersedeas bond by merely filing a motion. Just because the Rule provides a simplified procedure for collecting on a bond, however, does not mean that such a procedure, like the more complicated procedure of a full-fledged lawsuit, cannot be stayed by a lawfully entered injunction.

Much of our discussion dealing with the *jurisdiction* of the Bankruptcy Court under the “related to” language of §§ 1334(b) and 157(a) is likewise applicable in determining whether or not the Bankruptcy Court's Section 105 Injunction has “only a frivolous pretense to validity.” *GTE Sylvania*, 445 U.S., at 386, 100 S.Ct., at 1202 (internal quotation marks and citation omitted). The Fourth Circuit has upheld the merits of the Bankruptcy Court's Section 105 Injunction, see *Willis*, 978 F.2d, at 149–150, and even the Fifth Circuit in this case did not find “that the bankruptcy court in Florida was necessarily wrong.” See *Edwards II*, 6 F.3d, at 321. But we need not, and do not, address whether the Bankruptcy Court acted properly in issuing the Section 105 Injunction.⁹

*313 We have made clear that “ ‘[i]t is for the court of first instance to determine the question of the validity of the law, and until its decision is reversed for error by orderly review, either by itself or by a higher court, its orders based on its decision are to be respected.’ ” *Walker v. Birmingham*, 388 U.S. 307, 314, 87 S.Ct. 1824, 1828, 18 L.Ed.2d 1210 (1967) (quoting *Howat v. Kansas*, 258 U.S. 181, 189–190, 42 S.Ct. 277, 281, 66 L.Ed. 550 (1922)). If respondents believed the Section 105 Injunction was improper, they should have challenged it in the Bankruptcy Court, like other similarly situated bonded judgment creditors have done. See *Celotex*

II, 140 B.R., at 912. If dissatisfied with the Bankruptcy Court's ultimate decision, respondents can appeal “to the district court for the judicial district in which the bankruptcy judge is serving,” see 28 U.S.C. § 158(a), and then to the Court of Appeals for the Eleventh Circuit, see § 158(d). Respondents chose not to pursue this course of action, but instead to collaterally attack the Bankruptcy Court's Section 105 Injunction in the federal courts in Texas. This they cannot be permitted to do without seriously undercutting the orderly process of the law.

The judgment of the Court of Appeals, accordingly, is reversed.

It is so ordered.

Justice STEVENS, with whom Justice GINSBURG joins, dissenting.

Today the majority holds that an Article III court erred when it allowed plaintiffs who prevailed on appeal to collect on a supersedeas bond in the face of an injunction issued by a non-Article III judge. Because, in my view, the majority *314 attaches insufficient weight to the fact that the challenged injunction was issued by a non-Article III judge, I respectfully dissent.

**1502 I

The outlines of the problems I perceive are best drawn by starting with an examination of the injunctions and opinions issued by the Bankruptcy Judge in this case. As the majority notes, Bennie and Joann Edwards (the Edwards) won a tort judgment against Celotex Corporation for damages Bennie Edwards suffered as a result of exposure to asbestos. To stay the judgment pending appeal, Celotex arranged for Northbrook Property and Casualty Insurance Company (Northbrook) to post a supersedeas bond to cover the full amount of the judgment. On October 12, 1990, before Celotex filed its voluntary petition under Chapter 11 of the Bankruptcy Code, the Court of Appeals for the Fifth Circuit affirmed the Edwards' judgment against Celotex. It is undisputed that, when the Edwards' judgment was affirmed, any property interest that Celotex retained in the supersedeas bond was extinguished.

The filing of Celotex's bankruptcy petition on October 12, 1990, triggered the automatic stay provisions of the

Bankruptcy Code. See 11 U.S.C. § 362(a). On October 17, 1990, the Bankruptcy Judge, acting pursuant to 11 U.S.C. § 105(a),¹ supplemented the automatic stay provisions with an emergency order staying, *inter alia*, all proceedings “involving any of the Debtors [*i.e.*, Celotex].” App. to Pet. for Cert. A–28. The supersedeas bond filed in the Edwards’ case, however, evidences an independent obligation on the part of *315 Northbrook. For that reason, neither the automatic stay of proceedings against the debtor pursuant to § 362(a) of the Bankruptcy Code nor the Bankruptcy Judge’s October 17, § 105(a) stay restrained the Edwards from proceeding against Northbrook to enforce Northbrook’s obligations under the bond. As the Court of Appeals correctly held, the October 17 order enjoined the prosecution of proceedings involving “the Debtors,” but did not expressly enjoin the Edwards from proceeding against Northbrook. See *Edwards v. Armstrong World Industries, Inc.*, 6 F.3d 312, 315 (CA5 1993).

On May 3, 1991, the Edwards commenced their proceeding against Northbrook by filing a motion pursuant to Rule 65.1 of the Federal Rules of Civil Procedure² to enforce the supersedeas bond. Several weeks later—on June 13, 1991—the Bankruptcy Court entered a new three-paragraph order enjoining all of Celotex’s judgment creditors from collecting on their supersedeas bonds. Paragraph 1 of the order addressed creditors whose appellate process had not yet concluded. Paragraph 2 addressed creditors whose appellate process concluded only after Celotex had filed for bankruptcy. Paragraph 3 applied to judgment creditors, such as the Edwards, whose appeals had concluded before the filing of the bankruptcy petition. Paragraph 3 expressly precluded those creditors from proceeding against any bond “without first seeking to vacate the Section 105 stay entered by this Court.” *In re Celotex Corp.*, 128 B.R. 478, 485 (Bkrcty.Ct. MD Fla.1991).

*316 The opinion supporting that order explained that Paragraphs 1 and 2 rested in part on the theory that the debtor retains a property interest in the supersedeas bonds until the appellate process was complete, and any attempt to collect on those bonds was therefore covered in the first instance by § 362(a)’s automatic stay provisions. The opinion recognized that that rationale did not cover supersedeas bonds posted in litigation with judgment creditors, such as the Edwards, whose appellate process was complete. The Bankruptcy Judge concluded, however, that § 105(a) gave him the power to **1503 stay the collection efforts of such bonded judgment creditors. The Bankruptcy Judge contended that other courts had utilized the § 105(a) stay “to preclude

actions which may ‘impede the reorganization process,’ ” *id.*, at 483, quoting *In re Johns–Manville Corp.*, 837 F.2d 89, 93 (CA2), cert. denied, 488 U.S. 868, 109 S.Ct. 176, 102 L.Ed.2d 145 (1988), or “ ‘which will have an adverse impact on the Debtor’s ability to formulate a Chapter 11 plan,’ ” 128 B.R., at 483, quoting *A.H. Robins Co. v. Piccinin*, 788 F.2d 994 (CA4), cert. denied, 479 U.S. 876, 107 S.Ct. 251, 93 L.Ed.2d 177 (1986). But cf. n. 12, *infra*. Apparently viewing his own authority as virtually limitless, the Bankruptcy Judge described a general bankruptcy power “to stop ongoing litigation and to prevent peripheral court decisions from dealing with issues ... without first allowing the bankruptcy court to have an opportunity to review the potential effect on the debtor.” 128 B.R., at 484. He concluded that in “mega” cases in which “potential conflicts with other judicial determinations” might arise, “the powers of the bankruptcy court under Section 105 must in the initial stage be absolute.” *Ibid.*

I do not agree that the powers of a bankruptcy judge, a non-Article III judge, “must ... be absolute” at the initial stage or indeed at any stage. Instead, the jurisdiction and the power of bankruptcy judges are cabined by specific and important statutory and constitutional constraints that operate at every phase of a bankruptcy. In my view, those constraints *317 require that the judgment of the Court of Appeals be affirmed.

The majority concludes that the Court of Appeals must be reversed because the Bankruptcy Judge had jurisdiction to issue the injunction and because the injunction had more than a “ ‘frivolous pretense to validity.’ ” *Ante*, at 1501. Even applying the majority’s framework, I would affirm the Court of Appeals. As I will demonstrate, the constraints on the jurisdiction and authority of the Bankruptcy Judge compel the conclusion that the Bankruptcy Judge lacked jurisdiction to issue the challenged injunction, and that the injunction has only a “ ‘frivolous pretense to validity.’ ” I will also explain, however, why the majority’s deferential approach seems particularly inappropriate as applied to this particular injunction, now in its fifth year of preventing enforcement of supersedeas bonds lodged in an Article III court.

II

In my view, the Bankruptcy Judge lacked jurisdiction to issue an injunction that prevents an Article III court from allowing a judgment creditor to collect on a supersedeas bond posted in that court by a nondebtor. In reaching the contrary conclusion,

the majority relies primarily on the Bankruptcy Judge's "related to" jurisdiction, and thus I will address that basis of jurisdiction first. The majority properly observes that, under 28 U.S.C. § 1334(b), the district court has broad bankruptcy jurisdiction, extending to "all civil proceedings arising under title 11, or arising in or related to cases under title 11."³ The majority also notes correctly *318 **1504 that the Edwards' action to enforce the supersedeas bond is within the district court's "related to" jurisdiction,⁴ because allowing creditors such as the Edwards "to execute immediately on the bonds would have a direct and substantial adverse effect on Celotex's ability to undergo a successful reorganization." *Ante*, at 1500.⁵ The majority then observes *319 that, under 28 U.S.C. § 157(a), the district court may "refe[r]" to the bankruptcy judge "any or all cases under title 11 and any or all proceedings arising under title 11 or arising in or related to a case under title 11."⁶ Thus, the majority concludes that, because the Edwards' action to enforce the *320 supersedeas bond was within the District Court's "related to" jurisdiction and because the District Court referred all matters to the Bankruptcy Judge, the Bankruptcy Judge had jurisdiction over the Edwards' action.

In my view, the majority's approach pays insufficient attention to the remaining provisions of § 157, and, more importantly, to the decision of this Court that gave rise to their creation. The current jurisdictional structure of the Bankruptcy Code reflects this Court's decision in *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 102 S.Ct. 2858, 73 L.Ed.2d 598 (1982), which in turn addressed the Bankruptcy Reform Act of 1978, 92 Stat. 2549. The 1978 Act significantly restructured the Bankruptcy Code. The Act created "bankruptcy courts" and vested in them "jurisdiction over all 'civil proceedings arising under title 11 [the Bankruptcy title] or arising in or related to cases under title 11.'" *Northern Pipeline*, 458 U.S., at 54, 102 S.Ct., at 2862, quoting 28 U.S.C. § 1471(b) (1976 ed., Supp. **1505 IV). As the plurality opinion in *Northern Pipeline* observed, "[t]his jurisdictional grant empowers bankruptcy courts to entertain a wide variety of cases," involving "claims based on state law as well as those based on federal law." 458 U.S., at 54, 102 S.Ct., at 2863. The Act also bestowed upon the judges of the bankruptcy courts broad powers to accompany this expanded jurisdiction. See n. 6, *supra*; *Northern Pipeline*, 458 U.S., at 55, 102 S.Ct., at 2863. The Act did not, however, make the newly empowered bankruptcy judges Article III judges. In particular, it denied bankruptcy judges the life

tenure and salary protection that the Constitution requires for Article III judges. See U.S. Const., Art. III, § 1.

In *Northern Pipeline*, this Court held that the Act was unconstitutional, at least insofar as it allowed a non-Article III court to "entertain and decide" a purely state-law claim. 458 U.S., at 91, 102 S.Ct., at 2882 (REHNQUIST, J., concurring in judgment); see also *id.*, at 86, 102 S.Ct., at 2879 (plurality opinion). The plurality opinion distinguished the revamped bankruptcy courts from prior *321 district court "adjuncts" which the Court had found did not violate Article III. The plurality noted that, in contrast to the narrow, specialized jurisdiction exercised by these prior adjuncts, "the subject-matter jurisdiction of the bankruptcy courts encompasses not only traditional matters of bankruptcy, but also 'all civil proceedings arising under title 11 or arising in or related to cases under title 11.'" *Id.*, at 85, 102 S.Ct., at 2877. In addition, prior adjuncts "engaged in statutorily channeled factfinding functions," while the bankruptcy courts "exercise 'all of the jurisdiction' conferred by the Act on the district courts."⁷ *Ibid.*

In response to *Northern Pipeline*, Congress passed the Bankruptcy Amendments and Federal Judgeship Act of 1984 (1984 amendments), 98 Stat. 333. Section 157 was passed as part of the 1984 amendments. Section 157 establishes two broad categories of proceedings: "core proceedings" and "[n]on-core proceedings." For "all core proceedings arising under title 11, or arising in a case under title 11, referred under [§ 157(a)]," § 157(b)(1) permits bankruptcy judges to "hear and determine" the proceedings and to "enter appropriate orders and judgments." For noncore proceedings "otherwise related to a case under title 11," § 157(c)(1) permits the bankruptcy court only to "hear" the proceedings and to "submit proposed findings of fact and conclusions of law to the district court." See 1 Collier ¶ 3.01[1][c][iv], at 3–28 ("[C]ivil proceedings 'related to cases under title 11' " are "excluded from being treated as 'core proceedings' by 28 U.S.C. § 157(b)(1), and are the subject of special procedures contained in sections 157(c)(1) and (c)(2)"). For these "related proceedings," 1 Collier ¶ 3.01[1][c][iv], at 3–28, only the *322 district court has the power to enter "any final order or judgment."⁸

In my view, the distinction between the jurisdiction to "hear and determine" core proceedings on the one hand and the jurisdiction only to "hear" related proceedings on the other hand is critical, if not dispositive. I believe that the jurisdiction to hear (and yet not to determine) a case

under § 157(c)(1) provides insufficient jurisdiction to a bankruptcy judge to permit him to issue a binding injunction that prevents an Article III court from exercising its conceded jurisdiction over the case.⁹ The unambiguous text of **1506 § 157(c)(1) *323 requires that the bankruptcy judge's participation in related proceedings be merely advisory rather than adjudicative. In my view, having jurisdiction to grant injunctions over cases that one may not decide is inconsistent with such an advisory role. An injunction is an extraordinary remedy whose impact on private rights may be just as onerous as a final determination. The constitutional concerns that animate the current jurisdictional provisions of the Bankruptcy Code and that deny non-Article III tribunals the power to determine private controversies apply with equal force to the entry of an injunction interfering with the exercise of the admitted jurisdiction of an Article III tribunal.¹⁰

In sum, my view on the sufficiency of “related to” jurisdiction to sustain the injunction in this case can be stated quite simply: If a bankruptcy judge lacks jurisdiction to “determine” a question, the judge also lacks jurisdiction to issue an injunction that prevents an Article III court, which concededly does have jurisdiction, from determining that question. *324¹¹ Any conclusion to the contrary would trivialize the constitutional imperatives that shaped the Bankruptcy Code's jurisdictional provisions.¹²

**1507 III

Petitioner and the majority rely primarily on “related to” jurisdiction. Indeed, the Court's holding appears to rest almost entirely on the view that a bankruptcy judge has jurisdiction to enjoin proceedings in Article III courts whenever those proceedings are “related to” a pending Title 11 case. See *ante*, at 1498–1500. Two footnotes in the Court's opinion, however, might be read as suggesting alternative bases of *325 jurisdiction. See *ante*, at 1497, n. 4, 1500, n. 8. Those two footnotes require a brief response.

In footnote 4 of its opinion, the Court refers to two different claims advanced by Celotex in the bankruptcy proceedings: a claim that “the bonded judgment creditors should not be able to execute on their bonds because, by virtue of the collateralization of the bonds, the bonded judgment creditors are beneficiaries of Celotex asset transfers that are voidable as preferences and fraudulent transfers”; and a claim that “the punitive damages portions of the judgments can be

voided or subordinated.” There is little doubt that those claims are properly characterized as ones “arising under” Title 11 within the meaning of 28 U.S.C. § 1334(b),¹³ however, it does not necessarily follow from that characterization that the Bankruptcy Judge had jurisdiction to issue the injunction in support of the prosecution of those claims. Celotex's complaint was not filed until months after the Bankruptcy Judge's injunction issued. The claims raised in that complaint cannot retroactively provide a jurisdictional basis for the Bankruptcy Judge's injunction.

Moreover, Celotex's attempts to set aside the Edwards' supersedeas bond are patently meritless. It strains credulity, *326 to suggest that a supersedeas bond, posted almost a year and a half before the bankruptcy petition was filed, could be set aside as a preference or as a fraudulent transfer for the benefit of Celotex's adversaries in bitterly contested litigation. Conceivably, Celotex's provision of security to Northbrook might be voidable, but that possibility could not impair the rights of the judgment creditors to enforce the bond against Northbrook even though they might be unwitting beneficiaries of the fraud. That possibility, at most, would be relevant to the respective claims of Northbrook and Celotex to the pledged collateral. Similarly, the fact that the Edwards' judgment included punitive as well as compensatory damages does not provide even an arguable basis for reducing Northbrook's obligations under the supersedeas bond. Even if there is a basis for subordinating a portion of Northbrook's eventual claim against Celotex on “bankruptcy law grounds,” that has nothing to do with the Edwards' claim against Northbrook. It thus seems obvious that, at least with respect to the Edwards, Celotex has raised frivolous claims in an attempt to manufacture bankruptcy jurisdiction and thereby to justify a bankruptcy judge's injunction that had been issued over one year earlier. Cf. *Siler v. Louisville & Nashville R. Co.*, 213 U.S. 175, 191–192, 29 S.Ct. 451, 455, 53 L.Ed. 753 (1909) (“Of course, the Federal question must not be merely colorable or fraudulently set up for the mere purpose of endeavoring to give the court jurisdiction”).

**1508 In its footnote 8, the Court appears to suggest that the injunction prohibiting the Edwards from proceeding against Northbrook (described in the footnote as the “stay proceeding”) may “aris[e] under” Title 11 or may “arise in” the Title 11 case. Perhaps this is accurate in a literal sense: The injunction did, of course, “arise under” Title 11 because 11 U.S.C. § 105(a) created whatever power the bankruptcy judge had to issue the injunction. Similarly, the injunction “arises in” the Title 11 case because that is where it originated.

It cannot be the law, however, that a bankruptcy *327 judge has jurisdiction to enter any conceivable order that a party might request simply because § 105(a) authorizes some injunctions or because the request was first made in a pending Title 11 case. Cf. 2 Collier ¶ 105.01[1], at 105–3 (Section 105 “is not an independent source of jurisdiction, but rather it grants the courts flexibility to issue orders which preserve and protect their jurisdiction”). The mere filing of a motion for a § 105 injunction to enjoin a proceeding in another forum cannot be a jurisdictional bootstrap enabling a bankruptcy judge to exercise jurisdiction that would not otherwise exist.

IV

Even if I believed that the Bankruptcy Judge had jurisdiction to issue his injunction, I would still affirm the Court of Appeals because in my view the Bankruptcy Judge's injunction has only a “frivolous pretense to validity.”

In 1898, Congress codified the bankruptcy laws. Under the 1898 Bankruptcy Act, most bankruptcy proceedings were conducted by “referees” who resolved controversies involving property in the actual or constructive possession of the court, as well as certain disputes involving property in the possession of third parties. In § 2(a)(15) of the 1898 Act, Congress vested in bankruptcy courts the power to:

“[M]ake such orders, issue such process, and enter such judgments in addition to those specifically provided for as may be necessary for the enforcement of the provisions of this Act.” Act of July 1, 1898, 30 Stat. 546.

In 1938, Congress clarified both the powers and the limitations on the injunctive authority of referees in bankruptcy by adding to the end of § 2(a)(15), “*Provided, however, That an injunction to restrain a court may be issued by the judge only.*” 52 Stat. 843 (emphasis in original).

In 1978, through the Bankruptcy Reform Act, Congress significantly revised the Bankruptcy Code and the role of *328 bankruptcy referees.¹⁴ Though stopping short of making bankruptcy referees Article III judges, Congress significantly increased the status, the duties, and the powers of those referees. For example, as we noted in *Northern Pipeline*, the expanded powers under the new Act included “the power to hold jury trials, ... to issue declaratory judgments, [and] to issue writs of habeas corpus under certain circumstances.” 458 U.S., at 55, 102 S.Ct., at 2863. In addition, Congress again provided for broad injunctive powers. Thus, for example, in

the place of § 2(a)(15), Congress added 11 U.S.C. § 105, which provided in relevant part: “The [bankruptcy court] may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title.” See also 458 U.S., at 55, 102 S.Ct., at 2863 (“Congress has allowed bankruptcy judges the power ... to issue all writs necessary in aid of the bankruptcy court's expanded jurisdiction”). Once again, however, along with both this marked expansion of the power of bankruptcy judges and the broad delegation of injunctive authority, Congress indicated its intent to limit the power of those judges to enjoin other courts: Although Congress provided that “[a] bankruptcy court shall have the powers of a court of equity, law, and admiralty,” it also provided that bankruptcy courts “may not enjoin **1509 another court.” 28 U.S.C. § 1481 (1982 ed.).¹⁵ Thus, for well over 50 years prior to the adoption of the 1984 amendments to the Bankruptcy Code, it was clear that Congress intended to deny bankruptcy judges the power to enjoin other courts.

*329 The 1984 amendments, *inter alia*, repealed § 1481 (and its express limitation on injunctive authority), leaving § 105 as the only source of the bankruptcy judge's injunctive authority.¹⁶ Given that *Northern Pipeline* required a contraction in the authority of bankruptcy judges,¹⁷ and given that the 1984 amendments regarding the powers of the bankruptcy courts were passed to comply with *Northern Pipeline*,¹⁸ it would be perverse—and in my view “frivolous”—to contend that Congress intended the repeal of § 1481 to operate as an authorization for those judges to enjoin proceedings in other courts, thus significantly expanding the powers of bankruptcy judges.

My view of the consequence of the 1984 amendments is reinforced by the structure of § 1481. When Congress placed restrictions on the injunctive power of the bankruptcy courts, it did so in § 1481, right after the clause granting those courts “the powers of a court of equity, law, and admiralty.” In my view, this suggests that Congress saw § 1481—and not § 105(a)—as the source of any power to enjoin other courts. Thus, the removal of § 1481 by the 1984 amendments is properly viewed as eliminating the sole source of congressionally granted authority to enjoin other courts. Cf. *In re Hipp*, 895 F.2d 1503, 1515–1516 (CA5 1990) (concluding on similar reasoning that § 1481, not § 105(a), was the source of the bankruptcy court's power to punish criminal contempt under the 1978 Act).

***330** Nor does anything in the 1986 amendments to the Bankruptcy Code alter my analysis.¹⁹ The primary effect of those amendments was to give the bankruptcy judges the power to issue orders *sua sponte*.²⁰ The 1986 amendments, therefore, do not reflect any expansion of the power of bankruptcy judges to enjoin other courts.

The Bankruptcy Judge's error with respect to this injunction thus seems clear, and the injunction falls, therefore, within the exception recognized by the majority for injunctions with only a "frivolous pretense to validity." I recognize, of course, that one may legitimately question the "frivolousness" of the injunction in light of the Fourth Circuit's upholding the very injunction at issue in this case, see *Willis v. Celotex Corp.*, 978 F.2d 146 (1992), cert. denied, 507 U.S. 1030, 113 S.Ct. 1846, 123 L.Ed.2d 470 (1993), and the disagreement of a substantial number of my colleagues. In my view, however, the Bankruptcy Judge's error is sufficiently plain that the Court of Appeals was justified in allowing the Edwards to collect on their bond.²¹

***331 **1510 V**

The Court's holding today rests largely on its view that the Edwards' proper remedy is to appeal the Bankruptcy Judge's injunction, first to the District Court and then to the Court of Appeals for the Eleventh Circuit. The Court concedes, however, that the Edwards need not do so if the Bankruptcy Judge exceeded his jurisdiction, or if the injunction is supported by nothing more than "a frivolous pretense to validity." *Ante*, at 1501. For the reasons already stated, I think both of those conditions are satisfied in this case. The non-Article III Bankruptcy Judge simply lacked both jurisdiction and authority to prevent an Article III court from exercising its unquestioned jurisdiction to decide a matter that is related only indirectly to the bankruptcy proceeding. I think it important, however, to add a few brief words explaining why I find this injunction especially troubling and why the injunction should be viewed with a particularly critical eye.

First, the justification offered by the Bankruptcy Judge should give the Court pause. As originally articulated, the justification for this injunction was that emergency relief was required lest the reorganization of Celotex become impossible and liquidation follow. Apart from the fact that the "emergency" rationale is plainly insufficient to support an

otherwise improper injunction that has now lasted for more than four years, the judge's reasoning reveals reliance on the misguided notion that a good end is a sufficient justification for the existence and exercise of power. His reference to the need to exercise "absolute" power to override "potential conflicts with other judicial determinations" that might have a "potential impact on the debtor" should invite far ***332** more exacting scrutiny of his order than the Court deems appropriate.

Second, that the subject of the injunction was a supersedeas bond makes the injunction suspect. A supersedeas bond may be viewed as putting the integrity of the court in which it is lodged on the line. As the Court of Appeals noted, the Edwards were "promised by the court" that the supersedeas bond would be available if they prevailed on appeal. 6 F.3d, at 320. For that reason, in my opinion, questions relating to the enforceability of a supersedeas bond should generally be answered in the forum in which the bond is posted.

Moreover, whenever possible, such questions should be resolved before the court accepts the bond as security for collection of the judgment being appealed. After a debtor has benefited from the postponement of collection of an adverse judgment, both that debtor and its successors in interest should normally be estopped from asserting that the judgment creditors who relied to their detriment on the validity of the bond had no right to do so. The very purpose of a supersedeas bond is to protect judgment creditors from the risk that insolvency of the debtor may impair their ability to enforce the judgment promptly. When the bond has served the purpose of forestalling immediate levies on the judgment debtor's assets—levies that might have precipitated an earlier bankruptcy—it is inequitable to postpone payment merely because the risk against which the bond was intended to provide protection has actually occurred. See *id.*, at 319 ("It is manifestly unfair to force the judgment creditor to delay the right to collect with a promise to protect the judgment only to later refuse to allow that successful plaintiff to execute the bond because the debtor has sought protection under the laws of bankruptcy"); *In re Southmark*, 138 B.R. 820, 827–828 (Bkrcty.Ct. ND Tex.1992) (internal quotation marks omitted) ("The principal risk against which such bonds are intended as a ****1511** protection is insolvency. To hold ***333** that the very contingency against which they guard shall, if it happens, discharge them, seems to us bad law and worse logic"). The inequity that the Court today condones does not, of course, demonstrate that its legal analysis is incorrect. It does, however, persuade me that the Court should not review

this case as though it presented an ordinary collateral attack on an injunction entered by an Article III court.²² Instead, the Court should, I believe, more carefully consider which of the two competing tribunals is guilty of trespassing in the other's domain.

Accordingly, I respectfully dissent.

All Citations

514 U.S. 300, 115 S.Ct. 1493, 131 L.Ed.2d 403, 63 USLW 4269, 32 Collier Bankr.Cas.2d 685, 31 Fed.R.Serv.3d 355, 27 Bankr.Ct.Dec. 93, Bankr. L. Rep. P 76,456

Footnotes

* The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States v. Detroit Lumber Co.*, 200 U.S. 321, 337, 26 S.Ct. 282, 287, 50 L.Ed. 499.

1 For purposes of this case, we assume respondents' judgment became final before Celotex filed its petition in bankruptcy.

2 As of the filing date, more than 141,000 asbestos-related bodily injury lawsuits were pending against Celotex, and over 100 asbestos-related bodily injury cases were in some stage of appeal, with judgments totaling nearly \$70 million being stayed by supersedeas bonds that Celotex had posted.

3 The Bankruptcy Court noted that, upon request of a party in interest and following 30 days' written notice and a hearing, it would "consider granting relief from the restraints imposed" by the [Section 105](#) Injunction. App. to Pet. for Cert. A–28. Several of Celotex's bonded judgment creditors whose cases were still on appeal filed motions requesting that the Bankruptcy Court lift the [Section 105](#) Injunction (1) to enable their pending appellate actions to proceed and (2) to permit them to execute upon the bonds once the appellate process concluded in their favor. The Bankruptcy Court granted the first request but denied the second. *In re Celotex*, 128 B.R. 478, 484 (1991) (*Celotex I*).

4 Two days after the District Court entered its order, the Bankruptcy Court ruled on motions to lift the [Section 105](#) Injunction that had been filed by several bonded judgment creditors who, like respondents, had prevailed against Celotex on appeal. The Bankruptcy Court again reaffirmed the [Section 105](#) Injunction and it again explained that the injunction prohibited judgment creditors like respondents from executing on the supersedeas bonds against third parties without its permission. *In re Celotex*, 140 B.R. 912, 914 (1992) (*Celotex II*). It refused to lift the [Section 105](#) Injunction at that time, finding that Celotex would suffer irreparable harm. It reasoned that if the judgment creditors were allowed to execute against the sureties on the supersedeas bonds, the sureties would in turn seek to lift the [Section 105](#) Injunction to reach Celotex's collateral under the settlement agreements, possibly destroying any chance of a successful reorganization plan. See *id.*, at 914–915.

To protect the bonded judgment creditors, the Bankruptcy Court ordered that: (1) the sureties involved, including Northbrook, establish escrow accounts sufficient to insure full payment of the bonds; (2) Celotex create an interest-bearing reserve account or increase the face amount of any supersedeas bond to cover the full amount of judgment through confirmation; and (3) Celotex provide in any plan that the bonded claimants' claims be paid in full unless otherwise determined by the court or agreed by the claimant. *Id.*, at 917. The Bankruptcy Court also directed Celotex to file "any preference action or any fraudulent transfer action or any other action to avoid or subordinate any judgment creditor's claim against any judgment creditor or against any surety on any supersedeas bond within 60 days of the entry" of its order. *Ibid.* Accordingly, Celotex filed an adversary proceeding against respondents, 227 other similarly situated bonded judgment creditors in over 100 cases, and the sureties on the supersedeas bonds, including Northbrook. See Second Amended Complaint in *Celotex Corp. v. Allstate Ins. Co.*, Adversary No. 92–584 (Bkrtcy.Ct. MD Fla.). In that proceeding, Celotex asserts that the bonded judgment creditors should not be able to execute on their bonds because, by virtue of the collateralization of the bonds, the bonded judgment creditors are beneficiaries of Celotex asset transfers that are voidable as preferences and fraudulent transfers. See *ibid.* Celotex also contends that the punitive damages portions of the judgments can be voided or subordinated on other bankruptcy law grounds. See *ibid.* This adversary proceeding is currently pending in the Bankruptcy Court.

5 Proceedings “related to” the bankruptcy include (1) causes of action owned by the debtor which become property of the estate pursuant to [11 U.S.C. § 541](#), and (2) suits between third parties which have an effect on the bankruptcy estate. See 1 Collier on Bankruptcy ¶ 3.01[1] [c] [iv], p. 3–28 (15th ed. 1994). The first type of “related to” proceeding involves a claim like the state-law breach of contract action at issue in [Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.](#), 458 U.S. 50, 102 S.Ct. 2858, 73 L.Ed.2d 598 (1982). The instant case involves the second type of “related to” proceeding.

6 In attempting to strike an appropriate balance, the Third Circuit in [Pacor, Inc. v. Higgins](#), 743 F.2d 984 (1984), devised the following test for determining the existence of “related to” jurisdiction:

“The usual articulation of the test for determining whether a civil proceeding is related to bankruptcy is whether *the outcome of that proceeding could conceivably have any effect on the estate being administered in bankruptcy*.... Thus, the proceeding need not necessarily be against the debtor or against the debtor’s property. An action is related to bankruptcy if the outcome could alter the debtor’s rights, liabilities, options, or freedom of action (either positively or negatively) and which in any way impacts upon the handling and administration of the bankrupt estate.” *Id.*, at 994 (emphasis in original; citations omitted).

The First, Fourth, Fifth, Sixth, Eighth, Ninth, Tenth, and Eleventh Circuits have adopted the *Pacor* test with little or no variation. See [In re G.S.F. Corp.](#), 938 F.2d 1467, 1475 (CA1 1991); [A.H. Robins Co. v. Piccinin](#), 788 F.2d 994, 1002, n. 11 (CA4), cert. denied, 479 U.S. 876, 107 S.Ct. 251, 93 L.Ed.2d 177 (1986); [In re Wood](#), 825 F.2d 90, 93 (CA5 1987); [Robinson v. Michigan Consol. Gas Co.](#), 918 F.2d 579, 583–584 (CA6 1990); [In re Dogpatch U.S.A., Inc.](#), 810 F.2d 782, 786 (CA8 1987); [In re Fietz](#), 852 F.2d 455, 457 (CA9 1988); [In re Gardner](#), 913 F.2d 1515, 1518 (CA10 1990); [In re Lemco Gypsum, Inc.](#), 910 F.2d 784, 788, and n. 19 (CA11 1990). The Second and Seventh Circuits, on the other hand, seem to have adopted a slightly different test. See [In re Turner](#), 724 F.2d 338, 341 (CA2 1983); [In re Xonics, Inc.](#), 813 F.2d 127, 131 (CA7 1987); [Home Ins. Co. v. Cooper & Cooper, Ltd.](#), 889 F.2d 746, 749 (CA7 1989). But whatever test is used, these cases make clear that bankruptcy courts have no jurisdiction over proceedings that have no effect on the estate of the debtor.

7 The dissent agrees that respondents’ proceeding to execute on the supersedeas bond is “related to” Celotex’s bankruptcy, *post*, at 1504, n. 5, but noting that “only the district court has the power [under [28 U.S.C. § 157\(c\)\(1\)](#)] to enter ‘any final order or judgment’ ” in related “[n]on-core proceedings,” *post*, at 1505, the dissent concludes that the Bankruptcy Court here did not possess sufficient “related to” jurisdiction to issue the [Section 105](#) Injunction, *post*, at 1505. The [Section 105](#) Injunction, however, is only an *interlocutory* stay which respondents have yet to challenge. See *infra*, at 1501. Thus, the Bankruptcy Court did not lack jurisdiction under [§ 157\(c\)\(1\)](#) to issue the [Section 105](#) Injunction because that injunction was not a “final order or judgment.”

In any event, respondents have waived any claim that the granting of the [Section 105](#) Injunction was a noncore proceeding under [§ 157\(c\)\(1\)](#). Respondents base their arguments solely on [28 U.S.C. § 1334](#), and concede in their brief that the “bankruptcy court had subject matter jurisdiction to issue orders affecting the bond, then, only if the proceedings on the bond were ‘related’ to the Celotex bankruptcy itself within the meaning of [§ 1334\(b\)](#).” Brief for Respondents 22. We conclude, and the dissent agrees, that those proceedings are so related. See *post*, at 1503–1504, and n. 5. We thus need not (and do not) reach the question whether the granting of the [Section 105](#) Injunction was a “core” proceeding.

8 We recognize the theoretical possibility of distinguishing between the proceeding to execute on the bond in the Fifth Circuit and the [§ 105](#) stay proceeding in the Bankruptcy Court in the Eleventh Circuit. One might argue, technically, that though the proceeding to execute on the bond is “related to” the [Title 11](#) case, the stay proceeding “arises under” [Title 11](#), or “arises in” the [Title 11](#) case. See [In re Monroe Well Serv., Inc.](#), 67 B.R. 746, 753 (Bkrcty.Ct. ED Pa.1986). We need not and do not decide this question here.

9 The dissent contends that Celotex’s attempts to set aside the supersedeas bond are “patently meritless” because none of Celotex’s claims can impair Northbrook’s obligation to respondents. See *post*, at 1507. That premise, however, is not so clear as to give the [Section 105](#) Injunction “only a frivolous pretense to validity.” There is authority suggesting that, in certain circumstances, transfers from the debtor to another for the benefit of a third party may be recovered from that third party. See [In re Air Conditioning, Inc. of Stuart](#), 845 F.2d 293, 296–299 (CA11), cert. denied, 488 U.S. 993, 109 S.Ct. 557, 102 L.Ed.2d 584 (1988); [In re Compton Corp.](#), 831 F.2d 586, 595 (1987), modified on other grounds, 835

[F.2d 584 \(CA5 1988\)](#). Although we offer no opinion on the merits of that authority or on whether it fits the facts here, it supports our conclusion that the stay was not frivolous.

1 [Title 11 U.S.C. § 105\(a\)](#) provides:

"The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process."

2 [Rule 65.1](#) states:

"Whenever these rules ... require or permit the giving of security by a party, and security is given in the form of a bond or stipulation or other undertaking with one or more sureties, each surety submits to the jurisdiction of the court and irrevocably appoints the clerk of the court as the surety's agent upon whom any papers affecting the surety's liability on the bond or undertaking may be served. The surety's liability may be enforced on motion without the necessity of an independent action."

3 The full text of [§ 1334](#) reads as follows:

"(a) Except as provided in subsection (b) of this section, the district courts shall have original and exclusive jurisdiction of all cases under [title 11](#).

"(b) Notwithstanding any Act of Congress that confers exclusive jurisdiction on a court or courts other than the district courts, the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under [title 11](#), or arising in or related to cases under [title 11](#).

"(c)(1) Nothing in this section prevents a district court in the interest of justice, or in the interest of comity with State courts or respect for State law, from abstaining from hearing a particular proceeding arising under [title 11](#) or arising in or related to a case under [title 11](#).

"(2) Upon timely motion of a party in a proceeding based upon a State law claim or State law cause of action, related to a case under [title 11](#) but not arising under [title 11](#) or arising in a case under [title 11](#), with respect to which an action could not have been commenced in a court of the United States absent jurisdiction under this section, the district court shall abstain from hearing such proceeding if an action is commenced, and can be timely adjudicated, in a State forum of appropriate jurisdiction. Any decision to abstain or not to abstain made under this subsection is not reviewable by appeal or otherwise by the court of appeals under [section 158\(d\)](#), [1291](#), or [1292](#) of this title or by the Supreme Court of the United States under section 1254 of this title. This subsection shall not be construed to limit the applicability of the stay provided for by [section 362 of title 11, United States Code](#), as such section applies to an action affecting the property of the estate in bankruptcy.

"(d) The district court in which a case under [title 11](#) is commenced or is pending shall have exclusive jurisdiction of all of the property, wherever located, of the debtor as of the commencement of such case, and of property of the estate." [28 U.S.C. § 1334](#) (1988 ed. and Supp. V).

4 As [§ 1334\(b\)](#) indicates, the district court's "related to" jurisdiction is "original but not exclusive."

5 I do not take issue with the conclusion that the Edwards' attempt to collect on the supersedeas bond falls within the "related to" jurisdiction of the district court. Cf. 1 Collier on Bankruptcy ¶ 3.01 [1] [c][iv], p. 3–29 (15th ed. 1994) (hereinafter Collier) (" 'Related' proceedings which involve litigation between third parties, which could have some effect on the administration of the bankruptcy case, are illustrated by suits by creditors against guarantors"). Despite the Edwards' argument to the contrary, it seems to me quite clear that allowing the Edwards to recover from Northbrook on the supersedeas bond would have an adverse impact on Celotex because Northbrook would then be able to retain the insurance proceeds that Celotex pledged as collateral when the bond was issued. Indeed, I am willing to assume that if all of the bonds were enforced, the reorganization efforts would fail and Celotex would have to be liquidated. In my judgment, however, the

specter of liquidation is not an acceptable basis for concluding that a bankruptcy judge, and not just the district court, has jurisdiction to interfere with the performance of a third party's fixed obligation to a judgment creditor.

I also agree with the majority, *ante*, at 1499, n. 6, that the facts of this case do not require us to resolve whether *Pacor v. Higgins*, 743 F.2d 984 (CA3 1984), articulates the proper test for determining the scope of the district court's "related to" jurisdiction.

6 The text of § 157 reads in relevant part as follows:

"(a) Each district court may provide that any or all cases under title 11 and any or all proceedings arising under title 11 or arising in or related to a case under title 11 shall be referred to the bankruptcy judges for the district.

"(b)(1) Bankruptcy judges may hear and determine all cases under title 11 and all core proceedings arising under title 11, or arising in a case under title 11, referred under subsection (a) of this section, and may enter appropriate orders and judgments, subject to review under section 158 of this title.

* * * * *

"(c)(1) A bankruptcy judge may hear a proceeding that is not a core proceeding but that is otherwise related to a case under title 11. In such proceeding, the bankruptcy judge shall submit proposed findings of fact and conclusions of law to the district court, and any final order or judgment shall be entered by the district judge after considering the bankruptcy judge's proposed findings and conclusions and after reviewing de novo those matters to which any party has timely and specifically objected.

"(2) Notwithstanding the provisions of paragraph (1) of this subsection, the district court, with the consent of all the parties to the proceeding, may refer a proceeding related to a case under title 11 to a bankruptcy judge to hear and determine and to enter appropriate orders and judgments, subject to review under section 158 of this title."

7 The plurality also noted that, in contrast to the limited powers possessed by prior adjuncts, "the bankruptcy courts exercise all ordinary powers of district courts." 458 U.S., at 85, 102 S.Ct., at 2879. See n. 6, *supra*.

8 The district court may enter judgment only after *de novo* review of the Bankruptcy Judge's recommendation with respect to any matters to which one of the parties has raised a timely objection. See 28 U.S.C. § 157(c)(1).

9 It should be noted that the Bankruptcy Judge's order cannot be upheld on the ground that it purported to enjoin only the Edwards and thus did not enjoin directly the Article III court. First, the Bankruptcy Judge's orders cannot be interpreted so narrowly. The October 17 order enjoined, *inter alia*, "all Entities" from "commencing or continuing any judicial, administrative or other proceeding involving any of the Debtors." App. to Pet. for Cert. A–28. In my view, the word "entities" includes courts. Indeed, the Bankruptcy Judge's order tracks § 362(a)'s automatic stay provisions, which provide, in part, that the automatic stay is applicable "to all entities" and which enjoin "the commencement or continuation ... of a judicial, administrative, or other action or proceeding against the debtor." 11 U.S.C. § 362(a)(1). The Courts of Appeals have uniformly held that "entities," as used in § 362, include courts. See, e.g., *Maritime Electric Co. v. United Jersey Bank*, 959 F.2d 1194, 1206 (CA3 1991) ("§ 362's stay is mandatory and 'applicable to all entities', including state and federal courts"); *Pope v. Manville Forest Products Corp.*, 778 F.2d 238, 239 (CA5 1985) ("just the entry of an order of dismissal, even if entered sua sponte, constitutes a judicial act toward the disposition of the case and hence may be construed as a 'continuation' of a judicial proceeding"); *Ellis v. Consolidated Diesel Electric Corp.*, 894 F.2d 371, 372–373 (CA10 1990) (District Court's entry of summary judgment violated § 362(a)'s automatic stay); see also *Maritime Electric Co.*, 959 F.2d, at 1206 (collecting cases). Cf. 2 Collier ¶ 101.15, at 101–62 to 101–63 (" 'Entity' is the broadest of all definitions which relate to bodies or units").

More importantly, though the Bankruptcy Judge's June 13 order enjoins " 'the judgment creditor,' " *In re Celotex Corp.*, 128 B.R. 478, 485 (Bkrcty.Ct. MD Fla.1991), the order clearly has the same practical effect as if it enjoined the court directly. My objection to the majority's approach does not at all depend on whether the order that prevents the Article III court from exercising its jurisdiction does so directly or indirectly. Instead, my view is simply that a bankruptcy judge who

lacks jurisdiction to decide an issue may not prevent an [Article III](#) court that is ready and willing to exercise its conceded jurisdiction from doing so.

- 10 In addition, [28 U.S.C. § 1334\(c\)\(2\)](#) provides for mandatory abstention in cases involving state-law claims for which the sole basis of bankruptcy jurisdiction is “related to” jurisdiction. That provision thus makes clear that no order could have been entered over the Edwards’ objection if their tort action had been tried in a state rather than a federal court. The Bankruptcy Judge’s order, which does not distinguish proceedings to enforce supersedeas bonds that were posted in state-court proceedings, fails to address the implications of this mandatory abstention provision.

I also believe that Congress would have expected bankruptcy judges to show the same deference to federal courts adjudicating state-law claims under diversity jurisdiction, at least when the bankruptcy judge purports to act on the basis of his “related to” jurisdiction and when the federal action can be “timely adjudicated.” *Ibid.*

- 11 I agree with the majority that the Bankruptcy Judge’s order is a temporary injunction, and thus it is not a “final order or judgment.” *Ante*, at 1499, n. 7. The temporary nature of the injunction, however, is irrelevant. As I have stated repeatedly in the text, I believe that a statutory scheme that deprives a bankruptcy judge of jurisdiction to “determine” a case also deprives that judge of jurisdiction to issue binding injunctions—even temporary ones—that would prevent an [Article III](#) court with jurisdiction over the case from determining it.

- 12 The cases on which the Bankruptcy Judge relied are entirely consistent with my approach, and they provide at most indirect support for his order. In *A.H. Robins Co. v. Piccinin*, 788 F.2d 994, 997 (CA4), cert. denied, 479 U.S. 876, 107 S.Ct. 251, 93 L.Ed.2d 177 (1986), the challenged injunction was issued by an [Article III](#) court (“[T]he district court granted Robins’ request for a preliminary injunction”); and in *In re Johns–Manville Corp.*, 837 F.2d 89, 91–92 (CA2), cert. denied, 488 U.S. 868, 109 S.Ct. 176, 102 L.Ed.2d 145 (1988), the Court of Appeals found that the Bankruptcy Judge had jurisdiction to enter the injunction in a core proceeding because the insurance policies that were the subject of the injunction were property of the bankruptcy estate. Thus, those cases do not support the present injunction, which was issued by a non-[Article III](#) judge and which affects supersedeas bonds that are concededly not property of the debtor’s estate.

I also note that in *Willis v. Celotex Corp.*, 978 F.2d 146 (1992), cert. denied, 507 U.S. 1030, 113 S.Ct. 1846, 123 L.Ed.2d 470 (1993), though upholding the very injunction at issue in this case, the Fourth Circuit engaged in no detailed jurisdictional analysis and entirely omitted any discussion of the significance of the Bankruptcy Judge’s non-[Article III](#) status.

- 13 “[W]hen a cause of action is one which is created by [title 11](#), then that civil proceeding is one ‘arising under [title 11](#).’ ” 1 Collier ¶ 3.01[1][c][iii], at 3–26. A perusal of the complaint reveals that Celotex seeks relief under causes of action created by the Bankruptcy Code. See, e.g., Count I ([11 U.S.C. § 547\(b\)](#) (seeking to avoid preferential transfers)); Count III ([11 U.S.C. § 548\(a\)\(2\)\(A\)](#) (seeking to avoid constructively fraudulent transfers)); Count IV ([11 U.S.C. § 544](#) (seeking to avoid transactions that would constitute constructively fraudulent transfers under state law)); Count VII ([11 U.S.C. § 502](#) (seeking to disallow punitive damages awards)); Count VII ([11 U.S.C. § 510\(c\)\(1\)](#) (seeking equitable subordination of pending punitive damages awards to the claims of unsecured creditors)). Cf., e.g., 1 Collier ¶ 3.01 [1][c][iii], at 3–27 (“[C]ourts interpreting this language have held that ‘arising under [title 11](#)’ includes causes of action to recover fraudulent conveyances”). My acknowledgment of these claims, of course, is not intended as a suggestion that they have merit.

- 14 In 1973, bankruptcy “referees” were redesignated as “judges.” See *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 53, n. 2, 102 S.Ct. 2858, 2862, n. 2, 73 L.Ed.2d 598 (1982). As did the plurality opinion in *Northern Pipeline*, see *ibid.*, I will continue to refer to all judges under the pre-1978 Act as “referees.”

- 15 Congress also limited the power of bankruptcy courts to “punish a criminal contempt not committed in the presence of the judge of the court or warranting a punishment of imprisonment.” [28 U.S.C. § 1481](#) (1982 ed.).

- 16 The 1984 amendments also repealed the authorization of bankruptcy judges to act pursuant to the All Writs Act. See 2 Collier ¶ 105.01[1], at 105–3.

- 17 The plurality opinion expressly noted its concerns about the bankruptcy judge's exercise of broad injunctive powers. See n. 7, *supra*.
- 18 See, e.g., 130 Cong.Rec. 20089 (1984) (“*[Northern Pipeline]* held that the broad powers granted to bankruptcy judges under the Bankruptcy Act of 1978 were judicial powers and violated Article III of the Constitution. The present Bill attempts to cure the problem”).
- 19 See Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Pub L. 99–554, 100 Stat. 3088. With respect to 11 U.S.C. § 105, the 1986 amendments added the second sentence of the current version of § 105(a). See 100 Stat. 3097.
- 20 The only relevant legislative history regarding the changes to § 105(a) is contained in Senator Hatch's view that the amendment “allows a bankruptcy court to take any action on its own, or to make any necessary determination to prevent an abuse of process and to help expedite a case in a proper and justified manner.” 132 Cong.Rec. 28610 (1986).
- 21 Neither of the cases cited by the majority, *ante*, at 1501, n. 9, provides any reason to conclude otherwise. As the majority notes, those cases hold that the bankruptcy trustee may recover from a third party (e.g., the Edwards) funds transferred from the debtor (e.g., Celotex) to another (e.g., Northbrook) for the benefit of that third party. Both cases, however, make clear that the obligation of the Northbrook-like guarantor (a bank in each case) to pay the third party was not at issue. See *In re Compton Corp.*, 831 F.2d 586, 590 (1987) (“[T]he trustee is not attempting to set aside the post petition payments by [the bank] to [the third party] under the letter of credit as a preference”), modified on other grounds, 835 F.2d 584 (CA5 1988); *In re Air Conditioning, Inc. of Stuart*, 845 F.2d 293, 295–296 (CA11), cert. denied *sub nom. First Interstate Credit Alliance v. American Bank of Martin County*, 488 U.S. 993, 109 S.Ct. 557, 102 L.Ed.2d 584 (1988). Thus, in my view, those cases cannot form the basis for any nonfrivolous argument that Northbrook may avoid its obligation to pay the Edwards.
- 22 Indeed, one wonders if the same analysis would apply to a bankruptcy judge's injunction that purported to prevent this Court from allowing a successful litigant to enforce a supersedeas bond posted by a nondebtor in this Court pursuant to our Rule 23.4.

96 F.3d 949

United States Court of Appeals,
Seventh Circuit.

In the Matter of VICARS
INSURANCE AGENCY,
INCORPORATED, Debtor–Appellee.
Appeal of UNITED NATIONAL
INSURANCE COMPANY, Creditor, Diamond
State Insurance Company, Creditor, and
Hallmark Insurance Company, Creditor.
In the Matter of E&S FACILITIES,
INCORPORATED, Debtor–Appellee.
Appeal of UNITED NATIONAL
INSURANCE COMPANY, Creditor, and
Diamond State Insurance Company, Creditor.

Nos. 95–2712, 95–2713.

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Argued Dec. 5, 1995.

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Decided Sept. 19, 1996.

Synopsis

Suit was filed in the United States District Court for the Eastern District of Pennsylvania against debtors alleging, inter alia, violations of the Racketeer Influenced and Corrupt Organizations Act (RICO). Debtors then filed Chapter 11 petitions in the United States Bankruptcy Court for the Southern District of Indiana. Creditor moved for withdrawal of the reference to bankruptcy court with respect to creditor's claims against Chapter 11 debtor-corporation under Racketeer Influenced and Corrupt Organizations Act (RICO). The United States District Court for the Southern District of Indiana, Sarah Evans Barker, Chief Judge, and [Larry J. McKinney, J.](#), 181 B.R. 369, denied motion. The district court judges certified each order of denial for interlocutory appeal. Appeals were consolidated. The Court of Appeals, [Harlington Wood, Jr.](#), Circuit Judge, held that withdrawal of the reference was not mandatory for case involving RICO issues that had not yet been decided by the Seventh Circuit Court of Appeals.

Affirmed.

Attorneys and Law Firms

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[Beth Kramer](#), Office of the United States Trustee, Indianapolis, IN, for U.S. Trustee in Nos. 95–2712, 95–2713.

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Before [WOOD, Jr.](#), [COFFEY](#), and [MANION](#), Circuit Judges.

Opinion

[HARLINGTON WOOD, Jr.](#), Circuit Judge.

These consolidated cases require us to consider the scope of the mandatory “withdrawal of reference” provision of the Bankruptcy Code, 28 U.S.C. § 157(d). This statute requires district courts to reassume primary authority over a proceeding formerly delegated to the bankruptcy court when confronted with certain interpretive circumstances. While the statutory language in question is seemingly straightforward, the many and varied interpretations of this provision by bankruptcy and district courts demonstrate that its “plain meaning” has been somewhat difficult to discern. Despite the varied approaches, the question has received little attention

from the courts of appeals and is a matter of first impression in this circuit.

I. BACKGROUND

Appellants United National Insurance Company, Diamond State Insurance Company, and Hallmark Insurance Company are all part of the same corporate “family”¹ called the United National Group (“UNG”). In late 1991 these companies concluded an agreement with Transportation Underwriters, Inc. (“TUI”), a firm controlled by James K. Culley, allowing TUI to underwrite physical damage insurance for commercial vehicles according to certain terms. One term of particular relevance required TUI to write only policies limited to one month's duration, with renewal possible but subject to the same limited time basis. The agreement also permitted “continuous” policies, but required that these too be subject to monthly premium charges.

Soon after the agreement with TUI was concluded, Culley delegated the obligations of TUI to Vicars Insurance and E&S Facilities (“Vicars,” “E&S,” or “debtors”), other entities under his control. UNG alleges that these companies then intentionally violated the agreement by selling policies and collecting premiums on an annual rather than a monthly basis. UNG claims that Vicars and E & S falsely reported the policy terms to UNG as monthly (not annual) and improperly retained or diverted to other uses all but a small fraction of the premiums, all further violations of the agreement. Such practices allegedly occurred over about a year and involved more than 4800 insurance policies.

This alleged financial scheme was eventually discovered or otherwise went awry. The *951 record is unclear as to the next events, but these specifics need not detain us. UNG soon demanded various payments in accordance with the agreement. When these demands went unsatisfied, UNG filed a civil action in the United States District Court for the Eastern District of Pennsylvania in June, 1994 against Vicars, E & S, and one Richard Trakimas, an officer of Vicars. Based on the policy and premium irregularities described above, the complaint alleged five counts including violations of the Racketeer Influenced and Corrupt Organizations Act (“RICO”), 18 U.S.C. § 1961 *et seq.*, common law fraud, civil conspiracy, and unjust enrichment. This suit forced Vicars and E & S into bankruptcy; both companies filed voluntary petitions for reorganization under Chapter 11 of the

Bankruptcy Code in the Bankruptcy Court for the Southern District of Indiana.

UNG responded to these filings with a motion requesting the district court in Indianapolis to withdraw the reference of their civil claims from the bankruptcy court in each case. Some of the companies within UNG then filed proofs of claims for recovery of premiums due and treble damages amounting to several million dollars. The debtors answered with objections to these claims on various grounds and a counterclaim for tortious interference with contract. Both district judges denied the motions to withdraw the reference, with Judge McKinney joining the views of Judge Barker. Thereafter the district court judges certified each order of denial for an interlocutory appeal. This court granted permission for the same and ordered consolidation of the two appeals for argument.

II. DISCUSSION

As it is a question of law, we will review the denial of a motion to withdraw the reference to a bankruptcy court on a plenary basis.

Statutory language often finds its way into our law books by a tortuous path, and the mandatory withdrawal provision at issue here is no exception. Its immediate source, the Bankruptcy Amendments and Federal Judgeship Act of 1984 (“the Amendments Act” or “Act”), was enacted by Congress in response to the Supreme Court's decision in *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 102 S.Ct. 2858, 73 L.Ed.2d 598 (1982). The Court's plurality opinion in *Marathon* has been the subject of much academic speculation and commentary, and its precise contours remain open to debate. It will suffice here to note that in general terms the decision limited the power of Congress to assign adjudicative authority to federal bankruptcy judges.² Much bankruptcy law was thus rendered open to attack on constitutional grounds. Attempting to rectify this problem and abide by the constitutional constraints of *Marathon*,³ Congress passed the Amendments Act. The Act gave the district courts original jurisdiction over all cases arising under title 11 of the Bankruptcy Code, *see* 28 U.S.C. § 1334(b), but also allowed federal courts to “refer” bankruptcy cases to the bankruptcy judges for the district automatically. *See* 28 U.S.C. § 157(a). This authority to refer was tempered, however, with a provision that the reference may or shall be withdrawn in certain situations:

The district court may withdraw, in whole or in part, any case or proceeding referred under this section, on its own motion or on timely motion of a party, for cause shown. The district court shall, on timely motion of a party, so withdraw a proceeding if the court determines that resolution of the proceeding requires consideration of both *952 title 11 and other laws of the United States regulating organizations or activities affecting interstate commerce.

28 U.S.C. § 157(d).

The second sentence quoted above, the so-called mandatory withdrawal provision at issue here, has spawned several cases and generated a variety of readings. This is perhaps not surprising considering its several ambiguous phrases, which combine lower court discretion with flexible terms such as “resolution,” “consideration,” and “affecting.”

Appellants argue that the mandatory withdrawal provision should be interpreted almost literally, but concede that the “consideration” required of at least the non-title 11 law must be “material.” This expansive view of the term “consideration” has commanded little support. Overwhelmingly courts and commentators agree that the mandatory withdrawal provision cannot be given its broadest literal reading, for sending every proceeding that required passing “consideration” of non-bankruptcy law back to the district court would “eviscerate much of the work of the bankruptcy courts,” *In re Adelphi Institute, Inc.*, 112 B.R. 534, 536 (S.D.N.Y.1990) (quoting 1 *Collier on Bankruptcy* para. 3.01 (15th ed. 1987)).⁴ From a litigant's perspective, such a reading would also create an “escape hatch” by which bankruptcy matters could easily be removed to the district court. See Note, *Closing the Escape Hatch in the Mandatory Withdrawal Provision of 28 U.S.C. § 157(d)*, 36 U.C.L.A. L.Rev. 417 (1988). This might in turn encourage delaying tactics (perhaps further draining the resources of the debtor), forum shopping, and generally unnecessary litigation. The legislative history of the Act reveals that this concern was recognized by Congress (the term “escape hatch” comes from the congressional debates) and that the measure's author and proponents denied any such effect, stressing that they intended the provision to be read narrowly. See 130 Cong. Rec. H1849–50 (daily ed. Mar. 21, 1984) (remarks of Rep. Kastenmeier); S.Rep. No. 55, 98th Cong., 1st Sess. 16 (1983) (“the Committee intends ... mandatory recall [to] be construed narrowly.”).

As we indicated, courts have uniformly agreed that a narrow interpretation is indeed required. To achieve this, however,

several avenues have been taken. The first court to consider § 157(d) relied on the wording of the section, which requires withdrawal only when “consideration” of both title 11 and non-Code federal statutes is necessary for the “resolution” of a case or proceeding, together with “the congressional goal of having expert bankruptcy judges determine complex Code matters to the greatest extent possible,” and concluded that withdrawal should be granted only if the current proceeding could not be resolved without “substantial and material consideration” of the non-Code federal law. *In re White Motor Corp.*, 42 B.R. at 704. This “substantial and material” gloss has been accepted as an appropriate reading of the statute and effectuation of Congress' intent by most courts, including the Second Circuit. See *Shugrue v. Air Line Pilots Ass'n, Int'l (In re Ionosphere Clubs, Inc.)*, 922 F.2d 984 (2d Cir.1990), cert. denied, 502 U.S. 808, 112 S.Ct. 50, 116 L.Ed.2d 28 (1991). We join that view today.

Some courts and commentators have attempted to narrow the statute by focusing on other elements of the provision, including the usage of the words “both” and “and” (“both title 11 ... and other laws”) to determine whether “substantial and material consideration” is required of title 11 law in addition to non-Code federal law. See *American Freight Sys. v. I.C.C. (In re American Freight System)*, 150 B.R. 790, 793 (D.Kan.1993) (and citations therein). Still others have analyzed whether or how the non-Code law in question “affects” interstate commerce. See, e.g., *In re Blackman*, 55 B.R. 437, 450 (Bankr.D.D.C.1985); *In re Rubin Bros. Footwear, Inc.*, 73 B.R. 346, 351 (S.D.N.Y.1987). Neither party to this appeal questions the fact that this proceeding requires consideration of title 11 law, nor do they contest the proposition that the RICO *953 statute “affects” interstate commerce. We will thus leave these finer issues of interpretation for another day. We do note, however, that whatever one considers the rationale for the mandatory withdrawal provision to be—constitutional concerns, legislative preference, expertise of the respective courts, etc.—it would be somewhat anomalous to require withdrawal of a proceeding that contains, say, both title 11 and complex antitrust interpretation issues, but leaves to the bankruptcy court those cases or proceedings that require complex analysis of the antitrust statutes alone.

Thus we return to the “substantial and material consideration” test. A helpful adjective has been added, but this too is imprecise and has generated several readings. What constitutes “substantial” consideration of a non-title 11 statute? Answers to this question have a broad range. At the

least restrictive end of the spectrum, one court has held that this requirement is met if a proceeding merely “presents a non-Title 11 federal question which will affect the outcome of the proceeding.” *Contemporary Lithographers, Inc. v. Hibbert*, (In re *Contemporary Lithographers*), 127 B.R. 122, 127 (M.D.N.C.1991).

The majority of courts have taken a narrower view, however, examining a variety of factors. These generally require that the issues in question require more than the mere application of well-settled or “hornbook” non-bankruptcy law; “significant interpretation” of the non-Code statute must be required.⁵ *United States v. Johns–Manville Corp.* (In re *Johns–Manville Corp.*), 63 B.R. 600, 603 (S.D.N.Y.1986); *City of New York v. Exxon Corp.*, 932 F.2d 1020, 1026 (2d Cir.1991) (also using term “substantial interpretation”).

The most restrictive interpretations have identified particular contexts as the only situations appropriate for mandatory withdrawal. These have included proceedings where non-title 11 issues “dominated” bankruptcy issues, see *In re Lenard*, 124 B.R. 101, 102 (D.Colo.1991), or where the proceeding presented a conflict between statutes, a question of first impression, or a constitutional challenge. See *In re Adelphi Institute*, 112 B.R. 534, 537 (S.D.N.Y.1990).

We believe the proper approach to mandatory withdrawal analysis lies in the middle of this spectrum. Given the discretion granted to district courts by § 157(d), there is little reason to assume that withdrawal is required by the mere presence of a non-title 11 issue, even if that issue is outcome determinative. This reading, which makes withdrawal virtually automatic, reads out of the statute both district court discretion and any “consideration” whatsoever.⁶

Delimiting specific contexts where mandatory withdrawal is required is also a problematic approach. Such identification is useful only to the extent that the context in question will always require a court to devote substantial consideration to the issues involved. This may or may not be true in every particular instance. In any event the specifics of the particular context or posture should be fleshed out by the moving party to demonstrate that the grounds for withdrawal are satisfied (i.e., substantial and material consideration is required). That party ultimately bears the risk of nonpersuasion. *In re Michigan Real Estate Ins. Trust*, 87 B.R. 447, 459 (E.D.Mich.1988) (citations omitted).

In accordance with the statute's terms, then, the guiding question must be whether consideration is required, not merely the context in which the issue is presented. Here unfortunately no bright line can be drawn. Courts have defined “consideration” to mean “something more than the mere process of examining, thinking about, or taking *954 into account.” *In re McCrory Corp.*, 160 B.R. 502, 505 (S.D.N.Y.1993); *American Freight Sys.*, 150 B.R. at 792. This definition is similar to the application/interpretation distinction first drawn in *Johns–Manville*, which we believe identifies the heart of the matter. This approach is in accordance with the terms of § 157(d), Congress' intent, and the practicalities of litigation. We therefore hold that as far as non-title 11 issues are presented, mandatory withdrawal is required only when those issues require the interpretation, as opposed to mere application, of the non-title 11 statute, or when the court must undertake analysis of significant open and unresolved issues regarding the non-title 11 law. The legal questions involved need not be of “cosmic proportions,” *In re Rimsat, Ltd.*, 196 B.R. 791, 799 (N.D.Ind.1995), but must involve more than mere application of existing law to new facts.

We also note a decision regarding mandatory withdrawal does not prevent district court involvement. Indeed, a safety device is provided by the other sentence of § 157(d). This “permissive” withdrawal provision allows a district court to withdraw, at any time, even a part of a case or proceeding on its own motion or that of a party, for cause shown. See 28 U.S.C. § 157(d). Thus even if the court determines that mandatory withdrawal does not apply, it may prefer to withdraw or limit the reference nonetheless. Some bankruptcy courts, even though they are without jurisdiction to hear a motion for withdrawal, see 28 U.S.C. § 157(d), make recommendations to the district court as to whether this should be done. See, e.g., *In re Golden Gulf, Ltd.*, 73 B.R. 685, 686 (Bankr.E.D.Ark.1987) (recommendation regarding mandatory withdrawal); *In re Michigan Real Estate Ins. Trust*, 87 B.R. at 465 (recommendation regarding discretionary withdrawal).

This brings us to the application of these principles to this particular case. UNG claims that even under a narrow interpretation of § 157(d) withdrawal is required because of the RICO violations alleged in its civil complaint. These violations are based in part upon theories of aiding and abetting liability. While this circuit has not commented on the possibility of aiding and abetting liability in civil RICO actions, others have approved the theory. See *Jaguar Cars*,

Inc. v. Royal Oaks Motor Car Co., 46 F.3d 258, 270 (3d Cir.1995) (aiding and abetting liability appropriate where defendant knew of substantive act and acted with intent to facilitate it); *Armco Indus. Credit Corp. v. SLT Warehouse Co.*, 782 F.2d 475, 485 (5th Cir.1986) (“mere negative acquiescence” is not enough to establish aiding and abetting civil liability under RICO; defendant must have affirmatively acted in a way that facilitated success of illegal action).

Since UNG filed its civil complaint in the Third Circuit, it contends that it is unclear whether the law of that circuit or this one (the circuit in which the bankruptcy claim is adjudicated) should apply. Thus UNG argued to the district court that:

issues may arise in the consideration of [UNG]'s RICO claims which, although settled in favor of [UNG] in those jurisdictions in which such issues have been entertained, may be questions of first impression should the law of the Seventh Circuit rather than the Third Circuit be found to apply in this case.

The district court found that the possibility that RICO claims “might involve novel issues” was not enough to trigger mandatory withdrawal. The court characterized UNG's concerns as at most “speculative” and at worst “completely hypothetical.” Furthermore, the court stressed that the bankruptcy court was not without guidance on the issue from other courts, including district court holdings within this circuit. The court concluded that “[e]ither way, UNG falls far short of establishing ‘that this case involves anything more than a routine application of RICO law.’ ” *In re E & S Facilities*, 181 B.R. 369, 373 (S.D.Ind.1995) (quoting *In re Laventhol & Horwath*, 139 B.R. 109, 116 (S.D.N.Y.1992)).

We agree with this conclusion. UNG may be without guidance as to which circuit's law will definitively apply to the claim, but this conjectural concern by itself (for UNG offered little else to the district courts) does not necessarily trigger “substantial and material consideration” of a non-title 11 statute. Similarly, neither is it enough that an issue simply has not been considered at the circuit *955 court level. As the district court recognized, law from lower courts exists in both circuits (and others) for a bankruptcy judge's guidance and application. In the Seventh Circuit, for example, district courts have offered guidelines as to what elements must be met if civil RICO aiding and abetting liability were to be recognized at the circuit level. See *FMC Corp. v. Boesky*, 727 F.Supp. 1182, 1200 (N.D.Ill.1989); *WAIT Radio v. Price Waterhouse*, 691 F.Supp. 102, 108 (N.D.Ill.1988). So too other district courts have recognized aiding and abetting liability in a civil RICO context. See *Downing v. Halliburton & Assoc.*, 812 F.Supp. 1175, 1182 (M.D.Ala.1993), *aff'd*, 13 F.3d 410 (11th Cir.1994); *In re Sahlen & Assoc. Sec. Litig.*, 773 F.Supp. 342, 367 (S.D.Fla.1991); *Morrow v. Black*, 742 F.Supp. 1199, 1203 (E.D.N.Y.1990).

For these reasons we agree that UNG failed to satisfy its burden of persuasion on the issue of mandatory withdrawal, and the decisions of the district courts are accordingly Affirmed.

All Citations

96 F.3d 949, 65 USLW 2211, 29 Bankr.Ct.Dec. 994, Bankr. L. Rep. P 77,119, RICO Bus.Disp.Guide 9120

Footnotes

- 1 Hallmark's parent is Diamond State, whose parent, in turn, is United National.
- 2 “The Court's holding in that case establishes only that Congress may not vest in a non-Article III court the power to adjudicate, render final judgment, and issue binding orders in a traditional contract action arising under state law, without consent of the litigants, and subject only to ordinary appellate review.” *Thomas v. Union Carbide Agric. Prods. Co.*, 473 U.S. 568, 584, 105 S.Ct. 3325, 3334, 87 L.Ed.2d 409 (1985) (citations omitted).
- 3 There is some dispute as to whether the mandatory withdrawal provision of § 157(d) is properly considered a matter of constitutional mandate or a simple legislative preference. Compare *In re White Motor Corp.*, 42 B.R. 693, 699–701 (N.D. Ohio 1984) (finding the measure constitutionally mandated) with *In re Anthony Tammaro, Inc.*, 56 B.R. 999, 1006 (D.N.J.1986) (finding mere legislative decision). It is unnecessary for us to enter this debate today.
- 4 “[A]ny reading of § 157(d) which limits bankruptcy court jurisdiction to questions arising solely under the [Bankruptcy] Code would strip the court of much of its authority to resolve debtor-creditor disputes, since numerous Code provisions themselves require reference to other state and federal law.” *In re White Motor Corp.*, 42 B.R. at 703.

5 The court in *Johns–Manville* stated that:

It would seem incompatible with congressional intent to provide a rational structure for the assertion of bankruptcy claims to withdraw each case involving the straightforward application of a federal statute to a particular set of facts. It is issues requiring a significant *interpretation* of federal laws that Congress would have intended to have decided by a district judge rather than a bankruptcy judge. [In re Johns–Manville Corp.](#), 63 B.R. 600, 602 (S.D.N.Y.1986).

6 We note that “mandatory” withdrawal is never wholly “automatic” since it requires the motion of a party.

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922 F.2d 984

United States Court of Appeals,
Second Circuit.

In re IONOSPHERE CLUBS, INC.
and Eastern Airlines, Inc., Debtors.
Martin R. SHUGRUE, Jr., As Chapter 11
Trustee for Eastern Airlines, Inc., Appellant,

v.

AIR LINE PILOTS ASSOCIATION,
INTERNATIONAL, Appellee.

Nos. 580, 581, Dockets 90–5033, 90–5035.

|
Argued Nov. 14, 1990.

|
Decided Dec. 21, 1990.

Synopsis

On appeal from an order entered April 10, 1990, in the Southern District of New York, [Robert W. Sweet, District Judge, 114 B.R. 379](#), reversing two orders of the bankruptcy court that stayed appellee's attempts to arbitrate a dispute arising from its collective bargaining agreement with appellant and to bring an action to enjoin a practice of appellant as violative of the collective bargaining agreement, the Court of Appeals, Timbers, Circuit Judge, held: (1) that arbitration brought pursuant to collective bargaining agreement is not subject to automatic stay, and (2) that union's action seeking judicial enforcement of collective bargaining agreement provision was stayed.

Affirmed in part, reversed in part and remanded.

[Miner](#), Circuit Judge, concurred in part, dissented in part, and filed opinion.

Attorneys and Law Firms

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[Richard M. Seltzer](#), New York City ([James L. Linsey](#), [Russell S. Hollander](#), [Richard B. Miller](#), and Cohen, Weiss & Simon, New York City, on the brief), for appellee Air Line Pilots Ass'n, Intern.

Before [MINER](#) and TIMBERS, Circuit Judges, and SPRIZZO, District Judge, for the Southern District of New York, sitting by designation.

Opinion

TIMBERS, Circuit Judge:

Appellant Martin R. Shugrue, Jr., Chapter 11 Trustee for Eastern Airlines, Inc. (Eastern), appeals from an order entered April 10, 1990 in the Southern District of New York, Robert W. Sweet, *District Judge*, reversing two orders of the bankruptcy court that stayed attempts by the Air Line Pilots Association, International (ALPA) to arbitrate a dispute arising out of their collective bargaining agreement with Eastern and to prosecute a lawsuit seeking to enjoin Eastern's practice of wet-leasing aircraft and crews as violative of the collective bargaining agreement.

On March 9, 1989, Eastern filed a petition for reorganization under Chapter 11 of the Bankruptcy Code. Subsequently, ALPA, which was engaged in a sympathy strike against Eastern, sought relief from the automatic stay to initiate an arbitration to determine whether labor protective provisions (LPPs) in the collective bargaining agreement had been triggered by Eastern's merger with Continental. The bankruptcy court, Burton R. Lifland, *Chief Bankruptcy Judge*, denied that petition. *In re Ionosphere Clubs, Inc.*, 105 B.R. 765 (Bankr. S.D.N.Y.1989) (the LPP-decision).

After the strike began and after Eastern filed its petition for reorganization, Eastern entered into wet-lease contracts with Continental. Wet-leasing is a practice by which one airline leases aircraft and crews from another airline. ALPA commenced an action in the Southern District of Florida, seeking to enjoin this practice as violative of its collective bargaining agreement with Eastern. In response, Eastern commenced an adversary proceeding in the bankruptcy court to enjoin ALPA from prosecuting the Florida action. The bankruptcy court, Burton R. Lifland, *Chief Bankruptcy Judge*, held that ALPA's action was violative of the automatic stay and enjoined its prosecution pursuant to its powers under 11 U.S.C. § 105(a) (1988). *In re Ionosphere Clubs, Inc.*, 105 B.R. 773 (Bankr.S.D.N.Y.1989) (the wet-lease decision).

ALPA appealed both bankruptcy court orders to the district court pursuant to 28 U.S.C. § 158(a) (1988). The district court reversed them both. The court held that 11 U.S.C. § 1113(f) (1988) precludes the application of the automatic stay and the bankruptcy court's equitable powers to any proceeding brought by a union to enforce a collective bargaining agreement against a debtor, unless and until the debtor complies with the provisions of § 1113, which regulates the termination or modification of collective bargaining agreements by a debtor in bankruptcy. *In re Ionosphere Clubs, Inc.*, 114 B.R. 379 (S.D.N.Y.1990).

On appeal, Eastern contends that (1) § 1113(f) of the Bankruptcy Code does not preclude application of the automatic stay *987 provisions of § 362 or of the bankruptcy court's equitable powers under § 105 to ALPA's attempts to enforce the collective bargaining agreement outside the bankruptcy court; and (2) the bankruptcy court decisions should be reinstated.

For the reasons that follow, we affirm the district court's order as to the LPP-decision and reverse its order as to the wet-lease decision. We remand the case to the district court for further consideration.

I.

We shall summarize only those facts and prior proceedings believed necessary to an understanding of the issues raised on appeal.

This appeal involves two issues in a labor dispute between Eastern and ALPA. At all times relevant to this appeal, the relationship between the two parties was governed by a collective bargaining agreement dated February 23, 1986 and entered into pursuant to the Railway Labor Act (RLA), 45 U.S.C. § 151 *et seq.* (1988).

On March 4, 1989, the International Association of Machinists and Aerospace Workers (IAM) began a primary strike against Eastern. Soon thereafter, ALPA and the Transportation Workers Union of America struck Eastern in sympathy with the IAM. On March 9, 1989, Eastern filed a petition for reorganization under Chapter 11 of the Bankruptcy Code in the Southern District of New York. On June 21, 1989, Eastern filed a motion in the bankruptcy court to reject the collective bargaining agreement pursuant to § 1113. Eastern withdrew that motion on July 26, 1989. At the

time the bankruptcy court reached the decisions under review on the instant appeal, no application under § 1113 to terminate or modify the collective bargaining agreement was pending before it. Martin R. Shugrue, Jr. was appointed Trustee for Eastern on April 19, 1990.

(A)

The collective bargaining agreement contained LPPs designed to protect ALPA members in the event of a merger. The collective bargaining agreement provided that disputes arising from it would be submitted to arbitration and it set forth a procedure governing that process. Eastern was sold to Texas Air Corporation (Texas Air) within days after the collective bargaining agreement became operative. After Eastern's acquisition by Texas Air, a dispute arose as to the operation of the LPPs. On June 10, 1986, Eastern commenced an action in the Southern District of Florida, seeking a declaration that the collective bargaining agreement was invalid. That contention was rejected and Eastern was ordered to arbitrate the dispute. *Eastern Air Lines, Inc. v. Air Line Pilots Ass'n, Int'l*, 670 F.Supp. 947 (S.D.Fla.1987), *aff'd*, 861 F.2d 1546 (11 Cir.1988).

On August 6, 1986, pursuant to the provisions of the collective bargaining agreement, ALPA filed a grievance with the System Board of Adjustments, the body established to hear and determine grievances based on disputes concerning the collective bargaining agreement. On March 8, 1989, the arbitration panel ruled in favor of ALPA. It concluded that the LPPs provided that, in the event of a merger, seniority lists were to be merged. The panel did not decide whether a merger had taken place that would have triggered the LPPs. The decision was not signed by all the panel members until the next day, approximately seven minutes after Eastern filed its bankruptcy petition.

On July 21, 1989, ALPA filed a motion in the bankruptcy court, seeking a determination that the arbitration decision became effective prior to Eastern's Chapter 11 filing and, thus, was not affected by the automatic stay, or, in the alternative, it sought relief from the automatic stay to implement the arbitration decision. ALPA supplemented its motion requesting relief from the automatic stay with a request to commence a second arbitration to determine whether Eastern and Continental had merged, thus triggering the LPPs. Eastern did not oppose the request for relief from the stay to implement the first arbitration decision, but did

oppose the supplemental request to commence a second arbitration.

***988** The bankruptcy court lifted the stay for the limited purpose of formally issuing the arbitration decision interpreting the LPPs, but declined to lift the stay for the purpose of allowing ALPA to initiate an arbitration to determine whether a merger had taken place. *In re Ionosphere Clubs, Inc.*, *supra*, 105 B.R. 765. The court reasoned that issues raised in the arbitration would duplicate efforts being made by the examiner it had appointed. *Id.* at 771.

(B)

Wet-leasing refers to the practice of one airline leasing aircraft and crews from another airline. The collective bargaining agreement prohibited Eastern from engaging in this practice. It required Eastern to employ ALPA pilots on the Eastern pilot's system seniority list to perform its flying. In August 1989, since its pilots were on strike and replacement pilots were still being trained, Eastern entered into wet-lease contracts with Continental.

On September 1, 1989, ALPA commenced an action in the Southern District of Florida (the Florida action), seeking to enjoin the wet-leasing as violative of the collective bargaining agreement and of the RLA. The district court set the case on an expedited discovery schedule. On September 25, 1989, Eastern commenced an adversary proceeding in the bankruptcy court, seeking to enjoin ALPA from prosecuting the Florida action. In its complaint, Eastern alleged that its wet-lease contracts were reasonably necessary to its continued operation during the strike.

The bankruptcy court held that the Florida action violated the provisions of the automatic stay, specifically, 11 U.S.C. § 362(a)(3) (1988), which provides for a stay of “any act ... to exercise control over property of the estate.” *In re Ionosphere Clubs*, *supra*, 105 B.R. at 779. The court determined that Eastern's actions were “reasonably necessary” to its continued operation during the strike and were protected under the doctrine announced in *Brotherhood of Ry. & S.S. Clerks v. Florida East Coast Ry.*, 384 U.S. 238, 248, 86 S.Ct. 1420, 1425, 16 L.Ed.2d 501 (1966). *In re Ionosphere Clubs*, *supra*, 105 B.R. at 780. Finally, the bankruptcy court enjoined further prosecution of the Florida action pursuant to its powers under § 105(a). *Id.*

(C)

ALPA appealed both bankruptcy court orders to the district court pursuant to 28 U.S.C. § 158(a) (1988). The appeal from the LPP decision was assigned to Judge Sweet. The appeal from the wet-lease decision was assigned to Judge Leval. Subsequently, the two appeals were consolidated before Judge Sweet.

On April 10, 1990, the district court entered its opinion and order, reversing the orders of the bankruptcy court in both cases. *In re Ionosphere Clubs, Inc.*, 114 B.R. 379 (S.D.N.Y.1990). The district court reasoned that § 1113 of the Bankruptcy Code was intended to be the “exclusive ... means in the Bankruptcy Code by which a debtor could modify or reject its collective bargaining contract obligations.” *Id.* at 396. The court concluded that application of the automatic stay to bar enforcement of a collective bargaining agreement outside the bankruptcy court was precluded by § 1113(f), which provides that no provision of the Bankruptcy Code other than § 1113 should be construed to permit a trustee unilaterally to alter or terminate a collective bargaining agreement. *Id.* at 400.

This appeal followed.

II.

Initially, we set forth our standard of review. The district court order is subject to plenary review. *In re Hanratty*, 907 F.2d 1418, 1423 (3 Cir.1990); *In re Johnson*, 901 F.2d 513, 516 (6 Cir.1990); *In re Manville Forest Prods. Corp.*, 896 F.2d 1384, 1388 (2 Cir.1990). “This court exercises the same review over the district court's decision that the district court may exercise [over the bankruptcy court's decision].” *Brown v. Pennsylvania State Employees Credit Union*, 851 F.2d 81, 84 (3 Cir.1988). Accordingly, we review conclusions of law *de novo*, and findings of fact under a clearly erroneous standard.

***989** *In re Manville*, *supra*, 896 F.2d at 1388; *Brown*, *supra*, 851 F.2d at 84.

III.

This appeal raises the question of the effect of § 1113 of the Bankruptcy Code on the application of the automatic stay provisions of § 362 of the Bankruptcy Code to non-

bankruptcy proceedings to enforce a collective bargaining agreement. Resolution of this dispute requires us to consider the intent of Congress in enacting these sections.

(A)

Section 362 of the Bankruptcy Code provides that the filing of a petition in bankruptcy automatically stays certain actions directed against the debtor or against the debtor's property. 11 U.S.C. § 362(a) (1988). The automatic stay provisions promote two principal purposes of the Bankruptcy Code. First, the automatic stay “provides the debtor with ‘a breathing spell from his creditors.’ ” *Teachers Ins. & Annuity Ass’n of America v. Butler*, 803 F.2d 61, 64 (2 Cir.1986) (quoting legislative history); *In re Petrusch*, 667 F.2d 297, 299 (2 Cir.1981) (same), *cert. denied*, 456 U.S. 974, 102 S.Ct. 2238, 72 L.Ed.2d 848 (1982). In addition, the automatic stay allows the bankruptcy court to centralize all disputes concerning property of the debtor's estate in the bankruptcy court so that reorganization can proceed efficiently, unimpeded by uncoordinated proceedings in other arenas. The Bankruptcy Code “provide[s] for centralized jurisdiction and administration of the debtor, its estate and its reorganization in the Bankruptcy Court, and [this policy] is effectuated by Sections 362 and 105 of the Code.” *In re Chateaugay Corp.*, 109 B.R. 613, 621 (S.D.N.Y.1990); see also *Hunt v. Bankers Trust Co.*, 799 F.2d 1060, 1069 (5 Cir.1986); *Holland America Ins. Co. v. Succession of Roy*, 777 F.2d 992, 995 (5 Cir.1985).

(B)

We turn next to § 1113 of the Bankruptcy Code. Our discussion of that section must begin with the Supreme Court's decision in *National Labor Relations Bd. v. Bildisco & Bildisco*, 465 U.S. 513, 104 S.Ct. 1188, 79 L.Ed.2d 482 (1984). In *Bildisco*, the Court held, in part, that the filing of a petition in bankruptcy rendered collective bargaining agreements unenforceable. *Id.* at 532, 104 S.Ct. at 1199. The debtor, therefore, could terminate unilaterally the collective bargaining agreement or alter its provisions prior to seeking bankruptcy court approval for rejection of an executory contract under § 365(a). *Id.* at 533–34, 104 S.Ct. at 1199–1200.

In response to *Bildisco*, Congress enacted § 1113 of the Bankruptcy Code as part of the Bankruptcy Amendments and

Federal Judgeship Act of 1984 (“BAFJA”), Pub.L. No. 98–353, 98 Stat. 333, 390–91 (1984). Section 1113 governs the means by which a debtor may assume, reject or modify its collective bargaining agreement. 11 U.S.C. § 1113(a), (b) and (c) (1988). It ensures that the debtor attempt to negotiate with the union prior to seeking to terminate a collective bargaining agreement. § 1113(b). In the event such negotiations fail, it delineates the standard by which an application by the debtor to terminate the collective bargaining agreement is to be judged by the bankruptcy court and establishes a time frame in which this determination is to be made. 11 U.S.C. § 1113(c), (d) (1988). Subsection (f) provides:

“No provision of [the Bankruptcy Code] shall be construed to permit a trustee to unilaterally terminate or alter any provisions of a collective bargaining agreement prior to compliance with the provisions of [section 1113].”

11 U.S.C. § 1113(f) (1988).

In discerning Congress' intent in enacting § 1113, we look first to the language of the statute. *United States v. Bonanno Organized Crime Family of La Cosa Nostra*, 879 F.2d 20, 21 (2 Cir.1989). Subsection 1113(a) provides that a debtor “may assume or reject a collective bargaining agreement only in accordance with the provisions of [section 1113].” Subsection 1113(f) evinces an intent that other provisions of the Bankruptcy Code are inoperable to the extent that they allow a debtor to bypass the requirements of § 1113. The language of the statute indicates that Congress intended § 1113 to be the sole method *990 by which a debtor could terminate or modify a collective bargaining agreement and that application of other provisions of the Bankruptcy Code that allow a debtor to bypass the requirements of § 1113 are prohibited.

This conclusion is supported by the legislative history of § 1113. There are no committee reports accompanying the enactment of § 1113. We look therefore to statements made by sponsors of the legislation on the floor of Congress for an expression of legislative intent. *E.g.*, *Regents of the University of California v. Public Employment Relations Bd.*, 485 U.S. 589, 595–97, 108 S.Ct. 1404, 1408–10, 99 L.Ed.2d 664 (1988); *North Haven Bd. of Educ. v. Bell*, 456 U.S. 512, 527, 102 S.Ct. 1912, 1921, 72 L.Ed.2d 299 (1982). In support of the legislation, Senator Packwood, one of its sponsors, stated:

“The amendments also prohibit the trustee from unilaterally altering or terminating the labor agreement prior to compliance with the provisions of the section. This provision encourages the collective bargaining process,

so basic to federal labor policy. The provision overrules the 5–4 portion of the Supreme Court's *Bildisco* decision and means that the labor contract is enforceable and binding on both parties until a court approved rejection or modification.”

130 Cong. Rec. S8898 (daily ed. June 29, 1984).

Finally, the context in which § 1113 was enacted supports our conclusion. It is not disputed that § 1113 was enacted as the legislative response to the Supreme Court's decision in *Bildisco*. *In re Unimet Corp.*, 842 F.2d 879, 882 (6 Cir.), cert. denied, 488 U.S. 828, 109 S.Ct. 81, 102 L.Ed.2d 57 (1988); *Truck Drivers Local 807 v. Carey Transp., Inc.*, 816 F.2d 82, 88 (2 Cir.1987); *In re Century Brass Prods., Inc.*, 795 F.2d 265, 272 (2 Cir.1986). It stands to reason, therefore, that the events that took place in *Bildisco* are representative of the ill that Congress sought to cure in enacting § 1113.

In *Bildisco*, a debtor ignored “its obligations under the collective-bargaining agreement, including the payment of health and pension benefits and the remittance to the Union of dues collected under the agreement ... [and] refused to pay wage increases called for in the collective-bargaining agreement.” *Bildisco*, *supra*, 465 U.S. at 518, 104 S.Ct. at 1192. Those alterations were made prior to seeking relief from those obligations in the bankruptcy court and absent negotiation with the union.

“Section 1113(f) reverses that part of *Bildisco* & *Bildisco* which held that a trustee or debtor in possession was not legally bound to a collective bargaining agreement subsequent to the filing date and prior to the court determination of the application for authority to reject such agreement. The trustee or debtor in possession must adhere to the terms of the collective bargaining agreement unless the court approves the application for rejection pursuant to section 1113(c) or grants interim relief under section 1113(e).”

5 *Collier on Bankruptcy*, ¶ 1113.01 at 1113–11 (15th ed. 1990).

We conclude, from the language of the statute, statements made by the sponsors of the legislation, and the context in which it was enacted, that Congress intended that a collective bargaining agreement remain in effect and that the collective bargaining process continue after the filing of a bankruptcy petition unless and until the debtor complies with the provisions of § 1113. *E.g.*, *In re Unimet Corp.*, *supra*, 842 F.2d at 884 (“section 1113 unequivocally prohibits the employer from unilaterally modifying any provision of the collective

bargaining agreement”); *In re Century Brass Prods.*, *supra*, 795 F.2d at 272 (§ 1113 “created an expedited form of collective bargaining with several safeguards designed to insure that employers did not use Chapter 11 as medicine to rid themselves of corporate indigestion”); *In re Mile Hi Metal Sys., Inc.*, 51 B.R. 509, 510 (Bankr.D.Colo.1985) (“[o]ne of the primary purposes of [section 1113] was to emphasize the private collective bargaining process in an effort to avoid recourse to the bankruptcy court”).

We construe subsection 1113(f) quite literally. We hold that it was meant to prohibit the application of any other *991 provision of the Bankruptcy Code when such application would permit a debtor to achieve a unilateral termination or modification of a collective bargaining agreement without meeting the requirements of § 1113.

(C)

We consider, on the instant appeal, a very specific question, i.e., whether Congress intended in enacting § 1113(f) to preclude the application of the automatic stay provisions of § 362 to any dispute concerning a collective bargaining agreement absent compliance with the provisions of § 1113. We find no evidence that Congress had that specific intent.

Section 1113(f) is circumstance specific rather than section specific. Congress did not choose to direct § 1113(f) at any specific provision whose application it deemed would always permit a debtor unilaterally to alter a collective bargaining agreement. Rather, § 1113(f) presumes a particularized determination in any circumstance as to whether the application of another provision of the Bankruptcy Code will permit a debtor unilaterally to terminate or alter a collective bargaining agreement.

If Congress had intended to preclude application of the automatic stay to any dispute involving a collective bargaining agreement, it could have excepted explicitly proceedings to enforce a collective bargaining agreement from the automatic stay provisions. 11 U.S.C. § 362(b) (1988). Indeed, in enacting the legislation that included § 1113, Congress added two exceptions to the automatic stay. BAFJA, Pub.L. No. 98–353, 98 Stat. 333, 365, 371 (1984) (11 U.S.C. § 362(b)(7), (10) (1988)). Moreover, other sections of the Bankruptcy Code explicitly state that § 362 is inapplicable. *E.g.*, 11 U.S.C. § 1110(a) (1988) (right of secured creditor with purchase money security interest in

aircraft or its parts not subject to § 362); 11 U.S.C. § 1168 (1988) (right of secured creditor with purchase money security interest in rolling stock equipment or accessories used on such equipment not subject to § 362).

Since we discern no congressional intent on the specific issue before us, our analysis is governed by two rules of statutory construction. The first encourages consistent interpretations of statutes so as to give the fullest effect to congressional intent. *United States v. Lopez-Cavasos*, 915 F.2d 474, 479 (9 Cir.1990); *Strobl v. New York Mercantile Exchange*, 768 F.2d 22, 30 (2 Cir.), cert. denied, 474 U.S. 1006, 106 S.Ct. 527, 88 L.Ed.2d 459 (1985). “[W]hen two statutes are capable of co-existence, it is the duty of the courts ... to regard each as effective.” *Radzanower v. Touche Ross & Co.*, 426 U.S. 148, 155, 96 S.Ct. 1989, 1993, 48 L.Ed.2d 540 (1976) (citation omitted). The second instructs us that, when two statutes are in irreconcilable conflict, we must give effect to the most recently enacted statute since it is the most recent indication of congressional intent. *Id.* at 154, 96 S.Ct. at 1993.

We agree with the district court's conclusion that, to the extent the purpose of the automatic stay is to give the debtor a “breathing spell,” it cannot be reconciled with § 1113, which provides the sole method by which a debtor may obtain a “breathing spell” from its obligations under a collective bargaining agreement. *In re Ionosphere Clubs*, *supra*, 114 B.R. at 397. Were that the only purpose of the automatic stay, we would be inclined to affirm the district court's thorough opinion in its entirety.

The automatic stay, however, also allows the bankruptcy court to protect its jurisdiction over property of the debtor's estate by ruling on the appropriate manner and forum in which such disputes should be resolved. We previously have recognized the importance of that policy in reorganization proceedings. *Bohack Corp. v. Borden, Inc.*, 599 F.2d 1160, 1165 (2 Cir.1979). In view of the importance of that policy, we conclude that a bright line rule precluding the application of the automatic stay to any situation involving a collective bargaining agreement was not intended by Congress. Rather, we believe that a case by case adjudication is preferable. We will give effect to the automatic stay to the extent that its application is not in irreconcilable conflict with § 1113.

***992** We hold, therefore, that § 1113(f) precludes application of the automatic stay to disputes involving a collective bargaining agreement only when its application

allows a debtor unilaterally to terminate or alter any provision of a collective bargaining agreement.

IV.

We turn now to the application of the foregoing principles to the disputes at issue in the instant case. We consider the LPP decision first. Eastern contends that the district court erred in determining that § 1113(f) precluded application of the automatic stay to the arbitration that ALPA sought to commence to determine whether the LPPs in the collective bargaining agreement had been triggered. We disagree.

Eastern contends that a stay of arbitration does not deprive a union of a forum in which to enforce the collective bargaining agreement. That argument ignores the fact that adjudication of this dispute in the bankruptcy court would nullify effectively the arbitration clause in the collective bargaining agreement and would substitute the court's judgment for that of the arbitrator.

The collective bargaining agreement expressly provides for arbitration as the method of dispute resolution. “[S]ection 1113 unequivocally prohibits the employer from *unilaterally* modifying *any provision* of the collective bargaining agreement.” *In re Unimet*, *supra*, 842 F.2d at 884 (emphasis in original). This prohibition applies to arbitration clauses.

“It would be anomalous to find that Congress enacted a mandatory procedure for rejecting a collective bargaining agreement without which the agreement stays in full force and effect, and then to hold that a previously enacted section of the same statute—11 U.S.C. § 362, providing for a stay of claims against a debtor's estate—automatically invalidates the arbitration clause of a collective bargaining agreement....”

In re Marine Pollution Serv., Inc., 88 B.R. 588, 595 (S.D.N.Y.), rev'd on other grounds, 857 F.2d 91 (2 Cir.1988).

Application of the automatic stay to ALPA's attempt to invoke that provision of the collective bargaining agreement would allow Eastern unilaterally to alter the collective bargaining agreement by avoiding its obligation to arbitrate. *In re Bob's Supermarket's, Inc.*, 118 B.R. 783, 785–86 (Bankr.D.Mont.1990); *In re Marine Pollution Serv., Inc.*, *supra*, 88 B.R. at 595 (dicta); see also Haggard, *Labor Arbitration and Bankruptcy: A Trek into the Serbonian Bog*, 17 Loy.U.Chi.L.J. 171, 187–88 (1986) (“Under section 1113

of the Bankruptcy Code, a collective bargaining agreement remains in full force and effect until its rejection is approved by the bankruptcy judge or other interim relief is allowed. Thus, the debtor in possession or trustee has the contractual duty to adhere to the substantive provisions of the agreement and the duty to arbitrate any alleged breaches of those provisions.”). In this context, application of the automatic stay is in irreconcilable conflict with § 1113(f), which requires that Eastern seek relief under the provisions of § 1113 if it wishes to avoid its obligation to arbitrate labor disputes. Cf. *In re Marine Pollution Serv., Inc.*, 89 B.R. 344, 346 (S.D.N.Y.1988) (“if the Trustee believes that the threat of slowdowns or other disturbance is such that he wishes to undo the arbitration award, he has open to him either a return to the arbitrator or a rejection of the contract in the manner Congress prescribed in 11 U.S.C. § 1113”). We must give effect to § 1113(f) as the later expression of congressional intent.

Our holding is consistent with the purpose underlying § 1113 to the extent that it ensures that the collective bargaining process continue unless and until the bankruptcy court grants the debtor relief under § 1113. The federal judiciary and Congress both have recognized the importance to the collective bargaining process of arbitration. *E.g.*, *United Steelworkers v. Warrior & Gulf Navigation Co.*, 363 U.S. 574, 578, 80 S.Ct. 1347, 1351, 4 L.Ed.2d 1409 (1960) (“arbitration of labor disputes under collective bargaining agreements is *993 part and parcel of the collective bargaining process itself”); 29 U.S.C. § 173(d) (1988) (favoring method of labor dispute resolution agreed to by parties).

We hold that an arbitration brought pursuant to a provision in a collective bargaining agreement is not subject to the automatic stay since its application would allow a debtor unilaterally to avoid its obligation to arbitrate. The district court properly reversed the bankruptcy court's LPP decision.

V.

This brings us to the wet-lease decision. Eastern contends that the district court erred in reversing the bankruptcy court's determination that the Florida action was subject to the automatic stay. We agree.

(A)

Unlike the LPP decision, application of the automatic stay to the action commenced by ALPA in the Southern District of Florida did not relieve Eastern of the obligation to participate in the method of dispute resolution provided for in the collective bargaining agreement. Adjudication in the bankruptcy court itself does not violate § 1113(f). When a union seeks judicial enforcement of a collective bargaining agreement, the purposes behind §§ 362 and 1113(f) both can be promoted if the dispute can be adjudicated in the bankruptcy court.

We agree with ALPA's contention that precluding it from enforcing the collective bargaining agreement would render § 1113 illusory since a debtor would have no need to invoke it. If enforcement is foreclosed, then a union has no recourse against unilateral modifications imposed by a debtor.

The application of § 362 to a non-bankruptcy judicial proceeding only forecloses enforcement of the collective bargaining agreement if it cannot be enforced in the bankruptcy court. Accordingly, if a union has a procedural mechanism to place the dispute before the bankruptcy court and the bankruptcy court has jurisdiction to resolve the dispute, enforcement of the collective bargaining agreement is not foreclosed and application of the automatic stay does not permit a debtor unilaterally to alter its collective bargaining agreement.

We are not persuaded by ALPA's fear that the automatic stay may be interpreted to stay all proceedings against the debtor, even those commenced in the bankruptcy court. *E.g.*, *In re Coastal Group, Inc.*, 100 B.R. 177, 178 (Bankr.D.Del.1989) (pre-petition breach of contract claim brought as adversary proceeding subject to automatic stay); *In re Penney*, 76 B.R. 160, 161 (Bankr.N.D.Cal.1987) (creditor cannot commence adversary proceeding against debtor in bankruptcy court for a cause of action that, if commenced in state court, would violate automatic stay); *In re Lessig Constr., Inc.*, 67 B.R. 436, 443–44 (Bankr.E.D.Pa.1986) (automatic stay applies to bankruptcy proceedings). *But see In re Vylene Enters., Inc.*, 63 B.R. 900, 905–07 (Bankr.C.D.Cal.1986) (automatic stay not applicable to proceedings seeking injunctive relief commenced in bankruptcy court); *In re American Spinning Mills, Inc.*, 43 B.R. 365, 367 (Bankr.E.D.Pa.1984) (“stay implicitly does not bar a party from commencing an adversary or contested proceeding against the debtor under the caption of the bankruptcy case in the court where the petition is pending”). The only appropriate purpose that the stay promotes with respect to collective bargaining agreements is

allowing the bankruptcy court to protect its jurisdiction so that it can proceed efficiently with reorganization. Therefore, § 1113(f) compels the bankruptcy court to provide relief from the stay pursuant to § 362(d) to hear the dispute itself, to the extent that is necessary, or, in the event that the bankruptcy court determines that it is not the appropriate forum for the resolution of such a dispute, to allow the resolution of the dispute to proceed in a non-bankruptcy forum.

Moreover, the fact that the bankruptcy court may not have jurisdiction to hear every conceivable claim that might arise from the collective bargaining agreement does not invalidate our analysis. The relevant inquiry is whether the bankruptcy *994 court has jurisdiction to hear the particular dispute at issue. If the bankruptcy court does have jurisdiction to hear a dispute, it has the power to take the necessary steps to enforce its resolution. 11 U.S.C. § 105 (1988).

Finally, our concern with a procedural mechanism by which the union can present the dispute to the bankruptcy court does not foreclose debtor-initiated resolutions of disputes. A situation in which the union could not bring the dispute before the bankruptcy court and the debtor chose not to, however, would render the collective bargaining agreement unenforceable. That result is prohibited by § 1113(f).

(B)

It follows from our preceding analysis that, if the wet-lease dispute was properly presented to the bankruptcy court, or could have been, and the bankruptcy court could exercise jurisdiction over it, application of the automatic stay was not precluded by § 1113(f). In making this determination, we need not decide whether the bankruptcy court would have jurisdiction to resolve any dispute arising from the collective bargaining agreement, but only whether it had jurisdiction to decide this particular dispute.

Initially, since Eastern brought the merits of the dispute before the bankruptcy court, we need not consider whether ALPA had a procedural mechanism with which to place the dispute before the bankruptcy court. We turn, therefore, to the jurisdiction issue.

In *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 102 S.Ct. 2858, 73 L.Ed.2d 598 (1982), the Supreme Court considered constitutional restraints on bankruptcy court jurisdiction. The plurality distinguished

those issues “at the core of the federal bankruptcy power ... from the adjudication of state-created private rights.” *Id.* at 71, 102 S.Ct. at 2871. The bankruptcy court can exercise jurisdiction over the former, but cannot exercise jurisdiction over a state law contract claim that arose pre-petition. Such a claim can be adjudicated only in an Article III court.

In response to *Marathon*, as part of the BAFJA, Congress amended the jurisdictional grant to bankruptcy courts. Bankruptcy courts may enter “appropriate orders and judgments” in “core” proceedings. 28 U.S.C. § 157(b)(1) (1988). Congress provided a non-exclusive list of proceedings it deemed to be core. 28 U.S.C. § 157(b)(2) (1988). In addition, a bankruptcy court can hear non-core proceedings if they are related to the bankruptcy case and the bankruptcy court submits proposed findings of fact and conclusions of law for review by the district court. 28 U.S.C. § 157(c)(1) (1988).

“[B]ankruptcy jurisdiction [is] to be construed as broadly as possible within the constitutional constraints of *Marathon*.” *In re Ben Cooper, Inc.*, 896 F.2d 1394, 1398 (2 Cir.1990), *vacated on other grounds*, 498 U.S. 964, 111 S.Ct. 425, 112 L.Ed.2d 408 111 S.Ct. 425 (1990); *see also In re Chateaugay Corp.*, *supra*, 109 B.R. at 621 (“[t]he reach of bankruptcy jurisdiction encompasses all matters the outcome of which would affect the debtor or its reorganization”). With the foregoing in mind, we consider whether the wet-lease dispute is a matter concerning the administration of the estate, justifying bankruptcy jurisdiction. 28 U.S.C. § 157(b)(2)(A) (1988).

The instant dispute involves the effect of the collective bargaining agreement on a contract entered into post-petition. “Post-petition contracts with the debtor-in-possession ... are integral to the estate administration from the date they are entered into.” *In re Ben Cooper, supra*, 896 F.2d at 1399. Although this dispute involves an alleged breach of the collective bargaining agreement, rather than an alleged breach of the post-petition contract, the ramifications of the dispute on the administration of the estate are of sufficient importance to justify bankruptcy court jurisdiction. *E.g., Elsinore Shore Assocs. v. Local 54 Hotel Employees*, 820 F.2d 62, 66 (3 Cir.1987) (determination of whether underlying cause of strike was arbitrable justifying *Boys Market* injunction against strike was matter concerning administration of the estate); *995 *International Ass'n of Machinists and Aerospace Workers v. Eastern Air Lines, Inc.*, 121 B.R. 428, 432–33 — B.R. —, (S.D.N.Y.1990) (labor

dispute involving union's conduct during strike was matter concerning the administration of the estate).

We are aware that Congress has expressed an intent that district courts, rather than bankruptcy courts, hear disputes that involve “consideration of both [title 11](#) and other laws of the United States regulating organizations or activities affecting interstate commerce.” [28 U.S.C. § 157\(d\) \(1988\)](#). Our holding is not inconsistent with congressional intent as expressed in that provision, which provides for mandatory withdrawal of such cases from the bankruptcy court to the district court. It has been construed narrowly. “Withdrawal under [28 U.S.C. § 157\(d\)](#) is not available merely whenever non-Bankruptcy Code federal statutes will be considered in the Bankruptcy Court proceeding, but is reserved for cases where substantial and material consideration of non-Bankruptcy Code federal statutes is necessary for the resolution of the proceeding.” *In re Ionosphere Clubs, Inc.*, [103 B.R. 416, 418–19 \(S.D.N.Y.1989\)](#) (footnote omitted); see also *In re White Motor Corp.*, [42 B.R. 693, 700 \(N.D. Ohio 1984\)](#) (“[t]he district court should ... not allow a party to use this provision to require withdrawal where such laws are not material to resolution of the proceeding” (quoting legislative history)).

Eastern's rights in this dispute are governed by *Florida East Coast*, *supra*. In that case, the Court held that, during a strike, a carrier could make unilateral changes in a collective bargaining agreement without complying with the terms of the RLA that were reasonably necessary to its continued operation. *Florida East Coast*, *supra*, [384 U.S. at 246–48, 86 S.Ct. at 1424–26](#). Application of that doctrine does not require the bankruptcy court to engage itself in the intricacies of the RLA. Resolution of the dispute in the instant case, therefore, does not demand substantial consideration of the RLA, but, rather “involves the routine application of [a] non-Bankruptcy Code federal statute[].” *In re Ionosphere Clubs*, *supra*, [103 B.R. at 420](#).

We hold that the bankruptcy court had jurisdiction to resolve the issues presented by the Florida action.

VI.

We turn next to the propriety of the bankruptcy court's exercise of its powers under [§ 105](#) to enjoin ALPA from prosecuting the wet-lease action. Eastern contends that the district court erred in holding that the bankruptcy court was

precluded by [§ 1113\(f\)](#) from issuing an injunction against prosecution of the Florida lawsuit. We agree.

[Section 105\(a\) of the Bankruptcy Code](#) provides that: “The court may issue any order, process or judgment that is necessary or appropriate to carry out the provisions of this title.” This power “must and can only be exercised within the confines of the Bankruptcy Code.” *Norwest Bank Worthington v. Ahlers*, [485 U.S. 197, 206, 108 S.Ct. 963, 968, 99 L.Ed.2d 169 \(1988\)](#); see also *In re Johns–Manville Corp.*, [801 F.2d 60, 63 \(2 Cir.1986\)](#) (“[Section 105\(a\)](#) ... does not broaden the bankruptcy court's jurisdiction”). The bankruptcy court's equitable powers cannot be exercised in derogation of other sections of the Bankruptcy Code. *In re Morristown & Erie R.R. Co.*, [885 F.2d 98, 100 \(3 Cir.1989\)](#); *In re NWFx, Inc.*, [864 F.2d 593, 595 \(8 Cir.1989\)](#). The district court reasoned that an injunction issued to bar enforcement of a collective bargaining agreement outside the bankruptcy court would violate [§ 1113](#). It followed, from the district court's analysis, that the bankruptcy court's equitable powers could not be used to that end. *In re Ionosphere Clubs*, *supra*, [114 B.R. at 404–05](#).

Since [§ 105](#), like [§ 362](#), is a means by which the bankruptcy court can protect its jurisdiction, *In re Chateaugay Corp.*, *supra*, [109 B.R. at 621](#), we hold that its application is not always inconsistent with [§ 1113](#). We hold that the bankruptcy court's exercise of its equitable powers pursuant to [§ 105](#) to enjoin enforcement of a collective bargaining agreement is subject to the same considerations set forth above for the application of [§ 362](#).

*996 VII.

ALPA contends that the Norris–LaGuardia Act prohibited the bankruptcy court from enjoining the Florida action and raises several issues concerning the merits of the wet-lease decision. The district court did not reach these issues since it decided that application of the automatic stay violated [§ 1113\(f\)](#). In light of our contrary holding, we remand the case to the district court for consideration of ALPA's claims.

VIII.

To summarize:

We hold that application of the automatic stay provisions of § 362 of the Bankruptcy Code is precluded by § 1113(f) only to the extent that they permit a debtor unilaterally to terminate or alter a collective bargaining agreement. With respect to the LPP decision, we hold that application of the automatic stay to the arbitration brought pursuant to the collective bargaining agreement violated § 1113(f) since it allowed Eastern unilaterally to avoid its obligation to arbitrate. We hold that the bankruptcy court may stay a non-bankruptcy judicial proceeding to enforce a collective bargaining agreement if the union can bring the dispute before the bankruptcy court and the bankruptcy court has jurisdiction to resolve it. With respect to the wet-lease decision, we hold that the bankruptcy court had jurisdiction to resolve the issues raised by the Florida action and, therefore, the stay of that action was not precluded by § 1113(f). Finally, we hold that section 1113(f) did not prohibit the bankruptcy court from issuing an injunction against prosecution of the Florida action. We remand the case to the district court for further consideration of the wet-lease decision.

Affirmed in part, reversed in part and remanded.

MINER, Circuit Judge, concurring in part and dissenting in part:

I agree with my colleagues insofar as they conclude that application of the automatic stay provided by § 362 of the Bankruptcy Code to the arbitration of the labor protective provisions of the collective bargaining agreement is violative of § 1113(f) of the Code. I respectfully disagree with my colleagues insofar as they conclude that § 1113(f) does not bar an automatic stay of the Florida action, the injunction issued by the Bankruptcy Court against further prosecution of that action, and the Bankruptcy Court's resolution of the wet-leasing dispute.

Section 1 of the Collective Bargaining Agreement between Eastern and ALPA provides:

that all present or future flying including flight training (except for initial factory-conducted training in newly purchased equipment), revenue flying, ferry flights, charters and wet-leases performed in or for the service of Eastern Air Lines, Inc., shall be performed by pilots whose names appear on the then-current Eastern Air Lines' System Seniority List.

In apparent violation of the foregoing provision, Eastern entered into wet-leasing agreements whereby it leased aircraft

with crews from Continental while Eastern pilots were on strike. As a debtor in a Chapter 11 reorganization, however, Eastern may not "unilaterally ... alter any provisions of a collective bargaining agreement" prior to court approval in the manner specified by § 1113 of the Code. 11 U.S.C. § 1113(f).

Rather than first seeking the requisite court approval authorizing rejection of the collective bargaining agreement upon a showing that modifications in the agreement "are necessary to permit the reorganization of the debtor," 11 U.S.C. § 1113(b)(1)(A), Eastern proceeded to lease aircraft and crews for its normal business operations. Eastern made no effort to negotiate with ALPA before making its arrangements with Continental. As a consequence, ALPA sought in the district court in Florida to compel expedited arbitration of its wet-leasing grievance, to procure the issuance of an injunction in aid of arbitration and to obtain other relief as well. Arbitration of the wet-leasing grievance is required by the labor agreement, which *997 also requires arbitration of the labor protective provisions issue and of any other dispute that may arise out of the performance or non-performance of the agreement.

My colleagues "hold that application of the automatic stay to the arbitration brought pursuant to the collective bargaining agreement violated § 1113(f) since it allowed Eastern unilaterally to avoid the obligation to arbitrate." In their opinion, this holding serves only to bar the application of the stay to the labor protective provisions arbitration proceeding. To the extent that § 1113(f) is implicated, however, it seems to me that there is no difference between rejecting the automatic stay as a bar to that arbitration proceeding and rejecting it as a bar to an action to *compel arbitration* of the wet-leasing issue. See *In re Marine Pollution Serv., Inc.*, 88 Bankr. 588 (S.D.N.Y.1988).

In holding the automatic stay of § 362 applicable, and in enjoining further prosecution in the Florida District Court under the authority of § 105, the Bankruptcy Court proceeded to resolve the wet-lease issue by determining that "[t]hese wet-leases were, and are, reasonably necessary to Eastern's efforts to rebuild its operations." *In re Ionosphere Clubs, Inc.*, 105 Bankr. 773, 775 (S.D.N.Y.1989). The Bankruptcy Court also found that "[b]y proceeding to enjoin Eastern from continuing with those [wet-lease] operations, ALPA would disrupt Eastern's planned flight operations causing the estate to suffer irreparably by the substantial erosion of Eastern's operations." *Id.* While these determinations may be taken as

a finding that elimination of the wet-leasing prohibition is a modification “necessary to permit the reorganization of the debtor,” 11 U.S.C. § 1113(b)(1)(A), there was no compliance with the statutory scheme for rejection of the collective bargaining agreement, and the Bankruptcy Court therefore was without jurisdiction to excuse violation of the wet-leasing prohibition clause. *See generally* Note, *Nobody Likes Rejection Unless You're a Debtor in Chapter 11: Rejection of Collective Bargaining Agreements Under 11 U.S.C. § 1113*, 34 N.Y.L.Sch.L.Rev. 169, 171–74 (1989).

By obtaining its relief in the Bankruptcy Court in the context of an action to enforce an automatic stay, Eastern is able to avoid compliance with a carefully-drawn statute enacted by Congress to govern labor-management relations in a bankruptcy reorganization. As noted by my colleagues, the statute was designed to overcome the Supreme Court's decision in *National Labor Relations Board v. Bildisco & Bildisco*, 465 U.S. 513, 528–29, 104 S.Ct. 1188, 1197–98, 79 L.Ed.2d 482 (1984), which allowed a debtor unilaterally to terminate or alter a collective bargaining agreement prior to seeking bankruptcy court approval under § 365(a) for rejection of an executory contract. The statute specifically forbids termination in the manner permitted by *Bildisco* and promotes the long-established national labor policy of encouraging collective bargaining. *See In re Century Brass Prods., Inc.*, 795 F.2d 265, 266, 272 (2d Cir.), *cert. denied*, 479 U.S. 949, 107 S.Ct. 433, 93 L.Ed.2d 383 (1986).

Eastern simply cannot be relieved of its obligation to avoid wet-leasing unless it follows the step-by-step procedure established by Congress. Since it contends that the modification in employee benefits and protection it seeks is necessary to permit its reorganization, it first must make a proposal to ALPA. 11 U.S.C. § 1113(b)(1)(A). Eastern must provide ALPA with information relevant to an evaluation of the proposal. *Id.* § 1113(b)(1)(B). It must hold meetings with ALPA in a good faith effort to reach a mutually satisfactory modification. *Id.* § 1113(b)(2). It may file an application for rejection only after the modification proposal has been made, discussed and rejected. *Id.* § 1113(d)(1). The court then will decide, after a hearing on notice to interested parties, whether to reject the agreement. *Id.*

Eastern cannot prevail, even after a hearing, unless the court finds that a proposal of the sort contemplated by the statute was made prior to the hearing, ALPA has refused without good cause to accept the proposal and “the balance of the equities clearly favors rejection of [the collective bargaining]

agreement.” *Id.* § 1113(c). In making its decision, “the *998 court must consider whether rejection would increase the likelihood of successful reorganization.” *Truck Drivers Local 807 v. Carey Transp., Inc.*, 816 F.2d 82, 89 (2d Cir.1987); *see also In re Royal Composing Room, Inc.*, 62 Bankr. 403 (S.D.N.Y.), *aff'd*, 848 F.2d 345 (2d Cir.1988); *cert. denied*, 489 U.S. 1078, 109 S.Ct. 1529 103 L.Ed.2d 834 (1989). It is only after all the preliminary steps have been completed, and the court fails to rule on the application within thirty days after the hearing is commenced, that the debtor unilaterally “may terminate or alter any provisions of the collective bargaining agreement pending the ruling of the court on such application.” 11 U.S.C. § 1113(d)(2). Eastern took this one-sided action without bothering with the preliminaries. *See In re American Provision Co.*, 44 Bankr. 907, 909 (D.Minn.1984). We should not countenance this conduct, for it precludes resolution of the wet leasing dispute through the preferred process of collective bargaining.

I have no quarrel with the notion that the Bankruptcy Court has jurisdiction to perform the court functions described in § 1113. That jurisdiction was not invoked here, however, and there was accordingly an evasion of congressional purpose. My colleagues say that if a collective bargaining agreement can somehow be enforced in a bankruptcy court, then the automatic stay provisions of § 362 may be applied to enforcement of the agreement in a non-bankruptcy court; that the wet-leasing dispute properly was placed before the Bankruptcy Court here; and that the Bankruptcy Court's exercise of its equitable powers under § 105 to enjoin enforcement of the collective bargaining agreement is a means that may be used for the protection of bankruptcy court jurisdiction. I say that application of the automatic stay provisions of § 362 to an action brought to compel compliance with the arbitration provisions of a collective bargaining agreement is inconsistent with the broad purposes and specific language of § 1113; that the wet-leasing dispute was not properly placed before the Bankruptcy Court here; and that the equitable powers of a bankruptcy court under § 105 may not be used to enjoin enforcement of a collective bargaining agreement in any manner inconsistent with § 1113. Accordingly, I would affirm the judgment of the district court in all respects.

All Citations

922 F.2d 984, 136 L.R.R.M. (BNA) 2065, 59 USLW 2407, 118 Lab.Cas. P 10,548, Bankr. L. Rep. P 73,747

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200 F.3d 738

United States Court of Appeals,
Eleventh Circuit.

In Re Ruby Mae SIMMONS, Debtor.

Donald L. Dionne, as the Trustee,
of the Bankrupt Estate of Ruby
Mae Simmons, Plaintiff–Appellant,

v.

Ruby Mae Simmons, a.k.a. Ruby
Mae Simmons Rashid, and Abdul
R. Rashid, Defendants–Appellees.

No. 98–6136.

|

Jan. 11, 2000.

|

Rehearing Denied Apr. 20, 2000.

Synopsis

Debtor moved to dismiss voluntary Chapter 7 case, and Chapter 7 trustee objected. The Bankruptcy Court, No. 97-70461, Bennett, J., denied debtor's motion to dismiss, and, subsequently, issued report and recommendation that debtor be held in contempt for refusing to divulge information regarding location of her assets. The United States District Court for the Northern District of Alabama, No. 98-MC-0331-W, U.W. Clemon, J., withdrew the reference to the bankruptcy court, dismissed the case, and declined to hold debtor in contempt. Trustee appealed. The Court of Appeals, Owens, Senior District Judge, sitting by designation, held that: (1) case was not being handled inappropriately by bankruptcy court, and that court's actions did not provide cause for withdrawing the reference; (2) issue of whether debtor should be held in contempt was mooted by fact that trustee had located and taken possession of the disputed assets; and (3) cause did not exist to allow debtor to voluntarily dismiss the case, given her history of abuse of bankruptcy system.

Affirmed in part, reversed in part, and remanded.

Attorneys and Law Firms

*739 William Dennis Schilling, Birmingham, AL, for Plaintiff–Appellant.

Katrina Mu Min, Buffalo, NY, for Defendants–Appellees.

Appeals from the United States District Court for the Northern District of Alabama.

Before EDMONDSON and BIRCH, Circuit Judges, and OWENS*, Senior District Judge.

Opinion

OWENS, Senior District Judge:

This case requires that we review a district court order that without the benefit of reviewing the record or holding a hearing on the merits, withdrew the reference to the bankruptcy court. The district court order also reversed the bankruptcy court's order denying the debtor's motion to dismiss, and refused the bankruptcy court's recommendation that the debtor be held in contempt. We reverse in part and affirm in part.

I. Background

This case arises from Ruby Mae Simmons' (the “Debtor”) sixth filing for bankruptcy dating back to March 1988. Before us is her most recent Chapter 7 bankruptcy, 11 U.S.C. §§ 701–766, which was preceded by five separate voluntary filings under Chapter 13 of the Bankruptcy Code.¹ 11 U.S.C. §§ 1301–1330 (1994).

The Debtor owned a home mortgaged to S. Lee Pake. The Debtor defaulted on her mortgage and Pake began proceedings in Alabama state court to dispossess her and obtain damages due to the default. On July 16, 1997, a hearing was held in the state court action. The following day that court entered an order divesting the Debtor of the property, and vesting title and possession of the home in Pake. The court *740 set a hearing for damages to be held on July 29, 1997.

The day before the hearing was to be held, Debtor filed a petition for bankruptcy under Chapter 7 of the Bankruptcy Code. This automatically stayed the proceedings in state court. The case was assigned to Judge Bennett in the United States Bankruptcy Court for the Northern District of Alabama.² In her petition for relief the Debtor identified her

only creditor as Pake. The following day Pake filed a motion to dismiss the bankruptcy case, but this motion was denied. The bankruptcy court appointed Donald L. Dionne as trustee (the "Trustee"), and because the Debtor had listed no assets for distribution, a Bankruptcy Rule 2002(e) notice was sent to creditors.³

On August 28, 1997, Pake moved for relief from the automatic stay. This motion was granted on September 11, 1997, and as a result the Debtor was evicted from her home. Pake then obtained a judgment of \$19,892.64 for damages in the state court proceeding.

On September 24, 1997, at a § 341 meeting, the Debtor admitted that she owed monies to at least four other creditors not listed on her petition: Tucker Motors, Liborious Agwana, Alabama Power, and a student loan lender.

On October 22, 1997, the Debtor made a motion to dismiss her Chapter 7 proceeding, and the Trustee objected to the dismissal. The Trustee had become aware that the Debtor possessed two automobiles and a bank account, causing him to pursue an investigation into the location of one of the Debtor's vehicles, a 1994 Cadillac, which she had not listed on her petition. The Trustee also initiated two adversary proceedings in the bankruptcy court to obtain possession of the 1994 Cadillac and to obtain deposit account monies. The bankruptcy court issued a temporary restraining order and preliminary injunction to order the Debtor to turn over the Cadillac, monies, and accounts to the Trustee.

On October 29, 1997, the Debtor amended her motion to dismiss claiming her only creditor (Pake) had been relieved from the stay. The motion to dismiss was denied on November 5, 1997.

The Trustee attempted to depose the Debtor on February 5, 1998, to obtain information that would lead to the location of the 1994 Cadillac, which supposedly was in the possession of the Debtor's husband Abdul Rashid. The Debtor did not show up for the deposition. The Debtor was brought before the bankruptcy court on February 9, 1998, by the U.S. Marshal, but she refused to answer any questions, claiming she had a privilege against self-incrimination. The next day the Debtor again asserted her privilege and refused to be deposed.⁴

On February 10, 1998, the Clerk of the Bankruptcy Court issued notice under [F.R. Bankr.P. 3002\(c\)\(5\)](#)⁵ requesting that *741 all parties file their claims because assets had been

located. According to the Trustee, creditors filed six proofs of claims totaling \$22,653.58.⁶

The Debtor continuously denied any knowledge of the whereabouts of the Cadillac or her husband who supposedly was in possession of the car. The Trustee found evidence of at least 80 phone calls that the Debtor made to the Debtor's husband, as well as letters she addressed to him. The Bankruptcy Court submitted a report and recommendation that the Debtor be held in contempt of court until she divulged information regarding the location of her remaining assets. The report and recommendation of the bankruptcy court was forwarded to the United States District Court for the Northern District of Alabama on February 12, 1998.

The Trustee located and took possession of the 1994 Cadillac on February 17, 1998. Currently the Debtor's vehicles are being stored in a warehouse under the Trustee's control.

The bankruptcy court's recommendation and report was assigned to Judge U.W. Clemon on February 19, 1998. That same day, without a hearing and without giving notice to the trustee, Judge Clemon withdrew the reference of the case to the bankruptcy court and dismissed the entire bankruptcy case. The district court also refused to hold the debtor in contempt of court.

II. Discussion

This Court reviews the determination of law, whether from the bankruptcy court or the district court, *de novo*. See [General Trading Inc. v. Yale Materials Handling Corp.](#), 119 F.3d 1485, 1494 (11th Cir.1997), and reviews the bankruptcy court's factual findings under the clearly erroneous standard. See *id.*

A. Withdrawal of Reference

A district court may, for cause, withdraw the reference of a case or proceeding in bankruptcy under [28 U.S.C. § 157\(d\)](#) which provides:

The district court may withdraw, in whole or in part, any case or proceeding referred under this section, on its own motion or on timely motion of any party, *for cause shown*. The district court shall, on timely motion of a party, so withdraw a proceeding if the court determines that resolution of the proceeding requires consideration of both [title 11](#) and other laws of the United States regulating organization or activities affecting interstate commerce.

28 U.S.C. § 157(d) (1994) (emphasis added). The law of this circuit states that: “Once a bankruptcy court has assumed jurisdiction ... a district court may withdraw reference only ‘for cause shown.’” *In re Parklane/Atlanta Joint Venture*, 927 F.2d 532, 536 (11th Cir.1991). Although cause is not defined in the statute, this court has found that it is not an empty requirement. *See id.* (requiring cause must be shown for the district court to withdraw the reference under 28 U.S.C. § 157(d)).

As this court noted in *Parklane*:

*742 Although this Court has not yet articulated criteria for determining the existence of cause for withdrawal, other courts have. In *Holland America Ins. Co. v. Succession of Roy*, 777 F.2d 992 (5th Cir.1985), the Fifth Circuit noted in dicta that in determining whether cause existed a district court should consider such goals as advancing uniformity in bankruptcy administration, decreasing forum shopping and confusion, promoting the economical use of the parties' resources, and facilitating the bankruptcy process. *Id.* at 998

Parklane, 927 F.2d at 536 n. 5 (citations omitted). It can be inferred from the district court's memorandum order that the district court assumed there were no claims against the bankruptcy estate, and that the case was being handled inappropriately by the bankruptcy court. This assumption might be due to the fact that the district court never viewed the record before withdrawing the reference and dismissing the case. At the time the district court order was written, creditors still had 90 days to respond to the 3002(c)(5) notice, and file a claim. As shown earlier, at least six proofs of claim were filed in response to the 3002(c)(5) notice.⁷

None of the goals suggested in *Holland America Ins. Co.* were advanced by the district court's withdrawal. Dating back to 1988, this debtor had a history of grossly abusing the bankruptcy process. By withdrawing the reference, the district court did not facilitate the bankruptcy process. Instead, the district court decision hindered the process, and its actions threatened to allow the Debtor to once again evade her creditors, hardly promoting the most economical use of the parties' resources. The district court should have taken into consideration the possibility that claims might be filed against the bankruptcy estate before it withdrew the reference of the case.

We conclude that the case was not being handled inappropriately by the bankruptcy court, and the district court

was mistaken in believing that it was. The bankruptcy court's actions were not cause for withdrawing the reference to the bankruptcy court under 28 U.S.C. § 157(d).

B. Contempt charges

The bankruptcy judge recommended that the Debtor be found in both civil and criminal contempt. The bankruptcy judge also recommended that the debtor be incarcerated to force her to turn over the 1994 Cadillac, the deposit monies, and her husband's location. The Cadillac, deposit monies, and her husband's location were all acquired by the Trustee soon after this recommendation was filed. The district court refused the recommendation for sanctions noting there was “no credible evidence that [the Debtor could] comply with the court order requiring her to disclose [the Cadillac's] location to the Trustee.” *Dionne v. Simmons*, 5, No. 98–0331–W (N.D. Ala. filed Feb. 19, 1998). The Trustee only appeals the district court's denial of civil contempt.

The Court of Appeals reviews a district court's grant or denial of civil contempt in a bankruptcy proceeding for abuse of discretion. *See Jove Engineering, Inc. v. IRS*, 92 F.3d 1539, 1546 (11th Cir.1996). Soon after the contempt recommendation was filed the Trustee located and took possession of the Debtor's Cadillac and deposit monies, thereby mooted the issue. The district court may have been erroneous in its finding that there was no credible evidence about the Debtor's ability to comply with the bankruptcy court order to disclose the location of the Cadillac, but it is not necessary that we decide whether the district court abused its discretion. As there was no longer a need to hold the Debtor in contempt, we *743 agree that civil contempt penalties should not have then been imposed upon the Debtor.

C. Reversal of Refusal to Dismiss

The district court reversed the bankruptcy court's denial of the Debtor's motion to dismiss. Section 707(a) of the Bankruptcy Code provides for voluntary dismissal after a notice and hearing for cause. *See* 11 U.S.C. § 707(a), which provides: “The Court may dismiss a case under this chapter only after notice and a hearing and only for cause.” *Id.* Three nonexclusive examples of cause are provided.⁸

The district court in its memorandum opinion stated:

In the first place, the record does not disclose good cause for denial of Simmons' petition to dismiss the bankruptcy petition. The only known creditor has apparently obtained

all that he is entitled to. Whether he has or not is irrelevant, since he absented himself from the first meeting of creditors and has not filed a claim against the bankrupt estate. *In fact, no one has filed a claim against the estate!*

What, then is the justification for keeping this case on the presumably congested docket of the Bankruptcy Court? Surely, it cannot be that the Trustee needs to collect the assets of the bankrupt estate—for there are no creditors. What will he do with these assets once they are collected, other than turn over 40% of their value to his attorney?

The Bankruptcy Court plainly erred by denying Simmons' petition to dismiss the petition.

Memorandum Opinion, February 19, 1998. The district court suggests that cause was needed for the bankruptcy court not to grant the Debtor's motion to dismiss. [Section 707\(a\)](#) clearly states that a case shall only be dismissed for cause. *See* [11 U.S.C. § 707\(a\)](#). Therefore the burden for showing cause is on the moving party.

It is clear that the district court was mistaken as to the status of the case. We have already discussed *supra* as to why no claims had been filed at the time the district court ordered the dismissal.

We conclude that the bankruptcy court was correct when it did not find cause for dismissal. The bankruptcy court judge found that it would be in the best interests of the creditors and the Debtor to deny the motion and to allow her debts to

finally be resolved. *See In Simmons*, 97–72040, (Bankr.N.D Ala.) Transcript of Nov. 5, 1997 at 26. We agree with the bankruptcy judge that the Debtor's history of abuse warranted the bankruptcy court's denial of the Debtor's motion. When dismissal will only allow the Debtor to hinder creditors, secret assets, and further the Debtor's abuse of the system, dismissal of her voluntary petition is not warranted. Cause did not exist for dismissal. *See Peterson v. Atlas Supply Corp. (In re Atlas Supply Corp.)*, 857 F.2d 1061, 1063 (5th Cir.1988) (holding that a bankruptcy court did not abuse its discretion by failing to dismiss when dismissal would prejudice the creditors).

III. Conclusion

The district court erred in withdrawing the reference to the bankruptcy court as there was no cause for a permissive withdrawal under [28 U.S.C. § 157\(d\)](#). Accordingly, we **REVERSE** the decisions of the district court withdrawing the reference to the bankruptcy court and reversing the ***744** bankruptcy court's denial of Debtor's motion to dismiss. We **AFFIRM** the district court's refusal to hold the Debtor in contempt. The case is **REMANDED** to the district and bankruptcy courts for further proceedings in accordance with this opinion.

All Citations

200 F.3d 738, 43 Collier Bankr.Cas.2d 685, 35 Bankr.Ct.Dec. 134, 13 Fla. L. Weekly Fed. C 350

Footnotes

* Honorable [Wilbur D. Owens, Jr.](#), Senior U.S. District Judge for the Middle District of Georgia, sitting by designation.

1 The Debtor filed her first Chapter 13 petition on March 17, 1988. She dismissed her first two petitions voluntarily. The third case was dismissed on August 25, 1994, when the Debtor failed to make payments under her plan. She filed a fourth case on October 7, 1994, but the bankruptcy court dismissed it on July 17, 1995, for again failing to make payments under her plan. The fifth filing occurred on August 11, 1995. The Debtor received a personal injury settlement of \$64,082.28 on September 2, 1996, causing her to request her petition to be dismissed. On October 1, 1996, Bankruptcy Judge Bennett dismissed the Debtor's case, and barred the Debtor from filing again for a period of one year.

2 Apparently neither Debtor nor Judge Bennett heeded Judge Bennett's one year ban on filing.

3 Bankruptcy Rule 2002(e) states:

In a chapter 7 liquidation case, if it appears from the schedules that there are no assets from which a dividend can be paid, the notice of the meeting of creditors may include a statement to that effect; that it is unnecessary to file claims; and that if sufficient assets become available for the payment of a dividend, further notice will be given for the filing of claims.

[Fed. R. Bankr.P.2002\(e\)](#).

4 In fact the Trustee attempted to depose the Debtor on at least five occasions where the Debtor did not appear. Even when the Debtor did show up and answer questions, she was hardly forthcoming, sometimes claiming to not even remember the names of her relatives.

5 [Rule 3002\(c\)\(5\)](#) states:

If notice of insufficient assets to pay a dividend was given to creditors pursuant to [Rule 2002\(e\)](#), and subsequently the trustee notifies the court that payment of a dividend appears possible, the clerk shall notify the creditors of that fact and that they may file proofs of claim within 90 days after the mailing of the notice.

[F.R. Bankr.P. 3002\(c\)\(5\)](#).

6

<u>Claimant</u>	<u>Date Filed</u>	<u>Amount of Claim</u>
S. Lee Pake	2/23/98	\$19,892.64
City of Tuscaloosa	4/17/98	\$ 381.76
Alabama Power	4/24/98	\$ 260.84
Bell South	5/11/98	\$ 1,187.18
DCH Regional Medical Center	5/22/98	\$ 461.16
DCH Regional Medical Center	5/22/98	\$ 470.00
Total:		\$22,653.58

The Debtor argues that S. Lee Pake's claim was somehow invalid. The proper forum for an attack on a proof of claim is not this Court, but the bankruptcy court. The Court notes that pursuant to [11 U.S.C. § 502](#), a proof of claim is valid until it is objected to. The record shows that no adversary proceeding occurred and no objection was filed on the issue.

7 This Court does not mean to suggest that all of the proofs of claim were filed in a timely fashion under the rule.

8 These three causes are:

(1) unreasonable delay by the debtor that is prejudicial to creditors;

(2) nonpayment of any fees or charges required under chapter 123 of title 28; and

(3) failure of the debtor in a voluntary case to file, within fifteen days or such additional time as the court may allow after the filing of the petition commencing such case, the information required by paragraph (1) of section 521, but only on a motion by the United States trustee.

[11 U.S.C. § 707\(a\)](#).

124 F.3d 999

United States Court of Appeals, Ninth Circuit.

SECURITY FARMS; [El Dorado Farms](#);

Manriquez & Acuna, Inc.; [Higashi Farms, Inc.](#); [Pisoni Farms](#), a California Corporation, Plaintiffs–Appellants,

v.

INTERNATIONAL BROTHERHOOD
OF TEAMSTERS, CHAUFFERS,

WAREHOUSEMEN &

HELPERS, an Unincorporated

Association, Defendant–Appellee.

SECURITY FARMS; [El Dorado Farms](#);

Manriquez & Acuna, Inc.; [Higashi Farms, Inc.](#); [Pisoni Farms](#), a California Corporation, Plaintiffs–Appellees–Cross–Appellants,

v.

INTERNATIONAL BROTHERHOOD
OF TEAMSTERS, CHAUFFERS,

WAREHOUSEMEN & HELPERS,

an Unincorporated Association,

Defendant–Appellant–Cross–Appellee.

SECURITY FARMS; [El Dorado Farms](#);

Manriquez & Acuna, Inc.; [Higashi Farms, Inc.](#); [Pisoni Farms](#), a California Corporation, Plaintiffs–Appellants,

v.

INTERNATIONAL BROTHERHOOD
OF TEAMSTERS, CHAUFFERS,

WAREHOUSEMEN & HELPERS, an

Unincorporated Association, Defendant,

and

Teamsters Joint Council

No. 7, Defendant–Appellee.

In re: GENERAL TEAMSTERS,

WAREHOUSEMEN AND [HELPERS UNION](#)

[LOCAL 890](#), Debtor, Debtor–in–Possession,

Security Farms; [El Dorado Farms](#); Manriquez & Acuna, Inc.; [Higashi Farms, Inc.](#); [Pisoni Farms](#), a California Corporation, Freitas Farms;

[San Ysidro Farms](#), Plaintiffs–Appellees,

v.

INTERNATIONAL BROTHERHOOD

|
Argued and Submitted June 12, 1997.

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Decided Aug. 22, 1997.

Synopsis

Employers sued local union, intermediate union, and parent union, in state court, for violating state tort laws during labor dispute. Following removal and automatic transfer to bankruptcy court, the United States District Court for the Northern District of California, withdrew reference to bankruptcy court, and, following change of venue, per [James Ware](#), J., 1995 WL 761260, denied employers' motion for abstention, granted summary judgment in favor of parent and intermediate unions, entered judgment against local, and sanctioned employers' counsel. Appeals and cross-appeals followed. The Court of Appeals, [Sneed](#), Circuit Judge, held that: (1) district court did not abuse its discretion by withdrawing reference from bankruptcy court; (2) denial of abstention would be treated as nonreviewable decision not to remand; (3) parent union's appointment of individual to supervise local in administration of its affairs did not make individual a de facto trustee and expose parent and intermediate union to liability; (4) evidence was sufficient to impose liability on local union for members' tortious conduct; (5) award of \$500,000 was fair assessment of employers' loss; (6) counsel for employers violated its duty to conduct reasonable inquiry to determine that declarations were well grounded in fact before introducing declarations in opposition to union's summary judgment motion; but (7) damages would be remanded to permit district court to inform court of appeals what portion, if any, of damages awarded was attributable to violation of California's prohibition of violence, or threat of violence, against person or their property, because of their position in labor dispute.

Affirmed in part and reversed in part.

[Kleinfeld](#), Circuit Judge filed opinion dissenting in part.

Procedural Posture(s): On Appeal; Motion for Summary Judgment.

Attorneys and Law Firms

*1004 [David G. Finkle](#), Los Angeles, CA, [Charley M. Stoll](#), Camarillo, CA, for plaintiffs-appellees-cross-appellants.

[Christian L. Raisner](#), Van Bourg, Weinberg, Roger & Rosenfeld, Oakland, CA, [Duane B. Beeson](#), [Robert Bonsall](#),

[Kathleen A. Murray](#), Beeson, Tayer & Bodine, for defendants-appellants-cross-appellees.

Appeal from the United States District Court for the Northern District of California; [James Ware](#), District Judge, Presiding. D.C. No. CV-93-20491-JW.

Before: [SNEED](#) and [KLEINFELD](#), Circuit Judges, and [WALLACH](#),* International Trade Judge.

Opinion

[SNEED](#), Circuit Judge:

This opinion springs from controversies possible only in a highly specialized, vertically integrated industry, heavily dependent on relatively low skilled agricultural workers, whom a strong international union seeks to organize, and in which each major party is more than amply represented by members of the legal profession. The opinion thus reflects both the soil of California and the intense competitiveness of its people.

This case involves three defendants and three separate but related appeals. The appeals derive from Security Farms' and other agricultural growers' ("Growers")¹ request *1005 for damages for losses suffered by Growers in 1989 during a strike by General Teamsters, Warehousemen and Helpers Union, Local 890 ("Local 890"), against Bud Antle, Inc. ("Bud Antle"), a contractor of labor harvesting crops in California. Growers also seek to recover damages from the Local's parent union, the International Brotherhood of Teamsters ("the International"), and an intermediate union within the International's structure, Joint Council No. 7 ("the Joint Council").

I.

BACKGROUND AND PROCEDURAL HISTORY

Bud Antle is a vertically integrated company which harvests, packs, markets, and ships California produce. It gets its produce from various growers throughout California, who own the land and grow the crop. To harvest and pack the growers' crops, Bud Antle is dependent on thousands of laborers represented by Local 890.

Prior to the strike, Local 890 found itself in financial disarray. The Local's internal problems undermined its ability to administer and enforce its collective bargaining agreements. Its failures regarding the Bud Antle agreement inspired some Local 890 members to file a petition to decertify the union. This petition, the threat of others like it, and the fact that Local 890 was in arrears on regular payments due the International spurred the parent union to action. It considered but rejected placing Local 890 in trusteeship. Instead, in May 1989, the International's General President appointed Alejandro Ybarrolaza to oversee the Local in its daily functions, particularly its financial affairs.² Ybarrolaza had complete access to the Local's financial records. Moreover, he took a lead role in the representation of Union members and the negotiation of Local 890's collective bargaining agreements.

In the summer of 1989, Ybarrolaza participated in lengthy unsuccessful negotiations with Bud Antle. Toward the end of the 1989 summer, the employees represented by Local 890 voted down Bud Antle's final proposal for a new collective bargaining agreement. On September 11, 1989, the Joint Council granted Local 890's request for strike sanctions and on October 26, 1989 the strike commenced. Although Growers were not a party to the collective bargaining agreement, Local 890 members picketed Growers' fields.

A. The Strike

More than two thousand workers participated in the strike against Bud Antle. Local 890 established a chain of command whereby picket captains acted as liaisons between the picketers and Local 890's business agents. Picket captains lacked the authority to designate strike locations without the approval of a business agent, but were responsible for implementing the latter's instructions regarding strike activity.

On October 26, 1989, Bud Antle's union employees left the fields where they were harvesting and reported to Bud Antle's offices and cooler facilities—strike areas previously designated by Local 890 officials. Initially, Local 890 officials thought that field picketing would be unnecessary and Ybarrolaza advised them against it. Moreover, in the early stages of the strike, the business agents instructed both picket captains and picketers to strike peacefully, without violence, and to not “do anything that would create any problems.” However, Growers provided testimony and documentary evidence at trial which, despite the Union's early intentions, portrayed a violent strike not only tolerated but at times inspired by Local 890 officials.

Frank Gallegos, President of Local 890, was arrested by state police for impeding the entrance to a Bud Antle facility in Salinas and for resisting arrest. Arrests of other union officials followed. Teresa Escamilla, a picket captain, rushed into the fields owned by Growers, a technique used to intimidate replacement workers, and was arrested.

***1006** Arturo Castro, a business agent, conceded that field picketing occurred but maintained that he did not authorize it. However, a fellow business agent testified at trial that Castro himself entered a field on one occasion with the intent of confronting a nonstriking worker. In any event, Castro was present during many of the violent outbreaks. Although the Union knew of Castro's presence in the fields, it never removed him from his post nor disciplined him in any way. Likewise, Escamilla, despite her disobedience, maintained her position as a picket captain and her place on the negotiating committee.

Ybarrolaza, on the other hand, did not picket during the strike and, to repeat, did advise the Local against the practice of field picketing. He also participated in negotiations to end the strike and reported to the International and the Joint Council on the status of the strike and the negotiations.

B. The Lawsuit

Growers turned to the state courts for relief, filing a series of lawsuits alleging only state law violations by Local 890 for the actions of its picketers. On August 13, 1990, Local 890 filed a voluntary petition under Chapter 11 of the Bankruptcy Code which automatically stayed the pending state court actions. Growers then amended their complaints to substitute the International and the Joint Council for “Doe” defendants on the basis of the organizations' participation in the Bud Antle strike. Two years and several hearings later, the bankruptcy court lifted the automatic stay and Growers coordinated the many state lawsuits into one action, *Teamsters Labor Dispute II*, Judicial Council Coordination Proceeding No. 2650.

The International was not content; several procedural skirmishes ensued. On February 12, 1993, the International removed the coordinated proceeding to federal court pursuant to 28 U.S.C. § 1452(a), where it was automatically referred to the bankruptcy court. The International resisted the referral and on February 18, 1993, filed a motion to withdraw the reference from the bankruptcy court. Meanwhile, the bankruptcy court issued an order remanding the case back to

state court. That order was stayed by the federal district court pending a decision on the motion to withdraw the reference. That court, Judge Orrick presiding, subsequently granted the motion. The Growers responded with unsuccessful efforts to challenge the district court's decision. First, the Growers failed to obtain certification of an interlocutory appeal under [28 U.S.C. § 1292\(b\)](#); and second, they failed to convince this court to grant their petition for a writ of mandamus directing Judge Orrick to rescind the withdrawal of the reference, or to take other action restoring the state proceedings. Undeterred, Growers then moved for a change of venue and for abstention in favor of state court. Judge Orrick granted the request to transfer venue but did not decide the motion to abstain. He then transferred the proceeding to District Judge Ware in San Jose where Growers renewed their abstention motion. Judge Ware denied abstention, reasoning that the application of federal labor laws was necessary to the resolution of the dispute.

Thereafter, the International moved for summary judgment and for sanctions against Growers' counsel. The Joint Council also moved for summary judgment and, alternatively, for partial judgment on the pleadings. Local 890 moved for judgment on the pleadings with respect to Growers' cause-of-action for negligent supervision. On June 16, 1994, Judge Ware ordered summary judgment in favor of the International and the Joint Council, but denied Local 890's motion for judgment on the pleadings. Judge Ware initially denied a motion for sanctions against the Growers' counsel, but later reopened the matter and issued an order imposing such sanction. Months later, following Growers' bench trial against Local 890, Judge Ware found the Local liable for strike misconduct pursuant to section 6 of the Norris–LaGuardia Act, [29 U.S.C. § 106](#). Timely appeals and cross-appeals followed.

C. The Appeals

On appeal, Growers contest (1) Judge Orrick's decision to *withdraw the reference* of this case from the bankruptcy court, (2) Judge Ware's decision *not to abstain* in favor *1007 of state court, and (3) Judge Ware's grant of summary judgment in favor of the International and the Joint Council. Local 890 appeals, and Growers cross-appeal, the judgment against Local 890 for strike misconduct and the resulting damage award. Finally, the International appeals, and Growers' counsel cross-appeal, Judge Ware's order imposing sanctions against Growers' counsel for submitting improper declarations. We affirm in all respects save one. We

remand for clarification the district court's judgment against Local 890, and its award of damages.

II.

PROCEDURAL ISSUES

We turn first to the procedural issues raised by the retention of this action in federal district court.

These issues have their source in the difference between the applicable standards of proof. Section 6 of the Norris–LaGuardia Act applies to the *federal* adjudication of state tort claims arising out of labor disputes. See [United Mine Workers v. Gibbs](#), 383 U.S. 715, 737, 86 S.Ct. 1130, 1144–45, 16 L.Ed.2d 218 (1966). It requires “clear proof of actual participation in, or actual authorization of” the unlawful activity. [29 U.S.C. § 106](#) (1994). While some states have taken the position that section 6 of the Norris–LaGuardia Act applies to *state* court adjudications of these claims, see, e.g., [Hiestand v. Amalgamated Meatcutters, etc.](#), 233 Kan. 759, 666 P.2d 671 (1983); [Sowels v. Laborers' Int'l Union of N. Am.](#), 112 Mich.App. 616, 317 N.W.2d 195 (1981); [Melancon v. United Ass'n of Journeymen](#), 386 So.2d 669 (La.App.1980), writ refused 387 So.2d 596 (La.1980), California has not. Rather, California has specifically rejected the notion that section 6 applies in its courts' adjudication of purely state law claims. See [J.R. Norton Co. v. Gen. Teamsters Local 890](#), 208 Cal.App.3d 430, 256 Cal.Rptr. 246, 253–54 (1989) (determining the Union's liability on the basis of state agency law). Not surprisingly, the Growers—favoring the ordinary preponderance of the evidence standard—contend that this entire controversy should be litigated in California courts. The Union, equally unsurprisingly, prefers a federal venue.

A. Withdrawal of the Reference

The bankruptcy court's order remanding the state claims back to state court, to repeat, was stayed and eventually nullified by the district court's order withdrawing the reference from the bankruptcy court. The court determined that withdrawal was mandatory because, despite the Growers' state law causes of action, resolution of the consolidated cases required substantial and material consideration of federal law. Alternatively, if withdrawal was not mandatory, the district court exercised its discretion to grant permissive withdrawal because it was “the most appropriate forum for the resolution of these cases.” Growers contend that the court

abused its discretion by withdrawing the reference due to the lack of material federal issues presented by their state law allegations.³ Moreover, the Growers argue that withdrawing the reference in this case encouraged forum shopping by rewarding defendants' efforts to avail themselves of the more stringent federal standard of proof.

*1008 1. Jurisdiction and Standard of Review

We have jurisdiction over Growers' appeal from the order withdrawing the reference from the bankruptcy court under 28 U.S.C. § 1291. An order to withdraw the reference is interlocutory. However, "the rule in this circuit [is] that once a final judgment is entered, an appeal from an order that would otherwise be interlocutory is then appealable." *In re Eastport Associates*, 935 F.2d 1071, 1075 (9th Cir.1991). "There is no danger of piecemeal appeal confronting us if we find jurisdiction here, for nothing else remains in the federal courts." *Id.* (quoting *Anderson v. Allstate Insurance Co.*, 630 F.2d 677 (9th Cir.1980)). We review a district court's decision to withdraw the reference for an abuse of discretion. See *In re Cinematronics, Inc.*, 916 F.2d 1444, 1451 (9th Cir.1990).

2. Permissive Withdrawal of the Reference

To understand this issue, a bit of history is necessary. In *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 102 S.Ct. 2858, 73 L.Ed.2d 598 (1982), the Supreme Court held that the Bankruptcy Act of 1978 impermissibly shifted essential attributes of judicial power from the Article III district court to its non-Article III adjunct, the bankruptcy court. Congress responded by enacting the Bankruptcy Amendments and Federal Judgeship Act of 1984, which provided district courts with original but not exclusive jurisdiction over all bankruptcy proceedings. See 28 U.S.C. § 1334(b) (1994). Moreover, to insulate the 1984 Amendments from a constitutional assault like that in *Marathon*, Congress enacted 28 U.S.C. § 157. That section classifies matters as either "core proceedings," in which the bankruptcy court "may enter appropriate orders and judgments," or "non-core proceedings," which the bankruptcy court may hear but for which it may only submit proposed findings of fact and conclusions of law to the district court for *de novo* review. 28 U.S.C. § 157 (1994). Actions that do not depend on bankruptcy laws for their existence and that could proceed in another court are considered "non-core." See *In re Castlerock Properties*, 781 F.2d 159, 162 (9th Cir.1986).

Section 157 also governs the district court's authority to withdraw the reference and, consistent with the *Marathon*

decision, *mandates* withdrawal in cases requiring material consideration of non-bankruptcy federal law. See 28 U.S.C. § 157(d).⁴ The district court's authority for *permissive* withdrawal is governed by the first sentence of 28 U.S.C. § 157(d): "The district court *may* withdraw ... any case or proceeding referred [to the bankruptcy court] on its motion or on timely motion of a party, *for cause shown*." 28 U.S.C. § 157(d) (emphasis added). In determining whether cause exists, a district court should consider the efficient use of judicial resources, delay and costs to the parties, uniformity of bankruptcy administration, the prevention of forum shopping, and other related factors. See *In re Orion Pictures Corp.*, 4 F.3d 1095, 1101 (2d Cir.1993).

In this case efficiency was enhanced by withdrawing the reference because non-core issues predominate. The Growers' state law claims did not depend on Title 11, see *In re Castlerock Properties*, 781 F.2d at 162, but were in federal court only because of their potential impact on the administration of Local 890's estate.⁵ They *1009 were non-core. Inasmuch as a bankruptcy court's determinations on non-core matters are subject to *de novo* review by the district court, unnecessary costs could be avoided by a single proceeding in the district court. See *id.*; *In re Mann*, 907 F.2d 923, 926 (9th Cir.1990). Furthermore, we reject the Growers' claim that the district court's decision encourages forum shopping. Growers' argument misstates the effect of the district court's decision to withdraw the reference. Without regard to withdrawal, the bankruptcy court's order remanding Growers' non-core, state law claims inevitably was subject to the approval of the district court. See 28 U.S.C. § 157(c) (1). Thus, Growers' real complaint is not with the withdrawal of the reference, but with Judge Orrick's implicit rejection of the bankruptcy court's remand of the Growers' case to the state court⁶—an issue not raised by this appeal and, in any event, not reviewable by this court.⁷ Consequently, the district court's decision to withdraw the reference from the bankruptcy court did not amount to an abuse of discretion.⁸

B. Denial of Motion to Abstain As a Decision Not to Remand
Relying on the conclusions reached by Judge Orrick in his order withdrawing the reference, Judge Ware, now presiding because of the venue change, summarily denied Growers' motion to abstain.

Abstention is governed by 28 U.S.C. § 1334(c) and, like withdrawal of the reference, can be either permissive

or mandatory. Section 1334(c)(1) provides for permissive abstention in both core and non-core proceedings while the mandate to abstain contained in section 1334(c)(2) applies only to actions merely “related to” a bankruptcy case. Without reaching the merits of Judge Ware’s decision not to abstain, we hold that the abstention provisions are inapplicable to this case. Moreover, to the extent that we are required to construe Growers’ motion to abstain as a motion to remand, we note again that we lack appellate jurisdiction to review the district court’s decision not to remand.

1. Jurisdiction

Abstention can exist only where there is a parallel proceeding in state court. That is, inherent in the concept of abstention is the presence of a pendent state action in favor of which the federal court must, or may, abstain. See, e.g., *In re S.G. Phillips Constrs., Inc.*, 45 F.3d 702, 708 (2d Cir.1995) (including as a requirement for mandatory abstention the presence of a previously commenced state action); *In re Tucson Estates*, 912 F.2d 1162, 1167 (9th Cir.1990) (recognizing as a factor for permissive abstention the presence of a related proceeding commenced in state court or other nonbankruptcy court).⁹

***1010** To require a pendent state action as a condition of abstention eliminates any confusion with 28 U.S.C. § 1452(b), which provides district courts with the authority to remand civil actions properly removed to federal court, in situations where there is no parallel proceeding. Section 1334(c) abstention should be read in *pari materia* with section 1452(b) remand, so that the former applies only in those cases in which there is a related proceeding that either permits abstention in the interest of comity, section 1334(c)(1), or that, by legislative mandate, requires it, section 1334(c)(2).

The International extinguished the coordinated state proceeding on February 12, 1993 when it successfully removed this case to federal court. No other related proceeding thereafter exists.¹⁰ To avoid confusion and to protect against the inconsistent application of the law, we treat the denial of abstention in this case as a decision not to remand, which we cannot review because of 28 U.S.C. § 1452(b).

The International removed this action to federal court pursuant to 28 U.S.C. § 1452(a), the Bankruptcy Code’s analog to the general statutory provision governing removal, 28 U.S.C. § 1441. Thus, a decision *not to remand* this case

comes within the proscriptive language of section 1452(b), which provides in relevant part:

An order entered under this subsection remanding a claim or cause of action, or a decision not to remand, *is not reviewable by appeal or otherwise by the court of appeals* under section 158(d), 1291, or 1292 of this title....

(Emphasis added). See also *Things Remembered*, 516 U.S. at —, 116 S.Ct. at 499 (Ginsburg, J., concurring) (“... [28 U.S.C.] § 1452(b) independently warrants the judgment that remand orders in bankruptcy cases are not reviewable”). The purpose of section 1452 is to enlarge a trial court’s power to remove or remand a claim related to a bankruptcy case. See *Things Remembered*, 516 U.S. at —, 116 S.Ct. at 499 (Ginsburg, J., concurring). Section 1452(b) therefore bars our exercise of appellate jurisdiction over this aspect of Growers’ appeal.

III.

MERITS

A. Growers’ Claims Against the International Brotherhood of Teamsters and Joint Council No. 7

In February 1994, after the Growers had exhausted their efforts to return this case to state court, the International moved for summary judgment. In March 1994, the Joint Council also so moved.¹¹ The district court combined the motions for joint consideration and granted summary judgment in favor of the International and the Joint Council on all claims made by Growers. Growers now appeal the district court’s grant of summary judgment. We have jurisdiction and affirm.

***1011** 1. Authentication of the “Smoking-Gun” Declarations

As a preliminary matter, Growers argue that the district court erred by refusing to consider certain declarations presented by Growers on the basis that they were not properly authenticated. The submission of the declarations at issue, the “smoking-gun” declarations, ultimately resulted in the sanctioning of Growers’ counsel. Nonetheless, Growers contend that the district court should not have sustained the International’s objection to them at the motion for summary judgment.

We review a district court's evidentiary rulings for an abuse of discretion. See *United States v. Sarno*, 73 F.3d 1470, 1488 (9th Cir.1995), cert. denied, 518 U.S. 1020, 116 S.Ct. 2555, 135 L.Ed.2d 1073 (1996). The standard governing admissibility is as follows: "The requirement of authentication or identification as a condition precedent to admissibility is satisfied by evidence sufficient to support a finding that the matter in question is what its proponent claims." Fed.R.Evid. 901(a).

The International provided the district court with sworn deposition testimony of the declarants which contradicted significant portions of the declarations, undermining the authenticity of the evidence. In addition, the International successfully cast doubt upon the credibility of Victor Vidal, a private investigator and translator hired by Growers. Vidal swore under penalty of perjury that he was fluent in both Spanish and English and that he had translated the declarations from English to Spanish before the declarants, who understood only Spanish, signed them. However, the International's deposition of Vidal, during which he was forced to request the assistance of an interpreter, suggested that he was not fluent in Spanish. Vidal's need for an interpreter significantly called into question the reliability of the declarations. The sufficiency of authentication rests in the sound discretion of the district court. See *Gates v. Rivera*, 993 F.2d 697, 700 (9th Cir.1993). We see no basis for holding that it erroneously exercised such discretion here.

2. Review of Summary Judgment Against Growers

The proper litany is that we review a grant of summary judgment de novo. See *Bagdadi v. Nazar*, 84 F.3d 1194, 1197 (9th Cir.1996). Moreover, we must determine, viewing the evidence in the light most favorable to the nonmoving party, whether there are any genuine issues of material fact and whether the relevant substantive law was correctly applied. See *id.*

To avoid summary judgment, Growers were required to present evidence such that a reasonable trier-of-fact could return a verdict in their favor. See *Anderson v. Liberty Lobby*, 477 U.S. 242, 248–49, 106 S.Ct. 2505, 2510, 91 L.Ed.2d 202 (1986). Such evidence is to be measured against the substantive evidentiary standard of proof applicable at trial. See *id.* at 254, 106 S.Ct. at 2513. As previously discussed, the applicable standard of proof in this case is provided by section 6 of the Norris–LaGuardia Act, 29 U.S.C. § 106, which provides:

No officer or member of any association or organization, and no association or organization participating or interested in a labor dispute, shall be held responsible or liable in any court of the United States for the unlawful acts of individual officers, members, or agents, except upon *clear proof of actual participation in, or actual authorization of, such acts, or of ratification of such acts after actual knowledge thereof.*

(Emphasis added). The Supreme Court has equated "clear proof" with standards such as "clear, unequivocal and convincing proof." *Gibbs*, 383 U.S. at 737, 86 S.Ct. at 1145.

a. Role of the International's Representative Ybarrolaza

The Growers' case against the International and the Joint Council rests substantially on the significance properly attributable to the International's appointment of Ybarrolaza to oversee the operations of Local 890 and his actions thereafter.¹² They argue that: *1012 (1) The scope and influence of Ybarrolaza's involvement with the Local was such that the International and the Joint Council assumed de facto control over Local 890; (2) Ybarrolaza had knowledge of the unlawful strike activity, but did not intervene; and (3) Ybarrolaza was present during strike functions wherein Local 890 officials advocated the use of force.

(1) Did The International and The Joint Council "Control" the Local?

The Growers' first theory of liability does not rest on Ybarrolaza's actual participation in or authorization of the illegal activity. Instead, they attempt to demonstrate that his involvement with Local 890 was sufficient to support a finding, based on clear and convincing proof, that the International and the Joint Council "controlled" the Local.¹³

At summary judgment, Growers supplied documentary evidence and deposition testimony which established that Ybarrolaza had full access to Local 890 business records, that he maintained an office at Local 890 headquarters, and that he was expected to, and did, take a lead role in the negotiation of the Local's collective bargaining agreements. None of this is disputed by the defendants. In fact, all parties agree on the extent of Ybarrolaza's involvement in the daily operations of Local 890. They disagree only about that which reasonably can be inferred from Ybarrolaza's role. The International and the Joint Council insist that Ybarrolaza merely assisted the Local in carrying out its functions as a collective bargaining representative. Growers argue that Ybarrolaza's involvement

supports the inference that defendants “controlled” the actions of Local 890.

The Growers' conclusion is not supported by the facts. Despite increasing dissatisfaction with Local 890's performance, the International chose not to place it in trusteeship. It selected a lesser mode of involvement. The International appointed Ybarrolaza to supervise the Local in the administration of its affairs.¹⁴ In effect, Growers contend, despite the stated purpose of Ybarrolaza's appointment, that Ybarrolaza's relationship with Local 890 was that of a *de facto* trustee. We disagree. Growers provide no evidence that Ybarrolaza exercised control or even influence over the strike policy of the Local. What Growers can demonstrate is that Ybarrolaza participated in negotiations, assisted with the implementation of austerity measures, and reported to McCarthy on the status of the Local's progress.¹⁵ In short, they *1013 fail to create a triable issue of fact that the International or the Joint Council controlled the Local. See *Rodonich v. House Wreckers Union Local 95*, 817 F.2d 967, 974 (2d Cir.1987) (noting the well-settled rule that the exercise of supervisory powers is on its own insufficient to render an affiliate union the agent of the international). Thus, Ybarrolaza's appointment did not expose the International and the Joint Council to liability.

Our conclusion is not weakened by the Growers' subsequent presentation of evidence, in the lawsuit against Local 890, demonstrating that Ybarrolaza *lacked* control over the actions of the Local. In the bench trial against Local 890, Growers put into evidence deposition testimony indicating that Ybarrolaza “repeatedly admonished” Local 890 officials not to picket Growers' fields, and to reduce the number of picketers, “but to no avail.”

(2) *The International's and The Joint Council's Knowledge of Strike Misconduct*

Growers also argue that, through Ybarrolaza, the International had knowledge of the illegal activities. Norris–LaGuardia, however, requires more than knowledge of the unlawful activity. See 29 U.S.C. § 106. It requires either participation, or authorization of the illegal acts, or ratification of such acts in addition to “actual knowledge thereof.” See *id.* Thus, Growers' ability to establish that the International and the Joint Council had knowledge of the strike misconduct, without more, does not demonstrate liability on the part of the International or the Joint Council.¹⁶ Nor does Ybarrolaza's continued involvement as an advisor to the Local and in the negotiations to end the strike amount to ratification of

the unlawful acts. See *Gibbs*, 383 U.S. at 738–39, 86 S.Ct. at 1145–46 (requiring for ratification proof that the union approved of the violence).

Finally, Growers contend that Ybarrolaza was present when the use of force was advocated by Local 890 officials. We have examined the record and find no support for this contention. We therefore affirm the grant of summary judgment.

B. *Review of Bench Trial Judgment Against Local 890*

Following a bench trial, the district court found that Local 890 was an active participant in conduct which caused damages to Growers. The Local appeals the court's judgment. It contends that the court erred in its interpretation of section 6 of the Norris–LaGuardia Act, and that the evidence produced at trial did not rise to Norris–LaGuardia's requirement of *clear proof*. Growers cross-appeal the court's determination of the damage award. We uphold the district court's finding of liability, but remand on the issue of damages for the limited purpose of determining whether, and to what extent, the district court based the Union's liability on California Civil Code § 51.7.

1. *Application of Section 6*

The district court found “clear evidence that conduct in which Local 890 was an *active participant* caused damages to the plaintiffs.” (Emphasis added). Local 890 argues that the district court misinterpreted section 6 of the Norris–LaGuardia Act to impose liability when picketers commit illegal acts in violation of the Local's policies, and thus insists that we review the district court's liability determination *de novo*.

Local 890 also contends that the court's conclusion is inconsistent with its findings-of-fact. These findings include the statement: “There was no evidence that officials of Local 890 directed anyone to damage or destroy property.” From this perceived inconsistency, Local 890 infers error in the court's application of section 6. However, this statement is easily reconciled with the court's finding of liability under Norris–LaGuardia. The Union's active participation in conduct in violation of state law need not include an *1014 order to destroy property. Moreover, destruction of property, although a foreseeable result of strike misconduct, is not a requirement of section 6.¹⁷ We therefore decline to review the district court's application of Norris–LaGuardia *de novo*. It is clear to us that the district court did not misinterpret the meaning of section 6.

Our review of a district court's application of the law to the facts is for clear error. See *Masayesva v. Zah*, 65 F.3d 1445, 1453 (9th Cir.1995). Moreover, “review under the clearly erroneous standard is significantly deferential, requiring a definite and firm conviction that a mistake has been committed.” *Exxon Co. v. Sofec Inc.*, 54 F.3d 570, 576 (9th Cir.1995), *aff'd*, 517 U.S. 830, 116 S.Ct. 1813, 135 L.Ed.2d 113 (1996).

We now turn to whether the evidence in the record provides the required clear proof of Local 890's unlawful conduct. To repeat, the clear proof standard of Norris-LaGuardia's section 6 requires proof which is clear, convincing, and unequivocal. See *Gibbs*, 383 U.S. at 737, 86 S.Ct. at 1143. Local 890 asserts that the evidence in the record does not satisfy this stringent requirement. It argues that in each incident of illegality, union leadership was not present, had no knowledge of the incident, or took action to prevent or curtail the wrongful conduct. This contention does not find support in the record.

These leaders were often present. The record conveys several sightings of Arturo Castro, a Local 890 business agent. Castro was present when picketers committed violent acts and vandalized the property of Growers. And on at least one occasion, Castro himself trespassed onto a Grower's field to confront a nonstriking worker. Teresa Escamilla, one of the Local's picket captains, did the same. Authorities arrested Escamilla. Furthermore, Local 890 did have knowledge of the unlawful incidents. For example, it knew of the conduct of both Castro and Escamilla but failed to discipline either, and allowed each to keep his position of authority. Moreover, Local 890 did not always act to prevent or curtail the wrongful conduct. Ybarrolaza advised Local 890 officials against the practice of field picketing and to reduce the number of picketers. But, as the district court properly found, the Local dispatched “picketers to fields belonging to plaintiffs, with neither limits on the number of picketers nor sufficient numbers of picket captains to ensure that order was maintained.” District Court's Findings of Facts and Conclusions of Law, p. 4.

Section 6 draws its force from the principle that unions ought not “be held liable for damage done by acts beyond their practical control.” See *Gibbs*, 383 U.S. at 737, 86 S.Ct. at 1143. “What is required is proof, either that the union approved the violence which occurred, or that it participated actively or by knowing tolerance in further acts which were in themselves actionable under state law....” *Id.* at 739, 86 S.Ct.

at 1146. This is not a situation where the damage complained of was beyond the Union's practical control. The evidence presented supports a conclusion, based on *clear proof*, that the Local authorized or participated in conduct alleged by Growers. Accordingly, the district court did not clearly err by finding the Union liable in this case.

2. Growers' Cross-Appeal

The district court noted that actual damages to Growers were widespread, and divided them into two categories: damaged property and lost profits.¹⁸ However, the court failed to apportion these damages to the Growers' respective cause(s) of action. *1015 We conclude that, aside from the issue of the Union's liability under California Civil Code § 51.7 which we address separately, this failure is harmless. We review a district court's damage award for an abuse of discretion. See *Odima v. Westin Tucson Hotel*, 53 F.3d 1484, 1495 (9th Cir.1995). Neither party challenges the district court's assessment of damaged property.

a. Lost Profits

Both Growers and Local 890 submitted expert testimony on the issue of lost profits. The union's expert testified that there were no lost profits, while Growers' expert estimated loss at an amount in excess of three million dollars. The district court rejected each, as it was entitled to do, and set the damages at \$500,000. The district court observed that the actual amount of lost profits was difficult to determine. Growers claim that \$500,000 is an arbitrary and insufficient award.

We disagree. An approximate determination where the “evidence shows the extent of damages a matter of just and reasonable inference” will be sustained. *Sutton v. Earles*, 26 F.3d 903, 918 (9th Cir.1994). The court rejected Growers' theory of damages because it relied on an “extremely favorable market rate” and required every crop to be of “premium quality.” It then awarded a fraction of Growers' proposal, presumably based on what it considered to be more realistic factors. We believe the district court's award to be a fair assessment of Growers' loss.¹⁹ We therefore affirm this portion of the award.

b. California Civil Code § 51.7

Growers next argue that the court failed to designate and apportion liability pursuant to California Civil Code § 51.7. Among other things, Section 51.7 seeks to protect Californians from violence or the threat of violence,

committed against their persons or property, because of their position in a labor dispute.²⁰ The Growers are attracted to the possibility of exemplary damages and attorney fees provided for in [section 51.7](#) 's remedial counterpart, [California Civil Code § 52\(b\)](#).

The district court's failure to confront explicitly [section 51.7](#) leaves open only two possibilities; either that the amount of damages awarded included a [section 51.7](#) recovery, or that it did not. On this record we cannot ascertain which is the case.²¹

We must remand this case to the district court to permit it to inform us what, if any, portion of the damages awarded to the Growers is attributable to a violation of [section 51.7](#) and awarded pursuant to [section 52\(b\)](#). The district court should of course add additional ***1016** damages under [California Civil Code §§ 51.7](#) and [52](#) to the judgment if such damages were mistakenly omitted. We are reluctant to rely solely on the district court's curt rejection of the Growers' request that it find that the Union violated [section 51.7](#) and to reconsider its damage award in light of [section 52\(b\)](#).²² That explanation stated that "it found contrary to the requested amendments." If so, the district court's response to our limited remand properly would be "none." Should that be the proper response the district court should set forth its reasons for the holding.

C. Sanctions

Lastly, Growers cross-appeal the district court's decision to impose [Rule 11](#) sanctions on Growers' counsel for submitting false declarations. Growers argue their counsel was justified in filing the declarations because it had no reason to question the declarants' authenticity. The International also appeals the sanctions award on the grounds that it presented clear evidence that Growers and their counsel knowingly perpetrated a fraud on the district court and should reimburse the International for its entire defense—over \$730,000.00. We affirm the sanctions award in all respects.

We review all aspects of a district court's [Rule 11](#) determination for abuse of discretion. [Cooter & Gell v. Hartmarx Corp.](#), 496 U.S. 384, 405, 110 S.Ct. 2447, 2460, 110 L.Ed.2d 359 (1990). "A district court would necessarily abuse its discretion if it based its rule on an erroneous view of the law or on a clearly erroneous assessment of the evidence." *Id.* Such a standard requires that we "uphold any district court determination that falls within a broad range of permissible conclusions." *Id.* at 400, 110 S.Ct. at 2458.

[Rule 11](#) imposes a duty on attorneys to certify by their signature that (1) they have read the pleadings or the motions they file and (2) the pleading or motion is "well-grounded in fact," has a colorable basis in law, and is not filed for an improper purpose. [Fed.R.Civ.P. 11](#); [Smith v. Ricks](#), 31 F.3d 1478, 1488 (9th Cir.1994). Counsel, of course, may not avoid "the sting of [Rule 11](#) sanctions by operating under the guise of a pure heart and empty head." [Ricks](#), 31 F.3d at 1488 (quoting [Zuniga v. United Can Co.](#), 812 F.2d 443, 452 (9th Cir.1987)).

Growers filed suit against the International on the strength of eleven self-styled "smoking-gun" declarations tying it to the strike violence. Counsel obtained these declarations from its private investigator Victor Vidal.²³ After the International deposed Vidal and the eleven declarants, serious issues of credibility and authenticity surfaced. For instance, Vidal admitted he did not possess a private investigator's license and was unable to complete his deposition without an interpreter. In addition, the International uncovered numerous inconsistencies between the declarants' sworn deposition testimony and their previous declarations. Despite these developments, counsel filed the eleven declarations in response to the International's motion for summary judgment and sanctions.

Although it initially denied sanctions, the district court reopened the issue after the International submitted evidence that three of the declarants were impostors. Counsel defended its actions by attempting to shift blame to Vidal and by pleading ignorance. ***1017** We agree with the district court that by blindly relying on Vidal under these circumstances, counsel violated its duty to conduct a reasonable inquiry to determine that the declarations were "well grounded in fact." *See Cooter & Gell*, 496 U.S. at 393, 110 S.Ct. at 2454; *see also Smith*, 31 F.3d at 1488. On this record, we cannot say that the district court abused its discretion by finding that three of the declarants were in fact impostors or that there was insufficient evidence that counsel had knowingly and willfully attempted to deceive the court.²⁴

Bearing in mind our deferential review in these matters, we also conclude that sanctioning counsel for \$700.00 in costs and \$4,000.00 in attorneys fees, as opposed to a larger amount, was not an abuse of the district court's discretion. *See Cooter & Gell*, 496 U.S. at 404, 110 S.Ct. at 2460.²⁵

AFFIRMED IN PART; REVERSED IN PART.

[KLEINFELD](#), Circuit Judge, dissenting in part:

I concur in all of the opinion except section 2(C), regarding [Rule 11](#) sanctions against the Growers' attorneys. I respectfully dissent as to the sanctions, and would reverse that award. In my view, the district court was misled by the Teamsters' attorneys into a conclusion for which there was no foundation.

The conclusion, the basis for the sanctions, was that the Growers attorneys had filed declarations by imposters, people who claimed in the declarations to have picketed violently at the Local's behest, but who were not really the individuals named in those declarations. The judge did not conclude that the sanctioned attorneys willfully or knowingly sought to deceive the court. Rather, he found that the attorneys should have been more careful to verify the declarations, and were gulled by a private investigator they should not have trusted.

The majority assumes that the declarations were in fact by imposters, and that the Growers' attorneys presented a "pure heart and empty head" defense. The assumption is mistaken. The Growers' attorneys' position is that the declarations were true, by the persons who purported to make them, or at least they had no reason after due inquiry to suppose the contrary. The district judge concluded that the declarations were by imposters, as the Teamsters argued, but that alone does not suffice to support sanctions. If, as I think is the case, the Growers' attorneys had good reason to think the declarations were genuine and true when they filed them, they were entitled not to be sanctioned. [Fed.R.Civ.P. 11\(b\)\(3\)](#). A lawyer should not have to investigate independent investigators he hires and witnesses whose plausible affidavits he files, or else be in jeopardy of [Rule 11](#) sanctions if opposing counsel attacks them.

The Growers' attorneys sought the people named in the police reports on the violent incidents for declarations. They could not find them themselves, so they engaged a private investigator. The attorneys hired Vidal ***1018** as their investigator because they had become acquainted with him when he worked for a detective agency they had used in another case, and he spoke Spanish and English. The Teamsters apparently persuaded the judge that the attorneys should never have hired Vidal because he was, unbeknownst to them, unlicensed, he had been involved in a narcotics case and had acted for the United States as an informant, and his bilingual skills were not very good.

I do not see why it is the lawyer's fault that his detective turns out to be unlicensed, any more than it is a client's fault if his lawyer turns out to be unlicensed, or a patient's fault, if his doctor turns out to be a fraud. The relevant California statute makes it a misdemeanor if a person "knowingly engages an unlicensed investigator after being notified in writing by the bureau of the private investigator's unlicensed status." [Calif. Business & Professions Code § 7523\(b\)](#). The predicate, knowledge and written notice, was absent here. That Vidal had no license makes the lawyers his victim, just as a patient or client is a victim of an unlicensed doctor or lawyer. There was nothing in the record to show that the attorneys should have thought Vidal an untrustworthy person just because the government had trusted him to act as an informant. Had they known he had acted as an informant (the Union lawyers argue that the Growers' lawyers should have run a computer search and turned up newspaper articles or a decision mentioning this), they might as reasonably suppose that if he was good enough for the United States government, he should be good enough for them. As for Vidal's language skills, it is one thing to talk with a farm worker in Spanish and a lawyer in English, and another to answer questions at a deposition. The Growers' attorneys used a translator on at least some occasions when they took the declarations of the farmworkers Vidal brought in. There is nothing in the record to show that the Growers' attorneys had reason to fear that their investigator was bringing in ringers.

There are two grounds for the conclusion reached by the district court that the people Vidal brought in were in fact not who they purported to be. First, when they were deposed, the Union's lawyer developed some inconsistencies and impeachment evidence. That is the virtue of the ancient truth-finding mechanism of cross-examination, and does not require the party offering the evidence to withdraw it. The inconsistencies and impeachment would not make a reasonable lawyer think the declarations were false or fabricated.

To the extent the impeachment and inconsistencies might matter, the threatening conduct the Union attorneys used to obtain them undermined their significance. For example, with Betancurt, one of the people the Union claims were imposters, the Union's lawyer started off the deposition by getting Betancurt to admit he was in the United States illegally. Then he asked "Who told you it would be all right if you came and just told the truth?" and said "I can call the—you know I can call the immigration right now, right?" The Union attorney's threat appeared to be an innuendo that the truth alone would

not protect Betancurt from adverse consequences—if his testimony did not please the Union's attorney, the attorney would call the immigration authorities. *Cf.* California Rule of Professional Conduct 7–104 (a lawyer “shall not threaten to present criminal, administrative or disciplinary charges to obtain an advantage in a civil action.”). Considering the intervening threats by the Union's attorneys, the Growers' attorneys could reasonably credit what the witnesses said before the threats as the truth and discount any contradictions made after the threats.

On the Friday before the Monday start of trial, the Union's attorneys filed a motion to disqualify the Growers' attorneys and for sanctions, accompanied by what looked like depositions purporting to be by the witnesses whose declarations the Growers' attorneys had used. The “depositions” contained testimony by individuals purporting to be a number of the Growers' declarants, denying that they had ever made the declarations, and denying that they were the individuals who had been deposed. Basically, the apparent depositions said “I am the real Mr. X, and the declaration and deposition purporting to *1019 be me were by imposters.” The judge held a hearing Monday on an order to show cause, and the Growers attorneys explained that they had relied on Vidal and had no reason to think anything was wrong with the witnesses. The district judge assumed that the witnesses had in fact been imposters. Because the trial was starting and the witnesses were hard to locate or in Mexico, it was not practical to bring them in. Also, as the Growers' attorney explained, many of the witnesses were illegal aliens without identification who “weren't our clients, they weren't our friends, these were the people who confessed to doing damage to our clients.” The judge assumed the witnesses had been imposters.

At that point, where it was assumed that Growers' declarants were imposters, I think the district court made a prejudicial error. There was not adequate foundation to establish that the witnesses were imposters. The problem with foundation is that the purported depositions saying so were misleading fake depositions. The Betancurt document, for example, says “Deposition of Arturo Bravo Betancurt” on the cover, and has the caption, spacing, court reporter identification, typography, and formal language typical of a deposition.

But unlike an authentic deposition, there was no notice to opposing counsel and no opportunity for opposing counsel to be present and to cross examine, as is required under [Federal Rule of Civil Procedure 30](#). Union counsel, Mr. William A. Sokol of Van Bourg, Weinberg, Roger & Rosenfeld, the same lawyer who had engaged in the threatening cross examination quoted above, was present, but no one was present for the Growers. Most of us (including me) would have been fooled by the misleading appearance into thinking the papers were depositions, and I suspect that happened to the trial judge.

The fake depositions may be sworn declarations. Betancurt's is signed and recites that he was sworn. The others are not signed but contain the court reporters' statements that the witnesses were sworn. But the Union prevented the Growers' attorneys from having a fair chance even to learn whether the fake depositions were real sworn statements. Though the Union's attorneys filed complete copies of the fake depositions under seal with the court, they served redacted copies on the Growers' attorneys. The redacted copies hid the court reporters' names, addresses, and numbers, the translators' names, addresses and phone numbers, and the witnesses' addresses.

The district court perhaps could reasonably conclude that Vidal had brought in ringers, though the matter is far from certain. I do not think the District Court could reasonably conclude that the Growers' attorneys were careless in not knowing that they were submitting false declarations from imposters. Its implicit finding to that effect lacked adequate foundation. Sanctioning the Growers' attorneys for carelessly submitting declarations which they should have known were false was an abuse of discretion, because (1) the basis for concluding that the declarations were false was inadequate, and (2) the basis for concluding that the Growers' attorneys should have known their declarations were false was nonexistent.

All Citations

124 F.3d 999, 156 L.R.R.M. (BNA) 2148, 134 Lab.Cas. P 10,046, 38 Fed.R.Serv.3d 856, 47 Fed. R. Evid. Serv. 597, 97 Cal. Daily Op. Serv. 6727, 97 Daily Journal D.A.R. 10,940

Footnotes

* Honorable [Evan J. Wallach](#), Judge, United States Court of International Trade, sitting by designation.

- 1 In addition to Security Farms, plaintiffs to this action include H.Y. Minami, El Dorado Farms, Higashi Farms, Inc., Pisoni Farms, Inc., Joe Freitas & Sons, Freitas Farms, San Ysidro Farms, J.J.C., Inc. and labor contractor Manriquez & Acuna.
- 2 Ybarrolaza replaced John Blake, the International's original appointee, because of Blake's inability to speak Spanish.
- 3 Aside from the merits of the district court's decision, Growers also argue that the International's motion to withdraw was untimely. A motion to withdraw is timely "if it was made as promptly as possible in light of the developments in the bankruptcy proceeding." *In re Baldwin—United Corp.*, 57 B.R. 751, 754 (S.D.Ohio 1985). The International filed its motion to withdraw the reference six days after the coordinated proceeding was removed to the district court and automatically referred to the bankruptcy court. Growers claim that the International could have moved to withdraw the reference from the day it and the Joint Council were substituted for "Doe" defendants, almost two years earlier. We disagree. The International could not remove the state court proceeding until the bankruptcy court officially lifted the automatic stay. As a practical matter, there may not have been a basis for withdrawal prior to the removal. Furthermore, any action taken by the International to withdraw the reference prior to the lifting of the automatic stay would have risked sanctions and damages for violation of the stay under 11 U.S.C. § 362(h). See 11 U.S.C. § 362(h) (1994); *In re Bloom*, 875 F.2d 224, 226 (9th Cir.1989) (holding that a motion to withdraw the reference violated § 362). Accordingly, the district court did not abuse its discretion by determining that the motion was timely.
- 4 By contrast, permissive withdrawal does not hinge on the presence of substantial and material questions of federal law.
- 5 We note here that the district court did have subject matter jurisdiction over this dispute. We are, of course, as with any federal court, obliged to notice want of subject matter jurisdiction. See *Things Remembered, Inc. v. Petrarca*, 516 U.S. 124, —, 116 S.Ct. 494, 499, 133 L.Ed.2d 461 (1995) (Ginsburg, J., concurring). Growers' action against Local 890, a debtor in bankruptcy, satisfies the relatively facile requirement of being "related to" a case arising under Title 11. See 28 U.S.C. § 1334(a) (1994); *Pacor, Inc. v. Higgins*, 743 F.2d 984, 994 (3d Cir.1984). While only tenuously connected to Local 890's estate, Growers' claims against the International and the Joint Council come within the broad grant of supplemental jurisdiction. See 28 U.S.C. § 1367(a) (1994) (authorizing the grant of supplemental jurisdiction over any claim "so related" to the action within the district court's original jurisdiction "that they form part of the same case or controversy").
- 6 In the district court's order withdrawing the reference, it denied Growers' request for a hearing on the issue of remand. Judge Orrick stated: "Because the Court finds that the issues in the adversary proceeding involve federal law substantially and materially ... it denies the request."
- 7 Excluding an inquiry into the district court's subject matter jurisdiction, we may not review its decision not to remand. See 28 U.S.C. § 1452(b) (1994). To the extent that Growers' appeal from the district court's withdrawal of the reference is really an appeal from its decision not to remand, we are without jurisdiction to review that decision. Section 1452(b) prevents this court from reviewing a district court's decision not to remand. See section II.B.1., *infra*.
- 8 Because Judge Orrick properly exercised his discretion in withdrawing the reference, we need not address whether withdrawal of the reference was mandatory in this case.
- 9 The version of 28 U.S.C. § 1334(c) in effect at the time Local 890 filed its petition for bankruptcy, stated in part:

(c)(1) Nothing in this section prevents a district court in the interest of justice, or in the interest of comity with State courts or respect for State law, from abstaining from hearing a particular proceeding arising under title 11 or arising in or related to a case under title 11.

(c)(2) Upon timely motion of a party in a proceeding based upon a State law claim or State law cause of action, related to a case under title 11 but not arising under title 11 or arising in a case under title 11, with respect to which an action could not have been commenced in a court of the United States absent jurisdiction under this section, the district court shall abstain from hearing such proceeding if an action is commenced, and can be timely adjudicated, in a state forum of appropriate jurisdiction. *Any decision to abstain or not to abstain made under this subsection is not reviewable by appeal or otherwise by the court of appeal.*

(Emphasis added.)

Congress has since amended § 1334 by redesignating the portion of § 1334(c)(2) beginning “any decision to abstain” as § 1334(d) and adding additional language. The new § 1334(d) provides for appellate review of a trial court’s denial of mandatory abstention. The legislative history of the amendment indicates that Congress viewed this change as carving out a narrow exception to a general rule prohibiting appellate review of abstention decisions. See H.R.Rep. No. 103–835, 103d Cong., 2d Sess. (1994), reprinted in 1994 U.S.C.C.A.N. 3340, 3345–46 (“Any future decisions not to abstain, if made in cases filed before the effective date of the Act, would [] be governed by present law and thus would not be appealable to the Circuit Court of Appeals.”) Section 1334(d) would not apply to this case because Local 890 filed its petition prior to the effective date of the amending legislation. See The Bankruptcy Reform Act of 1994, Pub.L.No. 103–394, § 702(b) (1994). Nevertheless, were abstention the appropriate vehicle for Growers’ concerns, the 1994 amendments would undoubtedly impact our ability to review an order to abstain or not to abstain.

10 The dilemma, as summarized by a Texas bankruptcy court, is inescapable: “If [the] Court were to abstain, nothing would happen because there is only one lawsuit. What movant really seeks is remand ... back to State Court.” *In re Duval County Ranch Co.*, 167 B.R. 848, 849 (Bkrtcy.S.D.Tex.1994).

11 Alternatively, the Joint Council moved for partial judgment on the pleadings. The district court did not reach the Joint Council’s alternative motion and neither do we.

12 Growers alleged, inter alia, that the International and the Joint Council participated in or authorized: (1) physical obstruction of the entrances to Growers’ fields; (2) intimidation of nonstriking workers; (3) acts of violence; (4) vandalism of equipment belonging to Growers; and (5) acts in violation of California Civil Code §§ 51.7 and 52.

13 Norris–LaGuardia requires more than is required under ordinary doctrines of common-law agency. See *Gibbs*, 383 U.S. at 736, 86 S.Ct. at 1144. Under Growers’ line of analysis, Local 890 would, in effect, merge into the International or the Joint Council. Thus, the key ingredient for the International’s or the Joint Council’s liability would be that, through the conduct of Ybarrolaza, it assumed control over the situation. This accords with section 6 of Norris–LaGuardia which was designed to protect unions from liability “for damages done by acts beyond their practical control.” *Gibbs*, 383 U.S. at 737, 86 S.Ct. at 1144.

14 In a letter dated April 11, 1989, McCarthy notified the Local of John Blake’s appointment, the International’s original representative. McCarthy described the role of the appointee in the letter, which stated in part:

Brother Blake will be in contact with the Local Union and must have complete access to all Local Union financial records, contracts and applicable documents. As previously stated, the purpose of his assignment is to supervise the administrative affairs of the Local on my behalf and as such, this is not to be considered the equivalent of a trusteeship. Your Local Union will continue to have complete Local autonomy, but all matters concerning the operation of the Local Union must be brought before Brother Blake before they are implemented.

15 We accept Growers’ assertion that Ybarrolaza’s mission to steady the wayward Local was important to the International. The International has a vested interest in operationally sound and financially stable local chapters. Local 890 is both a constituent and a representative of the International Brotherhood of Teamsters. Its health and the International’s are inextricably linked. However, the importance of Ybarrolaza’s appointment to the International does not alone foster the inference that it or the Joint Council had assumed control over the Local, particularly in light of the International’s decision not to place Local 890 in trusteeship.

16 See *Phelan v. Local 305*, 973 F.2d 1050, 1061 (2d Cir.1992) (“An international union has no independent duty to intervene in the affairs of its local chapters, even where the international has knowledge of the local’s unlawful acts.”); *Chapa v. Local 18*, 737 F.2d 929, 932 (11th Cir.1984) (knowledge of illegal acts committed by the local union is not enough to require the international to intervene.)

17 Local 890 also calls to our attention the district court’s finding that the Union disseminated leaflets which instructed picketers to strike peacefully. However, as the Local itself concedes, the district court specifically found that the Union neglected to enforce its public antiviolence position. Again, we cannot agree with the Union that this finding of fact contradicts the court’s judgment.

- 18 Specifically, the court found that picketers entered the fields of Growers, overturned cartons of harvested crops, flattened tires of harvesting equipment, and smashed the windows and windshields of Growers' vehicles. Picketers also threatened nonstriking contract workers. The court noted that, in many instances, Growers called the police because nonstriking workers feared for their safety.
- 19 Growers' key contention on appeal is that the district court is bound by the testimony of Growers' expert. They argue that the court implicitly accepted the Growers' theory of damages when it rejected defendant's expert. We reject this argument. The district court did not err in this respect.
- 20 The parties disagree on whether § 51.7, which applies to "all persons within the jurisdiction of this state," can be invoked by a corporation.
- 21 In bench trials, Fed.R.Civ.P. 52(a) requires a court to "find the facts specially and state separately *its conclusions of law* thereon." "One purpose behind Rule 52(a) is to aid the appellate court's understanding of the trial court's decision." See *Barnett v. Sea Land Service*, 875 F.2d 741, 744 (9th Cir.1989). Failure to comply with the strictures of Rule 52(a) requires reversal when a full understanding of the issue presented on appeal is impossible without the aid of more specific findings. See *Ocean Garden, Inc. v. Marktrade Co., Inc.*, 953 F.2d 500, 508 (9th Cir.1991).

Growers contend that the district court erred by refusing to allocate damages under California Civil Code § 52(b). But without knowing whether the court based its liability determination on § 51.7, we cannot resolve that issue. For example, there would be no reason for us to entertain Growers' contention that liability under § 51.7 is appropriate in this case, if the district court, in fact, premised its liability finding on that statute. Our review would be limited to whether the court's failure to award special damages under § 52(b) constituted an abuse of discretion. See *Odima*, 53 F.3d at 1495. If, however, the district court rejected the Growers' § 51.7 claim, we would review that decision de novo. See *Saratoga Fishing Co. v. Marco Seattle, Inc.*, 69 F.3d 1432, 1437 (9th Cir.1995), *rev'd on other grounds*, 520 U.S. 875, 117 S.Ct. 1783, 138 L.Ed.2d 76 (1997). We simply cannot make this threshold determination on the basis of the information presented by the district court's judgment of liability.

- 22 Growers moved the district court, pursuant to Fed.R.Civ.P. 52(b), to amend its factual findings and legal conclusions to state liability in terms of the causes of actions pled in their first-amended complaint. In particular, Growers urged the court to find that the Union violated § 51.7 and to reconsider its damage award in light of § 52(b). However, the district court's order denying Growers' request to amend its findings is not helpful. The court's explanation that "it found contrary to the requested amendments" makes no sense because the Growers had requested, as part of the amendments, assignment of liability on any of the causes of action pled in their complaint. The district court must have found for Growers on at least one of their causes of action.
- 23 Vidal's reliability and credibility were crucial to Growers' lawsuit. Without conducting an inquiry into Vidal's background, counsel accepted at face value Vidal's representation that he held a private investigator's license and was fluent in both English and Spanish. Relying on Vidal's word, counsel used Vidal as interpreter and translator in transcribing all but two of the "smoking-gun" declarations into English.
- 24 Contrary to the dissent, we do not affirm the district court's Rule 11 sanctions award solely on the ground that Growers' counsel submitted false declarations. We affirm the sanctions award because Growers' counsel was duty bound under Rule 11 to make further inquiries to determine whether the eleven declarations were "well grounded in fact." See *Cooter & Gell*, 496 U.S. at 393, 110 S.Ct. at 2454. The defendants demonstrated, inter alia, that: (1) Vidal, "the translator and interpreter", could not complete his deposition in English; (2) numerous inconsistencies existed between the declarations and the declarants deposition testimony; (3) several of the declarants were unable to produce proper identification; and (4) Vidal, "the private investigator," was unlicensed. At the sanctions hearing, when asked to respond to the Teamsters' showing that three of the declarants were imposters, Growers' counsel stated "if there was some misconduct by the investigators, we're victims also and I'd like to know what is going on here as well." Elsewhere, when asked for an additional response to the Teamsters' evidence, Growers' counsel stated "I hired [Vidal] to bring me witnesses, and he brought me witnesses, and I assumed those people were who he assumed they were." Counsel's blind reliance on Vidal is strong support for the district court's sanctions ruling, a ruling which is accorded great deference by the reviewing court. See *id.* at 400, 110 S.Ct. at 2458.

- 25 The International's argument that the district court's sanction award encompasses "all of its fees and costs related to [Growers'] phony 'smoking-gun' witnesses" is belied by the record.

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743 F.2d 1069

United States Court of Appeals,
Fifth Circuit.

Jane H. BROWNING, Individually
and as co-independent executrix of the
Estate of William W. Browning, Jr.,
Deceased, et al., Plaintiffs-Appellants,
v.

Don NAVARRO, Individually and
as Trustee For Pat S. Holloway,
et al., Defendants-Appellees.

No. 84-1083.

|

Oct. 1, 1984.

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Rehearing and Rehearing En Banc Denied Nov. 7, 1984.

Synopsis

Plaintiffs' state suit for imposition of constructive trust on defendants' assets had been removed to Bankruptcy Court after defendant filed Chapter 11 petition, but was subsequently conditionally remanded to state court. After initial judgment was reversed, state court eventually entered judgment in favor of plaintiffs, and plaintiff filed federal action to enforce state judgment. [The United States District Court for the Northern District of Texas, Barefoot Sanders, J., 37 B.R. 201](#), entered summary judgment in favor of trustee, ruling that state court judgment was void for not being tried in accordance with remand order, and plaintiff appealed. The Court of Appeals, Randall, Circuit Judge, held that terms of remand order conditioning remand upon "final assignment" of case to visiting or retired state judge were sufficiently carried out by initial assignment to and trial before retired state judge, and when resulting judgment was subsequently reversed on appeal, second trial before active state judge did not divest state court of jurisdiction over matter.

Reversed and remanded.

Procedural Posture(s): On Appeal; Motion for Summary Judgment.

Attorneys and Law Firms

***1071** Law Offices of R. Jack Ayres, Jr., P.C., R. Jack Ayres, Jr., Thomas V. Murto, III, Kenneth F. Nye, Winstead, McGuire, Sechrest & Minick, P.C., Jay J. Madrid, Dallas, Tex., for plaintiffs-appellants.

G. Leroy Street, Gerald P. Urbach, Dallas, Tex., for Robbie Holloway.

Pat S. Holloway, Giddings, Tex., pro se.

Timothy J. Vineyard, Michael R. Cooper, Dallas, Tex., for Navarro, et al.

Appeal from the United States District Court for the Northern District of Texas.

Before TIMBERS*, POLITZ and RANDALL, Circuit Judges.

Opinion

RANDALL, Circuit Judge:

The plaintiffs filed suit in the district court to enforce a state court judgment imposing a constructive trust on the defendants' assets and awarding \$72,000,000 in damages for breach of fiduciary duty and fraud. Holding that the state court case was not tried in accordance with a bankruptcy court remand order and that the state court proceedings leading to the judgment were conducted in violation of the automatic stay, the district court granted the defendants' motion for summary judgment and declared the state court proceedings void. Because we hold that the parties complied with the bankruptcy court's remand order, that the stay was lifted, and that the resulting state court judgment was not void, we reverse the district court's judgment and remand the case.

I. Factual and Procedural Background.

Although the district court has set out in its opinion¹ the rather complex factual and procedural posture of this case, we recount here the pertinent events leading to this appeal.

On September 12, 1979, the plaintiffs ("Brownings") filed suit against Humble Exploration Co., Inc. ("Humble"), Pat Holloway ("Holloway"), and others in the 193rd Judicial District Court of Dallas County, Texas, seeking, as the alleged equitable owners of substantially all of the assets of Humble and Holloway, the imposition of a constructive trust

on Humble's and Holloway's assets, actual and exemplary damages, and the appointment of an interim receiver to manage the disputed assets. (This case is hereinafter referred to as the "1979 case.") On November 19, 1979, Humble and Holloway filed Chapter 11 voluntary bankruptcy petitions and removed the 1979 case to the United States Bankruptcy Court for the Northern District of Texas ("Bankruptcy Court") pursuant to 28 U.S.C. § 1478(a).

On November 21, 1979, the Brownings sued Sterling Pipeline Company ("Sterling") in the 191st Judicial District Court of Dallas County, alleging that Sterling was a wholly owned subsidiary of Humble or controlled by Holloway and therefore subject to the constructive trust sought in the 1979 case. The Sterling case was subsequently consolidated with the 1979 case and removed to the Bankruptcy Court.

The parties entered a "Stipulation and Agreement on Manner in Which Controversy Shall Be Heard, Determined and Liquidated," which was approved by the Bankruptcy Court and annexed to the court's January 18, 1980 "Order Remanding Causes of Action and Modifying Automatic *1072 Stay." The remand order purported to remand the 1979 case and the Sterling case to the 193rd Judicial District Court pursuant to the terms of the stipulation and agreement and to modify the automatic stay to permit trial of the cases upon remand again subject to the terms of the stipulation and agreement. The stipulation and agreement provided, *inter alia*, that, upon remand of the cases to the 193rd Judicial District Court, the parties would file joint motions to consolidate the cases into the 1979 case and to request that the presiding judge of the administrative judicial district be asked to assign a visiting or retired state judge to hear the consolidated cases. Paragraph 3 of the stipulation and agreement provides:

The order of the Bankruptcy Court remanding said consolidated cause to the state court for trial shall recite that such remand is *conditional upon and shall only take effect upon the final assignment* of said consolidated cause [to a visiting or retired state judge]. In the event that the BROWNING INTERESTS and Debtors [Humble and Holloway] are unable to obtain the assignment of said consolidated cause as prescribed ..., the *remand* of said consolidated cause *shall not take effect* and the Bankruptcy Court *shall retain jurisdiction* over said cause which shall proceed to trial in the Bankruptcy Court before a jury. (Emphasis added.)

The cases were remanded and consolidated and the presiding judge assigned the case to a retired state judge who ordered that a prior settlement agreement between the parties to the 1979 case entered in state court be enforced.² In 1981, the state court of appeals reversed and remanded the case for a jury trial and the Texas Supreme Court found no reversible error.³ Upon remand, the 1979 case was assigned to a different retired state judge who entered an instructed verdict after a separate trial on the settlement agreement declaring the prior settlement agreement to be unenforceable. He then ordered that the case proceed to trial on the merits.⁴

On May 26, 1982,⁵ a group of investors sued Holloway and Humble in the 162nd Judicial District Court of Dallas County, Judge Dee Brown Walker (an active state district judge) presiding, claiming that the defendants wrongfully shut-in some oil and gas wells jointly owned by the investors and Humble. The plaintiffs sought the appointment of a receiver over Humble's assets. (This case is hereinafter referred to as the "1982 case.") The Brownings were named as defendants in the 1982 case because of their claim to ownership of Humble's and Holloway's assets. The 1982 case was removed to the Bankruptcy Court and remanded on the same day. Believing that the Brownings, during a May 27 hearing on the 1982 case, had requested a receiver over the assets of Humble, Humble filed a complaint in Bankruptcy Court seeking enforcement of the Bankruptcy Court's January 18, 1980 order forbidding the appointment of a receiver over Humble's assets as a form of relief in the 1979 case. On May 28, 1982, the 162nd District Court appointed a receiver over Humble's and Holloway's assets that were the subject of dispute in the 1982 case.

On June 4, 1982, the Bankruptcy Court abstained from hearing the 1982 case pursuant to 28 U.S.C. § 1471(d).⁶ Thereafter "ensued a somewhat dizzying sequence of state court orders" recounted by the district *1073 court, 37 B.R. at 205–06, which resulted in the transfer and consolidation of the 1979 case with the 1982 case before Judge Walker in the 162nd Judicial District. On June 24, the May 28 receivership order having been vacated by the state court of appeals,⁷ Judge Walker granted the Brownings' request for a separate and expedited trial of the 1979 case. On August 26, 1982, after a month-long trial, judgment was entered in the 1979 case for the Brownings imposing the constructive trust on Humble's and Holloway's assets and awarding the Brownings actual and exemplary damages totalling \$72,000,000.⁸ Holloway and Humble appealed.

On October 5, 1982, the Bankruptcy Court enjoined the state court receiver from turning over the assets which were the subject of the state court judgment until that judgment became final. Humble's and Holloway's subsequent conversion of their Chapter 11 proceedings to Chapter 7 proceedings resulted in the appointment of a trustee, appellee Don Navarro ("Trustee"), over Humble's and Holloway's assets. When the Trustee refused to comply with the Brownings' demand to turn over assets in satisfaction of the state court judgment, the Brownings instituted the instant action on March 2, 1983, in the United States District Court for the Northern District of Texas, seeking an order to have Humble and Holloway post a supersedeas bond or, alternatively, turn over the assets. The Trustee filed a counterclaim, seeking an enforcement of the Bankruptcy Court's prior injunction against turning over the assets, further injunctive relief, and a declaratory judgment that the state court judgment was void. On December 5, 1983, the district court granted the Trustee's motion for summary judgment and declared void all proceedings before Judge Walker in the 1979 case.⁹ After the district court denied its motion for a reconsideration and stay of its judgment, the Brownings filed this appeal. On January 17, 1984, the district court enjoined the Brownings from enforcing the state court judgment.

On July 11, 1984, after we heard oral argument in this case, a special panel of the Fifth District Court of Appeals of Texas dismissed Humble's and Holloway's appeal of the state court judgment, holding that "if a party seeks review in the federal court of a state court judgment on the ground of an alleged violation of a condition of remand from bankruptcy court without pointing out the alleged error in the state court, he is barred from further relief under state law."¹⁰ The court of appeals reasoned that dismissal of the appeal was appropriate because a state appeal in addition to a federal appeal was a hardship that the parties need not be forced to bear and because it could not "justify proceeding with this appeal when the judgment under review ha[d] been declared void by the federal court."¹¹

II. The District Court Opinion.

In a carefully reasoned opinion, the district court adopted a construction of the January 18, 1980 remand order of the Bankruptcy Court and the annexed stipulation and agreement that had the effect of voiding the state court judgment rendered in favor of the Brownings. After establishing that the Bankruptcy Court's orders and jurisdiction in this matter

remained unimpaired by the Supreme Court's decision in *Northern Pipeline Construction Co. v. Marathon Pipeline Co.*, 458 U.S. 50, 102 S.Ct. 2858, 73 L.Ed.2d 598 (1982),¹² and that the district court was empowered to hear the case under 28 U.S.C. § 1471,¹³ the district court examined the statutory basis for the Bankruptcy Court's remand order.

The district court observed that: (1) the legislative history of 28 U.S.C. § 1478¹⁴ does not limit the broad remand power granted bankruptcy courts and, hence, does not circumscribe the Bankruptcy Court's authority to enter a remand order akin to the January 18, 1980 order; (2) the language and legislative history of 11 U.S.C. § 362(d),¹⁵ 11 U.S.C. § 105(a),¹⁶ and 28 U.S.C. § 1481¹⁷ give the Bankruptcy Court the authority and discretion to fashion the automatic stay to the needs manifest in a particular bankruptcy proceeding. Giving full scope to these provisions, the district court concluded that the Bankruptcy Court did not exceed its powers by conditioning the remand of the 1979 case and modifying the automatic stay upon compliance with the stipulation and agreement of the parties. The district court then examined whether there had been compliance with the Bankruptcy Court's remand order, observing that the trial of the 1979 case before an active judge contravened certain provisions of the stipulation and agreement.¹⁸ Because the 1979 case was tried contrary to the terms of the Bankruptcy Court's January 18, 1980 order and in violation of the modified automatic stay, the district court declared void the proceedings leading to the state court judgment and granted the Trustee's motion for summary judgment.

III. Contentions of the Parties.

On appeal, the Brownings contend that the Bankruptcy Court was divested of all jurisdiction in the case upon entry of the remand order because (1) although a Bankruptcy Court may precondition or limit the scope of the remand, the effectiveness of a *1075 remand cannot depend on post-remand events, and (2) the Bankruptcy Court cannot review, much less revoke, a remand once issued. The Brownings also contend that the removal and remand of the 1979 case terminated the automatic stay which then could not be reactivated with respect to the same matter. In the alternative, they suggest that the automatic stay terminated thirty days after the Bankruptcy Court entered the remand order because the Brownings' request for a remand amounted to a request for relief from the automatic stay under 11 U.S.C. § 362(d), and the Bankruptcy Court failed to expressly continue the stay

within the thirty days. The Brownings further argue that any attempt by the Bankruptcy Court to impose a condition on its remand order or on its modification of the automatic stay that dictates the qualifications of a trial judge to be selected by the state court is violative of various principles of federalism, including the reserved power of states to operate their judicial systems, comity, “Our Federalism,” and the lack of federal supervisory authority over state courts. The Brownings allege that the district court misconstrued the intent of the Bankruptcy Court’s remand order and the annexed stipulation and agreement and that the parties’ successful efforts to get a visiting or retired state judge assigned to the 1979 case in the first instance constituted a “final assignment” under the terms of the stipulation and agreement. The Brownings further contend that the Bankruptcy Court abstained on several occasions from deciding issues concerning the state court’s jurisdiction over the 1979 case and that such abstention is not reviewable under 28 U.S.C. § 1471(d). Moreover, they argue, comity dictates that the district court should have abstained from deciding the validity of the state court judgment while that judgment was on direct appeal in the state system. Finally, the Brownings contend that the district court’s injunction against enforcement of the state court judgment does not comply with Rule 65(d) of the Federal Rules of Civil Procedure because the injunction does not state the reason for its issuance or describe in reasonable detail the acts to be enjoined.

The Trustee contends that the Bankruptcy Court is vested with broad equitable powers in remanding a cause and modifying the automatic stay which would permit the court to condition its order in the manner contemplated by the stipulation and agreement, without such a conditional order constituting an impermissible interference with the operation of state courts. Because the automatic stay may only terminate under the conditions listed in 11 U.S.C. § 362, the Trustee argues, neither removal nor remand served to lift the automatic stay and the proceedings before an active state judge were in violation of that stay and are void. Moreover, the Trustee suggests that any judgment obtained in violation of the stay may be enjoined and the district court’s order to that end was in complete compliance with Rule 65(d) of the Federal Rules of Civil Procedure.

Holloway contends that the Bankruptcy Court had the equitable power to remand the case upon the condition that it be tried before a retired or visiting judge and to modify the automatic stay to permit such trial. He further contends that we cannot review the propriety of the Bankruptcy Court’s

order, that the remand order is void if the condition is held to be void, that the Bankruptcy Court’s order does not represent an impermissible attempt to exercise supervisory power over state courts, and that comity is a “two-way street” mandating “that the state court honor the orders of the federal court approving the agreement of the parties that it not be tried before an active local judge.”¹⁹ Finally, Holloway argues that the Bankruptcy Court’s February 22, 1980 confirmation of Humble’s plan of reorganization, which incorporated the stipulation and agreement, should be given preclusive effect, rendering the provision that the Brownings’ claims be tried before a retired or visiting state judge unassailable in this collateral proceeding.

The parties agree that the stipulation and agreement is not subject to attack *1076 by any consenting party except on jurisdictional grounds.²⁰ The contentions of the parties which raise issues necessary to our disposition of the case are addressed below.

IV. The Remand Order.

A. Reviewability.

Section 1478(b) provides that “[a]n order under this subsection remanding a claim or cause of action, or a decision not so remanding, is not reviewable by appeal or otherwise.” The legislative history of this provision offers no insight into its intended scope.²¹ The purpose of making nonreviewable the bankruptcy courts’ remand orders, or their decisions not to remand, was to avoid the delay that would result from litigating remand decisions. 1 Collier on Bankruptcy ¶ 3.01, at 3–80.1 to *1077 3–81 (15th ed. 1984); Reed, Sagar & Granoff, *Subject Matter Jurisdiction, Abstention and Removal Under the New Federal Bankruptcy Law*, 56 Am.Bank.L.J. 121, 146 (1982).

The statute plainly prohibits our review of a bankruptcy court’s remand order on direct appeal. *In re Compton*, 711 F.2d 626 (5th Cir.1983); see also *Shell Pipe Line Corp. v. West Texas Marketing Corp.*, 540 F.Supp. 1155 (S.D.Tex.1982) (bankruptcy court’s decision to remand under § 1478(b) not reviewable); 1 Collier on Bankruptcy, *supra*, ¶ 3.01, at 3–79; cf. *In re Potts*, 724 F.2d 47 (6th Cir.1984) (bankruptcy court’s refusal to remand not reviewable). This comports with the extensive jurisprudence under 28 U.S.C. § 1447(d),²² an analogous rule contained in the general remand provisions establishing that remand orders of a district court are unreviewable on direct appeal.²³ *Briscoe v. Bell*, 432 U.S.

404, 97 S.Ct. 2428, 53 L.Ed.2d 439 (1977); *Volvo of America Corp. v. Schwarzer*, 429 U.S. 1331, 97 S.Ct. 284, 50 L.Ed.2d 273 (Rehnquist, Circuit Justice, 1976) (nonreviewability bar applies whenever a federal court remands on the basis of a remand statute even if the federal court was in error in applying the statute); *Gravitt v. Southwestern Bell Telephone Co.*, 430 U.S. 723, 97 S.Ct. 1439, 52 L.Ed.2d 1 (per curiam), *reh'g denied*, 431 U.S. 975, 97 S.Ct. 2941, 53 L.Ed.2d 1073, *on remand* 556 F.2d 370 (5th Cir.1977) (per curiam); *In re Weaver*, 610 F.2d 335 (5th Cir.1980).

Whether the nonreviewability bar of § 1478(b) extends to an indirect review of a bankruptcy court's remand order is a question left open by the legislative history and existing jurisprudence interpreting § 1478(b). We resort to the jurisprudence interpreting § 1447(d) and its statutory predecessor²⁴ to receive some guidance. The United States Supreme Court has held that an order of a district court remanding a cause to the state court from which it was removed is not reviewable by the Supreme Court on appeal from a final judgment in the highest court of the state. *Metropolitan Casualty Insurance Co. v. Stevens*, 312 U.S. 563, 61 S.Ct. 715, 85 L.Ed. 1044 (1941); *McLaughlin Bros. v. Hallowell*, 228 U.S. 278, 33 S.Ct. 465, 57 L.Ed. 835 (1913); *Missouri Pacific Ry. v. Fitzgerald*, 160 U.S. 556, 16 S.Ct. 389, 40 L.Ed. 536 (1896).²⁵ Likewise, federal courts of appeals are precluded from reviewing in an ancillary proceeding the remand orders of a district court even after judgment has been entered in state court. *1078 *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Haydu*, 637 F.2d 391 (5th Cir.1981), *appeal after remand*, 675 F.2d 1169 (5th Cir.1982) (party cannot attack remand order collaterally by bringing subsequent independent action involving same parties and claims as in original action); *Chicago, St. Paul, Minneapolis & Omaha Ry. v. Hensley*, 25 F.2d 861 (8th Cir.1928) (interpreting 28 U.S.C. § 71); *cf. Atchison, Topeka & Santa Fe Ry. v. Smith*, 47 F.2d 223 (9th Cir.1931) (§ 71 prohibits ancillary suit to enjoin state court proceeding after remand). We hold that § 1478(b), which contains language paralleling that of § 1447(d), bars our review, however indirect, of a bankruptcy court's order of remand. Hence, we are not empowered to review the Bankruptcy Court's January 18, 1980 remand order.

It is axiomatic that remanding a case to state court terminates the jurisdiction of a federal bankruptcy or district court over that case. *United States v. Rice*, 327 U.S. 742, 66 S.Ct. 835, 90 L.Ed. 982 (1946) (applying 28 U.S.C. § 71); *Robertson v. Ball*, 534 F.2d 63, 66 n. 5 (5th Cir.1976) (“[O]nce the federal district court considers the proper factors and decides

to remand, the action should go forward in state court without the further delay of appeal, and without regard to whether the federal district court was correct or incorrect.”); 14 C. Wright, A. Miller & E. Cooper, *Federal Practice and Procedure: Jurisdiction* § 3739 (1976 & Supp.1983); *cf. E.D. Systems Corp. v. Southwestern Bell Telephone Co.*, 674 F.2d 453 (5th Cir.1982) (federal court lost jurisdiction as to claims it remanded to state court, but retained jurisdiction over proceedings excepted from the remand order). Even a federal court, persuaded that it has issued an erroneous remand order, cannot vacate the order once entered. *In re La Providencia Development Corp.*, 406 F.2d 251 (1st Cir.1969).²⁶ The federal court is completely divested of jurisdiction once it mails a certified copy of the order to the clerk of the state court.²⁷ See 28 U.S.C. § 1447(c); 1A J. Moore & B. Ringle, *Moore's Federal Practice* ¶ 0.169[2.-1], at 697 (2d ed. 1983); 14 C. Wright, A. Miller & E. Cooper, *supra*, § 3739, at 764-65; *see also Bucy v. Nevada Construction Co.*, 125 F.2d 213 (9th Cir.1942) (district court could review and set aside its own erroneous remand order before filing of certified copy of order in state court because remand order is not self-executing); Bankruptcy Rule 9027(e).²⁸ “[O]nce a district *1079 court has decided to remand a case and has so notified the state court, the district judge is without power to take any further action.” *Federal Deposit Insurance Corp. v. Santiago Plaza*, 598 F.2d 634, 636 (1st Cir.1979).

Conditional remand orders seem to be contrary to the principles underlying the concept of remand. The notion that a federal court can impose a condition on a remand order, the occurrence of which would void judicial proceedings resumed by a state court after notice of a federal court's remand order and which would thereafter reinvest the federal court with jurisdiction over the case, runs counter to fundamental precepts of remand. *Cf. Three J Farms, Inc. v. Alton Box Board Co.*, 609 F.2d 112, 115 (4th Cir.1979), *cert. denied*, 445 U.S. 911, 100 S.Ct. 1090, 63 L.Ed.2d 327 (1980); *In re La Providencia Development*, *supra*, at 252; *see generally* 14 C. Wright, A. Miller & E. Cooper, *supra*, § 3749. We recognize that conditional remand orders, while not common, are occasionally entered by bankruptcy courts. Nevertheless, we were cited to no cases or other writings, nor has our research discovered any, which would suggest that conditional remands are proper or improper.²⁹ The prohibition against reviewing remand orders presumably explains *1080 the dearth of jurisprudence addressing the validity of conditional remands. The quandry presented by the reviewability bar, however, is that conditional remands

continue to exist in the face of the principles governing remand orders and the applicable rules and even though they result in tension between the state and federal judicial systems and uncertainty as to whether a state or federal court has jurisdiction to act in a case. The remand order at issue in this case suffers from all of these defects and from the further defect that a federal bankruptcy court, in approving and effectuating the stipulation and agreement, may be viewed as having approved the parties' view that a state district judge is somehow unacceptable to try the case—all these defects being unreviewable.

B. Construction.

We are left, then, to determine whether there was compliance with the terms of the Bankruptcy Court's January 18, 1980 remand order. The stipulation and agreement, like a consent decree, being in the nature of a contract to which the court has given its formal approval, is subject to the rules of construction of contracts. *United States v. ITT Continental Baking Co.*, 420 U.S. 223, 236–38, 95 S.Ct. 926, 929–30, 43 L.Ed.2d 148 (1975) (“[S]ince consent decrees and orders have many of the attributes of ordinary contracts, they should be construed basically as contracts”); *Robinson v. Vollert*, 602 F.2d 87, 92 (5th Cir.1979) (“Consent orders are interpreted as contracts and are to be construed only by reference to the ‘four corners’ of the order itself.”), *reh'g denied*, 609 F.2d 1177 (5th Cir.1980); *see also In re New Mexico Properties, Inc.*, 18 B.R. 936, 941–42 (Bankr.D.N.M.1982) (“stipulation is binding on the parties entering into it” and subject to rules for construing contracts). Where the issue is solely a question of interpreting contractual language, it is a question of law. *Seal Offshore, Inc. v. American Standard, Inc.*, 736 F.2d 1078, 1080 (5th Cir.1984).

The district court noted that the case was to be remanded “pursuant to the terms set out in the annexed stipulation and agreement” The district court pinpointed the following provisions of the stipulation and agreement as dispositive in determining whether the parties complied with the remand order:³⁰

— ***1081** The “remand is conditional upon and shall *take effect* upon the *final assignment* of” the 1979 case to a visiting or retired state judge; and

—“In the event that the BROWNING INTERESTS and Debtors [Humble and Holloway] are unable to obtain the *assignment* of [the 1979 case to a visiting or retired

state judge], the remand ... shall not *take effect* and the Bankruptcy Court shall retain jurisdiction over said cause which shall proceed to trial in the Bankruptcy Court before a jury.”

(Emphasis added.) The district court, not unreasonably, interpreted the words “final assignment” to mean that the ultimate disposition of the issues extant in the 1979 case should be made before a retired or visiting state judge.

The polestar for courts in interpreting contracts is to ascertain the intent of the parties.³¹ 4 Williston on Contracts § 600 (3d ed. 1961 & Supp.1984); 3 Corbin on Contracts § 542 (1951). Determining the parties' intent in using the phrase “final assignment” is pivotal in interpreting the stipulation and agreement. The district court's interpretation that “final assignment” meant ultimate disposition before a retired or visiting state judge is not evident from examining the ordinary meaning of the words. The parties could have intended that the assignment by the presiding judge be “final” in terms of the last step before trial of the 1979 case. When the 1979 case was remanded, it was returned to the docket of an active state judge who then requested the presiding judge to reassign or perhaps “finally” assign the 1979 case to a retired state judge. This interpretation is supported by reading the stipulation and agreement as a whole, because the parties further provided that “[f]ull rights of appeal are preserved to all parties.”³² Presumably, on appeal, the state district court judgment could have been reversed and the cause remanded as occurred here. The parties did not specify that the case should have been assigned to a retired or visiting state judge a second time if remanded by the state court of appeals.

We should endeavor to render an “interpretation which gives a reasonable, lawful and effective meaning” to the stipulation and agreement while giving “great weight” to the “principal apparent purpose of the parties.” *Restatement of Contracts, supra*, § 236. We are mindful that the stipulation and agreement is in the nature of a consent decree and pay heed to Justice Marshall's pertinent observations:

Consent decrees are entered into by parties to a case after careful negotiation has produced agreement on their precise terms. The parties waive their right to litigate the issues involved in the case and thus save themselves the time, expense, and inevitable risk of litigation. Naturally, the agreement reached normally embodies a compromise; in exchange for the saving of cost and elimination of risk, the parties each give up something they might have won had they proceeded with the litigation. Thus the *decree* itself cannot be said to have a purpose; rather the *parties*

have purposes, generally opposed to each other, and the resultant decree embodies as much of those opposing purposes as the respective parties have the bargaining power and skill to achieve. For these reasons, the scope of a consent decree must be discerned within its four corners, and not by reference to what might satisfy the purposes of one of the parties to it.

United States v. Armour & Co., 402 U.S. 673, 681–82, 91 S.Ct. 1752, 1757, 29 L.Ed.2d 256 (1971). Thus, although it may be inferred (and we have assumed) that the principal apparent purpose of at least one *1082 of the parties was to avoid having an active state judge try the 1979 case, whether by oversight or purposeful omission following negotiation, the parties to the stipulation and agreement did not provide for what occurred after the initial assignment of the 1979 case—a judgment, appeal, reversal and remand, and another proceeding in the state district court.

Under the stipulation and agreement, the remand was to “*take effect*” upon the “*final assignment*” of a visiting or retired state judge to hear the case. In good faith, the presiding judge of the administrative judicial district upon request of the parties attempted to effectuate the Bankruptcy Court's remand order by *assigning* the case to a retired state judge not just once but twice. Following the initial assignment, there were proceedings, a verdict and judgment, and a reversal on appeal. There is no doubt that had these initial proceedings ended in a final judgment for either party, we would not have been called upon to decide the issues addressed herein. There is also no doubt that the parties pursued their cause in the state court system following remand confident that jurisdiction over the case had been restored to the state court.³³ In other words, the remand took effect no later than upon satisfaction of the condition—the final assignment of the 1979 case to the retired state judge. With the condition satisfied, the remand given effect, the Bankruptcy Court divested of jurisdiction, and the state court reinvested with jurisdiction, the subsequent assignment of the case to an active state district judge could not (under the principles applicable to remand orders discussed above) operate to divest the state court of jurisdiction, even had the parties intended to do so.

As it is, we find no evidence that the parties intended to divest the state court of jurisdiction once it had attached. While we recognize that perhaps the principal intent of at least one of the parties was to keep the 1979 case out of the hands of an active state judge, the language of the stipulation and agreement suggests that the parties may have recognized that there were

limits on their ability to realize that objective once jurisdiction had vested in the state courts. The stipulation and agreement never speaks in terms of the Bankruptcy Court reassuming jurisdiction over the case once the state court had been vested with jurisdiction following issuance of the remand order.³⁴ And we will not presume that the parties intended to do something that was impossible to accomplish. The suggestion that the subsequent trial of the 1979 case before an active state judge is void after two-and-a-half years of effort by the parties and the state courts is a waste of judicial resources never anticipated by the court in issuing its January 18, 1980 remand order or the parties in confecting the annexed stipulation and agreement. We refuse to countenance such a waste now by giving effect to a construction of the stipulation and agreement that confounds the general principles of remand *1083 and places at odds the federal and state judicial systems.³⁵

The Trustee contends that the remand order included an automatic revocation provision within its own terms. A bankruptcy court should not be permitted to devise a remand order providing for *revocation* upon the occurrence of a condition since the court could not itself directly review and revoke the order subsequent to the occurrence of the condition. If we held that a remand could be revoked by its issuing court via an automatic revocation provision which the court itself concocted, we would be authorizing a bankruptcy court to do indirectly that which it is prohibited from doing directly. See *In re La Providencia Development*, *supra*, at 252. The Trustee also contends that the concept of dual jurisdiction can explain a simultaneous jurisdiction of the state court and the Bankruptcy Court over the case. No authority—case law or commentary—was cited by the Trustee to support such a concept and we do not give it credence here. Professor Wright succinctly summarizes the widely accepted notion that “[a]n order of remand ends the jurisdiction of the federal court.” C. Wright, *Law of Federal Courts* § 41, at 237 (4th ed. 1983). There is no room for dual jurisdiction in this thinking.

V. The Automatic Stay.

We are not constrained in our review of the Bankruptcy Court's purported modification of the automatic stay by a statutory provision comparable to 28 U.S.C. § 1478(b) barring such review. Thus, we must assess whether the Bankruptcy Court achieved through a modification of the stay what we have held it did not achieve via its remand order.

The automatic stay under 11 U.S.C. § 362(a) accompanies the filing of a petition in bankruptcy and operates to prevent the commencement or continuation of any judicial, administrative, or other proceeding against the debtor “that was or could have been commenced before the commencement of the [bankruptcy] case” 11 U.S.C. § 362(a); 2 Collier on Bankruptcy, *supra*, ¶¶ 362.03–362.04[1]. The automatic stay is intended to give “the debtor a breathing spell from his creditors.” S.Rep. No. 989, 95th Cong., 2d Sess. 54–55, *reprinted in* 1978 U.S.Code Cong. & Ad.News 5787, 5840–41; H.R.Rep. No. 595, 95th Cong., 1st Sess. 340, *reprinted in* 1978 U.S.Code Cong. & Ad.News 5963, 6297; *see also* *Wedgeworth v. Fibreboard Corp.*, 706 F.2d 541, 544 (5th Cir.1983). Generally, a stay continues, in the case of an act against property of the estate, until the property is no longer property of the estate or, in the case of other acts under § 362(a), until the earliest of the closing of the case, the dismissal of the case, or the time a discharge is granted or denied. 11 U.S.C. § 362(c); *see* 2 Collier on Bankruptcy, *supra*, ¶ 362.06, at 362–43.

A party in interest who desires to pursue his pending but stayed action may file a complaint or motion in the bankruptcy court for relief from the automatic stay to proceed with his cause, *see* 11 U.S.C. § 362(d), or either party to the pending action may file a motion for removal pursuant to 28 U.S.C. § 1478. *See In re Critical Fork Coal Corp.*, 18 B.R. 422, 424 (Bankr.W.D.Va.1982) (§ 362(d) motion for relief from automatic stay and § 1478(b) remand are alternative methods of seeking relief from automatic stay). Section 362(d) provides that, “[o]n request of a party in interest and after notice and a hearing, the court shall grant relief from the [automatic] stay ... by terminating, annulling, modifying, or conditioning such stay ... for cause”³⁶

*1084 Section 362(d) expressly authorizes a bankruptcy court to modify or condition the automatic stay to provide relief to a party in interest who has requested it.³⁷ Thus, if a modification of the automatic stay was what was attempted by the Bankruptcy Court, the district court was correct in holding “that the Bankruptcy Court did not exceed its authority in conditioning the modification of the automatic stay upon each party's *compliance* with the stipulation and agreement.” 37 B.R. at 209 (emphasis added) (citing *In re Dublin Properties*, 27 B.R. 506, 506–07 (Bankr.E.D.Pa.1983); *In re Cosby*, 22 B.R. 682 (Bankr.E.D.Pa.1982); *In re Ideal Roofing & Sheet Metal Works Inc.*, 9 B.R. 2, 3 (Bankr.S.D.Fla.1980); *In re El Patio, Ltd.*, 6 B.R. 518 (Bankr.C.D.Cal.1980)). In the alternative, if removal and remand terminated the

automatic stay, the Bankruptcy Court's order calling for a modification of what it supposed was a continuing automatic stay amounted to the issuance of a new stay under 11 U.S.C. § 105(a). *In re Martin Exploration Co.*, 731 F.2d 1210 (5th Cir.1984). A bankruptcy court has the power to enjoin proceedings excepted from a § 362 stay under 11 U.S.C. § 105(e) and 28 U.S.C. § 1481. H.R.Rep. No. 595, 95th Cong., 1st Sess. 342, *reprinted in* 1978 U.S.Code Cong. & Ad.News 5963, 6298, *cited in* 1 Collier on Bankruptcy, *supra*, ¶ 3.01[2][e], at 3–73 n. 102. *Cf. In re Stuart Motel, Inc.*, 15 B.R. 28 (Bankr.S.D.Fla.1981) (once lifted, stay cannot be reimposed by bankruptcy court under § 362). Moreover, a bankruptcy court is invested with such broad equitable powers under § 105 that it may condition the issuance of a new stay upon each party's *compliance* with the stipulation and agreement. *See, e.g., In re Voegel Ice Cream Co.*, 7 B.R. 430 (Bankr.D.Minn.1980) (pursuant to stipulation agreement, bankruptcy court could *lift* stay and refuse to retain jurisdiction under § 105 upon debtor's default of obligations under agreement).

The contentions of the parties³⁸ notwithstanding, we find it unnecessary to determine the precise moment when the automatic *1085 stay terminates, if it does at all, upon the removal of a cause from a state court to a bankruptcy court and upon its subsequent remand. Whether the Bankruptcy Court's January 18, 1980 order is viewed as a modification of the automatic stay, as the district court itself suggested, or as the issuance of a new stay, it is a construction of the *terms* of that stay which is dispositive of the issue whether the stay was violated. Hence, as in our discussion of the remand order, we turn to a construction of the stipulation and agreement, which was annexed to the order modifying the stay, to determine whether the parties complied with its terms.

The operative language in the January 18, 1980 order deals with which court is to have “jurisdiction” to try the 1979 case. The order states that “the automatic stay provisions of section 362 of the Bankruptcy Code are modified so as to permit the remand of [the 1979 case] and the trial of same pursuant to the terms of the annexed Stipulation and Agreement as amended.” Paragraphs 1, 2, and 3 of the stipulation and agreement speak to the jurisdictional component, delineating the condition for retention or transfer of the case. Clearly, the parties intended that the automatic stay would be lifted to permit a trial of the 1979 case if the remand became effective. That the modification of the stay could operate independently of the remand so as to permit the remand to be given effect and yet, upon occurrence of the condition, there results a

reimposition of the automatic stay or an issuance of a new stay is a construction of the stipulation and agreement that is not feasible upon a careful reading of the document as a whole. Nor has the Trustee or Holloway proffered such a construction. Thus, we hold that the parties to the stipulation and agreement intended that the stay be modified to permit trial of the 1979 case when the remand became effective and that the instrument can not be interpreted to have stayed the state court proceedings at some point following effectuation of the Bankruptcy Court's remand.

The stipulation and agreement does not contain any provisions pertinent to the stay modification that were not implicated by our construction of the remand order. As we previously determined, the condition expressly appended to the remand order and impliedly appended to the stay was satisfied upon the “final assignment” of the cause by the presiding judge of the administrative judicial district to a retired state judge. This assignment resulted from the parties' joint application seeking such an assignment and was the fruition of the parties' compliance with the stipulation and agreement. Because each party complied with the terms of the stipulation and agreement and such compliance was the only precondition to a lifting of the stay—whether the stay is characterized as a continuation of the automatic stay or a newly issued stay—we hold that the stay of the proceedings concerning the 1979 case was terminated and those proceedings were not void.

VI. Other Matters.

Although the parties have raised a multitude of fascinating issues pertaining to the remand order and the modification of the stay, the answers to which would have far-reaching implications for the administration of our bankruptcy laws, our disposition of this case precludes us from exploring these issues. Because we determined that assignment of the 1979 case to a retired state judge in the first instance constituted a compliance with the terms of the stipulation and agreement so as to give effect to the modification of the stay and

the remand, we refrain from deciding: whether the parties' consent to the remand order precludes a later attack upon an enforcement of its terms; whether the automatic stay terminates upon a case's removal to bankruptcy court, its subsequent remand to state court, or thirty days after a party requests a remand to state court; whether the district court's injunction against enforcement of the state court judgment satisfied the requirements of [Rules 65\(d\) of the Federal Rules of Civil Procedure](#); whether the district court 1982 *1086 abstention order represented an abrogation of its jurisdiction over the 1979 case which acted to preclude the bankruptcy court's assumption of jurisdiction over the instant case; whether the incorporation of the stipulation and agreement into Humble's reorganization plan precluded a subsequent assessment of the validity of the conditional remand order.

VII. Conclusion.

We hold that the Bankruptcy Court was divested of jurisdiction upon the parties' compliance with the terms of the January 18, 1980 remand order and the annexed stipulation and agreement. We further hold that the assignment of a retired judge to try the case in the first instance constituted a “final assignment” of the case pursuant to the terms of the stipulation and agreement and satisfied the precondition to the lifting of the Bankruptcy Court's stay of the state court proceedings in the 1979 case such that the subsequent state court proceedings were not void. In view of the fact that this dispute has been festering in the courts for nearly five years, it is time for this litigation to be concluded as promptly as possible. Toward that end and for the reasons enunciated above, the case is reversed and remanded to the district court for proceedings not inconsistent with this opinion.

REVERSED and REMANDED.

All Citations

743 F.2d 1069, 11 Collier Bankr.Cas.2d 911, Bankr. L. Rep. P 70,329

Footnotes

* Circuit Judge of the Second Circuit, sitting by designation.

1 [Browning v. Navarro](#), 37 B.R. 201, 203–06 (N.D.Tex.1983).

2 The parties had entered a settlement agreement the terms of which were dictated into the state court record on October 17, 1979. Before the agreement was reduced to judgment, however, the Brownings withdrew their consent to the

agreement and the case was set for trial. See *Browning v. Holloway*, 620 S.W.2d 611, 614 (Tex.Civ.App.—Dallas), writ *ref'd n.r.e. per curiam*, 626 S.W.2d 485 (Tex.1981).

3 *Id.*

4 The trial was set for September 1982. Record Vol. C, Exhibit 14, para. 2.

5 The district court erroneously indicated that suit was filed on May 27, 1982—an error of no consequence. Compare 37 B.R. at 204 with Record on Appeal at 415.

6 There is some dispute as to whether the Bankruptcy Court's abstention extended to the 1979 case as well.

7 *Humble Exploration Co. v. Fairway Land Co.*, 641 S.W.2d 934 (Tex.App.—Dallas), enforced, 641 S.W.2d 941 (Tex.App.—Dallas 1982, n.r.e.).

8 This judgment was amended by Judge Walker on November 11, 1982.

9 37 B.R. at 210.

10 *Humble Exploration Co. v. Browning*, 677 S.W.2d 111 at 114 (Tex.App.—Dallas 1984, no writ) (not yet reported). Holloway and the Trustee contend that it had been pointed out to Judge Walker that his trying the case was violative of the terms of the stipulation and agreement. Although we requested supplementation of the record at oral argument to substantiate or refute this contention, our disposition of the case does not require us to resolve this issue.

11 *Id.* at 115.

12 Because “all actions of the courts and parties, as they relate to the motions for summary judgment, were taken prior to December 24, 1982—the final day of the stay of [Marathon],” the district court correctly noted that the Bankruptcy Court's jurisdiction was intact. 37 B.R. at 207.

13 Section 1471(a) vests district courts with original jurisdiction to hear all matters and proceedings in bankruptcy.

14 28 U.S.C. § 1478 provides:

(a) A party may remove any claim or cause of action in a civil action, other than a proceeding before the United States Tax Court or a civil action by a Government unit to enforce such governmental unit's police or regulatory power, to the bankruptcy court for the district where such civil action is pending, if the bankruptcy courts have jurisdiction over such claim or cause of action.

(b) The court to which such claim or cause of action is removed may remand such claim or cause of action on any equitable ground. An order under this subsection remanding a claim or cause of action, or a decision not so remanding, is not reviewable by appeal or otherwise.

28 U.S.C. § 1478 (1982) (reenacted as amended at 28 U.S.C. § 1452). This section was operative for the transition period from November 6, 1978, to April 1, 1984. See Pub.L. No. 95–598, § 405(b), 92 Stat. 2549, 2685 (1978).

15 11 U.S.C. § 362(d) provides:

(d) On request of a party in interest and after notice and a hearing, the court shall grant relief from the [automatic stay], such as by terminating, annulling, modifying, or conditioning such stay—

(1) for cause, including the lack of adequate protection of an interest in property of such party in interest; or

(2) with respect to a stay of an act against property, if—

(A) the debtor does not have an equity in such property; and

(B) such property is not necessary to an effective reorganization.

16 11 U.S.C. § 105(a) provides:

(a) The bankruptcy court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the bankruptcy laws].

17 28 U.S.C. § 1481 provides:

A bankruptcy court shall have the powers of a court of equity, law, and admiralty, but may not enjoin another court or punish a criminal contempt not committed in the presence of the judge of the court or warranting a punishment of imprisonment.

18 The implication is that, because the 1979 case was ultimately tried on the merits by an active state judge, a “final assignment” of the cause to a retired or visiting state judge was not obtained and the remand never became effective.

19 Holloway's Brief at 1.

20 The Trustee contends that the Brownings cannot now attack, on other than jurisdictional grounds, an order to which they consented, citing *Swift & Co. v. United States*, 276 U.S. 311, (1928), *United States v. Bechtel Corp.*, 648 F.2d 660 (9th Cir.), cert. denied, 454 U.S. 1083, 102 S.Ct. 638, 70 L.Ed.2d 617 (1981), and *Seymour-Heath v. Goggin*, 389 F.2d 327 (9th Cir.1968). See also *Haitian Refugee Center v. Civiletti*, 614 F.2d 92 (5th Cir.1980) (defendants cannot appeal injunction to which they agreed). Although some of the Brownings' contentions are seemingly cast as attacks upon the remand order and the annexed stipulation and agreement, the Brownings concede that a judgment to which they consented cannot be attacked by them. Reply Brief of Appellants at 2. We note in passing that a district court, or a bankruptcy court, exceeds its power if it enters a consent decree to which there was not actual consent or which was contrary to the public interest or was the result of a jurisdictional defect. See Note, *The Consent Judgment as an Instrument of Compromise and Settlement*, 72 Harv.L.Rev. 1314, 1316 (1959). In construing the stipulation and agreement, we pay heed to these restrictions on the power of a court to enter consent decrees.

21 See S.Rep. No. 989, 95th Cong., 2d Sess. 156, reprinted in 1978 U.S.Code Cong. & Ad.News 5787, 5942 (“An order of the bankruptcy judge remanding a claim or cause of action is not reviewable by appeal or otherwise.”); H.R.Rep. No. 595, 95th Cong., 1st Sess. 448, reprinted in 1978 U.S.Code Cong. & Ad.News 5963, 6403 (“A remand order is made unreviewable.”).

Under § 1478(b), a bankruptcy court has broad discretion to grant or deny a motion to remand a removed claim on any equitable ground, including: (1) forum non conveniens, 1 Collier on Bankruptcy ¶ 3.01, at 3–79 (15th ed. 1984); (2) a holding that, if the civil action has been bifurcated by removal, the entire action should be tried in the same court, *id.*; (3) a holding that a state court is better able to respond to questions involving state law, *id.*; (4) expertise of the particular court, *id.*; (5) duplicative and uneconomic effort of judicial resources in two forums, *In re U.S. Air Duct Corp.*, 8 B.R. 848, 854 (Bankr.N.D.N.Y.1981); (6) prejudice to the involuntarily removed parties, *id.*; (7) comity considerations, *id.*; and (8) a lessened possibility of an inconsistent result, *id.* This is a much broader range of discretion than is permitted district courts in deciding whether to remand under 28 U.S.C. § 1447(d). District courts may order a remand under § 1447(d) only when (1) removal was improvident or (2) the court lacks jurisdiction. 28 U.S.C. § 1447(c); see *Thermtron Products, Inc. v. Hermansdorfer*, 423 U.S. 336, 351–52, 96 S.Ct. 584, 593, 46 L.Ed.2d 542 (1976); 14 C. Wright, A. Miller & E. Cooper, *Federal Practice and Procedure* § 3739 (1976 & Supp.1983). Interim Bankruptcy Rule 7004(j) provided that a bankruptcy court may remand a case if it had been improvidently removed or the court was without jurisdiction. The comment appended to the rule pointed up the rule's obvious derivation from § 1447(c). Interim Bankr.R. 7004(j), 11 U.S.C. (1982), reprinted in 1 Collier on Bankruptcy, *supra*, ¶ 3.01, at 3–77 (adopted as Local Bankr.R. 7004(j), effective January 1, 1983, by the United States Bankruptcy Court for the Northern District of Texas).

While a district court's decision *not* to remand under § 1447 is reviewable once a final, appealable order has been entered, a bankruptcy court's decision *not* to remand under § 1478 is nonreviewable. Moreover, a district court's order of remand is reviewable when based on grounds other than those provided in § 1447(c). See *Thermtron Products, supra*, 423 U.S. at 346, 96 S.Ct. at 590; *In re Shell Oil Co.*, 631 F.2d 1156 (5th Cir.1980). The breadth of the equitable grounds on which a

bankruptcy court may base its remand decision under § 1478(b) lessens the possibility that a *Thermtron* -type exception will be generated to permit limited review. Thus, a bankruptcy court's remand orders will not be subject to review even in cases where there has been an abuse of discretion. See Reed, Sagar & Granoff, *Subject Matter Jurisdiction, Abstention and Removal Under the New Federal Bankruptcy Law*, 56 Am.Bank.L.J. 121, 152 (1982); cf. *Hurt v. Cypress Bank*, 9 B.R. 749, 755 (N.D.Ga.1981).

Nonreviewability extends only to the discretionary decision to remand or not to remand a properly removed action, not to whether the bankruptcy court originally had jurisdiction over the matter. See, e.g., *Flint v. Speir Insurance Agency, Inc.*, 33 B.R. 814, 816 (N.D.Ga.1983) ("Where either subject matter jurisdiction or venue is lacking, however, the decision should be reviewed."). There is no dispute in the instant case that the Bankruptcy Court had jurisdiction to act and the manner in which it acted is not subject to our review. In *Pacor, Inc. v. Higgins*, 743 F.2d 984, (3d Cir.1984), the Third Circuit held that, § 1478(b) notwithstanding, it could review a remand order when the bankruptcy court lacked jurisdiction under § 1471(b) because the removed proceeding was not "related to" bankruptcy. In contrast, the instant action involves a decision by the Bankruptcy Court, having jurisdiction and in the exercise of its discretion, to remand the 1979 case.

22 28 U.S.C. § 1447(d) provides: "An order remanding a case to the State court from which it was removed is not reviewable on appeal or otherwise, except that an order remanding a case to the state court from which it was removed pursuant to [28 U.S.C. § 1443] shall be reviewable by appeal or otherwise."

23 There are two exceptions to this general prescription for nonreviewability of a district court's remand orders. Such orders are reviewable if (1) removal was pursuant to 28 U.S.C. § 1443, or (2) the remand order is issued on grounds not authorized by 28 U.S.C. § 1447(c). See *Thermtron Products, supra*; *Royal v. State Farm & Casualty Co.*, 685 F.2d 124 (5th Cir.1982) (per curiam).

24 Former § 71 of the Judicial Code, 28 U.S.C. § 71 (1940), also prohibited review of a district court's remand order. It provided:

[W]henever any cause shall be removed from any state court into any district court of the United States, and the district court shall decide that the cause was improperly removed, and order the same to be remanded to the state court from whence it came, such remand shall be immediately carried into execution, and no appeal or writ of error from the decision of the district court so remanding such cause shall be allowed.

25 "Even on review in the Supreme Court of a state court proceeding following remand, the propriety of the remand, in a non-civil rights case, cannot be questioned." 14 C. Wright, A. Miller & E. Cooper, *supra*, § 3740, at 767–68.

26 The First Circuit, although writing in the context of a diversity case, made the following germane comments:

Removal ..., to the prejudice of state court jurisdiction, is a privilege to be strictly construed, ... and the state court proceedings are to be interfered with once, at most. This is not only in the interest of judicial economy, but out of respect for the state court and in recognition of principles of comity. *The action must not ricochet back and forth depending upon the most recent determination of a federal court.*

... [T]here is no more reason for a district court being able to review its own decision, and revoke the remand, than for an appellate court requiring it to do so. Both are foreclosed; nothing could be more inclusive than the phrase "on appeal or otherwise." The district court has *one shot, right or wrong.*

In re La Providencia Development, supra, at 252–53 (emphasis added).

27 Section 1447(c) provides in pertinent part: "A certified copy of the order of remand shall be mailed by its clerk to the clerk of the State court. The State Court may thereupon proceed with the case."

28 Rule 9027(e) provides:

(e) *Remand.* A motion for remand of the removed claim or cause of action may be filed only in the bankruptcy court and shall be served on the parties to the removed claim or cause of action. A motion to remand shall be determined

as soon as practicable. A certified copy of an order of remand shall be mailed to the clerk of the court from which the claim or cause of action was removed.

[Bankr.R. 9027\(e\)](#), 11 U.S.C.A. (West Supp.1983), *reprinted in* 1 app. Collier on Bankruptcy, *supra*, at 421. Former Interim [Rule 7004\(j\)](#) provided that a “certified copy of the remand shall be mailed by its clerk of the court from which the civil action or proceeding was removed *and that court may thereupon proceed with the case.*” Interim [Bankr.R. 7004\(j\)](#), 11 U.S.C. (1982), *reprinted in* 1 Collier on Bankruptcy, *supra*, ¶ 3.01, at 3–77 (emphasis added) (adopted as Local [Bankr.R. 7004\(j\)](#), effective January 1, 1979, by the United States Bankruptcy Court for the Northern District of Texas). Although the italicized language from Interim [Rule 7004\(j\)](#), which most directly illustrates the divestiture of a remanding federal court's jurisdiction, was excised when [Rule 9027](#) was adopted, the comments to [Rule 9027](#) do not assign any significance to this excision. We doubt that the drafters of the rule intended to alter the time at which a remand typically becomes effective by so subtle a change.

“[T]he new Rules are applicable to proceedings pending on August 1, 1983, except to the extent that in the opinion of the court the application ... would not be feasible or would work an injustice.” 1 Bankr.Serv. (L.Ed.) § 2:30.1 (1984).

- 29 Rule 11(f) of the Rules of Procedure of the Judicial Panel on Multidistrict Litigation makes express provision for “Conditional Remand Orders.” Manual for Complex Litigation § 5.22 (pt. 2), at 340 (5th ed. 1981) (supplement to C. Wright & A. Miller, Federal Practice and Procedure). The procedure established by [Rule 11\(f\)](#), however, clearly envisions that the remand order would not become effective until the passing of fifteen days from service of the proposed order on each party without any party noticing their opposition to it or, if a notice of opposition is filed, upon further order of the Judicial Panel on Multidistrict Litigation. Thus, the transferor court does not ever divest itself of jurisdiction in favor of the transferee court until the condition—fifteen days passage without notice of opposition or order of the judicial panel—is satisfied and the satisfaction of that condition is finally evidenced by filing the conditional remand order with the clerk of the transferee court. See also *In re A.H. Robins, Co., Inc., “Dalkon Shield” IUD Products Liability Litigation*, 453 F.Supp. 108, 109 n. 2 (J.P.M.L.1978); *In re Penn Central Securities Litigation*, 349 F.Supp. 1029 (J.P.M.L.1972).

Our research has turned up cases which have permitted partial remands, see, e.g., *In re Calabria*, 5 B.R. 73 (Bankr.D.Conn.1980) (partial remand constitutes a severance and remand of separate and independent claims), second removal petitions, see, e.g., *O'Bryan v. Chandler*, 496 F.2d 403 (10th Cir.) (developments subsequent to and not concluded by prior remand order provide grounds for a second removal petition), *cert. denied*, 419 U.S. 986, 95 S.Ct. 245, 42 L.Ed.2d 194 (1974); *Cliett v. Scott*, 233 F.2d 269 (5th Cir.1956) (same), and conditional judgments, see, e.g., *Zintmaster v. Werner*, 41 F.2d 634 (3d Cir.1930) (enforceability of judgment conditioned on party's perfecting title to property). Partial remands, second removal petitions, and conditional judgments do not involve the uncertainty over jurisdiction and the federal-state tensions that are presented by conditional remands in which occurrence of the condition abrogates the effectiveness of the remand.

Other federal courts have conditioned stays of federal proceedings pending determination of concurrent state actions for the purpose of preserving a party's procedural advantage in federal court even after the action is back in state court. See, e.g., *Mottolese v. Kaufman*, 176 F.2d 301 (2d Cir.1949) (stay conditioned on defendants consenting to use in state court of depositions taken in accordance with federal rules); *Finley v. Doyle*, 178 F.Supp. 863 (S.D.N.Y.1959) (stay conditioned on defendants submitting to depositions in accordance with federal rules); *Boggess v. Columbian Rope Co.*, 167 F.Supp. 854 (S.D.N.Y.1958) (stay conditioned on defendant's consent to use in state court of interrogatories or depositions gathered in federal discovery proceedings); *Finkelstein v. Boylan*, 33 F.Supp. 657 (S.D.N.Y.1940) (stay conditioned on defendants allowing completion and inspection of depositions begun under federal procedure before trial in state court). Conditional stays do not pose the same difficulties as are posed by conditions on remand that, if given effect, would void state proceedings altogether.

The district court cited cases for the different but analogous proposition that “the Bankruptcy Court did not exceed its authority in conditioning the modification of the automatic stay upon each party's compliance with the stipulation and agreement.” 37 B.R. at 209. See *In re Dublin Properties*, 27 B.R. 506, 506–07 (Bankr.E.D.Pa.1983) (modification of automatic stay contingent upon parties' execution of a mortgage note; stay was *not* modified because the mortgage note was never executed); *In re Cosby*, 22 B.R. 682 (Bankr.E.D.Pa.1982) (modification of automatic stay can be conditioned on payment of attorney's fees and other costs); *In re Ideal Roofing & Sheet Metal Works, Inc.*, 9 B.R. 2, 3

([Bankr.S.D.Fla.1980](#)) (parties stipulate to modification of stay to allow case to proceed to judgment; no condition); *In re El Patio, Ltd.*, 6 B.R. 518 ([Bankr.C.D.Cal.1980](#)) (relief from automatic stay can be conditioned on debtor's turning over rents collected by debtor as provided in absolute-assignment-of-rents clause of trust deed). The three conditions in these cases represent conditions precedent to the modification of the stay. Similarly, a condition precedent to the effectiveness of a remand would not pose the same kind of problems for conflict between the federal and state judicial systems as to jurisdiction over a case as is posed by a condition that vitiates an executed remand order.

The analogy between automatic stay cases and cases involving remands is imperfect, at best, because a condition imposed on a modification of a stay does not pose the jurisdictional problem. Theoretically a court could condition its modification of a stay on a subsequent event the occurrence of which would result in a reimposition of the stay. Jurisdiction over the case would remain with the state court but any proceedings *subsequent* to the reimposition of the stay would be void. Cf. *Borg Warner Acceptance Corp. v. Hall*, 685 F.2d 1306, 1308 (11th Cir.1982). Proceedings prior to the reimposition of the stay would not be void. In contrast, as the district court views it, giving effect to a condition subsequent on a remand order would apparently void proceedings that took place after the remand was executed and up to the time the condition subsequent occurs. Cf. *Browning v. Navarro*, *supra*, at 210. The vesting of jurisdiction should not be tied to so slender a thread as a conditional remand.

30 37 B.R. at 210.

31 The rules of interpretation of contracts are set out in varying degrees, and sometimes form, in [Restatement of Contracts §§ 230, 233, 235 \(1932\)](#); [Restatement \(Second\) of Contracts §§ 202–203, 207 \(1979\)](#); 4 Williston on Contracts §§ 618–626 (3d ed. 1961 & Supp.1984); 3 Corbin on Contracts §§ 545–550 (1951), and J. Calamari & J. Perillo, Contracts § 3–11 (1977).

32 Record Vol. C, Exhibit 7 (stipulation and agreement), para. 4.

33 Otherwise, the parties were indeed trifling with the state courts—a practice that we, like the state court of appeals, condemn. Compare *Lewis v. Brown & Root, Inc.*, 711 F.2d 1287, 1291 (5th Cir.1983) (dismissal for want of prosecution upheld; “trifling with a busy court, burdened with a heavy docket of serious matters, need not be borne”), with *Humble Exploration Co. v. Browning*, 677 S.W.2d 111 (Tex.App.—Dallas 1984, no writ) (“To allow both [state and federal appeal] would be to permit a party to trifle with the state court by allowing it to proceed to a judgment which he may accept or reject at will.”).

34 The Trustee and Holloway do not contend that the parties ever contemplated a “reverter remand” whereby jurisdiction would revert back to the Bankruptcy Court if the 1979 case was *ever* assigned to an active state judge. Instead, they contend that, when Judge Walker assumed jurisdiction over the case, the condition subsequent was implicated, the remand rendered a nullity, the interim state court proceedings presumably voided, and the Bankruptcy Court again invested with jurisdiction over the case. In other words, the Trustee's position is that the Bankruptcy Court *never* lost a jurisdiction that was to be retained by it if the condition specified in the stipulation and agreement occurred. The concepts of remand and comity would never be the same if we cloaked the Trustee's contentions with the mantle of legitimacy.

35 We are reminded of Justice Brook's admonition:

The party ought to direct his meaning according to the law, and not the law according to his meaning, for if a man should bend the law to the intent of the party rather than the intent of the party to the law, this would be the way to introduce barbarousness and ignorance and to destroy all learning and diligence.

Throckmerton v. Tracy, 75 Eng.Rep. 222, 251 (K.B.1554).

36 The House Report states:

[Section 1478(d)] requires the court, on request of a party in interest, to grant relief from the stay such as by terminating, annulling, *modifying*, or *conditioning the stay, for cause*. The lack of adequate protection of an interest in property of the party requesting relief from the stay is one cause for relief, but is not the only cause. As noted above, a *desire to*

permit an action to proceed to completion in another tribunal may provide another cause. Other causes might include the lack of any connection with or interference with the pending bankruptcy case.

H.R.Rep. No. 595, 95th Cong., 1st Sess. 343, *reprinted in* 1978 U.S.Code Cong. & Ad.News 5963, 6300 (emphasis added).

- 37 The Trustee contends that the Brownings never made a request for relief from the stay so the Bankruptcy Court could not have acted to lift the stay under [§ 362\(d\)](#). The Brownings argue that such a hypertechnical reading of their attempts to proceed in state court would amount to lifting form over substance and require parties to label any attempt to so proceed as a “Motion to Gain Relief from the Automatic Stay.” See 2 Collier on Bankruptcy, *supra*, ¶ 362.08, at 362–52. Although we are sympathetic with the Brownings’ position on this issue, we find it unnecessary to resolve the issue because, whether the stay is characterized as a continuation of the automatic stay or as a newly issued stay, the same result inures.
- 38 The Brownings contend that the automatic stay is lifted upon removal of a case to the bankruptcy court and that the court does not have authority to reimpose the automatic stay once it has been lifted. *In re Stuart Motel, Inc.*, 15 B.R. 28 (Bankr.S.D.Fla.1981). The Trustee contends that the automatic stay does not apply to “adversary proceedings” in the bankruptcy court and does not automatically terminate upon removal or remand. *In re Greco*, 3 B.R. 18 (Bankr.D.Hawaii 1979) (bankruptcy court expressly continues automatic stay as to husband-debtor, but not his wife, in remanding action to state court). A bankruptcy judge could remand a case but delay termination of the automatic stay, the Trustee argues, to provide the debtor with an additional “breathing spell” prior to litigating the remanded action. The Brownings suggest that the bankruptcy judge might more sensibly accomplish this purpose by imposing a stay under [11 U.S.C. § 105](#). Otherwise, state courts would be prohibited from taking action in a case remanded from a bankruptcy court unless the bankruptcy court expressly lifted the automatic stay in addition to remanding the case. The Brownings argue that this cumbersome procedure is an unreasonable construction of Congress’ intent in enacting [§ 362](#). We note, however, that the advisory committee note to [Rule 9027](#) states: “If the claim or cause of action which is removed to the bankruptcy court is subject to the automatic stay of [§ 362](#) of the Code, the litigation may not proceed in the bankruptcy court until relief from the stay is granted.” This note militates in favor of the Brownings’ position.

912 F.2d 1162

United States Court of Appeals,
Ninth Circuit.

In re TUCSON ESTATES, INC., Debtor.
Alphus CHRISTENSEN; Homer Lawrence;
Thomas Ward, Petitioners–Appellants,
v.

TUCSON ESTATES, INC., an
Arizona corporation, Debtor–Appellee.
Alphus CHRISTENSEN; Homer Lawrence;
Thomas Ward, Petitioners–Appellees,
Gordon Cox; Randall Newman; Murray
Samuell, Jr., Intervenor–Appellants,
v.

TUCSON ESTATES, INC., an
Arizona corporation, Debtor–Appellee.

Nos. 88–15745, 88–15776.

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Argued and Submitted March 12, 1990.

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Decided Aug. 30, 1990.

Synopsis

Chapter 11 debtor sought to stay state court class action brought against debtor and its sole shareholders by homeowners in mobile home subdivision in which debtor owned streets and common facilities. The United States Bankruptcy Court for the District of Arizona reimposed stay as to issue of whether there was implied restrictive covenant that golf course would be maintained for subdivision residents' exclusive use, but did not reimpose stay on homeowners' claim for misappropriation of maintenance fees, except to extent of entry of final judgment against debtor and shareholders. Homeowners appealed. The District Court, [Richard M. Bilby](#), Chief Judge, affirmed, and homeowners appealed. Shareholders also sought relief against homeowners' recordation of judgment against them. The Bankruptcy Court ordered release of recordation, and appeal was taken. The District Court reversed, and shareholders cross-appealed. The Court of Appeals, [Fletcher](#), Circuit Judge, held that: (1) staying entry of state court's judgment would not permit Bankruptcy Court to “review”

state court decision, and thus Bankruptcy Court could not decline to abstain on that basis; (2) state court action was not core proceeding, and thus Bankruptcy Court could not decline to abstain on that basis; (3) fact that golf course and income derived from it were estate property did not provide basis for Bankruptcy Court declining to abstain; and (4) cross appeal became moot when Arizona Court of Appeals vacated judgment.

Reversed on appeal; cross appeal moot.

Procedural Posture(s): On Appeal.

Attorneys and Law Firms

***1164** [John A. Baade](#), Miller & Pitt, Tucson, Ariz., for petitioners-appellants-appellees.

[Robert E. Miles](#), Streich, Lang, Weeks & Cardon, Phoenix, Ariz., for intervenors-appellants.

[Scott H. Gan](#), Mesch, Clark, & Rothschild, Tucson, Ariz., for debtor-appellee.

Appeal from the United States District Court for the District of Arizona.

Before [FLETCHER](#), [PREGERSON](#) and [NELSON](#), Circuit Judges.

Opinion

[FLETCHER](#), Circuit Judge:

Petitioners-appellants appeal the district court's affirmance of the bankruptcy court's stay of their state litigation against the debtor, Tucson Estates, Inc., and its three sole shareholders, who are also its officers and directors. The bankruptcy court permitted the state court to litigate one of plaintiffs' (petitioners-appellants in this court) claims but not another, prevented the state court from determining liability to individual claimants in respect to the litigated claim, and prohibited the state court from entering judgment. The three officers cross-appeal the district court's reversal of the bankruptcy court's order directing release of the recordation of the state court judgment against the officers which was recorded by the plaintiffs. We reverse the bankruptcy court's order staying the litigation and find the cross-appeal moot.

FACTS

Tucson Estates, Inc. (TE, Inc.) filed for bankruptcy protection under Chapter 11 of the Bankruptcy Code on November 24, 1987. At that time, a state court class action lawsuit against TE, Inc. and its three individual shareholders, directors, and officers, Murray Samuell, Jr., Gordon Cox, and Randall F. Newman, was about six years old. The class action plaintiffs are homeowners in a mobile home subdivision, Tucson Estates I (TE I), in which TE, Inc. owns the streets and common facilities.

The homeowners pay a fee to TE, Inc. for maintaining these facilities, among which is a golf course. Prior to gaining class action status, the original three individual homeowner plaintiffs made two claims in their state lawsuit, commenced in November 1981: (1) the homeowners are entitled to an accounting of the uses to which their maintenance fee had been put, ***1165** and (2) the homeowners are entitled to enforcement of the promises and representations made by the subdivision's original developer creating an implied restrictive covenant that the golf course would be maintained for TE I residents' exclusive use.

In March 1984, the state court ordered TE, Inc. to make annual accountings of the maintenance fee to the homeowners. After examining the first such accounting, the homeowners amended their complaint to allege a class action for damages for misappropriation of the maintenance fees. The plaintiffs joined the officers as individual defendants in January 1987.

On November 2, 1987, the state court granted partial summary judgment to the homeowners, holding that there was an implied restrictive covenant that the golf course be for "Tucson Estates" residents' exclusive use. The court left for trial the question of exactly what properties were encompassed by the term "Tucson Estates"—only TE I, the subdivision inhabited by the homeowners in the class action, or two neighboring areas as well. One of the neighboring areas is Tucson Estates II (TE II), owned by TE, Inc.¹

Appeal: Bankruptcy Court Stay

TE, Inc. filed its bankruptcy petition on November 24, 1987, shortly before the state trial was scheduled to begin (on December 1). The bankruptcy court lifted the automatic stay on the state court lawsuit on December 1, allowing the state trial to proceed, which it did on December 3. The bankruptcy court held an evidentiary hearing on the stay, requested by TE, Inc., on December 5.

In deciding whether to reimpose the stay, the bankruptcy court expressed concern that it would be bound by the state court judgments regarding (1) the amount of damages awarded and (2) the area benefitted by the restrictive covenant. Evidence indicated that applying the covenant to benefit only TE I would diminish the value of TE II, and thus the estate as well, by between \$1.18 million and \$2.8 million. On December 8, the bankruptcy court reimposed the stay on the state trial of the covenant issue but permitted the parties to try the misappropriation claim. The bankruptcy court prohibited the state court, however, from determining the liability to each claimant and entering a final judgment against the bankrupt.²

The three officers had intervened in the stay proceeding, and the bankruptcy court stayed execution of any judgment against both them and TE, Inc. The court was concerned that the officers were "really the alter ego of Tucson Estates" and that the plaintiff class could circumvent the stay against TE, Inc. by executing a judgment against the officers. Transcript of Proceedings at 15 (Dec. 5, 1987) [hereinafter Dec. 5 Transcript].³

On October 28, 1988, the district court on appeal found that the bankruptcy court did not abuse its discretion in staying litigation of the covenant issue and prohibiting determination of and entry of final judgment on the misappropriation damage claims. The homeowners appeal this ruling.

Cross-Appeal: Release of Judgment Recordation

The jury reached a verdict in the state trial on December 22, 1987. The state court entered judgment against the officers for \$4.8 million but reserved jurisdiction to enter judgment against TE, Inc. if and when permitted by the bankruptcy court. The homeowners recorded the judgment ***1166** against the officers the next day. The officers sought relief from the recordation, alleging that the bankruptcy court's stay prohibited it. On February 16, 1988, the bankruptcy court ordered the release of the recordation. The homeowners appealed the release order, arguing that the stay permitted recordation, although not execution. The district court reversed on October 28, 1988. On December 21, 1988, the Arizona Court of Appeals affirmed in part, reversed in part, and remanded the state case, appealed by the officers, to the Arizona trial court for retrial because of state law errors in the first trial. The Arizona Supreme Court denied a petition and cross-petition for review on June 5, 1990. The officers cross-appeal from the district court's decision denying release of the recordation.

JURISDICTION

An order denying relief from a bankruptcy stay is appealable. *In re Kemble*, 776 F.2d 802, 805 (9th Cir.1985). We have jurisdiction under 28 U.S.C. § 158(d).

STANDARD OF REVIEW

We review the district court's decision on an appeal from a bankruptcy court *de novo*. See *In re Windmill Farms, Inc.*, 841 F.2d 1467, 1469 (9th Cir.1988) (review of Bankruptcy Appellate Panel decision). We apply the same standard of review to the bankruptcy court findings as does the district court: findings of fact are reviewed under the clearly erroneous standard, and conclusions of law, *de novo*. *Id.* We may reverse the bankruptcy court's denial of the stay if that court abused its discretion. *In re Universal Farming Indus.*, 873 F.2d 1334, 1337 (9th Cir.1989).

DISCUSSION

I. Appeal: Bankruptcy Stay

A bankruptcy filing imposes an automatic stay of all litigation against the debtor. 11 U.S.C. § 362(a). A bankruptcy court “shall” lift the automatic stay “for cause.” *Id.* § 362(d) (1). “Cause” has no clear definition and is determined on a case-by-case basis, *In re MacDonald*, 755 F.2d 715, 717 (9th Cir.1985). Where a bankruptcy court may abstain from deciding issues in favor of an imminent state court trial involving the same issues, cause may exist for lifting the stay as to the state court trial. See *In re Castlerock Properties*, 781 F.2d 159, 163 (9th Cir.1986).

The circumstances under which a bankruptcy court should abstain are spelled out in 28 U.S.C. § 1334, part of the 1984 amendments to the Bankruptcy Act of 1978. Congress passed the amendments to heal constitutional infirmities in the Act's jurisdictional provisions found by the Supreme Court in *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 102 S.Ct. 2858, 73 L.Ed.2d 598 (1982). Bankruptcy Amendments and Federal Judgeship Act of 1984, Statements by Legislative Leaders, 1984 U.S.Code Cong. & Admin.News 576. The Court held in *Marathon* that a traditional state common-law action subjected to federal adjudication because of a bankruptcy filing must be heard by

an Article III judge. See *id.* at 92, 102 S.Ct. at 2882 (Burger, C.J., dissenting) (describing the plurality's holding as limited by the concurring opinion); *Castlerock*, 781 F.2d at 160 n. 1.

Section 1334 sets forth when a bankruptcy court must abstain and when it may abstain in favor of state court adjudication of an issue. Because the parties do not address the propriety of mandatory abstention under 28 U.S.C. § 1334(c)(2) and because we reverse on permissive abstention grounds, we need not consider mandatory abstention. Section 1334(c)(1) governs permissive abstention:

Nothing in this section prevents a district court in the interest of justice or in the interest of comity with State courts or respect for the State law, from abstaining from hearing a particular proceeding arising under title 11 or arising in or related to a case under title 11.

A Texas bankruptcy court has summarized the factors a court should consider when deciding whether to abstain:

***1167** (1) the effect or lack thereof on the efficient administration of the estate if a Court recommends abstention, (2) the extent to which state law issues predominate over bankruptcy issues, (3) the difficulty or unsettled nature of the applicable law, (4) the presence of a related proceeding commenced in state court or other nonbankruptcy court, (5) the jurisdictional basis, if any, other than 28 U.S.C. § 1334, (6) the degree of relatedness or remoteness of the proceeding to the main bankruptcy case, (7) the substance rather than form of an asserted “core” proceeding, (8) the feasibility of severing state law claims from core bankruptcy matters to allow judgments to be entered in state court with enforcement left to the bankruptcy court, (9) the burden of [the bankruptcy court's] docket, (10) the likelihood that the commencement of the proceeding in bankruptcy court involves forum shopping by one of the parties, (11) the existence of a right to a jury trial, and (12) the presence in the proceeding of nondebtor parties.

In re Republic Reader's Serv., Inc., 81 B.R. 422, 429 (Bankr.S.D.Tex.1987). The bankruptcy court in this case chose not to abstain because: (1) it could not determine based on the evidence before it whether execution of the state court judgment would have an economic impact on the debtor's estate, (2) the case is a core proceeding in which the bankruptcy court should enter the final order, and (3) the golf course and income derived from it are estate property, over which the bankruptcy court has exclusive jurisdiction. Transcript of Hearing for Proposed Findings of Fact and

Conclusions of Law at 11 (Dec. 8, 1987) [hereinafter Dec. 8 Transcript].

The court was concerned chiefly about the res judicata effect of the state determination of the restrictive covenant's reach because of the judgment's potential impact on the estate's value. A judgment that the restrictive covenant excluded benefits as to TE II, meaning TE II owners had no use-rights in the golf course, could decrease the estate's value by \$1.18 million to \$2.8 million. The court stated specifically that it did not want to be bound by the state court decision on the restrictive covenant's reach, *id.* at 12, and would not lift the stay unless it was not so bound, Dec. 5 Transcript at 14–15, 37–38.

The bankruptcy judge incorrectly reasoned that staying the entry of the state court's judgment would permit him to “review” the state court decision. In granting plaintiffs' motion for partial summary judgment prior to the bankruptcy, the state court had already determined preclusively that “Tucson Estates” is entitled to the benefits of the restrictive covenant. The only remaining question was what property constitutes “Tucson Estates.” An underlying assumption made by the bankruptcy court was that its decision on this issue and the misappropriation damages claim might be different from the state court's. Yet state law governs both issues, so both courts should reach the same result. The impact on the bankruptcy estate may be of grave concern to the bankrupt's creditors but it is irrelevant to the determination of which properties benefit from the covenant and what damages are due under state law. The bankruptcy court mistakenly confused the question whether the homeowners were entitled to judgment in state court that could serve as the basis for a claim in bankruptcy court, with the treatment of the claim in the bankruptcy. Another bankruptcy court judge has explained aptly that “section 1334 supports the duality of allowing a claim to be adjudicated to final judgment in state court while preserving the issues of the status and enforceability of the claim to the bankruptcy court.” *Republic Reader's*, 81 B.R. at 427; see also *In re Comer*, 723 F.2d 737, 740 (9th Cir.1984) (distinguishing between extent of debt, for which state court decision was res judicata, and nature of debt, the crucial issue in dischargeability for which a state court decision would not be res judicata in a bankruptcy court); *In re Ozai*, 34 B.R. 764, 766 (Bankr.9th Cir.1983) (existence of debt and dischargeability of debt are separate issues). The bankruptcy court cannot use the claim's impact on the value of the estate to justify reaching a different conclusion than that dictated by state law.

***1168** The bankruptcy court also attempted to justify its refusal to abstain by asserting that this dispute is a core proceeding. Under 28 U.S.C. § 157(b)(1), “[b]ankruptcy judges may hear and determine all core proceedings arising under title 11, or arising in a case under title 11, ... and may enter appropriate orders and judgments....” Subsection 157(b)(2) lists matters that qualify as core proceedings, two of which the bankruptcy court found satisfied, permitting it to decide the case. The court first considered the case to be about allowance and disallowance of claims. See *id.* § 157(b)(2)(B). This finding again confuses the tasks of determining whether the homeowners have a claim, and determining what to do with it in the bankruptcy if they do. The parties dispute not whether a claim should be disallowed but instead whether the plaintiffs have a claim to bring to the bankruptcy court in the first place.

The bankruptcy court also asserted that this case is a core proceeding because it involves identifying and administering estate property. If disputed, the issue of whether the golf course and income from it are property of the estate is subject only to federal determination. See 11 U.S.C. § 541. That the golf course and income from it are estate property, however, has remained undisputed. The issue that is disputed—what the debtor's interest in that property is (i.e., what use can be made of the property)—is governed by state law, *In re Loretto Winery, Ltd.*, 898 F.2d 715, 718 (9th Cir.1990), and need not be resolved by a federal court.

The bankruptcy court's two reasons for finding this a core proceeding are incorrect. We see no other basis that is viable.⁴ This case instead fits the description of a related proceeding under subsection 1334(c)(2). The property dispute is related to a case under title 11 (the bankruptcy proceeding) but does not arise under title 11; the action “could not have been commenced in a court of the United States absent jurisdiction under this section.” 28 U.S.C. § 1334(c)(2). To characterize such litigation as a core proceeding, thus permitting the bankruptcy court to hear and enter judgment in the case, would raise constitutional problems under *Marathon*, given the state litigation's common-law nature. See *Castlerock*, 781 F.2d at 161–62. We have held that “a court should avoid characterizing a proceeding as ‘core’ if to do so would raise constitutional problems. The apparent broad reading that can be given to § 157(b)(2) [defining core proceedings] should be tempered by the *Marathon* decision.” *Id.* at 162.

The bankruptcy court also supported its stay decision by finding that the golf course and income from it are estate property, over which the court has exclusive jurisdiction, and that any claims respecting them would likewise be subject to its exclusive jurisdiction. Under subsection 1334(d), “[t]he district court in which a case under [title 11](#) is commenced or is pending shall have exclusive jurisdiction of all of the property, wherever located, of the debtor as of the commencement of such case, and of property of the estate.” Congress did not intend this provision to reach as broadly as the bankruptcy court would have it. The provision’s purpose was to eliminate the jurisdictional distinctions between property in the possession and property not in the possession of the bankruptcy court. See 124 Cong.Rec. 11,108, 17,403, 17,425 (1978); 1 Collier Bankruptcy Manual § 23.00 (1978). Courts in applying the provision defer to state courts in many cases that concern estate property. See, e.g., [Pursifull v. Eakin](#), 814 F.2d 1501, 1506 (10th Cir.1987) (abstention enabling state court to determine rights in oil and gas lease); [In re Ozai](#), 34 B.R. at 766 (abstention appropriate for state court to hear claims on deed’s validity).

The bankruptcy court’s rationale for reimposing the stay is flawed in its interpretation and application of the law. Because state law governs the interpretation of the restrictive covenant, the state court and the bankruptcy court should reach the same conclusion regardless of impact on the estate’s value, making its concern that ***1169** the state judgment would have a res judicata effect inappropriate. The court incorrectly characterized the case as a “core” proceeding. That the golf course and income from it are estate property does not require the bankruptcy court, as opposed to the state court, to hear the dispute.

In deciding to lift the stay partially,⁵ the bankruptcy court made specific factual findings that provide a fully developed record and strongly support lifting the stay of the litigation entirely to allow the entry of judgment. (Execution of any judgment, of course, is another matter.) The bankruptcy court found that the debtor and officers waited until six years after the commencement of the state court litigation and until they had lost a very important summary judgment motion, to file for bankruptcy. The delay suggests that the filing’s purpose was to avoid an unfavorable state court judgment. The bankruptcy court found also that interests in judicial economy supported letting the state litigation continue, given its six-year length and status—the trial had already begun. Deferring to the state court would pose no financial hardship to the debtor. The state litigation would not interfere with the

bankruptcy proceedings but would in fact facilitate them by liquidating 1,600–2,300 class action plaintiff claims. Dec. 8 Transcript at 8–9. These findings, supported by the record and not clearly erroneous, strongly support a decision to abstain under the law of our circuit. See [Castlerock](#), 781 F.2d at 163 (affirming court’s decision to lift stay for abstention reasons, finding that state claims and imminent trial justify the decision); [In re Kemble](#), 776 F.2d at 807 (affirming court’s decision to lift stay, stating that extensive preparation for retrial alone justified the decision); see also [In re Titan Energy, Inc.](#), 837 F.2d 325, 330–34 (8th Cir.1988) (affirming abstention in case involving state law questions that could not have been brought in federal court absent bankruptcy jurisdiction and that would not hinder bankruptcy action).

The circumstances of this case viewed as a whole and evaluated in light of the factors well enunciated in *Republic Reader’s* lead us to conclude that the bankruptcy court abused its discretion by not abstaining and entirely lifting the stay. The following factors all support abstention: the beneficial impact that resolution of the class claims in state court will have on efficient administration of the estate, the extent to which state law issues predominate over bankruptcy issues, the existence of prior litigation of those issues which had already begun in state court, the difficult and unsettled nature of state law as applied to implied restrictive covenants,⁶ the lack of a federal jurisdictional basis other than bankruptcy jurisdiction for the state claims, the case’s status as a related rather than core proceeding, the ease of permitting completion of the state court litigation while reserving the judgment’s enforcement to the bankruptcy court, the likelihood that the company’s and officers’ instigation of the proceeding in bankruptcy court is forum shopping to avoid imminent defeat in state court, the right to a jury trial in state court, and the nondebtor status of the homeowner plaintiffs. Although the decision on the homeowners’ claims will affect significantly the bankruptcy estate’s value, and the value of the claims asserted against it, the issues reserved by the bankruptcy court—the restrictive covenant’s reach and the amount of the misappropriation claim damages—are distinct from the administration of the bankruptcy estate. They involve determining whether the homeowners have a liquidated claim to file in the bankruptcy, not how that claim should be administered.⁷ The bankruptcy court abused its discretion in imposing the ***1170** stay except as to the execution of any judgment.⁸

II. Cross Appeal: Recordation

The recordation issue is moot. An issue generally becomes moot when it is no longer “live” or “the parties lack a legally cognizable interest in the outcome.” *Murphy v. Hunt*, 455 U.S. 478, 481, 102 S.Ct. 1181, 1183, 71 L.Ed.2d 353 (1982) (quoting *Powell v. McCormack*, 395 U.S. 486, 496, 89 S.Ct. 1944, 1950, 23 L.Ed.2d 491 (1969)); see also *Walker v. Huston*, 689 F.2d 901, 902 (9th Cir.1982). The judgment which was recorded was entered on December 22, 1987, and amended on May 2, 1988. The Arizona Court of Appeals, ruling on the amended judgment on December 21, 1989, remanded for a new trial. *Lawrence v. Samuell*, No. 2 CA–CV 88–0285 (Ariz.Ct.App. Dec. 21, 1989) (unpublished memorandum). The Arizona Supreme Court denied a petition and cross-petition for review on June 5, 1990.

The recorded judgment no longer has any legal effect. The judgment as amended has been vacated by the Arizona Court of Appeals decision. The cross-appeal is moot.

CONCLUSION

We reverse the district court's decision affirming the bankruptcy court's reimposition of the stay, except as to execution of the judgment. The cross-appeal is moot.

All Citations

912 F.2d 1162, Bankr. L. Rep. P 73,613

Footnotes

- 1 The other is a recreational vehicle park; its relationship to TE, Inc., which may or may not be the owner of the roads and amenities within the park, is unclear from the record.
- 2 A jury eventually returned a verdict for the homeowners on the misappropriation claim. On appeal by the officers, the Arizona Court of Appeals remanded for a new trial because of state law errors in the trial. *Lawrence v. Samuell*, No. 2 CA–CV 88–0285 (Ariz.Ct.App. Dec. 21, 1988) (unpublished memorandum), *cert. denied*, No. CV 90–0125 (Ariz. June 5, 1990).
- 3 The bankruptcy court did not make specific factual findings on this issue, and it is unclear whether it properly stayed execution against the officers. We need not address this issue because the officers filed their own bankruptcy petitions on January 29, 1988, automatically staying execution against them.
- 4 Subsection 157(b)(2)'s list is nonexclusive.
- 5 The court may terminate, annul, modify, or condition its stay. 11 U.S.C. § 362(d).
- 6 The Arizona Court of Appeals first established the doctrine of implied restrictive covenants in *Shalimar Ass'n v. D.O.C. Enters., Ltd.*, 142 Ariz. 36, 688 P.2d 682 (Ct.App.1984). Further application of the doctrine and development of principles for interpreting such covenants have not appeared in Arizona published opinions.
- 7 As *Republic Reader's* notes, the burden a case has on the federal court's docket may support abstaining in favor of state adjudication. 81 B.R. at 428–29. That is not a factor here.
- 8 At oral argument, the officers argued that the Arizona Court of Appeals decision remanding the state case for a new trial moots the stay issue. They claim that the stay litigation will start all over again with the retrial and, essentially, that changed circumstances make the petitioners' request to lift the stay totally unsupportable now. The officers apparently believe that the only factor justifying lifting the stay on the first go-round was the pre-existing, ongoing state trial. That conclusion flies in the face of the bankruptcy court's findings and the record. As we have pointed out, even the bankruptcy judge agreed that several factors weighed against the stay. Time has changed none of those factors in the officers' favor. Specifically, it was not just that the parties were in the middle of the trial that supported letting it continue, but that the litigation had gone on so long in state court and that TE, Inc. was trying to escape from a disadvantaged position by filing its bankruptcy petition. To begin again in federal court would waste not only the parties' resources but also the many judicial resources invested by the state, for no reason authorized by federal bankruptcy law.

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91 B.R. 470

United States Bankruptcy Court,
N.D. Illinois, Eastern Division.

In re James DAVIS, Debtor.

Bankruptcy No. 88 B 04017.

|
May 13, 1988.**Synopsis**

Chapter 11 debtor's former employer moved for relief from automatic stay. The Bankruptcy Court, Ronald S. Barliant, J., held that risks of inconsistent results in two forums, of conflict on interpretation of state law between bankruptcy court and state court, and of duplication of efforts were "cause" for granting Chapter 11 debtor's former employer relief from stay to pursue state court action against debtor for breach of employment contracts containing covenant not to compete and conspiracy to circumvent restrictive covenants.

Motion granted.

Attorneys and Law Firms

***470** Zalutsky, Pinski & Di Giacomo, Chicago, Ill., for Adams Sales & service, inc.

Michael E. Schwartz, Bickley & Bickley, Chicago, Ill., for debtor.

MEMORANDUM OPINION

RONALD S. BARLIANT, Bankruptcy Judge.

Adam Sales & Service, Inc. ("Adam") has moved for relief from the automatic stay imposed under [11 U.S.C. § 362\(a\)](#). Adam seeks this relief to pursue its complaint in state court against the Debtor for conspiracy to interfere with business expectancy and breach of an employment contract. Adam's motion will be granted and the automatic stay modified to allow Adam to proceed to final judgment in the state court action.

Adam filed its complaint in the Circuit Court of Cook County in 1986 seeking damages against five defendants: the Debtor, Mr. James Davis a former employee of Adam; two other

former Adam employees for breach of their employment contracts and other misdeeds; and two other defendants for tortiously interfering with Adam's ***471** business. The most recent amended complaint (the third) was filed in February, 1988. That complaint alleges that the Debtor entered into both oral and written employment contracts with Adam, which provided that the Debtor would not compete with Adam for a period of eighteen months after the termination of the Debtor's employment. The Debtor allegedly breached these contracts. The complaint also alleges that the Debtor acted willfully and maliciously.

The Debtor filed his petition in bankruptcy on March 12, 1988, which automatically stayed further proceedings against the Debtor in the state court action. Adam argues that it is entitled to relief from the stay because the bases for the state court action are willful and malicious acts, liability for which is non-dischargeable under [§ 523\(a\)\(6\)](#). Adam also asserts that it will be unduly damaged by continuation of the stay because it would be forced to proceed in two courts on essentially similar claims—this court against the Debtor, and the state court against the other former employees and the other defendants.

The Bankruptcy Code, [11 U.S.C. § 362\(d\)\(1\)](#), provides that the automatic stay may be modified "for cause, including the lack of adequate protection." The Bankruptcy Code does not provide a definition of "cause" for which modification of the stay is appropriate. Therefore, the court must determine whether discretionary relief from the stay is appropriate on a case by case basis. *In re MacDonald*, 755 F.2d 715, 717 (9th Cir.1985). Cause for lifting the stay exists here, principally because of the risks, if the stay is not lifted, of inconsistent results in two forums, of a conflict in the interpretation of state law between this court and the state court, and of duplication of lawyer and judicial effort.

Adam's complaint consists of seven counts. The first three counts allege that the three former employees (including the Debtor) breached nearly identical employment contracts. The Debtor is the defendant in Count II. Although the breach of contract claim against the Debtor is stated in a separate count, disposition of that claim will depend on the construction of the same contract language and the application of the same principles of Illinois law as the disposition of the counts against the other two former employees.

Count VII alleges a conspiracy among the Debtor and two other defendants to "circumvent the provisions of

the restrictive covenants” of the employment contracts.¹ Specifically, the Debtor and another former employee are accused of diverting business to another defendant, a competitor of Adam. Adam relies on the Count VII allegations of willful and malicious conduct in asserting here that its claim against the Debtor is non-dischargeable. Although only this Court may determine the dischargeability of a debt, the predicate factual and legal issues are closely related to the claims against the other alleged co-conspirators.

Further, the administration of this bankruptcy case will not be prejudiced by granting Adam relief. Adam's claim can be determined in the state court without interfering with this Court's role. And this Court's decision as to the dischargeability of Adam's claims will simply await judgment in the state court. This Court can then rely upon that judgment to the extent appropriate in the dischargeability proceeding. *See, Brown v. Felsen*, 442 U.S. 127, 139, n. 10, 99 S.Ct. 2205, 2213, n. 10, 60 L.Ed.2d 767, 776, n. 10 (1979) (state court judgment may have collateral estoppel effect in bankruptcy proceeding to determine dischargeability of debt) (dicta); *In re Condict*, 71 B.R. 485, 487 (N.D.Ill.1987) (same). “In lifting the stay, this court would not be abdicating its duty to determine the dischargeability of the debt, if any; it would merely be deferring that determination until another court decides the plaintiff's ... claim.” *In re Larkham*, 31 B.R. 273, 277 (Bankr.Vt.1983) (stay lifted to permit employment discrimination action to proceed).

***472** Another factor weighing in favor of granting relief is that to do so is consistent with Congressional concerns for comity and respect for state court jurisdiction expressed in 28 U.S.C. § 1334(c).² Since no motion for abstention has been made under that Section, it is not directly applicable here for at least that reason. Nevertheless, that section usefully informs the exercise of discretion here.

Factors similar to those here were sufficient cause to lift the stay in *Piombo Corp. v. Castlerock Properties*, 781 F.2d 159 (9th Cir.1986). There, the Debtor filed a chapter 11 petition which stayed a state court breach of contract action. The Ninth Circuit modified the stay, allowing the plaintiff to proceed with the action in state court. The Court found that two factors constituted “cause”: first, “a clear congressional policy exist[ed] to give state law claimants a right to have

claims heard in state court” under 28 U.S.C. § 1334(c), 781 F.2d at 163; second, and more important, since the case was about to be tried in state court, usurpation of that function by the bankruptcy court would be wasteful and duplicative. The Court therefore allowed the entire action to be disposed of in one forum. *Id.*

Although the facts of *Castlerock* are somewhat unique,³ and here the state court case is not close to trial, the considerations that led to a finding of “cause” in *Castlerock* are applicable in the case at bar. The state court action commenced by Adam is “related to” the Chapter 11 case, but would not be a core proceedings. As such, the federal courts would lack jurisdiction to hear the state court action were it not for the Chapter 11 proceeding. These facts put Adam's contract action within the Congressional policy of allowing state court claims to be heard in state court. Further, a trial in the bankruptcy court involving the contract and conspiracy issues would be duplicative of a state court trial determining the rights of the other parties.

In addition, the Debtor will experience no hardship by defending the breach of contract action in state court. As suggested above, if the case is not tried in state court, the same proceeding will be conducted in bankruptcy court. A state court proceeding will neither prejudice the bankruptcy estate nor will it interfere with the bankruptcy proceedings. Where these factors are present, some courts have held that the mere desire of a party to modify the stay should constitute sufficient cause to lift the stay. *In re Larkham*, 31 B.R. 273, 276 (Bankr.Vt.1983); *In re Rounseville*, 20 B.R. 892, 893 (Bankr.D.R.I.1982), *In re Elegant Concepts*, 61 B.R. 723 (Bankr.E.D.N.Y.1986). While this Court need not go that far, these cases support the exercise of discretion under the more compelling circumstances found here.

An Order will be entered in accordance with the foregoing, modifying the stay to permit the continuation of the Adam's state court action to final judgment. In all other respects, the stay will remain in effect.

All Citations

91 B.R. 470

Footnotes

1 Counts IV, V and VI are not pertinent to this discussion. They state tort claims against parties other than the Debtor.

2 Section 1334(c) provides as follows:

(c)(1) Nothing in this section prevents a district court in the interest of justice, or in the interest of comity with State courts or respect for State law, from abstaining from hearing a particular proceeding arising under [title 11](#) or arising in or related to a case under [title 11](#).

(2) Upon timely motion of a party in a proceeding based upon a State law claim or State law cause of action, related to a case under [title 11](#) but not arising under [title 11](#) or arising in a case under [title 11](#), with respect to which an action could not have been commenced in a court of the United States absent jurisdiction under this section, the district court shall abstain from hearing such proceeding if an action is commenced, and can be timely adjudicated, in a State forum of appropriate jurisdiction. Any decision to abstain made under this subsection is not reviewable by appeal or otherwise. This subsection shall not be construed to limit the applicability of the stay provided for by [section 362 of title 11, United States Code](#), as such section applies to an action affecting the property of the estate in bankruptcy.

3 In *Castlerock*, the debtor included state law contract counterclaims in his answer to the plaintiff's motion to modify the automatic stay. The plaintiff answered the counterclaims and moved to allow his own counterclaims which was denied by the bankruptcy judge. The paper chase in the case at bar is not as involved, but the differences in no way diminish the applicability of the principles established by the Ninth Circuit.

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781 F.2d 159

United States Court of Appeals,
Ninth Circuit.

In re CASTLEROCK PROPERTIES, Debtor.
PIOMBO CORPORATION, a California
Corporation, Plaintiff-Appellee,

v.

CASTLEROCK PROPERTIES, a California
limited partnership, Defendant-Appellant.

No. 85-1514.

|
Argued and Submitted Oct. 10, 1985.

|
Decided Jan. 23, 1986.

Synopsis

The debtor appealed from an order of the United States District Court for the Northern District of California, John P. Vukasin, J., which vacated a bankruptcy court judgment and vacated a stay of California state court proceedings. The Court of Appeals, Fletcher, Circuit Judge, held that: (1) debtor's state law contract counterclaims, which were asserted before creditor's proof of claim was filed, were related proceedings under the Bankruptcy Amendments and Federal Judgeship Act; (2) creditor's filing of a proof of claim after debtor's assertion of related counterclaims did not constitute implied consent to jurisdiction of the bankruptcy court over the related counterclaims; and (3) district court did not abuse its discretion in terminating automatic stay so as to enable the creditor's state law claims to be determined along with the debtor's related counterclaims.

Affirmed.

Attorneys and Law Firms

*159 Robert A. Julian, Murphy, Weir, & Butler, San Francisco, Deborah S. Ballati, Fareello, Braun & Martel, Cal., for plaintiff-appellee.

*160 Christopher G. Costin, Misuraca, Beyers, & Costin, Santa Rosa, Cal., for defendant-appellant.

Micheal D. Dempsey, Finley, Kumble, Wagner, Heine, Underberg, Manley & Casey, Beverly Hills, Cal., for intervenor.

Appeal from the United States District Court for the Northern District of California.

Before SKOPIL, FLETCHER, and WIGGINS, Circuit Judges.

Opinion

FLETCHER, Circuit Judge:

This is an appeal from an order of the district court vacating a bankruptcy court judgment and vacating a stay of California state court proceedings. The order stated that the bankruptcy court did not have jurisdiction to determine appellant Castlerock Properties' counterclaims. We affirm.

I. BACKGROUND

Castlerock filed a Chapter 11 proceeding in bankruptcy court, thereby automatically staying a state court contract action involving Castlerock and Piombo. Piombo filed for relief from the automatic stay. Castlerock filed an answer incorporating state law contract counterclaims against Piombo. The bankruptcy judge elected to try the counterclaims but did not enter an order denying the relief from stay.

Although Piombo conceded subject matter jurisdiction, it moved to dismiss or sever the counterclaims questioning the propriety of deciding the counterclaims in a relief from stay proceeding. When the motion was denied, Piombo filed an answer to the counterclaims, and later filed a Proof of Secured Claim in the bankruptcy.

Piombo continued to object to trying the counterclaims in a relief from stay proceeding, but moved in the alternative to be allowed to bring its own counterclaim. The bankruptcy court denied both alternatives.

At the pretrial conference, Piombo objected to the bankruptcy court's jurisdiction, citing *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 102 S.Ct. 2858, 73 L.Ed.2d 598 (1982) (*Marathon*), which had been decided in the interim.¹ Piombo then moved the district court

to withdraw its reference to the bankruptcy court, arguing that the jurisdiction of the court over the state law claims was unconstitutional. This motion was summarily denied. The bankruptcy court then tried the relief of stay issue and Castlerock's contract counterclaims against Piombo and entered judgment for Castlerock.

The district court vacated the judgment on stipulation of the parties in order to determine whether the bankruptcy court could properly enter judgment. Piombo filed a motion for trial *de novo*; Castlerock filed a cross-motion for entry of judgment. After hearing, the district court entered its order holding that the bankruptcy court did not have jurisdiction to determine the substantive issues and vacating the automatic stay. Castlerock timely appealed.

II. APPLICABLE LAW

After the Supreme Court removed jurisdiction from the bankruptcy courts, see *Marathon*, 458 U.S. 50, 87, 102 S.Ct. 2858, 2880, the Judicial Council of the United States approved a model "Emergency Rule" that might be adopted by district courts for use upon the expiration of the stay in *Marathon* until Congress enacted remedial legislation. *Lucas v. Thomas (In *161 re Thomas)*, 765 F.2d 926, 928 n. 2 (9th Cir.1985). When the *Marathon* stay expired in December 1982, all the district courts in the Ninth Circuit adopted the model rule, some with minor variations. *Id.* Northern District General Order 24 [Emergency Rule] went into effect on December 24, 1982.

While this case was pending before the district court, the President signed into law the "Bankruptcy Amendments and Federal Judgeship Act of 1984" (1984 Act). Section 122 of the law provided that it would "take effect" on the date of enactment [July 10, 1984], P.L. 98-353 § 122(a), with exceptions for certain provisions that would not apply to pending cases. *Id.* § 122(b). The implication is that the balance of the act does apply to cases pending on July 10, 1984. However, the parties appear to be in some doubt as to whether this court should apply the 1984 Act or the Emergency Rule.

Absent manifest injustice or congressional intent to the contrary, we generally apply the law as it exists at the time the decision is rendered. *Rubin v. Belo Broadcasting Corp., (In re Rubin)*, 769 F.2d 611, 614 (9th Cir.1985). Thus, we have applied the 1984 Act to cases pending on July 10, 1984. *Id.* at 615 n. 4. Other circuits have done the same. *In re Amatex*

Corp., 755 F.2d 1034, 1037 (3d Cir.1985); *Carlton v. Baww, Inc.*, 751 F.2d 781, 787 n. 6 (5th Cir.1985); *Creasy v. Coleman Furniture Corp.*, 763 F.2d 656, 659-60 (4th Cir.1985). We apply the 1984 Act in this case.

III. BANKRUPTCY COURT'S JURISDICTION

The district court's order stated that the bankruptcy court did not have jurisdiction to "determine" Castlerock's state law claim against Piombo. We read this to mean simply that the bankruptcy court could not properly enter judgment. Thus, the question on appeal is whether, under the 1984 Act, the bankruptcy court had jurisdiction to enter final judgment on Castlerock's state law counterclaims. We review questions of jurisdiction *de novo*. *South Delta Water Agency v. U.S. Dept. of Interior*, 767 F.2d 531, 535 (9th Cir.1985).

The role of the bankruptcy court under the 1984 Act is succinctly described in *Production Steel, Inc. v. Bethlehem Steel Corp. (In re Production Steel, Inc.)*, 48 B.R. 841 (M.D.Tenn.1985).

In noncore matters, the bankruptcy court acts as an adjunct to the district court, in a fashion similar to that of a magistrate or special master. In noncore matters, the bankruptcy court may not enter final judgments without the consent of the parties, and its findings of fact and conclusions of law in noncore matters are subject to *de novo* review by the district court.... In contrast to the bankruptcy court's authority in noncore cases, the bankruptcy court may enter final judgments in so-called core cases, which are appealable to the district court. The standard for appeal of core matters of the district court is the same as in other civil matters appealed from the district court to the circuit courts of appeal. 28 U.S.C. § 158(c).

Id. at 844. Thus, the "essence of the jurisdictional system" is the distinction between core and noncore matters. *Lesser v. A-Z Associates, Inc. (In re Lion Capital Group)*, 46 B.R. 850, 852 (Bankr.S.D.N.Y.1985).

28 U.S.C. § 157(b)(2), which enumerates the proceedings designated as "core," consists of two "catch-all" provisions, § 157(b)(2)(A) and (O), and a list of more specific provisions. § 157(b)(2)(B)-(N). King, *Jurisdictional Procedure Under the Bankruptcy Amendments of 1984*, 38 Vand.L.Rev. 675, 687-88 (1985). The only one of the specific provisions which might apply to Castlerock's counterclaims is section 157(b)(2)(C), "counterclaims by the estate against persons filing

claims against the estate.” However, it seems unfair under the facts of this case to categorize the counterclaims as falling within this provision. The counterclaims were asserted before the Proof of Claim was filed. Piombo *162 would not have filed the Proof of Claim if the bankruptcy court had declined jurisdiction over the counterclaims. Nor are we persuaded that they fall within either of the catch-all provisions, “matters concerning the administration of the estate,” § 157(b)(2)(A) or “other proceedings affecting the liquidation of the assets of the estate,” § 157(b)(2)(O). State law contract claims that arguably fall within these catch-all provisions have been held to be “noncore” “related proceedings” under § 157(c). See *K–Rom Construction Corp. v. Behling (In re K–Rom Construction Corp.)*, 46 B.R., 745, 749 (S.D.N.Y.1985); *Mohawk Industries, Inc. v. Robinson Industries, Inc.*, 46 B.R. 464, 465–66 (D.Mass.1985); *Cameron v. Anderson (In re American Energy, Inc.)*, 50 B.R. 175, 178–79 (Bankr.D.N.D.1985); *Morse Electric Co., Inc. v. Logicon, Inc. (In re Morse Electric Co., Inc.)*, 47 B.R. 234, 237 (Bankr.N.D.Ind.1985). Cf. *Harry C. Partridge, Jr. & Sons, Inc. v. M & R Construction Corp. (In re Harry C. Partridge, Jr. & Sons, Inc.)*, 48 B.R. 1006, 1010 (Bankr.S.D.N.Y.1985) (state law contract claim characterized as core proceeding where it fit the description of § 157(b)(2)(E), one of the specific provisions).

Further, we are persuaded that a court should avoid characterizing a proceeding as “core” if to do so would raise constitutional problems. See *Mohawk*, 46 B.R. at 466; *Morse Electric*, 47 B.R. at 237–38. The apparent broad reading that can be given to § 157(b)(2) should be tempered by the *Marathon* decision. *American Energy*, 50 B.R. at 178.

This circuit has interpreted *Marathon* as depriving the bankruptcy court of jurisdiction “to make final determinations in matters that could have been brought in a district court or a state court.” *Thomas*, 765 F.2d at 929. However, if the district court can review *de novo*, giving no deference to findings of the bankruptcy judge, initial proceedings can be held before a non-Article III court. *Id.* Cf. *Briney v. Burley (In re Burley)*, 738 F.2d 981, 986 (9th Cir.1984) (non-Article III Bankruptcy Appeals Panel constitutional where *de novo* review by court of appeals). Accordingly, we hold that state law contract claims that do not specifically fall within the categories of core proceedings enumerated in 28 U.S.C. § 157(b)(2)(B)–(N) are related proceedings under § 157(c) even if they arguably fit within the literal wording of the two catch-all provisions, sections § 157(b)(2)(A) and (O). To hold otherwise would allow the bankruptcy court to enter final

judgments that this court has held unconstitutional. Since we find the case before us a “related proceeding,” the district court was correct in ruling that the bankruptcy court had no jurisdiction to enter judgment. 28 U.S.C. § 157(c)(1).

Castlerock, however, contends that the bankruptcy court nonetheless had jurisdiction because Piombo consented to the jurisdiction. Under the 1984 Act, the bankruptcy court is allowed to enter judgment in related proceedings with the consent of the parties. 28 U.S.C. § 157(c)(2). Castlerock argues that by filing its Proof of Claim, Piombo impliedly consented to the jurisdiction of the bankruptcy court. Although the district court found this not to be the case, implied consent is a question of law and is reviewed *de novo* by this court. See *Buttonwillow Ginning Co. v. Federal Crop Insurance Corp.*, 767 F.2d 612, 613 (9th Cir.1985).

Castlerock relies on well-settled law that a creditor consents to jurisdiction over related counterclaims by filing a proof of claim. *Northern Mutual Life Ins. Co. v. Axton (In re Axton)*, 641 F.2d 1262, 1268 (9th Cir.1981); *Peters v. Lines*, 275 F.2d 919, 925 (9th Cir.1960). However, Castlerock cites no case in which the filing of the proof of claim followed the bankruptcy court's assertion of jurisdiction over the counterclaims despite objections from the creditor. The purpose of the rule, to prevent a bankruptcy trustee from having “to split a cause of action by defending against the claim in the summary proceedings and then seeking affirmative relief in a plenary suit,” *Peters*, 275 F.2d at 925, is not served by forcing the creditor to file a proof of *163 claim as a defensive maneuver, thereby conferring jurisdiction on the bankruptcy court. Asserting an affirmative defense does not constitute consent. *Mohawk*, 46 B.R. at 466. By analogy, Piombo's filing the proof of claim should not be deemed consent. Cf. *Cline v. Kaplan*, 323 U.S. 97, 99, 65 S.Ct. 155, 156, 89 L.Ed. 97 (1944) (no consent where claimant resisted petition for turnover order and made formal protest against exercise of summary jurisdiction); *Dexter v. Gilbert (Matter of Kirchoff Frozen Foods, Inc.)*, 496 F.2d 84, 86 (9th Cir.1974) (no consent when no relief sought in bankruptcy court “save in the event the trustee first prevailed in the dispute initiated by him.”)

IV. TERMINATION OF STAY

The bankruptcy court did not act on Piombo's original request for relief from stay.² The district court exercised its discretion to terminate the stay. We review for abuse of discretion.

MacDonald v. MacDonald (In re MacDonald), 755 F.2d 715, 716 (9th Cir.1985).

11 U.S.C. § 362(d)(1) allows relief from the automatic stays provided by § 362(a) for “cause.” “Because there is no clear definition of what constitutes ‘cause’, discretionary relief from the stay must be determined on a case by case basis.” *MacDonald*, 755 F.2d at 717.

In this case, several factors could constitute “cause.” A clear congressional policy exists to give state law claimants a right to have claims heard in state court. See 28 U.S.C. § 1334(c). If the case were brought today, it would be heard in state court.

Id. § 1334(c)(2). More importantly, a state court trial is about to take place involving the very same issues. Under these circumstances, the district court did not abuse its discretion in terminating the stay, thus allowing the entire case to be determined in one forum.

AFFIRMED.

All Citations

781 F.2d 159, 15 Collier Bankr.Cas.2d 20, 14 Bankr.Ct.Dec. 322, Bankr. L. Rep. P 70,970

Footnotes

- 1 In *Marathon*, the Supreme Court held that the portion of the Bankruptcy Act of 1978 which allowed a bankruptcy court to entertain and decide a state law contract claim over the objection of one of the parties violated Article III of the United States Constitution. See 458 U.S. at 87, 102 S.Ct. at 2880 (plurality opinion), 91 (Rehnquist, J. concurring). The Court held that when dealing with rights not created by Congress, the essential attributes of judicial power must be retained in the Article III court. *Id.* at 81, 102 S.Ct. at 2876. The plurality noted a number of problems with the bankruptcy courts established by the 1978 Act including their broad subject matter jurisdiction, their exercise of all jurisdiction and all ordinary powers of the district courts, review of their decisions under the clearly erroneous standard, and the fact that they could enter final judgments on state law claims. *Id.* at 85–86, 102 S.Ct. at 2878–79.
- 2 Castlerock claims an August 21, 1981 memorandum of hearing constituted a final order. There is nothing on the face of the memorandum to suggest it disposed of the relief from stay issue. Moreover, we find it incredible that the parties or the court would allow the issue to be litigated in trial in June, 1983, if it had been disposed of two years earlier.

135 S.Ct. 1932

Supreme Court of the United States

WELLNESS INTERNATIONAL
NETWORK, LTD., et al., Petitioners

v.

Richard SHARIF.

No. 13–935

|

Argued Jan. 14, 2015.

|

Decided May 26, 2015.

Synopsis

Background: Judgment creditor brought adversary proceeding against Chapter 7 debtor, seeking denial of debtor's discharge as well as a declaration that a particular trust, of which debtor was alleged trustee, was debtor's alter ego and that its assets should be treated as part of bankruptcy estate. The United States Bankruptcy Court for the Northern District of Illinois entered default judgment in judgment creditor's favor as a discovery sanction and awarded attorneys fees to judgment creditor. Debtor appealed. The District Court, [Harry D. Leinenweber, J.](#), 2012 WL 469980, affirmed, and debtor appealed. The United States Court of Appeals for the Seventh Circuit, [Tinder, Circuit Judge](#), 727 F.3d 751, affirmed in part, reversed in part, and remanded. Certiorari was granted.

The Supreme Court, Justice [Sotomayor](#), held that Article III permits bankruptcy courts to adjudicate *Stern* claims, that is, claims designated for final adjudication in the bankruptcy court as a statutory matter but prohibited from proceeding in that way as a constitutional matter, with the parties' knowing and voluntary consent.

Reversed and remanded.

Justice [Alito](#) filed an opinion concurring in part and concurring in the judgment.

Chief Justice [Roberts](#) filed a dissenting opinion in which Justice [Scalia](#) joined and Justice [Thomas](#) joined in part.

Justice [Thomas](#) filed a dissenting opinion.

Procedural Posture(s): On Appeal.

****1936 Syllabus***

Respondent Richard Sharif tried to discharge a debt he owed petitioners, Wellness International Network, Ltd., and its owners (collectively Wellness), in his Chapter 7 bankruptcy. Wellness sought, *inter alia*, a declaratory judgment from the Bankruptcy Court, contending that a trust Sharif claimed to administer was in fact Sharif's alter-ego, and that its assets were his personal property and part of his bankruptcy estate. The Bankruptcy Court eventually entered a default judgment against Sharif. While Sharif's appeal was pending in District Court, but before briefing concluded, this Court held that [Article III](#) forbids bankruptcy courts to enter a final judgment on claims that seek only to “augment” the bankruptcy estate and would otherwise “exis[t] without regard to any bankruptcy proceeding.” [Stern v. Marshall](#), 564 U.S. —, —, 131 S.Ct. 2594, 2618, 180 L.Ed.2d 475. After briefing closed, Sharif sought permission to file a supplemental brief raising a *Stern* objection. The District Court denied the motion, finding it untimely, and affirmed the Bankruptcy Court's judgment. As relevant here, the Seventh Circuit determined that Sharif's *Stern* objection could not be waived because it implicated structural interests and reversed on the alter-ego claim, holding that the Bankruptcy Court lacked constitutional authority to enter final judgment on that claim.

Held :

1. [Article III](#) permits bankruptcy judges to adjudicate *Stern* claims with the parties' knowing and voluntary consent. Pp. 1942 – 1947.

(a) The foundational case supporting the adjudication of legal disputes by non-[Article III](#) judges with the consent of the parties is [Commodity Futures Trading Comm'n v. Schor](#), 478 U.S. 833, 106 S.Ct. 3245, 92 L.Ed.2d 675. There, the Court held that the right to adjudication before an [Article III](#) court is “personal” and therefore “subject to waiver.” *Id.*, at 848, 106 S.Ct. 3245. The Court also recognized that if Article III's structural interests as “ ‘an inseparable element of the constitutional system of checks and balances’ ” are implicated, “the parties cannot by consent cure the constitutional difficulty.” *Id.*, at 850–851, 106 S.Ct. 3245. The importance of consent was reiterated in two later

cases involving the Federal Magistrates Act's assignment of non-[Article III](#) magistrate judges to supervise *voir dire* in felony trials. In ****1937** *Gomez v. United States*, 490 U.S. 858, 109 S.Ct. 2237, 104 L.Ed.2d 923, the Court held that a magistrate judge was not permitted to select a jury without the defendant's consent, *id.*, at 864, 109 S.Ct. 2237. But in *Peretz v. United States*, 501 U.S. 923, 111 S.Ct. 2661, 115 L.Ed.2d 808, the Court stated that “the defendant's consent significantly changes the constitutional analysis,” *id.*, at 932, 111 S.Ct. 2661. Because an [Article III](#) court retained supervisory authority over the process, the Court found “no structural protections ... implicated” and upheld the Magistrate Judge's action. *Id.*, at 937, 111 S.Ct. 2661. Pp. 1942 – 1944.

(b) The question whether allowing bankruptcy courts to decide *Stern* claims by consent would “impermissibly threate[n] the institutional integrity of the Judicial Branch,” *Schor*, 478 U.S., at 851, 106 S.Ct. 3245, must be decided “with an eye to the practical effect that the” practice “will have on the constitutionally assigned role of the federal judiciary,” *ibid.* For several reasons, this practice does not usurp the constitutional prerogatives of [Article III](#) courts. Bankruptcy judges are appointed and may be removed by [Article III](#) judges, see 28 U.S.C. §§ 152(a)(1), (e); “serve as judicial officers of the United States district court,” § 151; and collectively “constitute a unit of the district court” for the district in which they serve, § 152(a)(1). Bankruptcy courts hear matters solely on a district court's reference, § 157(a), and possess no free-floating authority to decide claims traditionally heard by [Article III](#) courts, see *Schor*, 478 U.S., at 854, 856, 106 S.Ct. 3245. “[T]he decision to invoke” the bankruptcy court's authority “is left entirely to the parties,” *id.*, at 855, 106 S.Ct. 3245 and “the power of the federal judiciary to take jurisdiction” remains in place, *ibid.* Finally, there is no indication that Congress gave bankruptcy courts the ability to decide *Stern* claims in an effort to aggrandize itself or humble the Judiciary. See, e.g., *Peretz*, 501 U.S., at 937, 111 S.Ct. 2661. Pp. 1944 – 1946.

(c) *Stern* does not compel a different result. It turned on the fact that the litigant “did not truly consent to” resolution of the claim against it in a non-[Article III](#) forum, 564 U.S., at —, 131 S.Ct. 2594 and thus, does not govern the question whether litigants may validly consent to adjudication by a bankruptcy court. Moreover, expanding *Stern* to hold that a litigant may not waive the right to an [Article III](#) court through consent would be inconsistent with that opinion's own description of its holding as “a ‘narrow’ one” that did “not change all

that much” about the division of labor between district and bankruptcy courts. *Id.*, at —, 131 S.Ct. 2594. Pp. 1946 – 1947.

2. Consent to adjudication by a bankruptcy court need not be express, but must be knowing and voluntary. Neither the Constitution nor the relevant statute—which requires “the consent of all parties to the proceeding” to hear a *Stern* claim, § 157(c)(2)—mandates express consent. Such a requirement would be in great tension with this Court's holding that substantially similar language in § 636(c)—which authorizes magistrate judges to conduct proceedings “[u]pon consent of the parties”—permits waiver based on “actions rather than words,” *Roell v. Withrow*, 538 U.S. 580, 589, 123 S.Ct. 1696, 155 L.Ed.2d 775. *Roell*'s implied consent standard supplies the appropriate rule for bankruptcy court adjudications and makes clear that a litigant's consent—whether express or implied—must be knowing and voluntary. Pp. 1947 – 1948.

3. The Seventh Circuit should decide on remand whether Sharif's actions evinced the requisite knowing and voluntary consent and whether Sharif forfeited his *Stern* argument below. Pp. 1948 – 1949.

727 F.3d 751, reversed and remanded.

****1938** SOTOMAYOR, J., delivered the opinion of the Court, in which KENNEDY, GINSBURG, BREYER, and KAGAN, JJ., joined, and in which ALITO, J., joined in part. ALITO, J., filed an opinion concurring in part and concurring in the judgment. ROBERTS, C.J., filed a dissenting opinion, in which SCALIA, J., joined, and in which THOMAS, J., joined as to Part I. THOMAS, J., filed a dissenting opinion.

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Opinion

Justice SOTOMAYOR delivered the opinion of the Court.

*668 Article III, § 1, of the Constitution provides that “[t]he judicial Power of the United States, shall be vested in one supreme Court, and in such inferior Courts as the Congress may from time to time ordain and establish.” Congress has in turn established 94 District Courts and 13 Courts of Appeals, composed of judges who enjoy the protections of Article III: life tenure and pay that cannot be diminished. Because these protections help to ensure the integrity and independence of the Judiciary, “we have long recognized that, in general, Congress may not withdraw from” the Article III courts “any matter which, from its nature, is the subject of a suit at the common law, or in equity, or in admiralty.” *Stern v. Marshall*, 564 U.S. —, —, 131 S.Ct. 2594, 2609, 180 L.Ed.2d 475 (2011) (internal quotation marks omitted).

Congress has also authorized the appointment of bankruptcy and magistrate judges, who do not enjoy the protections of Article III, to assist Article III courts in their work. The number of magistrate and bankruptcy judgeships exceeds the number of circuit and district judgeships.¹ And it is no exaggeration to say that without **1939 the distinguished service of these judicial colleagues, the work of the federal court system would grind nearly to a halt.²

*669 Congress' efforts to align the responsibilities of non-Article III judges with the boundaries set by the Constitution have not always been successful. In *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 102 S.Ct. 2858, 73 L.Ed.2d 598 (1982) (plurality opinion), and more recently in *Stern*, this Court held that Congress violated Article III by authorizing bankruptcy judges to decide certain claims for which litigants are constitutionally entitled to an Article III adjudication. This case presents the question whether Article III allows bankruptcy judges to adjudicate such claims with the parties' consent. We hold that Article III is not violated when the parties knowingly and voluntarily consent to adjudication by a bankruptcy judge.

I

A

Before 1978, district courts typically delegated bankruptcy proceedings to “referees.” *Executive Benefits Ins. Agency v. Arkison*, 573 U.S. —, —, 134 S.Ct. 2165, 2170, 189 L.Ed.2d 83 (2014). Under the Bankruptcy Act of 1898, bankruptcy referees had “[s]ummary jurisdiction” over “claims involving ‘property in the actual or constructive possession of the bankruptcy court’ ”—that is, over the apportionment of the bankruptcy estate among creditors. *Ibid.* (alteration omitted). They could preside over other proceedings—matters implicating the court's “plenary jurisdiction”—by consent. *Id.*, at —, 134 S.Ct., at 2170; see also *MacDonald v. Plymouth County Trust Co.*, 286 U.S. 263, 266–267, 52 S.Ct. 505, 76 L.Ed. 1093 (1932).

In 1978, Congress enacted the Bankruptcy Reform Act, which repealed the 1898 Act and gave the newly created bankruptcy courts power “much broader than that exercised under the former referee system.” *Northern Pipeline*, 458 U.S., at 54, 102 S.Ct. 2858. The Act “[e]liminat[ed] the distinction between ‘summary’ and ‘plenary’ jurisdiction” and enabled bankruptcy *670 courts to decide “all ‘civil proceedings arising under title 11 [the Bankruptcy title] or arising in or related to cases under title 11.’ ” *Ibid.* (emphasis deleted). Congress thus vested bankruptcy judges with most of the “‘powers of a court of equity, law, and admiralty,’ ” *id.*, at 55, 102 S.Ct. 2858 without affording them the benefits of Article III. This Court therefore held parts of the system unconstitutional in *Northern Pipeline*.

Congress responded by enacting the Bankruptcy Amendments and Federal Judgeship Act of 1984. Under that Act, district courts have original jurisdiction over bankruptcy cases and related proceedings. 28 U.S.C. §§ 1334(a), (b). But “[e]ach district court may provide that any or all” bankruptcy cases and related proceedings “shall be referred to the bankruptcy judges for the district.” § 157(a). Bankruptcy judges are “judicial officers of the United States district court,” appointed to 14-year terms by the courts of appeals, and subject to removal for cause. §§ 152(a)(1), (e). “The district court may withdraw” a reference to the bankruptcy court “on its own motion or on timely motion of any party, for cause shown.” § 157(d).

****1940** When a district court refers a case to a bankruptcy judge, that judge's statutory authority depends on whether Congress has classified the matter as a “[c]ore proceedin[g]” or a “[n]on-core proceedin [g],” §§ 157(b)(2), (4)—much as the authority of bankruptcy referees, before the 1978 Act, depended on whether the proceeding was “summary” or “plenary.” Congress identified as “[c]ore” a nonexclusive list of 16 types of proceedings, § 157(b)(2), in which it thought bankruptcy courts could constitutionally enter judgment.³ Congress gave bankruptcy courts the power to “hear and determine” core proceedings and to “enter appropriate orders and judgments,” subject to appellate review by the district court. ***671** § 157(b)(1); see § 158. But it gave bankruptcy courts more limited authority in non-core proceedings: They may “hear and determine” such proceedings, and “enter appropriate orders and judgments,” only “with the consent of all the parties to the proceeding.” § 157(c)(2). Absent consent, bankruptcy courts in non-core proceedings may only “submit proposed findings of fact and conclusions of law,” which the district courts review *de novo*. § 157(c)(1).

B

Petitioner Wellness International Network is a manufacturer of health and nutrition products.⁴ Wellness and respondent Sharif entered into a contract under which Sharif would distribute Wellness' products. The relationship quickly soured, and in 2005, Sharif sued Wellness in the United States District Court for the Northern District of Texas. Sharif repeatedly ignored Wellness' discovery requests and other litigation obligations, resulting in an entry of default judgment for Wellness. The District Court eventually sanctioned Sharif by awarding Wellness over \$650,000 in attorney's fees. This case arises from Wellness' long-running—and so far unsuccessful—efforts to collect on that judgment.

In February 2009, Sharif filed for Chapter 7 bankruptcy in the Northern District of Illinois. The bankruptcy petition listed Wellness as a creditor. Wellness requested documents concerning Sharif's assets, which Sharif did not provide. Wellness later obtained a loan application Sharif had filed in 2002, listing more than \$5 million in assets. When confronted, Sharif informed Wellness and the Chapter 7 trustee that he had lied on the loan application. The listed assets, Sharif claimed, were actually owned by the Soad Wattar Living Trust (Trust), an entity Sharif said he administered on behalf of his mother, and for the benefit of his sister. ***672** Wellness

pressed Sharif for information on the Trust, but Sharif again failed to respond.

Wellness filed a five-count adversary complaint against Sharif in the Bankruptcy Court. See App. 5–22. Counts I–IV of the complaint objected to the discharge of Sharif's debts because, among other reasons, Sharif had concealed property by claiming that it was owned by the Trust. Count V of the complaint sought a declaratory judgment that the Trust was Sharif's alter ego and that its assets should therefore be treated as part of Sharif's bankruptcy estate. *Id.*, at 21. In his answer, ****1941** Sharif admitted that the adversary proceeding was a “core proceeding” under 28 U.S.C. § 157(b)—*i.e.*, a proceeding in which the Bankruptcy Court could enter final judgment subject to appeal. See §§ 157(b)(1), (2)(J); App. 24. Indeed, Sharif requested judgment in his favor on all counts of Wellness' complaint and urged the Bankruptcy Court to “find that the Soad Wattar Living Trust is not property of the [bankruptcy] estate.” *Id.*, at 44.

A familiar pattern of discovery evasion ensued. Wellness responded by filing a motion for sanctions, or, in the alternative, to compel discovery. Granting the motion to compel, the Bankruptcy Court warned Sharif that if he did not respond to Wellness' discovery requests a default judgment would be entered against him. Sharif eventually complied with some discovery obligations, but did not produce any documents related to the Trust.

In July 2010, the Bankruptcy Court issued a ruling finding that Sharif had violated the court's discovery order. See App. to Pet. for Cert. 92a–120a. It accordingly denied Sharif's request to discharge his debts and entered a default judgment against him in the adversary proceeding. And it declared, as requested by count V of Wellness' complaint, that the assets supposedly held by the Trust were in fact property of Sharif's bankruptcy estate because Sharif “treats [the Trust's] assets as his own property.” *Id.*, at 119a.

***673** Sharif appealed to the District Court. Six weeks before Sharif filed his opening brief in the District Court, this Court decided *Stern*. In *Stern*, the Court held that Article III prevents bankruptcy courts from entering final judgment on claims that seek only to “augment” the bankruptcy estate and would otherwise “exis[t] without regard to any bankruptcy proceeding.” 564 U.S., at —, —, 131 S.Ct., at 2614, 2618. Sharif did not cite *Stern* in his opening brief. Rather, after the close of briefing, Sharif moved for leave to file a supplemental brief, arguing that in light of *In re Ortiz*,

665 F.3d 906 (C.A.7 2011)—a recently issued decision interpreting *Stern*—“the bankruptcy court’s order should only be treated as a report and recommendation.” App. 145. The District Court denied Sharif’s motion for supplemental briefing as untimely and affirmed the Bankruptcy Court’s judgment.

The Court of Appeals for the Seventh Circuit affirmed in part and reversed in part. 727 F.3d 751 (2013). The Seventh Circuit acknowledged that ordinarily Sharif’s *Stern* objection would “not [be] preserved because he waited too long to assert it.” 727 F.3d, at 767.⁵ But the court determined that the ordinary rule did not apply because Sharif’s argument concerned “the allocation of authority between bankruptcy courts and district courts” under Article III, and thus “implicate [d] structural interests.” *Id.*, at 771. Based on those separation-of-powers considerations, the court held that “a litigant may not waive” a *Stern* objection. *Id.*, at 773. Turning to the merits of Sharif’s contentions, the Seventh Circuit agreed with the Bankruptcy Court’s resolution of counts I–IV of Wellness’ adversary complaint. It further concluded, however, that count V of the complaint alleged a so-called “*Stern* claim,” that is, “a claim designated *674 for final adjudication in the bankruptcy court as a statutory matter, but prohibited from proceeding in that way as **1942 a constitutional matter.” *Executive Benefits*, 573 U.S., at —, 134 S.Ct., at 2170. The Seventh Circuit therefore ruled that the Bankruptcy Court lacked constitutional authority to enter final judgment on count V.⁶

We granted certiorari, 573 U.S. —, 134 S.Ct. 2901, 189 L.Ed.2d 854 (2014), and now reverse the judgment of the Seventh Circuit.⁷

II

Our precedents make clear that litigants may validly consent to adjudication by bankruptcy courts.

A

Adjudication by consent is nothing new. Indeed, “[d]uring the early years of the Republic, federal courts, with the consent of the litigants, regularly referred adjudication of entire disputes to non-Article III referees, masters, or arbitrators, for entry of final judgment in accordance with the referee’s report.” Brubaker, *The Constitutionality of Litigant Consent*

to Non-Article III Bankruptcy Adjudications, 32 Bkrcty. L. Letter No. 12, p. 6 (Dec. 2012); see, e.g., *675 *Thornton v. Carson*, 7 Cranch 596, 597, 3 L.Ed. 451 (1813) (affirming damages awards in two actions that “were referred, by consent under a rule of Court to arbitrators”); *Heckers v. Fowler*, 2 Wall. 123, 131, 17 L.Ed. 759 (1865) (observing that the “[p]ractice of referring pending actions under a rule of court, by consent of parties, was well known at common law,” and “is now universally regarded ... as the proper foundation of judgment”); *Newcomb v. Wood*, 97 U.S. 581, 583, 24 L.Ed. 1085 (1878) (recognizing “[t]he power of a court of justice, with the consent of the parties, to appoint arbitrators and refer a case pending before it”).

The foundational case in the modern era is *Commodity Futures Trading Comm’n v. Schor*, 478 U.S. 833, 106 S.Ct. 3245, 92 L.Ed.2d 675 (1986). The Commodity Futures Trading Commission (CFTC), which Congress had authorized to hear customer complaints against commodities brokers, issued a regulation allowing itself to hear state-law counterclaims as well. William Schor filed a complaint with the CFTC against his broker, and the broker, which had previously filed claims against Schor in federal court, refiled them as counterclaims in the CFTC proceeding. The CFTC ruled against Schor on the counterclaims. This Court upheld that ruling against both statutory and constitutional challenges.

On the constitutional question (the one relevant here) the Court began by holding that Schor had “waived any right he may have possessed to the full trial of [the broker’s] counterclaim before an Article III court.” *Id.*, at 849, 106 S.Ct. 3245. **1943 The Court then explained why this waiver legitimated the CFTC’s exercise of authority: “[A]s a personal right, Article III’s guarantee of an impartial and independent federal adjudication is subject to waiver, just as are other personal constitutional rights”—such as the right to a jury —“that dictate the procedures by which civil and criminal matters must be tried.” *Id.*, at 848–849, 106 S.Ct. 3245.

The Court went on to state that a litigant’s waiver of his “personal right” to an Article III court is not always dispositive because Article III “not only preserves to litigants their *676 interest in an impartial and independent federal adjudication of claims ..., but also serves as ‘an inseparable element of the constitutional system of checks and balances.’ ... To the extent that this structural principle is implicated in a given case”—but only to that extent—“the

parties cannot by consent cure the constitutional difficulty....” *Id.*, at 850–851, 106 S.Ct. 3245.

Leaning heavily on the importance of Schor's consent, the Court found no structural concern implicated by the CFTC's adjudication of the counterclaims against him. While “Congress gave the CFTC the authority to adjudicate such matters,” the Court wrote,

“the decision to invoke this forum is left entirely to the parties and the power of the federal judiciary to take jurisdiction of these matters is unaffected. In such circumstances, separation of powers concerns are diminished, for it seems self-evident that just as Congress may encourage parties to settle a dispute out of court or resort to arbitration without impermissible incursions on the separation of powers, Congress may make available a quasi-judicial mechanism through which willing parties may, at their option, elect to resolve their differences.” *Id.*, at 855, 106 S.Ct. 3245.

The option for parties to submit their disputes to a non-[Article III](#) adjudicator was at most a “*de minimis*” infringement on the prerogative of the federal courts. *Id.*, at 856, 106 S.Ct. 3245.

A few years after *Schor*, the Court decided a pair of cases—*Gomez v. United States*, 490 U.S. 858, 109 S.Ct. 2237, 104 L.Ed.2d 923 (1989), and *Peretz v. United States*, 501 U.S. 923, 111 S.Ct. 2661, 115 L.Ed.2d 808 (1991)—that reiterated the importance of consent to the constitutional analysis. Both cases concerned whether the Federal Magistrates Act authorized magistrate judges to preside over jury selection in a felony trial;⁸ the difference was that Peretz consented to the practice while Gomez did not. That difference was dispositive.

*677 In *Gomez*, the Court interpreted the statute as not allowing magistrate judges to supervise *voir dire* without consent, emphasizing the constitutional concerns that might otherwise arise. See 490 U.S., at 864, 109 S.Ct. 2237. In *Peretz*, the Court upheld the Magistrate Judge's action, stating that “the defendant's consent significantly changes the constitutional analysis.” 501 U.S., at 932, 111 S.Ct. 2661. The Court concluded that allowing a magistrate judge to supervise jury selection—with consent—does not violate [Article III](#), explaining that “litigants may waive their personal right to have an [Article III](#) judge preside over a civil trial,” *id.*, at 936, 111 S.Ct. 2661 (citing *Schor*, 478 U.S., at 848, 106 S.Ct. 3245), and that “[t]he most basic rights of criminal defendants

are similarly subject to waiver,” **1944 501 U.S., at 936, 111 S.Ct. 2661. And “[e]ven assuming that a litigant may not waive structural protections provided by Article III,” the Court found “no such structural protections ... implicated by” a magistrate judge's supervision of *voir dire* :

“Magistrates are appointed and subject to removal by [Article III](#) judges. The ‘ultimate decision’ whether to invoke the magistrate's assistance is made by the district court, subject to veto by the parties. The decision whether to empanel the jury whose selection a magistrate has supervised also remains entirely with the district court. Because ‘the entire process takes place under the district court's total control and jurisdiction,’ there is no danger that use of the magistrate involves a ‘congressional attempt[t] “to transfer jurisdiction [to non-[Article III](#) tribunals] for the purpose of emasculating” constitutional courts.’ ” *Id.*, at 937, 111 S.Ct. 2661 (citations omitted; alteration in original).⁹

*678 The lesson of *Schor*, *Peretz*, and the history that preceded them is plain: The entitlement to an [Article III](#) adjudicator is “a personal right” and thus ordinarily “subject to waiver,” *Schor*, 478 U.S., at 848, 106 S.Ct. 3245. [Article III](#) also serves a structural purpose, “barring congressional attempts ‘to transfer jurisdiction [to non-[Article III](#) tribunals] for the purpose of emasculating’ constitutional courts and thereby prevent [ing] ‘the encroachment or aggrandizement of one branch at the expense of the other.’ ” *Id.*, at 850, 106 S.Ct. 3245 (citations omitted). But allowing [Article I](#) adjudicators to decide claims submitted to them by consent does not offend the separation of powers so long as [Article III](#) courts retain supervisory authority over the process.

B

The question here, then, is whether allowing bankruptcy courts to decide *Stern* claims by consent would “impermissibly threate[n] the institutional integrity of the Judicial Branch.” *Schor*, 478 U.S., at 851, 106 S.Ct. 3245. And that question must be decided not by “formalistic and unbending rules,” but “with an eye to the practical effect that the” practice “will have on the constitutionally assigned role of the federal judiciary.” *Ibid.*; see *Thomas v. Union Carbide Agricultural Products Co.*, 473 U.S. 568, 587, 105 S.Ct. 3325, 87 L.Ed.2d 409 (1985) (“[P]ractical attention to substance rather than doctrinaire reliance on formal categories should inform application of Article III”). The Court must weigh

“the extent to which the essential attributes of judicial power are reserved to [Article III](#) courts, and, conversely, the extent to which the non-[Article III](#) forum exercises the range of jurisdiction and powers normally vested only in [Article III](#) courts, the origins and importance of the right to be adjudicated, and the concerns that drove Congress to depart from the requirements of *679 [Article III](#).” *Schor*, 478 U.S., at 851, 106 S.Ct. 3245 (internal quotation marks omitted).

Applying these factors, we conclude that allowing bankruptcy litigants to waive the right to [Article III](#) adjudication of *Stern* claims does not usurp the **1945 constitutional prerogatives of [Article III](#) courts. Bankruptcy judges, like magistrate judges, “are appointed and subject to removal by [Article III](#) judges,” *Peretz*, 501 U.S., at 937, 111 S.Ct. 2661; see 28 U.S.C. §§ 152(a)(1), (e). They “serve as judicial officers of the United States district court,” § 151, and collectively “constitute a unit of the district court” for that district, § 152(a)(1). Just as “[t]he ‘ultimate decision’ whether to invoke [a] magistrate [judge]’s assistance is made by the district court,” *Peretz*, 501 U.S., at 937, 111 S.Ct. 2661 bankruptcy courts hear matters solely on a district court’s reference, § 157(a), which the district court may withdraw *sua sponte* or at the request of a party, § 157(d). “[S]eparation of powers concerns are diminished” when, as here, “the decision to invoke [a non-[Article III](#)] forum is left entirely to the parties and the power of the federal judiciary to take jurisdiction” remains in place. *Schor*, 478 U.S., at 855, 106 S.Ct. 3245.

Furthermore, like the CFTC in *Schor*, bankruptcy courts possess no free-floating authority to decide claims traditionally heard by [Article III](#) courts. Their ability to resolve such matters is limited to “a narrow class of common law claims as an incident to the [bankruptcy courts’] primary, and unchallenged, adjudicative function.” *Id.*, at 854, 106 S.Ct. 3245. “In such circumstances, the magnitude of any intrusion on the Judicial Branch can only be termed *de minimis*.” *Id.*, at 856, 106 S.Ct. 3245.

Finally, there is no indication that Congress gave bankruptcy courts the ability to decide *Stern* claims in an effort to aggrandize itself or humble the Judiciary. As in *Peretz*, “[b]ecause ‘the entire process takes place under the district court’s total control and jurisdiction,’ there is no danger that use of the [bankruptcy court] involves a ‘congressional attempt[t] ‘to transfer jurisdiction [to non-[Article III](#) tribunals] *680 for the purpose of emasculating” constitutional courts.’ ” 501 U.S., at 937, 111 S.Ct. 2661 (citation omitted);

see also *Schor*, 478 U.S., at 855, 106 S.Ct. 3245 (allowing CFTC’s adjudication of counterclaims because of “the degree of judicial control saved to the federal courts, as well as the congressional purpose behind the jurisdictional delegation, the demonstrated need for the delegation, and the limited nature of the delegation” (citation omitted)); *Pacemaker Diagnostic Clinic of America, Inc. v. Instromedix, Inc.*, 725 F.2d 537, 544 (C.A.9 1984) (en banc) (Kennedy, J.) (magistrate judges may adjudicate civil cases by consent because the Federal Magistrates Act “invests the [Article III](#) judiciary with extensive administrative control over the management, composition, and operation of the magistrate system”).¹⁰

**1946 Congress could choose to rest the full share of the Judiciary’s labor on the shoulders of [Article III](#) judges. But doing so would require a substantial increase in the number of district *681 judgeships. Instead, Congress has supplemented the capacity of district courts through the able assistance of bankruptcy judges. So long as those judges are subject to control by the [Article III](#) courts, their work poses no threat to the separation of powers.

C

Our recent decision in *Stern*, on which Sharif and the principal dissent rely heavily, does not compel a different result. That is because *Stern*—like its predecessor, *Northern Pipeline*—turned on the fact that the litigant “did not truly consent to” resolution of the claim against it in a non-[Article III](#) forum. 564 U.S., at —, 131 S.Ct., at 2614.

To understand *Stern*, it is necessary to first understand *Northern Pipeline*. There, the Court considered whether bankruptcy judges “could ‘constitutionally be vested with jurisdiction to decide [a] state-law contract claim’ against an entity that was not otherwise part of the bankruptcy proceedings.” 564 U.S., at —, 131 S.Ct., at 2609–2610. In answering that question in the negative, both the plurality and then-Justice Rehnquist, concurring in the judgment, noted that the entity in question did not consent to the bankruptcy court’s adjudication of the claim. See 458 U.S., at 80, n. 31, 102 S.Ct. 2858 (plurality opinion); *id.*, at 91, 102 S.Ct. 2858 (opinion of Rehnquist, J.). The Court confirmed in two later cases that *Northern Pipeline* turned on the lack of consent. See *Schor*, 478 U.S., at 849, 106 S.Ct. 3245 (“[I]n *Northern Pipeline*, ... the absence of consent to an initial adjudication before a non-[Article III](#) tribunal was relied on as

a significant factor in determining that [Article III](#) forbade such adjudication”); *Thomas*, 473 U.S., at 584, 105 S.Ct. 3325.

Stern presented the same scenario. The majority cited the dissent's observation that *Northern Pipeline* “establish[ed] only that Congress may not vest in a non-[Article III](#) court the power to adjudicate, render final judgment, and issue binding orders in a traditional contract action arising under state law, without consent of the litigants, and subject *682 only to ordinary appellate review,” 564 U.S., at —, 131 S.Ct., at 2615 (emphasis added; internal quotation marks omitted). To which the majority responded, “Just so: Substitute ‘tort’ for ‘contract,’ and that statement directly covers this case.” *Id.*, at —, 131 S.Ct., at 2615; see also *id.*, at —, 131 S.Ct., at 2614 (defendant litigated in the Bankruptcy Court because he “had nowhere else to go” to pursue his claim). Because *Stern* was premised on nonconsent to adjudication by the Bankruptcy Court, the “constitutional bar” it announced, see *post*, at 1957 (ROBERTS, C.J., dissenting), simply does not govern the question whether litigants may validly consent to adjudication by a bankruptcy court.

An expansive reading of *Stern*, moreover, would be inconsistent with the opinion's own description of its holding. The Court in *Stern* took pains to note that the question before it was “a ‘narrow’ one,” and that its answer did “not change all **1947 that much” about the division of labor between district courts and bankruptcy courts. *Id.*, at —, 131 S.Ct., at 2620; see also *id.*, at —, 131 S.Ct., at 2620 (stating that Congress had exceeded the limitations of [Article III](#) “in one isolated respect”). That could not have been a fair characterization of the decision if it meant that bankruptcy judges could no longer exercise their longstanding authority to resolve claims submitted to them by consent. Interpreting *Stern* to bar consensual adjudications by bankruptcy courts would “meaningfully chang[e] the division of labor” in our judicial system, contra *id.*, at —, 131 S.Ct., at 2620.¹¹

In sum, the cases in which this Court has found a violation of a litigant's right to an [Article III](#) decisionmaker have involved an objecting defendant forced to litigate involuntarily *683 before a non-[Article III](#) court. The Court has never done what Sharif and the principal dissent would have us do—hold that a litigant who has the right to an [Article III](#) court may not waive that right through his consent.

D

The principal dissent warns darkly of the consequences of today's decision. See *post*, at 1958 – 1960. To hear the principal dissent tell it, the world will end not in fire, or ice, but in a bankruptcy court. The response to these ominous predictions is the same now as it was when Justice Brennan, dissenting in *Schor*, first made them nearly 30 years ago:

“This is not to say, of course, that if Congress created a phalanx of non-[Article III](#) tribunals equipped to handle the entire business of the [Article III](#) courts without any [Article III](#) supervision or control and without evidence of valid and specific legislative necessities, the fact that the parties had the election to proceed in their forum of choice would necessarily save the scheme from constitutional attack. But this case obviously bears no resemblance to such a scenario....” 478 U.S., at 855, 106 S.Ct. 3245 (citations omitted).

Adjudication based on litigant consent has been a consistent feature of the federal court system since its inception. Reaffirming that unremarkable fact, we are confident, poses no great threat to anyone's birthrights, constitutional or otherwise.

III

Sharif contends that to the extent litigants may validly consent to adjudication by a bankruptcy court, such consent must be express. We disagree.

Nothing in the Constitution requires that consent to adjudication by a bankruptcy court be express. Nor does the relevant statute, 28 U.S.C. § 157, mandate express consent; it states only that a bankruptcy court must obtain “the consent”—consent *684 *simpliciter*—“of all parties to the proceeding” before hearing and determining a non-core claim. § 157(c)(2). And a requirement of express consent would be in great tension with our decision in *Roell v. Withrow*, 538 U.S. 580, 123 S.Ct. 1696, 155 L.Ed.2d 775 (2003). That **1948 case concerned the interpretation of § 636(c), which authorizes magistrate judges to “conduct any or all proceedings in a jury or nonjury civil matter and order the entry of judgment in the case,” with “the consent of the parties.”¹² The specific question in *Roell* was whether, as a statutory matter, the “consent” required by § 636(c) had to be express. The dissent argued that “[r]eading § 636(c)(1) to require express consent not only is more consistent with the text of the statute, but also” avoids constitutional concerns

by “ensur[ing] that the parties knowingly and voluntarily waive their right to an [Article III judge](#).” 538 U.S., at 595, 123 S.Ct. 1696 (opinion of THOMAS, J.). But the majority—thus placed on notice of the constitutional concern—was untroubled by it, opining that “the [Article III](#) right is substantially honored” by permitting waiver based on “actions rather than words.” *Id.*, at 589, 590, 123 S.Ct. 1696.

The implied consent standard articulated in *Roell* supplies the appropriate rule for adjudications by bankruptcy courts under [§ 157](#). Applied in the bankruptcy context, that standard ***685** possesses the same pragmatic virtues—increasing judicial efficiency and checking gamesmanship—that motivated our adoption of it for consent-based adjudications by magistrate judges. See *id.*, at 590, 123 S.Ct. 1696. It bears emphasizing, however, that a litigant's consent—whether express or implied—must still be knowing and voluntary. *Roell* makes clear that the key inquiry is whether “the litigant or counsel was made aware of the need for consent and the right to refuse it, and still voluntarily appeared to try the case” before the non-[Article III](#) adjudicator. *Ibid.*; see also *id.*, at 588, n. 5, 123 S.Ct. 1696 (“notification of the right to refuse” adjudication by a non-[Article III](#) court “is a prerequisite to any inference of consent”).¹³

IV

It would be possible to resolve this case by determining whether Sharif in fact consented to the Bankruptcy Court's adjudication ****1949** of count V of Wellness' adversary complaint. But reaching that determination would require a deeply factbound analysis of the procedural history unique to this protracted litigation. Our resolution of the consent question—unlike the antecedent constitutional question—would provide little guidance to litigants or the lower courts. Thus, consistent with our role as “a court of review, not of first view,” ***686** *Nautilus, Inc. v. Biosig Instruments, Inc.*, 572 U.S. —, —, 134 S.Ct. 2120, 2131, 189 L.Ed.2d 37 (2014) (internal quotation marks omitted), we leave it to the Seventh Circuit to decide on remand whether Sharif's actions evinced the requisite knowing and voluntary consent, and also whether, as Wellness contends, Sharif forfeited his *Stern* argument below.

* * *

The Court holds that [Article III](#) permits bankruptcy courts to decide *Stern* claims submitted to them by consent.

The judgment of the United States Court of Appeals for the Seventh Circuit is therefore reversed, and the case is remanded for further proceedings consistent with this opinion.

It is so ordered.

Justice ALITO, concurring in part and concurring in the judgment.

I join the opinion of the Court insofar as it holds that a bankruptcy judge's resolution of a “*Stern* claim”^{*} with the consent of the parties does not violate [Article III of the Constitution](#). The Court faithfully applies *Commodity Futures Trading Comm'n v. Schor*, 478 U.S. 833, 106 S.Ct. 3245, 92 L.Ed.2d 675 (1986). No one believes that an arbitrator exercises “[t]he judicial Power of the United States,” [Art. III, § 1](#), in an ordinary, run-of-the mill arbitration. And whatever differences there may be between an arbitrator's “decision” and a bankruptcy court's “judgment,” those differences would seem to fall within the Court's previous rejection of “formalistic and unbending rules.” *Schor, supra*, at 851, 106 S.Ct. 3245. Whatever one thinks of *Schor*, it is still the law of this Court, and the parties do not ask us to revisit it.

Unlike the Court, however, I would not decide whether consent may be implied. While the Bankruptcy Act just ***687** speaks of “consent,” 28 U.S.C. [§ 157\(c\)\(2\)](#), the Federal Rules of Bankruptcy Procedure provide that “[i]n non-core proceedings final orders and judgments shall not be entered on the bankruptcy judge's order except with the express consent of the parties,” [Rule 7012\(b\)](#). When this Rule was promulgated, no one was thinking about a *Stern* claim. But now, assuming that [Rule 7012\(b\)](#) represents a permissible interpretation of [§ 157](#), the question arises whether a *Stern* claim should be treated as a non-core or core claim for purposes of the bankruptcy rules. See *Executive Benefits Ins. Agency v. Arkison*, 573 U.S. —, —, —, 134 S.Ct. 2165, 2172–2173, 189 L.Ed.2d 83 (2014) (holding that, for reasons of severability, a bankruptcy court should treat a *Stern* claim as a non-core claim).

There is no need to decide that question here. In this case, respondent forfeited any *Stern* objection by failing to present that argument properly in the courts below. *Stern* vindicates [Article III](#), but that does not mean that *Stern* arguments are exempt from ordinary principles of appellate procedure. See ****1950** *B & B Hardware, Inc. v. Hargis Industries, Inc.*,

—U.S. —, —, 135 S.Ct. 1293, 1304, 191 L.Ed.2d 222 (2015).

Chief Justice [ROBERTS](#), with whom Justice SCALIA joins, and with whom Justice THOMAS joins as to Part I, dissenting.

The Bankruptcy Court in this case granted judgment to Wellness on its claim that Sharif's bankruptcy estate contained assets he purportedly held in a trust. Provided that no third party asserted a substantial adverse claim to those assets, the Bankruptcy Court's adjudication "stems from the bankruptcy itself" rather than from "the stuff of the traditional actions at common law tried by the courts at Westminster in 1789." *Stern v. Marshall*, 564 U.S. —, —, 131 S.Ct. 2594, 2609, 180 L.Ed.2d 475 (2011) (internal quotation marks omitted). [Article III](#) poses no barrier to such a decision. That is enough to resolve this case.

Unfortunately, the Court brushes aside this narrow basis for decision and proceeds to the serious constitutional question *688 whether private parties may consent to an [Article III](#) violation. In my view, they cannot. By reserving the judicial power to judges with life tenure and salary protection, [Article III](#) constitutes "an inseparable element of the constitutional system of checks and balances"—a structural safeguard that must "be jealously guarded." *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 58, 60, 102 S.Ct. 2858, 73 L.Ed.2d 598 (1982) (plurality opinion).

Today the Court lets down its guard. Despite our precedent directing that "parties cannot by consent cure" an [Article III](#) violation implicating the structural separation of powers, *Commodity Futures Trading Comm'n v. Schor*, 478 U.S. 833, 850–851, 106 S.Ct. 3245, 92 L.Ed.2d 675 (1986), the majority authorizes litigants to do just that. The Court justifies its decision largely on pragmatic grounds. I would not yield so fully to functionalism. The Framers adopted the formal protections of [Article III](#) for good reasons, and "the fact that a given law or procedure is efficient, convenient, and useful in facilitating functions of government, standing alone, will not save it if it is contrary to the Constitution." *INS v. Chadha*, 462 U.S. 919, 944, 103 S.Ct. 2764, 77 L.Ed.2d 317 (1983).

The impact of today's decision may seem limited, but the Court's acceptance of an [Article III](#) violation is not likely to go unnoticed. The next time Congress takes judicial power from [Article III](#) courts, the encroachment may not be so modest—and we will no longer hold the high ground of principle. The

majority's acquiescence in the erosion of our constitutional power sets a precedent that I fear we will regret. I respectfully dissent.

I

The Court granted certiorari on two questions in this case. The first is whether the Bankruptcy Court's entry of final judgment on Wellness's claim violated [Article III](#) based on *Stern*. The second is whether an [Article III](#) violation of the kind recognized in *Stern* can be cured by consent. Because the first question can be resolved on narrower grounds, I would answer it alone.

*689 A

The Framers of the Constitution "lived among the ruins of a system of intermingled legislative and judicial powers." *Plaut v. Spendthrift Farm, Inc.*, 514 U.S. 211, 219, 115 S.Ct. 1447, 131 L.Ed.2d 328 (1995). Under British rule, the King "made Judges dependent on his Will alone, for the tenure of their offices, and the amount and payment of their salaries." **1951 The Declaration of Independence ¶ 11. Between the Revolution and the Constitutional Convention, state legislatures routinely interfered with judgments of the courts. This history created the "sense of a sharp necessity to separate the legislative from the judicial power." *Plaut*, 514 U.S., at 221, 115 S.Ct. 1447; see *Perez v. Mortgage Bankers Assn.*, 575 U.S. —, — – —, 135 S.Ct. 1199, 1215–1217, 191 L.Ed.2d 186 (2015) (THOMAS, J., concurring in judgment). The result was [Article III](#), which established a judiciary "truly distinct from both the legislature and the executive." The Federalist No. 78, p. 466 (C. Rossiter ed. 1961) (A. Hamilton).

[Article III](#) vests the "judicial Power of the United States" in "one supreme Court, and in such inferior Courts as the Congress may from time to time ordain and establish." [Art. III, § 1](#). The judges of those courts are entitled to hold their offices "during good Behaviour" and to receive compensation "which shall not be diminished" during their tenure. *Ibid*. The judicial power extends "to all Cases, in Law and Equity, arising under this Constitution, the Laws of the United States, and Treaties" and to other enumerated matters. [Art. III, § 2](#). Taken together, these provisions define the constitutional birthright of [Article III](#) judges: to "render dispositive judgments" in cases or controversies within the

bounds of federal jurisdiction. *Plaut*, 514 U.S., at 219, 115 S.Ct. 1447 (internal quotation marks omitted).

With narrow exceptions, Congress may not confer power to decide federal cases and controversies upon judges who do not comply with the structural safeguards of Article III. Those narrow exceptions permit Congress to establish non-Article III courts to exercise general jurisdiction in the territories *690 and the District of Columbia, to serve as military tribunals, and to adjudicate disputes over “public rights” such as veterans’ benefits. *Northern Pipeline*, 458 U.S., at 64–70, 102 S.Ct. 2858 (plurality opinion).

Our precedents have also recognized an exception to the requirements of Article III for certain bankruptcy proceedings. When the Framers gathered to draft the Constitution, English statutes had long empowered nonjudicial bankruptcy “commissioners” to collect a debtor’s property, resolve claims by creditors, order the distribution of assets in the estate, and ultimately discharge the debts. See 2 W. Blackstone, Commentaries *471–488. This historical practice, combined with Congress’s constitutional authority to enact bankruptcy laws, confirms that Congress may assign to non-Article III courts adjudications involving “the restructuring of debtor-creditor relations, which is at the core of the federal bankruptcy power.” *Northern Pipeline*, 458 U.S., at 71, 102 S.Ct. 2858 (plurality opinion).

Although Congress may assign some bankruptcy proceedings to non-Article III courts, there are limits on that power. In *Northern Pipeline*, the Court invalidated statutory provisions that permitted a bankruptcy court to enter final judgment on a creditor’s state law claim for breach of contract. Because that claim arose not from the bankruptcy but from independent common law sources, a majority of the Court determined that Article III required an adjudicator with life tenure and salary protection. See *id.*, at 84, 102 S.Ct. 2858; *id.*, at 90–91, 102 S.Ct. 2858 (Rehnquist, J., concurring in judgment).

Congress responded to *Northern Pipeline* by allowing bankruptcy courts to render final judgments only in “core” bankruptcy proceedings. 28 U.S.C. § 157(b). Those judgments may be appealed to district courts and reviewed under deferential standards. § 158(a). In non-core proceedings, bankruptcy judges may submit proposed **1952 findings of fact and conclusions of law, which the district court must review *de novo* before entering final judgment. § 157(c)(1).

*691 In *Stern*, we faced the question whether a bankruptcy court could enter final judgment on an action defined by Congress as a “core” proceeding—an estate’s counterclaim against a creditor based on state tort law. § 157(b)(2)(C). We said no. Because the tort claim neither “stem[med] from the bankruptcy itself” nor would “necessarily be resolved in the claims allowance process,” it fell outside the recognized exceptions to Article III. 564 U.S., at —, 131 S.Ct., at 2618. Like the contract claim in *Northern Pipeline*, the tort claim in *Stern* involved “the stuff of the traditional actions at common law tried by the courts at Westminster in 1789.” *Id.*, at —, 131 S.Ct., at 2609 (quoting *Northern Pipeline*, 458 U.S., at 90, 102 S.Ct. 2858 (Rehnquist, J., concurring in judgment)). Congress had no power under the Constitution to assign the resolution of such a claim to a judge who lacked the structural protections of Article III.

B

The question here is whether the claim Wellness submitted to the Bankruptcy Court is a “*Stern* claim” that requires final adjudication by an Article III court. See *Executive Benefits Ins. Agency v. Arkison*, 573 U.S. —, — – —, 134 S.Ct. 2165, 2172–2173 (2014) (assuming without deciding that a fraudulent conveyance action is a “*Stern* claim”). As the Court recounts, Wellness alleged that Sharif had concealed about \$5 million of assets by claiming that they were owned by a trust. Wellness sought a declaratory judgment that the trust was in fact Sharif’s alter ego and that its assets should accordingly be part of his bankruptcy estate. The Bankruptcy Court granted final judgment (based on Sharif’s default) to Wellness, declaring that the trust assets were part of Sharif’s estate because he had treated them as his own property. *Ante*, at 1940 – 1941.

In my view, Article III likely poses no barrier to the Bankruptcy Court’s resolution of Wellness’s claim. At its most basic level, bankruptcy is “an adjudication of interests claimed in a *res*.” *Katchen v. Landy*, 382 U.S. 323, 329, 86 S.Ct. 467, 15 L.Ed.2d 391 (1966) (internal quotation marks omitted). Wellness asked *692 the Bankruptcy Court to declare that assets held by Sharif are part of that *res*. Defining what constitutes the estate is the necessary starting point of every bankruptcy; a court cannot divide up the estate without first knowing what’s in it. See 11 U.S.C. § 541(a). As the Solicitor General explains, “Identifying the property of the estate is therefore inescapably central to the restructuring of

the debtor-creditor relationship.” Brief for United States as *Amicus Curiae* 14.

Identifying property that constitutes the estate has long been a central feature of bankruptcy adjudication. English bankruptcy commissioners had authority not only to collect property in the debtor's possession, but also to “cause any house or tenement of the bankrupt to be broken open,” in order to uncover and seize property the debtor had concealed. 2 W. Blackstone, Commentaries *485. America's first bankruptcy statute, enacted by Congress in 1800, similarly gave commissioners “power to take into their possession, all the estate, real and personal, of every nature and description to which the [debtor] may be entitled, either in law or equity, in any manner whatsoever.” § 5, 2 Stat. 23. That is peculiarly a bankruptcy power.

The Bankruptcy Act of 1898 provides further support for Wellness's position. Under that Act, bankruptcy referees had ****1953** authority to exercise “summary” jurisdiction over certain claims, while other claims could only be adjudicated in “plenary” proceedings before an [Article III](#) district court. See [Arkison](#), 573 U.S., at ———, 134 S.Ct., at 2170. This Court interpreted the 1898 Act to permit bankruptcy referees to exercise summary jurisdiction to determine whether property in the actual or constructive possession of a debtor should come within the estate, at least when no third party asserted more than a “merely colorable” claim to the property. [Mueller v. Nugent](#), 184 U.S. 1, 15, 22 S.Ct. 269, 46 L.Ed. 405 (1902). In the legal parlance of the times, a “merely colorable” claim was one that existed “in appearance only, and not in reality.” Black's Law Dictionary ***693** 223 (1891). So a bankruptcy referee could exercise summary jurisdiction over property in the debtor's possession as long as no third party asserted a “substantial adverse” claim. [Taubel–Scott–Kitzmillier Co. v. Fox](#), 264 U.S. 426, 431–433, 44 S.Ct. 396, 68 L.Ed. 770 (1924).

Here, Sharif does not contest that he held legal title to the assets in the trust. Assuming that no third party asserted a substantial adverse claim to those assets—an inquiry for the Bankruptcy Court on remand—Wellness's alter ego claim fits comfortably into the category of cases that bankruptcy referees could have decided by themselves under the 1898 Act.

In [Mueller](#), for example, this Court held that a bankruptcy referee could exercise summary jurisdiction over property in the possession of a third party acting as the debtor's agent.

184 U.S., at 14–17, 22 S.Ct. 269; see Black's Law Dictionary 302 (10th ed. 2014) (example of a merely “colorable” claim is “one made by a person holding property as an agent or bailee of the bankrupt”). Similarly, this Court held that a bankruptcy referee could exercise summary jurisdiction over a creditor's claim that the debtor had concealed assets under the veil of a corporate entity that was “nothing but a sham and a cloak.” [Sampsell v. Imperial Paper & Color Corp.](#), 313 U.S. 215, 216–217, 61 S.Ct. 904, 85 L.Ed. 1293 (1941) (internal quotation marks omitted), rev'g 114 F.2d 49, 52 (C.A.9 1940) (describing creditor's claim that corporation was debtor's “alter ego”). As the Court explained in [Sampsell](#), the “legal existence of the affiliated corporation” did not automatically require a plenary proceeding, because “[m]ere legal paraphernalia will not suffice to transform into a substantial adverse claimant a corporation whose affairs are so closely assimilated to the affairs of the dominant stockholder that in substance it is little more than his corporate pocket.” 313 U.S., at 218, 61 S.Ct. 904. Just as the bankruptcy referee in that case had authority to decide whether assets allegedly concealed behind the corporate veil belonged to the bankruptcy estate, the Bankruptcy Court ***694** here had authority to decide whether the assets allegedly concealed in the trust belonged to Sharif's estate.

Sharif contends that Wellness's alter ego claim is more like an allegation of a fraudulent conveyance, which this Court has implied must be adjudicated by an [Article III](#) court. See [Granfinanciera, S.A. v. Nordberg](#), 492 U.S. 33, 56, 109 S.Ct. 2782, 106 L.Ed.2d 26 (1989); [Arkison](#), 573 U.S., at ———, 134 S.Ct., at 2172–2173. Although both actions aim to remedy a debtor's deception, they differ in a critical respect. A fraudulent conveyance claim seeks assets in the hands of a third party, while an alter ego claim targets only the debtor's “second self.” Webster's New International Dictionary 76 (2d ed. 1954). That distinction is significant given bankruptcy's historic domain over property within the actual or constructive “possession [of] the bankrupt at the time of the filing of the petition.” ****1954** [Thompson v. Magnolia Petroleum Co.](#), 309 U.S. 478, 481, 60 S.Ct. 628, 84 L.Ed. 876 (1940). Through a fraudulent conveyance, a dishonest debtor *relinquishes* possession of assets before filing for bankruptcy. Reclaiming those assets for the estate requires depriving third parties of property within their otherwise lawful possession and control, an action that “quintessentially” required a suit at common law. [Granfinanciera](#), 492 U.S., at 56, 109 S.Ct. 2782. By contrast, a debtor's possession of property provided “an adequate basis” for a bankruptcy referee to adjudicate a dispute over

title in a summary proceeding. *Thompson*, 309 U.S., at 482, 60 S.Ct. 628; see *Mueller*, 184 U.S., at 15–16, 22 S.Ct. 269 (distinguishing claim to property in possession of debtor's agent from fraudulent conveyance claim in determining that bankruptcy referee could exercise summary jurisdiction).

In sum, unlike the fraudulent conveyance claim in *Granfinanciera*, Wellness's alter ego claim alleges that assets within Sharif's actual or constructive possession belong to his estate. And unlike the breach of contract and tort claims at issue in *Northern Pipeline* and *Stern*, Wellness's claim stems not from any independent source of law but “from the bankruptcy itself.” *Stern*, 564 U.S., at —, 131 S.Ct., at 2618. Provided *695 that no third party asserted a substantial adverse claim to the trust assets, Wellness's claim therefore falls within the narrow historical exception that permits a non-Article III adjudicator in certain bankruptcy proceedings. I would reverse the contrary holding by the Court of Appeals and end our inquiry there, rather than deciding a broader question that may not be necessary to the disposition of this case.

II

The Court “expresses no view” on whether Wellness's claim was a *Stern* claim. *Ante*, at 1942, n. 7. Instead, the Court concludes that the Bankruptcy Court had constitutional authority to enter final judgment on Wellness's claim either way. The majority rests its decision on Sharif's purported consent to the Bankruptcy Court's adjudication. But Sharif has no authority to compromise the structural separation of powers or agree to an exercise of judicial power outside Article III. His consent therefore cannot cure a constitutional violation.

A

“[I]f there is a principle in our Constitution ... more sacred than another,” James Madison said on the floor of the First Congress, “it is that which separates the Legislative, Executive, and Judicial powers.” 1 Annals of Cong. 581 (1789). A strong word, “sacred.” Madison was the principal drafter of the Constitution, and he knew what he was talking about. By diffusing federal powers among three different branches, and by protecting each branch against incursions from the others, the Framers devised a structure of government that promotes both liberty and accountability.

See *Bond v. United States*, 564 U.S. —, — — —, 131 S.Ct. 2355, 2364–2365, 180 L.Ed.2d 269 (2011); *Free Enterprise Fund v. Public Company Accounting Oversight Bd.*, 561 U.S. 477, 497–501, 130 S.Ct. 3138, 177 L.Ed.2d 706 (2010) (*PCAOB*); *Youngstown Sheet & Tube Co. v. Sawyer*, 343 U.S. 579, 635, 72 S.Ct. 863, 96 L.Ed. 1153 (1952) (Jackson, J., concurring).

*696 Preserving the separation of powers is one of this Court's most weighty responsibilities. In performing that duty, we have not hesitated to enforce the Constitution's mandate “that one branch of the Government may not intrude upon the central prerogatives of another.” **1955 *Loving v. United States*, 517 U.S. 748, 757, 116 S.Ct. 1737, 135 L.Ed.2d 36 (1996). We have accordingly invalidated executive actions that encroach upon the power of the Legislature, see *NLRB v. Noel Canning*, 573 U.S. —, 134 S.Ct. 2550, 189 L.Ed.2d 538 (2014); *Youngstown*, 343 U.S. 579, 72 S.Ct. 863, 96 L.Ed. 1153; legislative actions that invade the province of the Executive, see *PCAOB*, 561 U.S. 477, 130 S.Ct. 3138, 177 L.Ed.2d 706; *Bowsher v. Synar*, 478 U.S. 714, 106 S.Ct. 3181, 92 L.Ed.2d 583 (1986); *Chadha*, 462 U.S. 919, 103 S.Ct. 2764, 77 L.Ed.2d 317; *Myers v. United States*, 272 U.S. 52, 47 S.Ct. 21, 71 L.Ed. 160 (1926); and actions by either branch that trench upon the territory of the Judiciary, see *Stern*, 564 U.S. —, 131 S.Ct. 2594, 180 L.Ed.2d 475; *Plaut*, 514 U.S. 211, 115 S.Ct. 1447, 131 L.Ed.2d 328; *United States v. Will*, 449 U.S. 200, 101 S.Ct. 471, 66 L.Ed.2d 392 (1980); *United States v. Klein*, 13 Wall. 128, 20 L.Ed. 519 (1872); *Hayburn's Case*, 2 Dall. 409, 1 L.Ed. 436 (1792).

In these and other cases, we have emphasized that the values of liberty and accountability protected by the separation of powers belong not to any branch of the Government but to the Nation as a whole. See *Bowsher*, 478 U.S., at 722, 106 S.Ct. 3181. A branch's consent to a diminution of its constitutional powers therefore does not mitigate the harm or cure the wrong. “Liberty is always at stake when one or more of the branches seek to transgress the separation of powers.” *Clinton v. City of New York*, 524 U.S. 417, 450, 118 S.Ct. 2091, 141 L.Ed.2d 393 (1998) (KENNEDY, J., concurring). When the Executive and the Legislature agreed to bypass the Article I, § 7, requirements of bicameralism and presentment by creating a Presidential line-item veto—a very pragmatic proposal—the Court held that the arrangement violated the Constitution notwithstanding the voluntary participation of both branches. *Id.*, at 421, 118 S.Ct. 2091 (majority opinion). Likewise, the Court struck down a one-House “legislative veto” that violated Article I, § 7, even though Presidents

and Congresses had agreed to include similar provisions in hundreds of laws for more than 50 years. *Chadha*, 462 U.S., at 944–945, 103 S.Ct. 2764.

***697** In neither of these cases did the branches' willing embrace of a separation of powers violation weaken the Court's scrutiny. To the contrary, the branches' "enthusiasm" for the offending arrangements " 'sharpened rather than blunted' our review." *Noel Canning*, 573 U.S., at —, 134 S.Ct., at 2593 (SCALIA, J., concurring in judgment) (quoting *Chadha*, 462 U.S., at 944, 103 S.Ct. 2764). In short, because the structural provisions of the Constitution protect liberty and not just government entities, "the separation of powers does not depend on ... whether 'the encroached-upon branch approves the encroachment.' " *PCAOB*, 561 U.S., at 497, 130 S.Ct. 3138 (quoting *New York v. United States*, 505 U.S. 144, 182, 112 S.Ct. 2408, 120 L.Ed.2d 120 (1992)).

B

If a branch of the Federal Government may not consent to a violation of the separation of powers, surely a private litigant may not do so. Just as a branch of Government may not consent away the individual liberty interest protected by the separation of powers, so too an individual may not consent away the institutional interest protected by the separation of powers. To be sure, a private litigant may consensually relinquish *individual* constitutional rights. A federal criminal defendant, for example, may knowingly and voluntarily waive his Sixth Amendment right to a jury trial by pleading guilty to a charged offense. See *Brady v. United States*, 397 U.S. 742, 748, 90 S.Ct. 1463, 25 L.Ed.2d 747 (1970). But that same defendant may ****1956** not agree to stand trial on federal charges before a state court, a foreign court, or a moot court, because those courts have no constitutional authority to exercise judicial power over his case, and he has no power to confer it. A "lack of federal jurisdiction cannot be waived or be overcome by an agreement of the parties." *Mitchell v. Maurer*, 293 U.S. 237, 244, 55 S.Ct. 162, 79 L.Ed. 338 (1934).

As the majority recognizes, the Court's most extensive discussion of litigant consent in a separation of powers case occurred in ***698** *Commodity Futures Trading Comm'n v. Schor*, 478 U.S. 833, 106 S.Ct. 3245, 92 L.Ed.2d 675 (1986). There the Court held that *Article III* confers both a "personal right" that can be waived through consent and a structural component that "safeguards the role of the Judicial Branch in our tripartite system." *Id.*, at 848, 850, 106 S.Ct. 3245. "To

the extent that this structural principle is implicated in a given case, the parties cannot by consent cure the constitutional difficulty for the same reason that the parties by consent cannot confer on federal courts subject-matter jurisdiction beyond the limitations imposed by *Article III*." *Id.*, at 850–851, 106 S.Ct. 3245. Thus, when "*Article III* limitations are at issue, notions of consent and waiver cannot be dispositive because the limitations serve institutional interests that the parties cannot be expected to protect." *Id.*, at 851, 106 S.Ct. 3245.

Schor's holding that a private litigant can consent to an *Article III* violation that affects only his "personal right" has been vigorously contested. See *id.*, at 867, 106 S.Ct. 3245 (Brennan, J., dissenting) ("Because the individual and structural interests served by *Article III* are coextensive, I do not believe that a litigant may ever waive his right to an *Article III* tribunal where one is constitutionally required"); *Granfinanciera*, 492 U.S., at 70, 109 S.Ct. 2782 (SCALIA, J., concurring in part and concurring in judgment). But whatever the merits of that position, nobody disputes that *Schor* forbids a litigant from consenting to a constitutional violation when the structural component of *Article III* "*is implicated*." 478 U.S., at 850–851, 106 S.Ct. 3245. Thus, the key inquiry in this case—as the majority puts it—is "whether allowing bankruptcy courts to decide *Stern* claims by consent would 'impermissibly threaten the institutional integrity of the Judicial Branch.' " *Ante*, at 1944 (quoting *Schor*, 478 U.S., at 851, 106 S.Ct. 3245; alteration omitted).

One need not search far to find the answer. In *Stern*, this Court applied the analysis from *Schor* to bankruptcy courts and concluded that they lack *Article III* authority to enter final judgments on matters now known as *Stern* claims. The Court noted that bankruptcy courts, unlike the administrative agency in *Schor*, were endowed by Congress with ***699** "substantive jurisdiction reaching any area of the *corpus juris*," power to render final judgments enforceable without any action by *Article III* courts, and authority to adjudicate counterclaims entirely independent of the bankruptcy itself. 564 U.S., at —, —, 131 S.Ct., at 2613–2616. The Court concluded that allowing Congress to bestow such authority on non-*Article III* courts would "compromise the integrity of the system of separated powers and the role of the Judiciary in that system." *Id.*, at —, 131 S.Ct., at 2620. If there was any room for doubt about the basis for its holding, the Court dispelled it by asking a question: "Is there really a threat to the separation of powers where Congress has conferred the judicial power outside *Article III* only over

certain counterclaims in bankruptcy?” *Id.*, at —, 131 S.Ct., at 2620. “The short but emphatic answer is yes.” *Ibid.*

****1957** In other words, allowing bankruptcy courts to decide *Stern* claims by consent would “impermissibly threaten the institutional integrity of the Judicial Branch.” *Ante*, at 1944 (internal quotation marks and alteration omitted). It is little wonder that the Court of Appeals felt itself bound by *Stern* and *Schor* to hold that Sharif’s consent could not cure the *Stern* violation. 727 F.3d 751, 771 (C.A.7 2013). Other Courts of Appeals have adopted the same reading. See *In re BP RE, L.P.*, 735 F.3d 279, 287 (C.A.5 2013); *Waldman v. Stone*, 698 F.3d 910, 917–918 (C.A.6 2012).

The majority attempts to avoid this conclusion through an imaginative reconstruction of *Stern*. As the majority sees it, *Stern* “turned on the fact that the litigant ‘did not truly consent to’ resolution of the claim” against him in the Bankruptcy Court. *Ante*, at 1946 (quoting 564 U.S., at —, 131 S.Ct., at 2614). That is not a proper reading of the decision. The constitutional analysis in *Stern*, spanning 22 pages, contained exactly one affirmative reference to the lack of consent. See *ibid.* That reference came amid a long list of factors distinguishing the proceeding in *Stern* from the proceedings in *Schor* and other “public rights” cases. 564 U.S., at — —, 131 S.Ct., at 2614–2616. *Stern*’s subsequent sentences made clear that the notions of consent relied ***700** upon by the Court in *Schor* did not apply in bankruptcy because “creditors lack an alternative forum to the bankruptcy court in which to pursue their claims.” 564 U.S., at —, 131 S.Ct., at 2615 (quoting *Granfinanciera*, 492 U.S., at 59, n. 14, 109 S.Ct. 2782). Put simply, the litigant in *Stern* did not consent because he *could not* consent given the nature of bankruptcy.

There was an opinion in *Stern* that turned heavily on consent: the dissent. 564 U.S., at — —, 131 S.Ct., at 2627–2629 (opinion of BREYER, J.). The *Stern* majority responded to the dissent with a counterfactual: *Even if* consent were relevant to the analysis, that factor would not change the result because the litigant did not truly consent. *Id.*, at — —, 131 S.Ct., at 2614–2616. Moreover, *Stern* held that “it does not matter who” authorizes a bankruptcy judge to render final judgments on *Stern* claims, because the “constitutional bar remains.” *Id.*, at —, 131 S.Ct., at 2619. That holding is incompatible with the majority’s conclusion today that two litigants can authorize a bankruptcy judge to render final judgments on *Stern* claims, despite the constitutional bar that remains.

The majority also relies heavily on the supervision and control that **Article III** courts exercise over bankruptcy courts. *Ante*, at 1944 – 1946. As the majority notes, court of appeals judges appoint bankruptcy judges, and bankruptcy judges receive cases only on referral from district courts (although every district court in the country has adopted a standing rule automatically referring all bankruptcy filings to bankruptcy judges, see 1 Collier on Bankruptcy ¶ 3.02[1], p. 3–26 (16th ed. 2014)). The problem is that Congress has also given bankruptcy courts authority to enter final judgments subject only to deferential appellate review, and **Article III** precludes those judgments when they involve *Stern* claims. The fact that **Article III** judges played a role in the **Article III** violation does not remedy the constitutional harm. We have already explained why.

It is a fundamental principle that no branch of government can delegate its constitutional functions to an actor who lacks ***701** authority to exercise those functions. See *Whitman v. American Trucking Assns., Inc.*, 531 U.S. 457, 472, 121 S.Ct. 903, 149 L.Ed.2d 1 (2001); *Carter v. Carter Coal Co.*, 298 U.S. 238, 311, 56 S.Ct. 855, 80 L.Ed. 1160 (1936). Such delegations ****1958** threaten liberty and thwart accountability by empowering entities that lack the structural protections the Framers carefully devised. See *Department of Transportation v. Association of American Railroads*, 575 U.S. —, — —, 135 S.Ct. 1225, 1236–1238, 191 L.Ed.2d 153 (2015) (ALITO, J., concurring); *id.*, at — —, 135 S.Ct., at 1240–1241 (THOMAS, J., concurring in judgment); *Mistretta v. United States*, 488 U.S. 361, 417–422, 109 S.Ct. 647, 102 L.Ed.2d 714 (1989) (SCALIA, J., dissenting). **Article III** judges have no constitutional authority to delegate the judicial power—the power to “render dispositive judgments”—to non-**Article III** judges, no matter how closely they control or supervise their work. *Plaut*, 514 U.S., at 219, 115 S.Ct. 1447 (internal quotation marks omitted).

In any event, the majority’s arguments about supervision and control are not new. They were considered and rejected in *Stern*. See 564 U.S., at —, 131 S.Ct., at 2619 (“it does not matter who appointed the bankruptcy judge or authorized the judge to render final judgments”); see also *Northern Pipeline*, 458 U.S., at 84–86, 102 S.Ct. 2858 (plurality opinion); *id.*, at 91, 102 S.Ct. 2858 (Rehnquist, J., concurring in judgment). The majority points to no differences between the bankruptcy proceeding in *Stern* and the bankruptcy proceeding here, except for Sharif’s purported consent. The majority thus treats consent as “dispositive” in curing the structural separation of

powers violation—precisely what *Schor* said consent could not do. 478 U.S., at 851, 106 S.Ct. 3245.

C

Eager to change the subject from *Stern*, the majority devotes considerable attention to defending the authority of magistrate judges, who may conduct certain proceedings with the consent of the parties under 28 U.S.C. § 636. No one here challenges the constitutionality of magistrate judges or disputes that they, like bankruptcy judges, may issue reports and recommendations that are reviewed *de novo* by Article III judges. The cases about magistrate judges cited by the majority therefore have little bearing on this case, because none of them involved a constitutional challenge to the entry of final judgment by a non-Article III actor. See *Roell v. Withrow*, 538 U.S. 580, 123 S.Ct. 1696, 155 L.Ed.2d 775 (2003) (statutory challenge only); *Peretz v. United States*, 501 U.S. 923, 111 S.Ct. 2661, 115 L.Ed.2d 808 (1991) (challenge to a magistrate judge's conduct of *voir dire* in a felony trial); *Gomez v. United States*, 490 U.S. 858, 109 S.Ct. 2237, 104 L.Ed.2d 923 (1989) (same).

The majority also points to 19th-century cases in which courts referred disputes to non-Article III referees, masters, or arbitrators. *Ante*, at 1942. In those cases, however, it was the Article III court that ultimately entered final judgment. *E.g.*, *Thornton v. Carson*, 7 Cranch 596, 600, 3 L.Ed. 451 (1813) (“the Court was right in entering the judgment for the sums awarded”). Article III courts do refer matters to non-Article III actors for assistance from time to time. This Court does so regularly in original jurisdiction cases. See, *e.g.*, *Kansas v. Nebraska*, 574 U.S. —, —, 135 S.Ct. 1042, 1048–1049, 191 L.Ed.2d 1 (2015). But under the Constitution, the “ultimate responsibility for deciding” the case must remain with the Article III court. *Id.*, at —, 135 S.Ct., at 1051 (quoting *Colorado v. New Mexico*, 467 U.S. 310, 317, 104 S.Ct. 2433, 81 L.Ed.2d 247 (1984)).

The concurrence's comparison of bankruptcy judges to arbitrators is similarly inapt. *Ante*, at 1949 (opinion of ALITO, J.). Arbitration is “a matter of contract” by which parties agree to resolve their disputes in a private forum. *Rent-A-Center, West, Inc. v. Jackson*, 561 U.S. 63, 67, 130 S.Ct. 2772, 177 L.Ed.2d 403 (2010). Such an arrangement does not implicate Article III any more than does an agreement between two business partners to submit a difference of opinion to a mutually trusted friend. Arbitration

agreements, like most private contracts, can be enforced in court. And Congress, pursuant to its Commerce Clause power, has authorized district courts to enter judgments enforcing arbitration awards under certain circumstances. See 9 U.S.C. § 9. But this ordinary scheme of contract enforcement creates no constitutional concern. As the concurrence *703 acknowledges, only Article III judges—not arbitrators—may enter final judgments enforcing arbitration awards. *Ante*, at 1949.

The discussion of magistrate judges, masters, arbitrators, and the like fits with the majority's focus on the supposedly dire consequences that would follow a decision that parties cannot consent to the final adjudication of *Stern* claims in bankruptcy courts. Of course, it “goes without saying” that practical considerations of efficiency and convenience cannot trump the structural protections of the Constitution. *Stern*, 564 U.S., at —, 131 S.Ct., at 2619; see *Perez*, 575 U.S., at —, 135 S.Ct., at 1223–1224 (THOMAS, J., concurring in judgment) (“Even in the face of perceived necessity, the Constitution protects us from ourselves.”). And I find it hard to believe that the Framers in Philadelphia, who took great care to ensure that the Judiciary was “truly distinct” from the Legislature, would have been comforted to know that Congress's incursion here could “only be termed *de minimis*.” *Ante*, at 1945 (quoting *Schor*, 478 U.S., at 856, 106 S.Ct. 3245).

In any event, the majority overstates the consequences of enforcing the requirements of Article III in this case. As explained in Part I, Wellness's claim may not be a *Stern* claim, in which case the bankruptcy statute would apply precisely as Congress wrote it. Even if Wellness's claim were a *Stern* claim, the District Court would not need to start from scratch. As this Court held in *Arkison*, the District Court could treat the bankruptcy judge's decision as a recommendation and enter judgment after performing *de novo* review. 573 U.S., at —, 134 S.Ct., at 2170.

In *Stern*, the Court cautioned that Congress “may no more lawfully chip away at the authority of the Judicial Branch than it may eliminate it entirely.” 564 U.S., at —, 131 S.Ct., at 2620. The majority sees no reason to fret, however, so long as two private parties consent. *Ante*, at 1945 – 1946, n. 10. But such parties are unlikely to carefully weigh the long-term structural independence of the Article III judiciary against their own *704 short-term priorities. Perhaps the majority's acquiescence in this diminution of constitutional authority will escape notice. Far more likely, however, it will amount to the kind of “blueprint for extensive expansion of the

legislative power” that we have resisted in the past. *PCAOB*, 561 U.S., at 500, 130 S.Ct. 3138 (quoting *Metropolitan Washington Airports Authority v. Citizens for Abatement of Aircraft Noise, Inc.*, 501 U.S. 252, 277, 111 S.Ct. 2298, 115 L.Ed.2d 236 (1991)).

The encroachment at issue here may seem benign enough. Bankruptcy judges are devoted professionals who strive to be fair to all sides, and litigants can be trusted to protect their own interests when deciding whether to consent. But the fact remains that Congress controls the salary and tenure of bankruptcy judges, and the Legislature's present solicitude provides no guarantee of its future restraint. See ****1960** *Glidden Co. v. Zdanok*, 370 U.S. 530, 534, 82 S.Ct. 1459, 8 L.Ed.2d 671 (1962) (plurality opinion). Once Congress knows that it can assign federal claims to judges outside *Article III* with the parties' consent, nothing would limit its exercise of that power to bankruptcy. Congress may consider it advantageous to allow claims to be heard before judges subject to greater legislative control in any number of areas of federal concern. As for the requirement of consent, Congress can find ways to “encourage” consent, say by requiring it as a condition of federal benefits. That has worked to expand Congress's power before. See, e.g., *College Savings Bank v. Florida Prepaid Postsecondary Ed. Expense Bd.*, 527 U.S. 666, 686, 119 S.Ct. 2219, 144 L.Ed.2d 605 (1999) (“Congress may, in the exercise of its spending power, condition its grant of funds to the States upon their taking certain actions that Congress could not require them to take”); *South Dakota v. Dole*, 483 U.S. 203, 207, 107 S.Ct. 2793, 97 L.Ed.2d 171 (1987) (same).

Legislative designs of this kind would not displace the *Article III* judiciary overnight. But steady erosion of *Article III* authority, no less than a brazen usurpation, violates the constitutional separation of powers. In a Federal Government of limited powers, one branch's loss is another branch's ***705** gain, see *PCAOB*, 561 U.S., at 500, 130 S.Ct. 3138 so whether a branch aims to “arrogate power to itself” or to “impair another in the performance of its constitutional duties,” the Constitution forbids the transgression all the same. *Loving*, 517 U.S., at 757, 116 S.Ct. 1737. As we have cautioned, “[s]light encroachments create new boundaries from which legions of power can seek new territory to capture.” *Stern*, 564 U.S., at —, 131 S.Ct., at 2620 (internal quotation marks omitted).

The Framers understood this danger. They warned that the Legislature would inevitably seek to draw greater power

into its “impetuous vortex,” The Federalist No. 48, at 309 (J. Madison), and that “power over a man's subsistence amounts to a power over his will,” *id.*, No. 79, at 472 (A. Hamilton) (emphasis deleted). In response, the Framers adopted the structural protections of *Article III*, “establishing high walls and clear distinctions because low walls and vague distinctions will not be judicially defensible in the heat of interbranch conflict.” *Plaut*, 514 U.S., at 239, 115 S.Ct. 1447. As this Court once put it, invoking Frost, “Good fences make good neighbors.” *Id.*, at 240, 115 S.Ct. 1447.

Ultimately, however, the structural protections of *Article III* are only as strong as this Court's will to enforce them. In Madison's words, the “great security against a gradual concentration of the several powers in the same department consists in giving to those who administer each department the necessary constitutional means and personal motives to resist encroachments of the others.” The Federalist No. 51, at 321–322 (J. Madison). The Court today declines to resist encroachment by the Legislature. Instead it holds that a single federal judge, for reasons adequate to him, may assign away our hard-won constitutional birthright so long as two private parties agree. I hope I will be wrong about the consequences of this decision for the independence of the Judicial Branch. But for now, another literary passage comes to mind: It profits the Court nothing to give its soul for the whole world ... but to avoid *Stern* claims?

I respectfully dissent.

Justice THOMAS, dissenting.

706** Like THE CHIEF JUSTICE, I would have remanded this case to the lower courts to determine, under the proper standard, whether Wellness' alter-ego claim is a *Stern* claim. See *1961** *Stern v. Marshall*, 564 U.S. —, 131 S.Ct. 2594, 180 L.Ed.2d 475 (2011). I write separately to highlight a few questions touching on the consent issue that merit closer attention than either the Court or THE CHIEF JUSTICE gives them.

I agree with THE CHIEF JUSTICE that individuals cannot consent to violations of the Constitution, but this principle has nothing to do with whose interest the violated provision protects. Anytime the Federal Government acts in a manner inconsistent with the separation of powers, it acts in excess of its constitutional authority. That authority is carefully defined by the Constitution, and, except through *Article*

V's amendment process, that document does not permit individuals to bestow additional power upon the Government.

The majority today authorizes non-[Article III](#) courts to adjudicate, with consent, claims that we have held to require an exercise of the judicial power based on its assessment that few “structural interests” are implicated by consent to the adjudication of *Stern* claims. See *ante*, at 1941 – 1942, 1944. That reasoning is flawed. It matters not whether *we* think the particular violation threatens the structure of our Government. Our duty is to enforce the Constitution as written, not as revised by private consent, innocuous or otherwise. Worse, amidst the tempest over whether “structural interests” are implicated when an individual consents to adjudication of *Stern* claims by a non-[Article III](#) court, both the majority and THE CHIEF JUSTICE fail to grapple with the antecedent question: whether a violation of the Constitution has actually occurred. That question is a difficult one, and the majority makes a grave mistake by skipping over it in its quest to answer the question whether consent can authorize a constitutional violation. Because I would resolve this case on narrower [*707](#) grounds, I need not decide that question here. I nevertheless write separately to highlight the complexity of the issues the majority simply brushes past.

I

A

“The principle, that [the Federal Government] can exercise only the powers granted to it, ... is now universally admitted.” *McCulloch v. Maryland*, 4 Wheat. 316, 405, 4 L.Ed. 579 (1819). A corollary to this principle is that each branch of the Government is limited to the exercise of those powers granted to it. Every violation of the separation of powers thus involves an exercise of power in excess of the Constitution. And because the only authorities capable of granting power are the Constitution itself, and the people acting through the amendment process, individual consent cannot authorize the Government to exceed constitutional boundaries.

This does not mean, however, that consent is invariably irrelevant to the constitutional inquiry. Although it may not authorize a constitutional violation, consent may prevent one from occurring in the first place. This concept is perhaps best understood with the example on which the majority and THE CHIEF JUSTICE both rely: the right to a jury trial. *Ante*, at 1942 – 1943 (majority opinion); *ante*, at 1955 –

1956 (ROBERTS, C.J., dissenting).¹ ****1962** Although the Government incurably contravenes the Constitution when it acts in *violation* of the jury [*708](#) trial right, our precedents permit the Government to convict a criminal defendant without a jury trial when he waives that right. See *Brady v. United States*, 397 U.S. 742, 748, 90 S.Ct. 1463, 25 L.Ed.2d 747 (1970). The defendant's waiver is thus a form of consent that lifts a limitation on government action by satisfying its terms—that is, the right is exercised and honored, not disregarded. See *Patton v. United States*, 281 U.S. 276, 296–298, 50 S.Ct. 253, 74 L.Ed. 854 (1930), abrogated on other grounds by *Williams v. Florida*, 399 U.S. 78, 90 S.Ct. 1893, 26 L.Ed.2d 446 (1970). Provided the Government otherwise acts within its powers, there is no constitutional violation.

B

Consent to the adjudication of *Stern* claims by bankruptcy courts is a far more complex matter than waiver of a jury trial. Two potential violations of the separation of powers occur whenever bankruptcy courts adjudicate *Stern* claims. First, the bankruptcy courts purport to exercise power that the Constitution vests exclusively in the judiciary, even though they are not [Article III](#) courts because bankruptcy judges do not enjoy the tenure and salary protections required by [Article III](#). See *Art. III, § 1*. Second, the bankruptcy courts act pursuant to statutory authorization that is itself invalid. For even when acting pursuant to an enumerated power, such as the bankruptcy power, Congress exceeds its authority when it purports to authorize a person or entity to perform a function that requires the exercise of a power vested elsewhere by the Constitution. See *Whitman v. American Trucking Assns., Inc.*, 531 U.S. 457, 472, 121 S.Ct. 903, 149 L.Ed.2d 1 (2001).

Rather than attempt to grapple with these problems, the majority seizes on some statements from *Commodity Futures Trading Comm'n v. Schor*, 478 U.S. 833, 106 S.Ct. 3245, 92 L.Ed.2d 675 (1986), to resolve the difficult constitutional issue before us. See *ante*, at 1942 – 1944. But to the extent *Schor* suggests that individual consent could authorize non-[*709 Article III courts to exercise the judicial power](#), 478 U.S., at 850–851, 106 S.Ct. 3245 it was wrongly decided and should be abandoned. Consent to adjudication by non-[Article III](#) judges may waive whatever individual right to impartial adjudication [Article III](#) implies, thereby lifting that affirmative barrier on Government action. But non-[Article III](#) courts must still act within the bounds of their constitutional authority. That is, they must act through a power properly

delegated to the Federal Government and not vested by the Constitution in a different governmental actor. Because the judicial power is vested exclusively in [Article III](#) courts, non-[Article III](#) courts may not exercise it.

Schor's justification for authorizing such a transgression was that it judged the "practical effect [the allocation would] have on the constitutionally assigned role of the federal judiciary" not to be too great. *Id.*, at 851, 106 S.Ct. 3245. But we "can[not] preserve a system of separation of powers on the basis of such intuitive judgments regarding 'practical effects.'" *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 70, 109 S.Ct. 2782, 106 L.Ed.2d 26 (1989) (SCALIA, J., concurring in part and concurring in judgment). Put more starkly, "[t]o uphold" a violation of the Constitution because one perceives "the infraction assailed [a]s unimportant when compared **1963 with similar but more serious infractions which might be conceived ... is not to interpret that instrument, but to disregard it." *Patton, supra*, at 292, 50 S.Ct. 253. Our Constitution is not a matter of convenience, to be invoked when we feel uncomfortable with some Government action and cast aside when we do not. See *Perez v. Mortgage Bankers Assn.*, — U.S., at —, 135 S.Ct., at 1215 (THOMAS, J., concurring in judgment).

II

Properly understood, then, the answer to the consent question in this case depends on whether bankruptcy courts act within the bounds of their constitutional authority when they adjudicate *Stern* claims with the consent of the parties. In order to answer that question, we must consider what form of governmental power that type of adjudication requires and whether bankruptcy courts are qualified to exercise *710 that power. *Department of Transportation v. Association of American Railroads*, — U.S., at —, 135 S.Ct., at 1253 (THOMAS, J., concurring in judgment).

Many Government functions "may be performed by two or more branches without either exceeding its enumerated powers under the Constitution." *Ante*, at 1939–1940. Certain core functions, however, demand the exercise of legislative, executive, or judicial power, and their allocation is controlled by the Vesting Clauses contained in the first three articles of the Constitution. *Ibid*. We have already held that adjudicating *Stern* claims, at least *without* consent of the parties, requires an exercise of the judicial power vested exclusively in [Article III](#) courts. *Stern*, 564 U.S., at — —, 131 S.Ct., at 2614–

2616. The difficult question presented by this case, which the Court glosses over, is whether the parties' consent somehow transforms the nature of the power exercised.

A

As the concepts were understood at the time of the founding, the legislative, executive, and judicial powers played different roles in the resolution of cases and controversies. In this context, the judicial power is the power "to determine all differences according to the established law"; the legislative power is the power to make that "established law"; and the executive power is the power "to back and support the sentence, and to give it due execution." J. Locke, *Second Treatise of Civil Government* §§ 124–126, pp. 62–63 (J. Gough ed. 1947) (Locke); see also *Wayman v. Southard*, 10 Wheat. 1, 46, 6 L.Ed. 253 (1825).

It should be immediately apparent that consent does not transform the adjudication of *Stern* claims into a function that requires the exercise of legislative or executive power. Parties by their consent do not transform the function of adjudicating controversies into the functions of creating rules or enforcing judgments.

The more difficult question is whether consent somehow eliminates the need for an exercise of the judicial power.

*711 Our precedents reveal that the resolution of certain cases or controversies requires the exercise of that power, but that others "may or may not" be brought "within the cognizance of [[Article III](#) courts], as [Congress] deem[s] proper." *Murray's Lessee v. Hoboken Land & Improvement Co.*, 18 How. 272, 284, 15 L.Ed. 372 (1856). The distinction generally has to do with the types of rights at issue. Disposition of private rights to life, liberty, and property falls within the core of the judicial power, whereas disposition of public rights does not. From that core of the judicial power, we have identified two narrow historical exceptions. Those exceptions, along with **1964 the treatment of cases or controversies not falling within that core, provide useful guidance for understanding whether bankruptcy courts' adjudication of *Stern* claims with the consent of the parties requires the exercise of [Article III](#) judicial power.

Under our precedents, the three categories of cases that may be adjudicated by [Article III](#) courts but that do not demand the exercise of the judicial power are those arising in the territories, those arising in the Armed Forces, and those involving public-rights disputes. *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 63–67, 102 S.Ct. 2858, 73 L.Ed.2d 598 (1982) (plurality opinion).

The first two represent unique historical exceptions that tell us little about the overall scope of the judicial power. From an early date, this Court has long upheld laws authorizing the adjudication of cases arising in the territories in non-[Article III](#) “territorial courts” on the ground that such courts exercise power “conferred by Congress, in the execution of those general powers which [Congress] possesses over the territories of the United States.” *American Ins. Co. v. 356 Bales of Cotton*, 1 Pet. 511, 546, 7 L.Ed. 242 (1828) (*Canter*).² And ***712** the Court has upheld laws authorizing the adjudication of cases arising in the Armed Forces in non-[Article III](#) courts-martial, inferring from a constellation of constitutional provisions that Congress has the power to provide for the adjudication of disputes among the Armed Forces it creates and that [Article III](#) extends only to *civilian* judicial power. *Dynes v. Hoover*, 20 How. 65, 78–79, 15 L.Ed. 838 (1858). Whatever their historical validity, these precedents exempt cases arising in the territories and in the land and naval forces from [Article III](#) because of other provisions of the Constitution, not because of the definition of judicial power in [Article III](#) itself. See Nelson, *Adjudication in the Political Branches*, 107 Colum. L. Rev. 559, 576 (2007) (noting that both exceptions enjoy “special textual rationales that d[o] not spill over into other areas”).

The third category consists of so-called “public rights” cases. Unlike the other two categories, which reflect carve-outs from the core of the judicial power, this category describes cases outside of that core and therefore has more to tell us about the scope of the judicial power.

713** The distinction between disputes involving “public rights” and those involving “private rights” is longstanding, but the *1965** contours of the “public rights” doctrine have been the source of much confusion and controversy. See generally *Granfinanciera*, 492 U.S., at 66–70, 109 S.Ct. 2782 (opinion of SCALIA, J.) (tracing the evolution of the doctrine). Our cases attribute the doctrine to this Court’s mid-19th century decision, *Murray’s Lessee*, *supra*. In that case, the Court observed that there are certain cases addressing “public rights, which may be presented in such form that the

judicial power is capable of acting on them, and which are susceptible of judicial determination, but which congress may or may not bring within the cognizance of the courts of the United States, as it may deem proper.” *Id.*, at 284 (emphasis added).

Historically, “public rights” were understood as “rights belonging to the people at large,” as distinguished from “the private unalienable rights of each individual.” *Lansing v. Smith*, 4 Wend. 9, 21 (N.Y.1829) (Walworth, C.). This distinction is significant to our understanding of [Article III](#), for while the legislative and executive branches may dispose of public rights at will—including through non-[Article III](#) adjudications—an exercise of the judicial power is required “when the government want[s] to act authoritatively upon core private rights that had vested in a particular individual.” Nelson, *supra*, at 569; see *B & B Hardware, Inc. v. Hargis Industries, Inc.*, —U.S., at —, 135 S.Ct., at 1316 (THOMAS, J., dissenting).

The distinction was well known at the time of the founding. In the tradition of John Locke, William Blackstone in his *Commentaries* identified the private rights to life, liberty, and property as the three “absolute” rights—so called because they “appertain[ed] and belong[ed] to particular men ... merely as individuals,” not “to them as members of society [or] standing in various relations to each other”—that is, not dependent upon the will of the government. 1 W. Blackstone, *Commentaries on the Laws of England* 119 ***714** (1765) (*Commentaries*); see also Nelson, *supra*, at 567.³ Public rights, by contrast, belonged to “the whole community, considered as a community, in its social aggregate capacity.” 4 *Commentaries* 5 (1769); see also Nelson, *supra*, at 567. As the modern doctrine of the separation of powers emerged, “the courts became identified with the enforcement of private right, and administrative agencies with the execution of public policy.” Jaffe, *The Right to Judicial Review I*, 71 Harv. L. Rev. 401, 413 (1958).

The Founders carried this idea forward into the Vesting Clauses of our Constitution. Those Clauses were understood to play a role in ensuring that the federal courts alone could act to deprive individuals of private rights because the power to act conclusively against those rights was the core of the judicial power. As one early treatise explained, the judiciary is “that department of the government to whom the protection of the rights of the individual is by the constitution especially confided.” 1 St. George Tucker, *Blackstone’s Commentaries*, App. 357 (1803). If “public rights” were not

thought to fall within the core of the judicial power, then that could explain why Congress would be able to perform or authorize non-Article III adjudications of public rights without transgressing Article III's Vesting Clause.

****1966** Nineteenth-century American jurisprudence confirms that an exercise of the judicial power was thought to be necessary for the disposition of private, but not public, rights.⁴ See ***715** *B & B Hardware*, — U.S., at —, 135 S.Ct., at 1316–1317. The treatment of land patents illustrates the point well: Although Congress could authorize executive agencies to dispose of *public* rights in land—often by means of adjudicating a claimant's qualifications for a land grant under a statute—the United States had to go to the courts if it wished to revoke a patent. See generally Nelson, 107 Colum. L. Rev., at 577–578 (discussing land patents). That differential treatment reflected the fact that, once “legal title passed out of the United States,” the patent “[u]ndoubtedly” constituted “a vested right” and consequently could “only be divested according to law.” *Johnson v. Towsley*, 13 Wall. 72, 84–85, 20 L.Ed. 485 (1871). By contrast, a party who sought to protect only a “public right” in the land had no such vested right and could not invoke the intervention of Article III courts. See *Smelting Co. v. Kemp*, 104 U.S. 636, 647, 26 L.Ed. 875 (1882) (“It does not lie in the mouth of a stranger to the title to complain of the act of the government with respect to it”); see also *Bagnell v. Broderick*, 13 Pet. 436, 450, 10 L.Ed. 235 (1839) (refusing to examine the propriety of a land patent on the ground that “Congress has the sole power to declare the dignity and effect of titles emanating from the United States”).

Over time, the line between public and private rights has blurred, along with the Court's treatment of the judicial power. See *B & B Hardware*, — U.S., at — – —, —, 135 S.Ct., at 1315–1316, 1316–1317. The source of the confusion may be *Murray's Lessee*—the ***716** putative source of the public rights doctrine itself. Dictum in the case muddles the distinction between private and public rights, and the decision is perhaps better read as an expression of the principle of sovereign immunity. *Granfinanciera*, 492 U.S., at 68–69, 109 S.Ct. 2782 (opinion of SCALIA, J.).⁵ Some cases appear to have done just that, thus reading *Murray's Lessee* to apply only in ****1967** disputes arising between the Government and others. See, e.g., *Crowell v. Benson*, 285 U.S. 22, 50, 52 S.Ct. 285, 76 L.Ed. 598 (1932).

Another strain of cases has confused the distinction between private and public rights, with some cases treating public

rights as the equivalent of private rights entitled to full judicial review, *American School of Magnetic Healing v. McAnnulty*, 187 U.S. 94, 108, 23 S.Ct. 33, 47 L.Ed. 90 (1902), and others treating what appear to be private rights as public rights on which executive action could be conclusive, see, e.g., *Sunshine Anthracite Coal Co. v. Adkins*, 310 U.S. 381, 401–404, 60 S.Ct. 907, 84 L.Ed. 1263 (1940); see also *B & B Hardware*, — U.S., at —, 135 S.Ct., at 1304 (observing that *Sunshine Anthracite* may reflect a unique historical exception for tax cases). Cf. *Northern Pipeline*, 458 U.S., at 84–85, 102 S.Ct. 2858 (plurality opinion) (discussing other cases that appear to reflect the historical distinction between private rights and rights created by Congress). Perhaps this confusion explains why the Court has more recently expanded the concept of public rights to include any right “so closely integrated into a public regulatory scheme as to be a matter appropriate for agency ***717** resolution with limited involvement by the Article III judiciary.” *Thomas v. Union Carbide Agricultural Products Co.*, 473 U.S. 568, 593–594, 105 S.Ct. 3325, 87 L.Ed.2d 409 (1985). A return to the historical understanding of “public rights,” however, would lead to the conclusion that the inalienable core of the judicial power vested by Article III in the federal courts is the power to adjudicate *private* rights disputes.

2

Although Congress did not enact a permanent federal bankruptcy law until the late 19th century, it has assigned the adjudication of certain bankruptcy disputes to non-Article III actors since as early as 1800. Plank, *Why Bankruptcy Judges Need Not and Should Not Be Article III Judges*, 72 Am. Bankr. L. J. 567, 608 (1998) (describing the bankruptcy powers vested by Congress in non-Article III judges). Modern bankruptcy courts, however, adjudicate a far broader array of disputes than their earliest historical counterparts. And this Court has remained carefully noncommittal about the source of their authority to do so. See *Northern Pipeline*, 458 U.S., at 71, 102 S.Ct. 2858 (plurality opinion).

Applying the historical categories of cases discussed above, one can understand why. Bankruptcy courts clearly do not qualify as territorial courts or courts-martial, but they are not an easy fit in the “public rights” category, either. No doubt certain aspects of bankruptcy involve rights lying outside the core of the judicial power. The most obvious of these is the right to discharge, which a party may obtain if he satisfies certain statutory criteria. *Ibid.* Discharge is

not itself a private right, but, together with the claims allowance process that precedes it, it can act conclusively on the core private rights of the debtor's creditors. We have nevertheless implicitly recognized that the claims allowance process may proceed in a bankruptcy court, as can any matter that would necessarily be resolved by that process, even one that affects core private rights. ***718** *Stern*, 564 U.S., at ———, 131 S.Ct., at 2616–2617. For this reason, bankruptcy courts and their predecessors more likely enjoy a unique, textually based exception, much like territorial courts and courts-martial do. See *id.*, at ———, 131 S.Ct., at 2621 (SCALIA, J., concurring). That is, Article I's Bankruptcy Clause serves to carve cases and controversies traditionally subject to resolution by bankruptcy commissioners out of [Article III](#), giving Congress ****1968** the discretion, within those historical boundaries, to provide for their resolution outside of [Article III](#) courts.

3

Because *Stern* claims by definition fall outside of the historical boundaries of the bankruptcy carve-out, they are subject to [Article III](#). This means that, if their adjudication requires the exercise of the judicial power, then only [Article III](#) courts may perform it.

Although *Stern* claims indisputably involve private rights, the “public rights” doctrine suggests a way in which party consent may transform the function of adjudicating *Stern* claims into one that does not require the exercise of the judicial power. The premise of the “public rights” doctrine, as described above, is not that public rights affirmatively require adjudication by some other governmental power, but that the Government has a freer hand when private rights are not at issue. Accordingly, this premise may not require the presence of a public right at all, but may apply equally to any situation in which private rights are not asserted.

Party consent, in turn, may have the effect of lifting that “private rights” bar, much in the way that waiver lifts the bar imposed by the right to a jury trial. Individuals may dispose of their own private rights freely, without judicial intervention. A party who consents to adjudication of a *Stern* claim by a bankruptcy court is merely making a conditional surrender of whatever private right he has on the line, contingent on some future event—namely, that the bankruptcy court rules against him. Indeed, it is on this logic ***719** that the law has long encouraged and permitted private settlement of disputes,

including through the action of an arbitrator not vested with the judicial power. See *ante*, at 1949 (ALITO, J., concurring in part and concurring in judgment); T. Cooley, Constitutional Limitations 399 (1868). Perhaps for this reason, decisions discussing the relationship between private rights and the judicial power have emphasized the “*involuntary* divestiture” of a private right. *Newland v. Marsh*, 19 Ill. 376, 382–383 (1857) (emphasis added).

But all of this does not necessarily mean that the majority has [wound](#) up in the right place by the wrong path. Even if consent could lift the private-rights barrier to non-judicial Government action, it would not necessarily follow that consent removes the *Stern* adjudication from the core of the judicial power. There may be other aspects of the adjudication that demand the exercise of the judicial power, such as entry of a final judgment enforceable without any further action by an [Article III](#) court. We have recognized that judgments entered by [Article III](#) courts bear unique qualities that spring from the exercise of the judicial power, *Plaut v. Spendthrift Farm, Inc.*, 514 U.S. 211, 218–219, 115 S.Ct. 1447, 131 L.Ed.2d 328 (1995), and it may be that the entry of a final judgment bearing these qualities—irrespective of the subject matter of the dispute—is a quintessential judicial function. See *ante*, at 1958 – 1959 (ROBERTS, C.J., dissenting). See generally *Northern Pipeline*, *supra*, at 85–86, and *n. 38*, 102 S.Ct. 2858 (plurality opinion) (distinguishing the agency orders at issue in *Crowell* from bankruptcy court orders on this ground). As Thomas Cooley explained in his influential treatise, “If the judges should sit to hear ... controversies [beyond their cognizance], they would not sit as a court; at the most they would be arbitrators only, and their ... decision could not be binding as a judgment, but only as an award.” Cooley, *supra*, at 399.⁶

720** *1969** Ultimately, this case implicates difficult questions about the nature of bankruptcy procedure, judicial power, and remedies. In particular, if we were to determine that current practice accords bankruptcy court judgments a feature that demands the exercise of the judicial power, would that mean that all bankruptcy judgments resolving *Stern* claims are void, or only that courts may not give effect to that single feature that triggers Article III? The parties have briefed none of these issues, so I do not resolve them. But the number and magnitude of these important questions—questions implicated by thousands of bankruptcy and magistrate judge decisions each year—merit closer attention than the majority has given them.

B

Even assuming we were to decide that adjudication of *Stern* claims with the consent of the parties does not require the exercise of the judicial power, that decision would not end the constitutional inquiry. As instrumentalities of the *721 Federal Government, the bankruptcy courts must act pursuant to some constitutional grant of authority. Even if the functions bankruptcy courts perform do not require an exercise of legislative, executive, or judicial power, we would need to identify the source of Congress' authority to establish them and to authorize them to act.

The historical carve-outs for territorial courts and courts-martial might provide some guidance. The Court has anchored Congress' authority to create territorial courts in "the general right of sovereignty which exists in the government, or in virtue of that clause which enables Congress to make all needful rules and regulations, respecting the territory belonging to the United States." *Canter*, 1 Pet., at 546. And it has anchored Congress' authority to create courts-martial in Congress' Article I powers concerning the Army and Navy, understood alongside the Sixth Amendment's exception of " 'cases arising in the land or naval forces,' " from the grand jury requirement, and Article II's requirement that the President serve as commander in chief. *Dynes*, 20 How., at 78–79.

Although our cases examining the constitutionality of statutes allocating the power to the bankruptcy courts have not considered the source of Congress' authority to establish them, the obvious textual basis is the fourth clause of Article I, § 8, which empowers Congress to "establish ... uniform

Laws on the subject of Bankruptcies **1970 throughout the United States."⁷ But as with the other two historical carve-outs, *722 Congress' power to establish tribunals within that grant is informed by historical understandings of the bankruptcy power.⁸ We have suggested that, under this historical understanding, Congress has the power to establish bankruptcy courts that exercise jurisdiction akin to that of bankruptcy commissioners in England, subject to review traditionally had in England. *Ante*, at 1950 – 1952 (ROBERTS, C.J., dissenting). Although *Stern* claims, by definition, lie outside those historical boundaries, a historical practice of allowing broader adjudication by bankruptcy commissioners acting with the consent of the parties could alter the analysis. The parties once again do not brief these questions, but they merit closer attention by this Court.

* * *

Whether parties may consent to bankruptcy court adjudication of *Stern* claims is a difficult constitutional question. It turns on issues that are not adequately considered by the Court or briefed by the parties. And it cannot—and should not—be resolved through a cursory reading of *Schor*, which itself is hardly a model of careful constitutional interpretation. For these reasons, I would resolve the case on the narrow grounds set forth in Part I of THE CHIEF JUSTICE's opinion. I respectfully dissent.

All Citations

575 U.S. 665, 135 S.Ct. 1932, 191 L.Ed.2d 911, 83 USLW 4337, 73 C.B.C. 1575, 61 Bankr.Ct.Dec. 32, Bankr. L. Rep. P 82,806, 15 Cal. Daily Op. Serv. 5151, 2015 Daily Journal D.A.R. 5667, 25 Fla. L. Weekly Fed. S 263

Footnotes

* The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States v. Detroit Timber & Lumber Co.*, 200 U.S. 321, 337, 26 S.Ct. 282, 50 L.Ed. 499.

1 Congress has authorized 179 circuit judgeships and 677 district judgeships, a total of 856. United States Courts, Status of Article III Judgeships, <http://www.uscourts.gov/Statistics/JudicialBusiness/2014/status-article-iii-judgeships.aspx> (all Internet materials as visited May 22, 2015, and available in Clerk of Court's case file). The number of authorized magistrate and bankruptcy judgeships currently stands at 883: 534 full-time magistrate judgeships and 349 bankruptcy judgeships. United States Courts, Appointments of Magistrate Judges, <http://www.uscourts.gov/Statistics/JudicialBusiness/2014/appointments-magistrate-judges.aspx>; United States Courts, Status of Bankruptcy Judgeships, <http://www.uscourts.gov/Statistics/JudicialBusiness/2014/status-bankruptcy-judgeships.aspx>.

- 2 Between October 1, 2013, and September 30, 2014, for example, litigants filed 963,739 cases in bankruptcy courts—more than double the total number filed in district and circuit courts. United States Courts, Judicial Caseload Indicators, [http://www.uscourts.gov/Statistics/Judicial Business/2014/judicial-caseload-indicators.aspx](http://www.uscourts.gov/Statistics/Judicial%20Business/2014/judicial-caseload-indicators.aspx).
- 3 Congress appears to have drawn the term “core” from *Northern Pipeline*’s description of “the restructuring of debtor-creditor relations” as “the core of the federal bankruptcy power.” *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S., 50, 71, 102 S.Ct. 2858, 73 L.Ed.2d 598 (1982).
- 4 Individual petitioners Ralph and Cathy Oats are Wellness’ founders. This opinion refers to all petitioners collectively as “Wellness.”
- 5 Although the Seventh Circuit referred to Sharif’s failure to raise his *Stern* argument in a timely manner as a waiver, that court has since clarified that its decision rested on forfeiture. See *Peterson v. Somers Dublin Ltd.*, 729 F.3d 741, 747 (2013) (“The issue in *Wellness International Network* was forfeiture rather than waiver”).
- 6 The Seventh Circuit concluded its opinion by considering the remedy for the Bankruptcy Court’s purportedly unconstitutional issuance of a final judgment. The court determined that if count V of Wellness’ complaint raised a core claim, the only statutorily authorized remedy would be for the District Court to withdraw the reference to the Bankruptcy Court and set a new discovery schedule. The Seventh Circuit’s reasoning on this point was rejected by our decision last Term in *Executive Benefits*, which held that district courts may treat *Stern* claims like non-core claims and thus are not required to restart proceedings entirely when a bankruptcy court improperly enters final judgment.
- 7 Because the Court concludes that the Bankruptcy Court could validly enter judgment on Wellness’ claim with the parties’ consent, this opinion does not address, and expresses no view on, Wellness’ alternative contention that the Seventh Circuit erred in concluding the claim in count V of its complaint was a *Stern* claim.
- 8 In relevant part, the Act provides that district courts may assign magistrate judges certain enumerated duties as well as “such additional duties as are not inconsistent with the Constitution and the laws of the United States.” 28 U.S.C. § 636(b)(3).
- 9 Discounting the relevance of *Gomez* and *Peretz*, the principal dissent emphasizes that neither case concerned the entry of final judgment by a non-Article III actor. See *post*, at — (opinion of ROBERTS, C.J.). Here again, the principal dissent’s insistence on formalism leads it astray. As we explained in *Peretz*, the “responsibility and importance [of] presiding over *voir dire* at a felony trial” is equivalent to the “supervision of entire civil and misdemeanor trials,” 501 U.S., at 933, 111 S.Ct. 2661 tasks in which magistrate judges may “order the entry of judgment” with the parties’ consent, § 636(c)(1).
- 10 The principal dissent accuses us of making Sharif’s consent “‘dispositive’ in curing [a] structural separation of powers violation,” contrary to the holding of *Schor*. *Post*, at —. That argument misapprehends both *Schor* and the nature of our analysis. What *Schor* forbids is using consent to excuse an actual violation of Article III. See 478 U.S., at 850–851, 106 S.Ct. 3245 (“To the extent that th[e] structural principle [protected by Article III] is implicated in a given case, the parties cannot by consent cure the constitutional difficulty ...” (emphasis added)). But *Schor* confirms that consent remains highly relevant when determining, as we do here, whether a particular adjudication in fact raises constitutional concerns. See *id.*, at 855, 106 S.Ct. 3245 (“separation of powers concerns are diminished” when “the decision to invoke [a non-Article III] forum is left entirely to the parties”). Thus, we do not rely on Sharif’s consent to “cur[e]” a violation of Article III. His consent shows, in part, why no such violation has occurred. Cf. Meltzer, *Legislative Courts, Legislative Power, and the Constitution*, 65 Ind. L. J. 291, 303 (1990) (“[C]onsent provides, if not complete, at least very considerable reason to doubt that the tribunal poses a serious threat to the ideal of federal adjudicatory independence”); Fallon, *Of Legislative Courts, Administrative Agencies, and Article III*, 101 Harv. L. Rev. 915, 992 (1988) (when the parties consent, “there is substantial assurance that the agency is not generally behaving arbitrarily or otherwise offending separation-of-powers values. Judicial integrity is not at risk”).
- 11 In advancing its restrictive view of *Stern*, the principal dissent ignores the sweeping jurisprudential implications of its position. If, as the principal dissent suggests, consent is irrelevant to the Article III analysis, it is difficult to see how *Schor* and *Peretz* were not wrongly decided. But those decisions obviously remain good law. It is the principal dissent’s position that breaks with our precedents. See *Plaut v. Spendthrift Farm, Inc.*, 514 U.S. 211, 231, 115 S.Ct. 1447, 131 L.Ed.2d

328 (1995) (“[T]he proposition that legal defenses based upon doctrines central to the courts’ structural independence can never be waived simply does not accord with our cases”).

- 12 Consistent with our precedents, the Courts of Appeals have unanimously upheld the constitutionality of § 636(c). See *Sinclair v. Wainwright*, 814 F.2d 1516, 1519 (C.A.11 1987); *Bell & Beckwith v. United States*, 766 F.2d 910, 912 (C.A.6 1985); *Gairola v. Virginia Dept. of Gen. Servs.*, 753 F.2d 1281, 1285 (C.A.4 1985); *D.L. Auld Co. v. Chroma Graphics Corp.*, 753 F.2d 1029, 1032 (C.A.Fed.1985); *United States v. Dobey*, 751 F.2d 1140, 1143 (C.A.10 1985); *Fields v. Washington Metropolitan Area Transit Auth.*, 743 F.2d 890, 893 (C.A.D.C.1984); *Geras v. Lafayette Display Fixtures, Inc.*, 742 F.2d 1037, 1045 (C.A.7 1984); *Lehman Bros. Kuhn Loeb Inc. v. Clark Oil & Refining Corp.*, 739 F.2d 1313, 1316 (C.A.8 1984) (en banc); *Puryear v. Ede’s Ltd.*, 731 F.2d 1153, 1154 (C.A.5 1984); *Goldstein v. Kelleher*, 728 F.2d 32, 36 (C.A.1 1984); *Collins v. Foreman*, 729 F.2d 108, 115–116 (C.A.2 1984); *Pacemaker Diagnostic Clinic, Inc. v. Instromedix, Inc.*, 725 F.2d 537, 540 (C.A.9 1984) (en banc) (Kennedy, J.); *Wharton–Thomas v. United States*, 721 F.2d 922, 929–930 (C.A.3 1983).
- 13 Even though the Constitution does not require that consent be express, it is good practice for courts to seek express statements of consent or nonconsent, both to ensure irrefutably that any waiver of the right to Article III adjudication is knowing and voluntary and to limit subsequent litigation over the consent issue. Statutes or judicial rules may require express consent where the Constitution does not. Indeed, the Federal Rules of Bankruptcy Procedure already require that pleadings in adversary proceedings before a bankruptcy court “contain a statement that the proceeding is core or non-core and, if non-core, that the pleader does or does not consent to entry of final orders or judgment by the bankruptcy judge.” Fed. Rule Bkrcty. *Proc.* 7008 (opening pleadings); see Fed. Rule Bkrcty. *Proc.* 7012 (responsive pleadings). The Bankruptcy Court and the parties followed that procedure in this case. See App. 6, 24; *supra*, at 1940 – 1941.
- * See *Stern v. Marshall*, 564 U.S. —, 131 S.Ct. 2594, 180 L.Ed.2d 475 (2011). A “Stern claim” is a claim that is “core” under the statute but yet “prohibited from proceeding in that way as a constitutional matter.” *Executive Benefits Ins. Agency v. Arkison*, 573 U.S. —, —, 134 S.Ct. 2165, 2170, 189 L.Ed.2d 83 (2014).
- 1 There is some dispute whether the guarantee of a jury trial protects an individual right, a structural right, or both, raising serious questions about how it should be treated under *Commodity Futures Trading Comm’n v. Schor*, 478 U.S. 833, 106 S.Ct. 3245, 92 L.Ed.2d 675 (1986). My view, which does not turn on such taxonomies, leaves no doubt: It is a “fundamental reservation of power in our constitutional structure,” *Blakely v. Washington*, 542 U.S. 296, 306, 124 S.Ct. 2531, 159 L.Ed.2d 403 (2004), meaning its *violation* may not be authorized by the consent of the individual.
- 2 Chief Justice Marshall’s explanation in *Canter* has come under attack on the ground that it fails to clarify the precise constitutional status of the power exercised by the territorial courts. Lawson, *Territorial Governments and the Limits of Formalism*, 78 Cal. L. Rev. 853, 892 (1990) (criticizing it as “fatuous” dictum). On the one hand, some early evidence suggests that the courts were thought to be dealing primarily with local matters that lie *beyond* federal judicial cognizance. Pfander, *Article I Tribunals, Article III Courts, and the Judicial Power of the United States*, 118 Harv. L. Rev. 643, 706–711 (2004). Yet *Canter* involved a controversy indisputably *capable* of adjudication by Article III courts, because it both arose in admiralty and fell within the Supreme Court’s appellate jurisdiction. Pfander, *supra*, at 713–714, n. 314. The best explanation for this apparent tension is that territorial courts adjudicate matters that Congress may or may not assign to Article III courts, as it wishes. Nelson, *Adjudication in the Political Branches*, 107 Colum. L. Rev. 559, 575–576 (2007). To recognize Congress’ discretion requires no distortion of the meaning of judicial power because Chief Justice Marshall’s reasoning has nothing to do with the intrinsic qualities of the adjudication itself—e.g., whether it involves “the stuff of the traditional actions at common law tried by the courts of Westminster in 1789,” *Stern v. Marshall*, 564 U.S. —, —, 131 S.Ct. 2594, 2609, 180 L.Ed.2d 475 (2011) (internal quotation marks omitted).
- 3 The protection of private rights in the Anglo–American tradition goes back to at least Magna Carta. The original 1215 charter is replete with restrictions on the King’s ability to proceed against private rights, including most notably the provision that “[n]o free man shall be taken, imprisoned, disseised, outlawed, banished, or in any way destroyed, ... except by the lawful judgment of his peers and by the law of the land.” A. Howard, *Magna Carta: Text and Commentary* 43 (1964).
- 4 Contemporary state-court decisions provide even more explication of the distinction between public and private rights, and many expressly tie the distinction to the separation of powers. See, e.g., *Newland v. Marsh*, 19 Ill. 376, 383 (1857) (“The legislative power ... cannot directly reach the property or vested rights of the citizen, by providing for their forfeiture

or transfer to another, without trial and judgment in the courts; for to do so, would be the exercise of a power which belongs to another branch of the government, and is forbidden to the legislature"); see also *Gaines v. Gaines*, 48 Ky. 295, 301 (1848) (describing the judiciary as "the tribunal appointed by the Constitution and the law, for the ascertainment of private rights and the redress of private wrongs"); *State ex rel. Atty. Gen. v. Hawkins*, 44 Ohio St. 98, 109, 5 N.E. 228, 232 (1886) ("[P]ower to hear and determine rights of property and of person between private parties is judicial, and can only be conferred on the courts"); see generally T. Cooley, *Constitutional Limitations* 175 (1868) (explaining that only the judicial power was thought capable of disposing of private rights).

- 5 Another potential explanation is that *Murray's Lessee v. Hoboken Land & Improvement Co.*, 18 How. 272, 15 L.Ed. 372 (1856), recognized yet another special exception to Article III's allocation of judicial power, applicable whenever the Government exercises its power of taxation. Nelson, *Adjudication in the Political Branches*, 107 Colum. L. Rev. 559, 588–589 (2007); see also *B & B Hardware, Inc. v. Hargis Industries, Inc.*, — U.S., at —, 135 S.Ct., at 1316 (THOMAS, J., dissenting) (discussing other decisions that appear to rest on this exception). To the extent that *Murray's Lessee* purported to recognize such an exception, however, it did so only in dictum after noting that the statute provided a mechanism for judicial review of the accounting decision on which the distress warrant was based. 18 How., at 280–281.
- 6 Numerous 19th-century State Supreme Courts held unconstitutional laws authorizing individuals to consent to have their cases heard by an individual not qualified as a judge under provisions of State Constitutions similar to Article III, § 1. See, e.g., *Winchester v. Ayres*, 4 Greene 104 (1853); *Haverly Invincible Mining Co. v. Howcutt*, 6 Colo. 574, 575–576 (1883); *Ex parte Alabama State Bar Assn.*, 92 Ala. 113, 8 So. 768 (1891); see also Cooley, *Constitutional Limitations*, at 399. Acknowledging the similarity between the practices under review and the legitimate practice of private arbitration, many of these decisions premised their finding of unconstitutionality on the issuance of a judgment or other writ that only judges may issue. See, e.g., *Bishop v. Nelson*, 83 Ill. 601 (1876) (*per curiam*) ("This was not an arbitration ... but it was an attempt to confer upon [Mr. Wood] the power of a judge, to decide the pending case, and he did decide it, the court carrying out his decision by entering the judgment he had reached, and not [its] own judgment"); *Van Slyke v. Trempealeau Cty. Farmers' Mut. Fire Ins. Co.*, 39 Wis. 390, 393 (1876) ("We cannot look into the bill of exceptions or consider the order denying a new trial, because both are unofficial and devoid of judicial authority"); see also *id.*, at 395–396 (tracing this rule back to English understandings of judicial power). These decisions treat the rule as a corollary to the rule that parties may not, by consent, confer jurisdiction. See, e.g., *Higby v. Ayres*, 14 Kan. 331, 334 (1875); *Hoagland v. Creed*, 81 Ill. 506, 507–508 (1876); see also Cooley, *supra*, at 399.
- 7 In *Northern Pipeline*, the plurality rejected the argument that "Congress' constitutional authority to establish 'uniform Laws on the subject of Bankruptcies throughout the United States' carries with it an inherent power to establish legislative courts capable of adjudicating 'bankruptcy-related controversies.' " *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 72, 102 S.Ct. 2858, 73 L.Ed.2d 598 (1982) (plurality opinion) (citation omitted). In that context, however, it was considering whether Article III imposes limits on Congress' bankruptcy power, *id.*, at 73, 102 S.Ct. 2858 which is a distinct question from whether Congress has the power to establish bankruptcy courts as an antecedent matter, leaving aside any Article III limitations.
- 8 I would be wary of concluding that every grant of lawmaking authority to Congress includes the power to establish "legislative courts" as part of its legislative scheme. Some have suggested that Congress' authority to establish tribunals pursuant to substantive grants of authority is informed and limited by its Article I power to "constitute Tribunals inferior to the supreme Court," U.S. Const., Art. I, § 8 cl. 9. See Pfander, 118 Harv. L. Rev., at 671–697.

134 S.Ct. 2165

Supreme Court of the United States

EXECUTIVE BENEFITS
INSURANCE AGENCY, Petitioner

v.

Peter H. ARKISON, chapter 7 trustee of the
Estate of Bellingham Insurance Agency, Inc.

No. 12–1200

|

Argued Jan. 14, 2014.

|

Decided June 9, 2014.

Synopsis

Background: Bankruptcy trustee filed complaint under fraudulent transfer theory to recover commissions deposited into account of noncreditor as property of estate of Chapter 7 debtor. The United States Bankruptcy Court for the Western District of Washington granted summary judgment in favor of trustee. Noncreditor appealed. The District Court, [Marsha J. Pechman](#), Chief Judge, affirmed. Noncreditor appealed. The United States Court of Appeals for the Ninth Circuit, [Paez](#), Circuit Judge, [702 F.3d 553](#), affirmed. Certiorari was granted.

Holdings: The Supreme Court, Justice [Thomas](#), held that:

when, under the reasoning of *Stern v. Marshall*, the Constitution does not permit a bankruptcy court to enter final judgment on a bankruptcy-related claim, the relevant statute nevertheless permits a bankruptcy court to issue proposed findings of fact and conclusions of law to be reviewed de novo by the district court;

assuming without deciding that the subject fraudulent conveyance claims were so-called “*Stern* claims,” the bankruptcy court could have adjudicated the claims as non-core and submitted proposed findings of fact and conclusions of law to the district court to be reviewed de novo; and

even if the bankruptcy court's entry of judgment was invalid, as noncreditor contended, the district court's de novo review and entry of its own final judgment cured any error.

Affirmed.

Procedural Posture(s): On Appeal; Motion for Summary Judgment.

West Codenotes**Recognized as Unconstitutional**[28 U.S.C.A. § 157\(b\)\(2\)\(C\)](#)****2166 Syllabus***

Bellingham Insurance Agency, Inc. (BIA), filed a voluntary chapter 7 bankruptcy petition. Respondent Peter Arkison, the bankruptcy trustee, filed a complaint in the Bankruptcy Court against petitioner Executive Benefits Insurance Agency (EBIA) and others alleging the fraudulent conveyance of assets from BIA to EBIA. The Bankruptcy Court granted summary judgment for the trustee. EBIA appealed to the District Court, which affirmed the Bankruptcy Court's decision after *de novo* review and entered judgment for the trustee. While EBIA's appeal to the Ninth Circuit was pending, this Court held that [Article III](#) did not permit a Bankruptcy Court to enter final judgment on a counterclaim for tortious interference, even though final adjudication of that ****2167** claim by the Bankruptcy Court was authorized by statute. *Stern v. Marshall*, 564 U.S. —, —, 131 S.Ct. 2594, —, 180 L.Ed.2d 475. In light of *Stern*, EBIA moved to dismiss its appeal for lack of jurisdiction. The Ninth Circuit rejected EBIA's motion and affirmed. It acknowledged the trustee's claims as “*Stern* claims,” *i.e.*, claims designated for final adjudication in the bankruptcy court as a statutory matter, but prohibited from proceeding in that way as a constitutional matter. The Court of Appeals nevertheless concluded that EBIA had impliedly consented to jurisdiction. The Court of Appeals also observed that the Bankruptcy Court's judgment could instead be treated as proposed findings of fact and conclusions of law, subject to *de novo* review by the District Court.

Held :

1. Under the Bankruptcy Amendments and Federal Judgeship Act of 1984, federal district courts have original jurisdiction in bankruptcy cases and may refer to bankruptcy judges two statutory categories of proceedings: “core” proceedings and “non-core” proceedings. See generally [28 U.S.C. § 157](#). In core proceedings, a bankruptcy judge “may hear and determine ... and enter appropriate orders and judgments,”

134 S.Ct. 2165, 189 L.Ed.2d 83, 82 USLW 4450, 71 Collier Bankr.Cas.2d 875, 59 Bankr.Ct.Dec. 160, Bankr. L. Rep. P 82,642...

subject to the district court's traditional appellate review. § 157(b)(1). In non-core proceedings—those that are “not ... core” but are “otherwise related to a case under title 11,” § 157(c)(1)—final judgment must be entered by the district court after *de novo* review of the bankruptcy judge's proposed findings of fact and conclusions of law, *ibid.*, except that the bankruptcy judge may enter final judgment if the parties consent, § 157(c)(2).

In *Stern*, the Court confronted an underlying conflict between the 1984 Act and the requirements of Article III. The Court held that Article III prohibits Congress from vesting a bankruptcy court with the authority to finally adjudicate the “core” claim of tortious interference. The Court did not, however, address how courts should proceed when they encounter a *Stern* claim. Pp. 2170 – 2172.

2. *Stern* claims may proceed as non-core within the meaning of § 157(c). Lower courts have described *Stern* claims as creating a statutory “gap,” since bankruptcy judges are not explicitly authorized to propose findings of fact and conclusions of law in a core proceeding. However, this so-called gap is closed by the Act's severability provision, which instructs that where a “provision of the Act or [its] application ... is held invalid, the remainder of th[e] Act ... is not affected thereby.” 98 Stat. 344. As applicable here, when a court identifies a *Stern* claim, it has “held invalid” the “application” of § 157(b), and the “remainder” not affected includes § 157(c), which governs non-core proceedings. Accordingly, where a claim otherwise satisfies § 157(c)(1), the bankruptcy court should simply treat the *Stern* claim as non-core. This conclusion accords with the Court's general approach to severability, which is to give effect to the valid portion of a statute so long as it “remains ‘fully operative as a law,’ ” *Free Enterprise Fund v. Public Company Accounting Oversight Bd.*, 561 U.S. 477, 509, 130 S.Ct. 3138, 177 L.Ed.2d 706, and so long as the statutory text and context do not suggest that Congress would have preferred no statute at all, *ibid.* Pp. 2172 – 2173.

3. Section 157(c)(1)'s procedures apply to the fraudulent conveyance claims here. This Court assumes without deciding that these claims are *Stern* claims, which Article III does not permit to be treated as “core” claims under § 157(b). But because the claims assert that property of the bankruptcy estate was improperly **2168 removed, they are self-evidently “related to a case under title 11.” Accordingly, they fit comfortably within the category of claims governed by § 157(c)(1). The Bankruptcy Court would have been

permitted to follow that provision's procedures, *i.e.*, to submit proposed findings of fact and conclusions of law to the District Court for *de novo* review. P. 2174.

4. Here, the District Court's *de novo* review of the Bankruptcy Court's order and entry of its own valid final judgment cured any potential error in the Bankruptcy Court's entry of judgment. EBIA contends that it was constitutionally entitled to review by an Article III court regardless of whether the parties consented to bankruptcy court adjudication. In the alternative, EBIA asserts that even if such consent were constitutionally permissible, it did not in fact consent. Neither contention need be addressed here, because EBIA received the same review from the District Court that it would have received had the Bankruptcy Court treated the claims as non-core proceedings under § 157(c)(1). Pp. 2174 – 2175.

702 F.3d 553, affirmed.

THOMAS, J., delivered the opinion for a unanimous Court.

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Opinion

Justice THOMAS delivered the opinion of the Court.

*28 In *Stern v. Marshall*, 564 U.S. —, 131 S.Ct. 2594, 180 L.Ed.2d 475 (2011), this Court held that even though bankruptcy courts are statutorily authorized to enter final judgment on a class of bankruptcy-related claims, Article III of the Constitution prohibits bankruptcy courts from

134 S.Ct. 2165, 189 L.Ed.2d 83, 82 USLW 4450, 71 Collier Bankr.Cas.2d 875, 59 Bankr.Ct.Dec. 160, Bankr. L. Rep. P 82,642...

finally adjudicating certain of those claims. *Stern* did not, however, decide how bankruptcy or district courts should proceed when a “*Stern* claim” is identified. We hold today that when, under *Stern*’s reasoning, the Constitution does not permit a bankruptcy court to enter final judgment on a bankruptcy-related claim, the relevant statute nevertheless permits a bankruptcy court to issue proposed findings of fact and conclusions of law to be reviewed *de novo* by the district court. Because the District Court in this case conducted the *de novo* review that petitioner demands, we affirm the judgment of the Court of Appeals upholding the District Court’s decision.

I

Nicolas Paleveda and his wife owned and operated two companies—Aegis Retirement Income Services, Inc. (ARIS), and Bellingham Insurance Agency, Inc. (BIA). By early 2006, BIA had become ****2169** insolvent, and on January 31, 2006, the company ceased operation. The next day, Paleveda used BIA funds to incorporate Executive Benefits Insurance Agency, Inc. (EBIA), petitioner in this case. Paleveda and ***29** others initiated a scheme to transfer assets from BIA to EBIA. The assets were deposited into an account held jointly by ARIS and EBIA and ultimately credited to EBIA at the end of the year.

On June 1, 2006, BIA filed a voluntary Chapter 7 bankruptcy petition in the United States Bankruptcy Court for the Western District of Washington. Peter Arkison, the bankruptcy trustee and respondent in this case, filed a complaint in the same Bankruptcy Court against EBIA and others. As relevant here, the complaint alleged that Paleveda used various methods to fraudulently convey BIA assets to EBIA.¹ EBIA filed an answer and denied many of the trustee’s allegations.

After some disagreement as to whether the trustee’s claims should continue in the Bankruptcy Court or instead proceed before a jury in Federal District Court, the trustee filed a motion for summary judgment against EBIA in the Bankruptcy Court. The Bankruptcy Court granted summary judgment for the trustee on all claims, including the fraudulent conveyance claims. EBIA then appealed that determination to the District Court. The District Court conducted *de novo* review, affirmed the Bankruptcy Court’s decision, and entered judgment for the trustee.

EBIA appealed to the United States Court of Appeals for the Ninth Circuit. After EBIA filed its opening brief, this Court decided *Stern, supra*. In *Stern*, we held that [Article III of the Constitution](#) did not permit a bankruptcy court to enter final judgment on a counterclaim for tortious interference, *id.*, at —, 131 S.Ct., at —, even though final adjudication of that claim by the Bankruptcy Court was authorized by statute, see Part II–B, *infra*.² In light of *Stern*, EBIA moved to dismiss ***30** its appeal in the Ninth Circuit for lack of jurisdiction, contending that [Article III](#) did not permit Congress to vest authority in a bankruptcy court to finally decide the trustee’s fraudulent conveyance claims.

The Ninth Circuit rejected EBIA’s motion and affirmed the District Court. *In re Bellingham Ins. Agency, Inc.*, 702 F.3d 553 (2012). As relevant here, the court held that *Stern, supra*, and *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 109 S.Ct. 2782, 106 L.Ed.2d 26 (1989),³ taken together, lead to the conclusion that [Article III](#) does not permit a bankruptcy court to enter final judgment on a fraudulent conveyance claim against a noncreditor unless the parties consent. 702 F.3d, at 565. The Ninth Circuit concluded that EBIA had impliedly consented to the Bankruptcy Court’s jurisdiction, and that the Bankruptcy Court’s adjudication of the fraudulent conveyance claim was therefore permissible. *Id.*, at 566, 568. The Court ****2170** of Appeals also observed that the Bankruptcy Court’s judgment could instead be treated as proposed findings of fact and conclusions of law, subject to *de novo* review by the District Court. *Id.*, at 565–566.

We granted certiorari, 570 U.S. —, 133 S.Ct. 2880, 186 L.Ed.2d 908 (2013).

II

In *Stern*, we held that [Article III](#) prohibits Congress from vesting a bankruptcy court with the authority to finally adjudicate certain claims. 564 U.S., at —, 131 S.Ct., at —. But we did not address how courts should proceed when they encounter one of these “*Stern* claims”—a claim designated for final adjudication in the bankruptcy court as a statutory matter, but ***31** prohibited from proceeding in that way as a constitutional matter.⁴

As we explain in greater detail below, when a bankruptcy court is presented with such a claim, the proper course is to issue proposed findings of fact and conclusions of law. The

134 S.Ct. 2165, 189 L.Ed.2d 83, 82 USLW 4450, 71 Collier Bankr.Cas.2d 875, 59 Bankr.Ct.Dec. 160, Bankr. L. Rep. P 82,642...

district court will then review the claim *de novo* and enter judgment. This approach accords with the bankruptcy statute and does not implicate the constitutional defect identified by *Stern*.

A

We begin with an overview of modern bankruptcy legislation. Prior to 1978, federal district courts could refer matters within the traditional “summary jurisdiction” of bankruptcy courts to specialized bankruptcy referees.⁵ See *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 53, 102 S.Ct. 2858, 73 L.Ed.2d 598 (1982) (plurality opinion). Summary jurisdiction covered claims involving “property in the actual or constructive possession of the [bankruptcy] court,” *ibid.*, i.e., claims regarding the apportionment of the existing bankruptcy estate among creditors. See Brubaker, A “Summary” Statutory and Constitutional Theory of Bankruptcy Judges’ Core Jurisdiction After *Stern v. Marshall*, 86 Am. Bankr. L.J. 121, 124 (2012). Proceedings to augment the bankruptcy estate, on the other hand, implicated the district court’s plenary jurisdiction and were not referred to the bankruptcy courts absent both parties’ consent. See *32 *MacDonald v. Plymouth County Trust Co.*, 286 U.S. 263, 266, 52 S.Ct. 505, 76 L.Ed. 1093 (1932); see also Brubaker, *supra*, at 128.

In 1978, Congress enacted sweeping changes to the federal bankruptcy laws. See 92 Stat. 2549. The Bankruptcy Reform Act eliminated the historical distinction between “‘summary’” jurisdiction belonging to bankruptcy courts and “‘plenary’” jurisdiction belonging to either a district court or an appropriate state court. *Northern Pipeline*, *supra*, at 54, 102 S.Ct. 2858 (plurality opinion); see also 1 W. Norton & W. Norton Bankruptcy Law and Practice § 4:12, p. 4–44 (3d ed. 2013). Instead, the 1978 Act mandated that bankruptcy judges “shall exercise” jurisdiction over “all civil proceedings arising under title 11 or arising in or related to cases under title 11.” **2171 28 U.S.C. § 1471(b)-(c) (1976 ed., Supp. IV). Under the 1978 Act, bankruptcy judges were “vested with all of the ‘powers of a court of equity, law, and admiralty,’” with only a few limited exceptions. *Northern Pipeline*, 458 U.S., at 55, 102 S.Ct. 2858 (plurality opinion) (quoting § 1481). Notwithstanding their expanded jurisdiction and authority, these bankruptcy judges were not afforded the protections of Article III—namely, life tenure and a salary that may not be diminished. *Id.*, at 53, 102 S.Ct. 2858.

In *Northern Pipeline*, this Court addressed whether bankruptcy judges under the 1978 Act could “constitutionally be vested with jurisdiction to decide [a] state-law contract claim” against an entity not otherwise a party to the proceeding. *Id.*, at 53, 87, n. 40, 102 S.Ct. 2858. The Court concluded that assignment of that claim for resolution by the bankruptcy judge “violates Art. III of the Constitution.” *Id.*, at 52, 87, 102 S.Ct. 2858 (plurality opinion); see *id.*, at 91, 102 S.Ct. 2858 (Rehnquist, J., concurring in judgment). The Court distinguished between cases involving so-called “public rights,” which may be removed from the jurisdiction of Article III courts, and cases involving “private rights,” which may not. See *id.*, at 69–71, 102 S.Ct. 2858 (plurality opinion); *id.*, at 91, 102 S.Ct. 2858 (Rehnquist, J., concurring in judgment). Specifically, the plurality noted that “the restructuring of *33 debtor-creditor relations, which is at the core of the federal bankruptcy power, must be distinguished from the adjudication of state-created private rights,” which belong in an Article III court. *Id.*, at 71–72, and n. 26, 102 S.Ct. 2858.

B

Against that historical backdrop, Congress enacted the Bankruptcy Amendments and Federal Judgeship Act of 1984—the Act at issue in this case. See 28 U.S.C. § 151 *et seq.* Under the 1984 Act, federal district courts have “original and exclusive jurisdiction of all cases under title 11,” § 1334(a), and may refer to bankruptcy judges any “proceedings arising under title 11 or arising in or related to a case under title 11,” § 157(a).⁶ Bankruptcy judges serve 14-year terms subject to removal for cause, §§ 152(a)(1), (e), and their salaries are set by Congress, § 153(a).

The 1984 Act largely restored the bifurcated jurisdictional scheme that existed prior to the 1978 Act. The 1984 Act implements that bifurcated scheme by dividing all matters that may be referred to the bankruptcy court into two categories: “core” and “non-core” proceedings. See generally § 157.⁷ It is the bankruptcy court’s responsibility to determine whether each claim before it is core or non-core. § 157(b)(3); cf. Fed. Rule Bkrcty. Proc. 7012. For core proceedings, the statute contains a nonexhaustive list of examples, including—as relevant here—“proceedings to determine, avoid, or recover fraudulent conveyances.” § 157(b)(2)(H). The statute authorizes bankruptcy judges *34 to “hear and determine” such claims and “enter appropriate orders and judgments” on them. § 157(b)(1). A final judgment entered in a **2172

134 S.Ct. 2165, 189 L.Ed.2d 83, 82 USLW 4450, 71 Collier Bankr.Cas.2d 875, 59 Bankr.Ct.Dec. 160, Bankr. L. Rep. P 82,642...

core proceeding is appealable to the district court, § 158(a)(1), which reviews the judgment under traditional appellate standards, Rule 8013.

As for “non-core” proceedings—*i.e.*, proceedings that are “not ... core” but are “otherwise related to a case under title 11”—the statute authorizes a bankruptcy court to “hear [the] proceeding,” and then “submit proposed findings of fact and conclusions of law to the district court.” § 157(c)(1). The district court must then review those proposed findings and conclusions *de novo* and enter any final orders or judgments. *Ibid.* There is one statutory exception to this rule: If all parties “consent,” the statute permits the bankruptcy judge “to hear and determine and to enter appropriate orders and judgments” as if the proceeding were core. § 157(c)(2).

Put simply: If a matter is core, the statute empowers the bankruptcy judge to enter final judgment on the claim, subject to appellate review by the district court. If a matter is non-core, and the parties have not consented to final adjudication by the bankruptcy court, the bankruptcy judge must propose findings of fact and conclusions of law. Then, the district court must review the proceeding *de novo* and enter final judgment.

C

Stern v. Marshall, 564 U.S. —, 131 S.Ct. 2594, 180 L.Ed.2d 475, confronted an underlying conflict between the 1984 Act and the requirements of Article III. In particular, *Stern* considered a constitutional challenge to the statutory designation of a particular claim as “core.” The bankrupt in that case had filed a common-law counterclaim for tortious interference against a creditor to the estate. *Id.*, at —, 131 S.Ct., at —. Section 157(b)(2)(C), as added by the 1984 Act, lists “counterclaims by the estate against persons filing claims against the estate” as a core proceeding, thereby authorizing the bankruptcy court to adjudicate the *35 claim to final judgment. See *supra* this page. The respondent in *Stern* objected that Congress had violated Article III by vesting the power to adjudicate the tortious interference counterclaim in bankruptcy court. *Stern*, 564 U.S., at —, 131 S.Ct., at —.

We agreed. *Id.*, at —, 131 S.Ct., at —. In that circumstance, we held, Congress had improperly vested the Bankruptcy Court with the “ ‘judicial Power of the United States,’ ” just as in *Northern Pipeline*. 564 U.S., at —, —, 131 S.Ct., at 2611, 2620. Because “[n]o ‘public right’

exception excuse[d] the failure to comply with Article III,” we concluded that Congress could not confer on the Bankruptcy Court the authority to finally decide the claim. *Id.*, at —, 131 S.Ct., at 2611.

III

Stern made clear that some claims labeled by Congress as “core” may not be adjudicated by a bankruptcy court in the manner designated by § 157(b). *Stern* did not, however, address how the bankruptcy court should proceed under those circumstances. We turn to that question now.

The Ninth Circuit held that the fraudulent conveyance claims at issue here are *Stern* claims—that is, proceedings that are defined as “core” under § 157(b) but may not, as a constitutional matter, be adjudicated as such (at least in the absence of consent, see n. 4, *supra*). See 702 F.3d, at 562. Neither party contests that conclusion.

The lower courts, including the Ninth Circuit in this case, have described *Stern* claims as creating a statutory “gap.” See, e.g., 702 F.3d, at 565. By definition, a *Stern* claim may not be adjudicated to final **2173 judgment by the bankruptcy court, as in a typical core proceeding. But the alternative procedure, whereby the bankruptcy court submits proposed findings of fact and conclusions of law, applies only to non-core claims. See § 157(c)(1). Because § 157(b) does not explicitly authorize bankruptcy judges to submit proposed findings of fact and conclusions of law in a *core proceeding*, the argument goes, *Stern* created a “gap” in the bankruptcy *36 statute. See 702 F.3d, at 565. That gap purportedly renders the bankruptcy court powerless to act on *Stern* claims, see Brief for Petitioner 46–48, thus requiring the district court to hear all *Stern* claims in the first instance.

We disagree. The statute permits *Stern* claims to proceed as non-core within the meaning of § 157(c). In particular, the statute contains a severability provision that accounts for decisions, like *Stern*, that invalidate certain applications of the statute:

“If any provision of this Act or the application thereof to any person or circumstance is held invalid, the remainder of this Act, or the application of that provision to persons or circumstances other than those as to which it is held invalid, is not affected thereby.” 98 Stat. 344, note following 28 U.S.C. § 151.

The plain text of this severability provision closes the so-called “gap” created by *Stern* claims. When a court identifies a claim as a *Stern* claim, it has necessarily “held invalid” the “application” of § 157(b)—*i.e.*, the “core” label and its attendant procedures—to the litigant’s claim. Note following § 151. In that circumstance, the statute instructs that “the remainder of th[e] Act ... is not affected thereby.” *Ibid.* That remainder includes § 157(c), which governs non-core proceedings. With the “core” category no longer available for the *Stern* claim at issue, we look to § 157(c)(1) to determine whether the claim may be adjudicated as a non-core claim—specifically, whether it is “not a core proceeding” but is “otherwise related to a case under title 11.” If the claim satisfies the criteria of § 157(c)(1), the bankruptcy court simply treats the claims as non-core: The bankruptcy court should hear the proceeding and submit proposed findings of fact and conclusions of law to the district court for *de novo* review and entry of judgment.

The conclusion that the remainder of the statute may continue to apply to *Stern* claims accords with our general approach *37 to severability. We ordinarily give effect to the valid portion of a partially unconstitutional statute so long as it “remains ‘fully operative as a law,’ ” *Free Enterprise Fund v. Public Company Accounting Oversight Bd.*, 561 U.S. 477, 509, 130 S.Ct. 3138, 177 L.Ed.2d 706 (2010) (quoting *New York v. United States*, 505 U.S. 144, 186, 112 S.Ct. 2408, 120 L.Ed.2d 120 (1992)), and so long as it is not “‘evident’ ” from the statutory text and context that Congress would have preferred no statute at all, 561 U.S., at 509, 130 S.Ct. 3138 (quoting *Alaska Airlines, Inc. v. Brock*, 480 U.S. 678, 684, 107 S.Ct. 1476, 94 L.Ed.2d 661 (1987)). Neither of those concerns applies here. Thus, § 157(c) may be applied naturally to *Stern* claims. And, EBIA has identified “nothing in the statute’s text or historical context” that makes it “evident” that Congress would prefer to suspend *Stern* claims in limbo. 561 U.S., at 509, 130 S.Ct. 3138.⁸

**2174 IV

A

Now we must determine whether the procedures set forth in § 157(c)(1) apply to the fraudulent conveyance claims at issue in this case. The Court of Appeals held, and we assume without deciding, that the fraudulent conveyance claims in

this case are *Stern* claims. See Part III, *supra*. For purposes of this opinion, the “application” of both the “core” label and the procedures of § 157(b) to the trustee’s claims has therefore been “held invalid.” Note following § 151. Accordingly, we must decide whether the fraudulent conveyance claims brought by the trustee are within the scope of § 157(c)(1)—that is, “not ... core” proceedings but “otherwise related to a case under title 11.” We hold that *38 this language encompasses the trustee’s claims of fraudulent conveyance.

First, the fraudulent conveyance claims in this case are “not ... core.” The Ninth Circuit held—and no party disputes—that Article III does not permit these claims to be treated as “core.” See Part III, *supra*. Second, the fraudulent conveyance claims are self-evidently “related to a case under title 11.” At bottom, a fraudulent conveyance claim asserts that property that should have been part of the bankruptcy estate and therefore available for distribution to creditors pursuant to Title 11 was improperly removed. That sort of claim is “related to a case under title 11” under any plausible construction of the statutory text, and no party contends otherwise. See, *e.g.*, *Celotex Corp. v. Edwards*, 514 U.S. 300, 307, n. 5, 308, 115 S.Ct. 1493, 131 L.Ed.2d 403 (1995) (“Proceedings ‘related to’ the bankruptcy include ... suits between third parties which have an effect on the bankruptcy estate”). Accordingly, because these *Stern* claims fit comfortably within the category of claims governed by § 157(c)(1), the Bankruptcy Court would have been permitted to follow the procedures required by that provision, *i.e.*, to submit proposed findings of fact and conclusions of law to the District Court to be reviewed *de novo*.

B

Although this case did not proceed in precisely that fashion, we affirm nonetheless. A brief procedural history of the case helps explain why.

As noted, § 157 permits a bankruptcy court to adjudicate a claim to final judgment in two circumstances—in core proceedings, see § 157(b), and in non-core proceedings “with the consent of all the parties,” § 157(c)(2). In this case, the Bankruptcy Court entered judgment in favor of the bankruptcy trustee without specifying in its order whether it was acting pursuant to § 157(b) (core) or § 157(c)(2) (non-core with consent). EBIA immediately appealed to the District Court, see § 158, but it did not argue that the Bankruptcy *39 Court lacked constitutional authority to

134 S.Ct. 2165, 189 L.Ed.2d 83, 82 USLW 4450, 71 Collier Bankr.Cas.2d 875, 59 Bankr.Ct.Dec. 160, Bankr. L. Rep. P 82,642...

grant summary judgment. As a result, the District Court did not analyze whether there was a *Stern* problem and did not, as some district courts have done, relabel the bankruptcy order as mere proposed findings of fact and conclusions of law. See, e.g., *In re Parco Merged Media Corp.*, 489 B.R. 323, 326 (D.Me.2013) (collecting cases). The District Court did, however, review *de novo* the Bankruptcy Court's grant of summary judgment for the trustee—a legal question—and issued a reasoned opinion affirming the Bankruptcy Court. The District Court then separately entered judgment in favor of the trustee. See 28 U.S.C. § 1334(b) (“[T]he district courts **2175 shall have original but not exclusive jurisdiction of all civil proceedings ... related to cases under title 11”).

EBIA now objects on constitutional grounds to the Bankruptcy Court's disposition of the fraudulent conveyance claims. EBIA contends that it was constitutionally entitled to review of its fraudulent conveyance claims by an Article III court regardless of whether the parties consented to adjudication by a bankruptcy court. Brief for Petitioner 25–27. In an alternative argument, EBIA asserts that even if the Constitution permitted the Bankruptcy Court to adjudicate its claim with the consent of the parties, it did not in fact consent. *Id.*, at 38.

In light of the procedural posture of this case, however, we need not decide whether EBIA's contentions are correct on either score. At bottom, EBIA argues that it was entitled to have an Article III court review *de novo* and enter judgment on the fraudulent conveyance claims asserted by the trustee.

In effect, EBIA received exactly that. The District Court conducted *de novo* review of the summary judgment claims, concluding in a written opinion that there were no disputed issues of material fact and that the trustee was entitled to judgment as a matter of law. In accordance with its statutory authority over matters related to the bankruptcy, see § 1334(b), the District Court then separately *40 entered judgment in favor of the trustee. EBIA thus received the same review from the District Court that it would have received if the Bankruptcy Court had treated the fraudulent conveyance claims as non-core proceedings under § 157(c)(1). In short, even if EBIA is correct that the Bankruptcy Court's entry of judgment was invalid, the District Court's *de novo* review and entry of its own valid final judgment cured any error. Cf. *Carter v. Kubler*, 320 U.S. 243, 248, 64 S.Ct. 1, 88 L.Ed. 26 (1943) (bankruptcy commissioner's error was cured after the District Court “made an independent and complete review of the conflicting evidence”).

Accordingly, we affirm the judgment of the Court of Appeals.

It is so ordered.

All Citations

573 U.S. 25, 134 S.Ct. 2165, 189 L.Ed.2d 83, 82 USLW 4450, 71 Collier Bankr.Cas.2d 875, 59 Bankr.Ct.Dec. 160, Bankr. L. Rep. P 82,642, Bankr. L. Rep. P 82,642, 14 Cal. Daily Op. Serv. 6325, 2014 Daily Journal D.A.R. 7295, 24 Fla. L. Weekly Fed. S 824

Footnotes

* The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States v. Detroit Timber & Lumber Co.*, 200 U.S. 321, 337, 26 S.Ct. 282, 50 L.Ed. 499.

1 The trustee asserted claims of fraudulent conveyance under 11 U.S.C. § 544, and under state law, Wash. Rev. Code, ch. 19.40 (2012).

2 As we explain below, see Part II–B, *infra*, the statutory scheme at issue both in *Stern* and in this case grants bankruptcy courts the authority to “hear and determine” and “enter appropriate orders and judgments” in “core” proceedings. 28 U.S.C. § 157(b)(1). The statute lists counterclaims like the one brought in *Stern* as “core” claims. § 157(b)(2)(C).

3 *Granfinanciera* held that a fraudulent conveyance claim under Title 11 is not a matter of “public right” for purposes of Article III, 492 U.S., at 55, 109 S.Ct. 2782, and that the defendant to such a claim is entitled to a jury trial under the Seventh Amendment, *id.*, at 64, 109 S.Ct. 2782.

4 Because we conclude that EBIA received the *de novo* review and entry of judgment to which it claims constitutional entitlement, see Part IV–B, *infra*, this case does not require us to address whether EBIA in fact consented to the

134 S.Ct. 2165, 189 L.Ed.2d 83, 82 USLW 4450, 71 Collier Bankr.Cas.2d 875, 59 Bankr.Ct.Dec. 160, Bankr. L. Rep. P 82,642...

Bankruptcy Court's adjudication of a *Stern* claim and whether [Article III](#) permits a bankruptcy court, with the consent of the parties, to enter final judgment on a *Stern* claim. We reserve that question for another day.

- 5 Bankruptcy referees were designated “judges” in 1973. See [Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.](#), 458 U.S. 50, 53, n. 2, 102 S.Ct. 2858, 73 L.Ed.2d 598 (1982) (plurality opinion).
- 6 In addition, district courts may also withdraw such matters from the bankruptcy courts for “cause shown.” [§ 157\(d\)](#).
- 7 In using the term “core,” Congress tracked the *Northern Pipeline* plurality's use of the same term as a description of those claims that fell within the scope of the historical bankruptcy court's power. See 458 U.S., at 71, 102 S.Ct. 2858 (“[T]he restructuring of debtor-creditor relations, which is at the core of the federal bankruptcy power, must be distinguished from the adjudication of state-created private rights ...” (emphasis added)).
- 8 To the contrary, we noted in *Stern* that removal of claims from core bankruptcy jurisdiction does not “meaningfully chang[e] the division of labor in the current statute.” 564 U.S., at —, 131 S.Ct., at 2620. Accepting EBIA's contention that district courts are required to hear all *Stern* claims in the first instance, see Brief for Petitioner 46–48, would dramatically alter the division of responsibility set by Congress.

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131 S.Ct. 2594

Supreme Court of the United States

Howard K. STERN, Executor of the Estate
of Vickie Lynn Marshall, Petitioner,

v.

Elaine T. MARSHALL, Executrix
of the Estate of E. Pierce Marshall.

No. 10–179.

|

Argued Jan. 18, 2011.

|

Decided June 23, 2011.

Synopsis

Background: Widow brought adversary proceeding in her Chapter 11 bankruptcy case to recover for her stepson's alleged tortious interference with her expectancy of inheritance or gift from her deceased husband. The United States Bankruptcy Court for the Central District of California, Samuel L. Bufford, J., [253 B.R. 550](#), entered judgment for widow, and stepson appealed. The District Court, [David O. Carter, J., 275 B.R. 5](#), treated Bankruptcy Court's judgment as proposed findings of fact and conclusions of law and adopted them as modified. Both widow and stepson appealed. The United States Court of Appeals for the Ninth Circuit, [Beezer](#), Circuit Judge, [392 F.3d 1118](#), vacated. After granting certiorari, the Supreme Court, Justice [Ginsburg](#), [547 U.S. 293](#), [126 S.Ct. 1735](#), [164 L.Ed.2d 480](#), remanded. On remand, the Court of Appeals, [600 F.3d 1037](#), reversed and remanded with instructions.

After again granting certiorari, the Supreme Court, Chief Justice [Roberts](#), held that Bankruptcy Court lacked authority under Article III to enter final judgment on widow's counterclaim.

Affirmed.

Justice [Scalia](#) filed concurring opinion.

Justice [Breyer](#) filed dissenting opinion in which Justice [Ginsburg](#), Justice [Sotomayor](#), and Justice [Kagan](#) joined.

West Codenotes**Unconstitutional as Applied**[28 U.S.C.A. § 157\(b\)\(2\)\(C\)](#)****2595 Syllabus***

Article III, § 1, of the Constitution mandates that “[t]he judicial Power of the United States, shall be vested in one supreme Court, and in such inferior Courts as the Congress may from time to time ordain and establish,” and provides that the judges of those constitutional courts “shall hold their Offices during good Behaviour” and “receive for their Services[] a Compensation[] [that] shall not be diminished” during their tenure. The questions presented in this case are whether a Bankruptcy Court Judge who did not enjoy such tenure and salary protections had the authority under [28 U.S.C. § 157](#) and Article III to enter final judgment on a counterclaim filed by Vickie Lynn Marshall (whose estate is the petitioner) against Pierce Marshall (whose estate is the respondent) in Vickie's bankruptcy proceedings.

Vickie married J. Howard Marshall II, Pierce's father, approximately a year before his death. Shortly before J. Howard died, Vickie filed a suit against Pierce in Texas state court, asserting that J. Howard meant to provide for Vickie through a trust, and Pierce tortiously interfered with that gift. After J. Howard died, Vickie filed for bankruptcy in federal court. Pierce filed a proof of claim in that proceeding, asserting that he should be able to recover damages from Vickie's bankruptcy estate because Vickie had defamed him by inducing her lawyers to tell the press that he had engaged in fraud in controlling his father's assets. Vickie responded by filing a counterclaim for tortious ****2596** interference with the gift she expected from [J. Howard](#).

The Bankruptcy Court granted Vickie summary judgment on the defamation claim and eventually awarded her hundreds of millions of dollars in damages on her counterclaim. Pierce objected that the Bankruptcy Court lacked jurisdiction to enter a final judgment on that counterclaim because it was not a “core proceeding” as defined by [28 U.S.C. § 157\(b\)\(2\)\(C\)](#). As set forth in [§ 157\(a\)](#), Congress has divided bankruptcy proceedings into three categories: those that “aris[e] under title 11”; those that “aris[e] in” a Title 11 case; and those that are “related to a case under title 11.” District courts may refer all such proceedings to the bankruptcy judges of their district, and bankruptcy courts may enter final judgments in

“all core proceedings arising under title 11, or arising in a case under title 11.” §§ 157(a), (b)(1). In non-core proceedings, by contrast, a bankruptcy judge may only “submit proposed findings of fact and conclusions of law to the district court.” § 157(c)(1). Section 157(b)(2) lists 16 categories of core proceedings, including “counterclaims by the estate against persons filing claims against the estate.” § 157(b)(2)(C).

The Bankruptcy Court concluded that Vickie's counterclaim was a core proceeding. The District Court reversed, reading this Court's precedent in *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 102 S.Ct. 2858, 73 L.Ed.2d 598, to “suggest[] that it would be unconstitutional to hold that any and all counterclaims are core.” The court held that Vickie's counterclaim was not core because it was only somewhat related to Pierce's claim, and it accordingly treated the Bankruptcy Court's judgment as proposed, not final. Although the Texas state court had by that time conducted a jury trial on the merits of the parties' dispute and entered a judgment in Pierce's favor, the District Court went on to decide the matter itself, in Vickie's favor. The Court of Appeals ultimately reversed. It held that the Bankruptcy Court lacked authority to enter final judgment on Vickie's counterclaim because the claim was not “so closely related to [Pierce's] proof of claim that the resolution of the counterclaim is necessary to resolve the allowance or disallowance of the claim itself.” Because that holding made the Texas probate court's judgment the earliest final judgment on matters relevant to the case, the Court of Appeals held that the District Court should have given the state judgment preclusive effect.

Held: Although the Bankruptcy Court had the statutory authority to enter judgment on Vickie's counterclaim, it lacked the constitutional authority to do so. Pp. 2603 – 2620.

1. Section 157(b) authorized the Bankruptcy Court to enter final judgment on Vickie's counterclaim. Pp. 2604 – 2608.

(a) The Bankruptcy Court had the statutory authority to enter final judgment on Vickie's counterclaim as a core proceeding under § 157(b)(2)(C). Pierce argues that § 157(b) authorizes bankruptcy courts to enter final judgments only in those proceedings that are both core and either arise in a Title 11 case or arise under Title 11 itself. But that reading necessarily assumes that there is a category of core proceedings that do not arise in a bankruptcy case or under bankruptcy law, and the structure of § 157 makes clear that no such category exists. Pp. 2604 – 2605.

(b) In the alternative, Pierce argues that the Bankruptcy Court lacked jurisdiction to resolve Vickie's counterclaim because his defamation claim is a “personal injury tort” that the Bankruptcy Court lacked jurisdiction to hear under **2597 § 157(b)(5). The Court agrees with Vickie that § 157(b)(5) is not jurisdictional, and Pierce consented to the Bankruptcy Court's resolution of the defamation claim. The Court is not inclined to interpret statutes as creating a jurisdictional bar when they are not framed as such. See generally *Henderson v. Shinseki*, 562 U.S. 428, 131 S.Ct. 1197, 179 L.Ed.2d 159; *Arbaugh v. Y & H Corp.*, 546 U.S. 500, 126 S.Ct. 1235, 163 L.Ed.2d 1097. Section 157(b)(5) does not have the hallmarks of a jurisdictional decree, and the statutory context belies Pierce's claim that it is jurisdictional. Pierce consented to the Bankruptcy Court's resolution of the defamation claim by repeatedly advising that court that he was happy to litigate his claim there. Pp. 2606 – 2608.

2. Although § 157 allowed the Bankruptcy Court to enter final judgment on Vickie's counterclaim, Article III of the Constitution did not. Pp. 2608 – 2620.

(a) Article III is “an inseparable element of the constitutional system of checks and balances” that “both defines the power and protects the independence of the Judicial Branch.” *Northern Pipeline*, 458 U.S., at 58, 102 S.Ct. 2858 (plurality opinion). Article III protects liberty not only through its role in implementing the separation of powers, but also by specifying the defining characteristics of Article III judges to protect the integrity of judicial decisionmaking.

This is not the first time the Court has faced an Article III challenge to a bankruptcy court's resolution of a debtor's suit. In *Northern Pipeline*, the Court considered whether bankruptcy judges serving under the Bankruptcy Act of 1978—who also lacked the tenure and salary guarantees of Article III—could “constitutionally be vested with jurisdiction to decide [a] state-law contract claim” against an entity that was not otherwise part of the bankruptcy proceedings. *Id.*, at 53, 87, n. 40, 102 S.Ct. 2858 (plurality opinion). The plurality in *Northern Pipeline* recognized that there was a category of cases involving “public rights” that Congress could constitutionally assign to “legislative” courts for resolution. A full majority of the Court, while not agreeing on the scope of that exception, concluded that the doctrine did not encompass adjudication of the state law claim at issue in that case, and rejected the debtor's argument that the Bankruptcy Court's exercise of jurisdiction was constitutional because

the bankruptcy judge was acting merely as an adjunct of the district court or court of appeals. *Id.*, at 69–72, 102 S.Ct. 2858; see *id.*, at 90–91, 102 S.Ct. 2858 (Rehnquist, J., concurring in judgment). After the decision in *Northern Pipeline*, Congress revised the statutes governing bankruptcy jurisdiction and bankruptcy judges. With respect to the “core” proceedings listed in § 157(b)(2), however, the bankruptcy courts under the Bankruptcy Amendments and Federal Judgeship Act of 1984 exercise the same powers they wielded under the 1978 Act. The authority exercised by the newly constituted courts over a counterclaim such as Vickie’s exceeds the bounds of Article III. Pp. 2608 – 2611.

(b) Vickie’s counterclaim does not fall within the public rights exception, however defined. The Court has long recognized that, in general, Congress may not “withdraw from judicial cognizance any matter which, from its nature, is the subject of a suit at the common law, or in equity, or admiralty.” *Murray’s Lessee v. Hoboken Land & Improvement Co.*, 59 U.S. 272, 18 How. 272, 284, 15 L.Ed. 372. The Court has also recognized that “[a]t the same time there are matters, involving public rights, ... which are susceptible of judicial determination, but which congress may or may not bring within the cognizance of the courts of the United States, as it may ****2598** deem proper.” *Ibid.* Several previous decisions have contrasted cases within the reach of the public rights exception—those arising “between the Government and persons subject to its authority in connection with the performance of the constitutional functions of the executive or legislative departments”—and those that are instead matters “of private right, that is, of the liability of one individual to another under the law as defined.” *Crowell v. Benson*, 285 U.S. 22, 50, 51, 52 S.Ct. 285, 76 L.Ed. 598.

Shortly after *Northern Pipeline*, the Court rejected the limitation of the public rights exception to actions involving the Government as a party. The Court has continued, however, to limit the exception to cases in which the claim at issue derives from a federal regulatory scheme, or in which resolution of the claim by an expert Government agency is deemed essential to a limited regulatory objective within the agency’s authority. In other words, it is still the case that what makes a right “public” rather than private is that the right is integrally related to particular Federal Government action. See *United States v. Jicarilla Apache Nation*, ante, at 174, 131 S.Ct. 2313, 180 L.Ed.2d 187 (2011); *Thomas v. Union Carbide Agricultural Products Co.*, 473 U.S. 568, 584, 105 S.Ct. 3325, 87 L.Ed.2d 409; *Commodity Futures Trading*

Comm’n v. Schor, 478 U.S. 833, 844, 856, 106 S.Ct. 3245, 92 L.Ed.2d 675.

In *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 109 S.Ct. 2782, 106 L.Ed.2d 26, the most recent case considering the public rights exception, the Court rejected a bankruptcy trustee’s argument that a fraudulent conveyance action filed on behalf of a bankruptcy estate against a noncreditor in a bankruptcy proceeding fell within the exception. Vickie’s counterclaim is similar. It is not a matter that can be pursued only by grace of the other branches, as in *Murray’s Lessee*, supra, at 284; it does not flow from a federal statutory scheme, as in *Thomas*, supra, at 584–585, 105 S.Ct. 3325; and it is not “completely dependent upon” adjudication of a claim created by federal law, as in *Schor*, supra, at 856, 106 S.Ct. 3245. This case involves the most prototypical exercise of judicial power: the entry of a final, binding judgment by a court with broad substantive jurisdiction, on a common law cause of action, when the action neither derives from nor depends upon any agency regulatory regime. If such an exercise of judicial power may nonetheless be taken from the Article III Judiciary simply by deeming it part of some amorphous “public right,” then Article III would be transformed from the guardian of individual liberty and separation of powers the Court has long recognized into mere wishful thinking. Pp. 2611 – 2615.

(c) The fact that Pierce filed a proof of claim in the bankruptcy proceedings did not give the Bankruptcy Court the authority to adjudicate Vickie’s counterclaim. Initially, Pierce’s defamation claim does not affect the nature of Vickie’s tortious interference counterclaim as one at common law that simply attempts to augment the bankruptcy estate—the type of claim that, under *Northern Pipeline* and *Granfinanciera*, must be decided by an Article III court. The cases on which Vickie relies, *Katchen v. Landy*, 382 U.S. 323, 86 S.Ct. 467, 15 L.Ed.2d 391, and *Langenkamp v. Culp*, 498 U.S. 42, 111 S.Ct. 330, 112 L.Ed.2d 343 (*per curiam*), are inapposite. *Katchen* permitted a bankruptcy referee to exercise jurisdiction over a trustee’s voidable preference claim against a creditor only where there was no question that the referee was required to decide whether there had been a voidable preference in determining whether and to what ****2599** extent to allow the creditor’s claim. The *Katchen* Court “intimate[d] no opinion concerning whether” the bankruptcy referee would have had “summary jurisdiction to adjudicate a demand by the [bankruptcy] trustee for affirmative relief, all of the substantial factual and legal bases for which ha[d] not been disposed of in passing on objections to the [creditor’s proof of] claim.” 382 U.S., at 333, n. 9, 86

[S.Ct. 467](#). The *per curiam* opinion in *Langenkamp* is to the same effect. In this case, by contrast, the Bankruptcy Court—in order to resolve Vickie's counterclaim—was required to and did make several factual and legal determinations that were not “disposed of in passing on objections” to Pierce's proof of claim. In both *Katchen* and *Langenkamp*, moreover, the trustee bringing the preference action was asserting a right of recovery created by federal bankruptcy law. Vickie's claim is instead a state tort action that exists without regard to any bankruptcy proceeding. Pp. 2615 – 2618.

(d) The bankruptcy courts under the 1984 Act are not “adjuncts” of the district courts. The new bankruptcy courts, like the courts considered in *Northern Pipeline*, do not “ma[k]e only specialized, narrowly confined factual determinations regarding a particularized area of law” or engage in “statutorily channeled factfinding functions.” [458 U.S., at 85, 102 S.Ct. 2858](#) (plurality opinion). Whereas the adjunct agency in *Crowell v. Benson* “possessed only a limited power to issue compensation orders ... [that] could be enforced only by order of the district court,” [458 U.S., at 85, 102 S.Ct. 2858, 73 L.Ed.2d 598](#), a bankruptcy court resolving a counterclaim under [§ 157\(b\)\(2\)\(C\)](#) has the power to enter “appropriate orders and judgments”—including final judgments—subject to review only if a party chooses to appeal, see [§§ 157\(b\)\(1\), 158\(a\)-\(b\)](#). Such a court is an adjunct of no one. Pp. 2618 – 2619.

(e) Finally, Vickie and her *amici* predict that restrictions on a bankruptcy court's ability to hear and finally resolve compulsory counterclaims will create significant delays and impose additional costs on the bankruptcy process. It goes without saying that “the fact that a given law or procedure is efficient, convenient, and useful in facilitating functions of government, standing alone, will not save it if it is contrary to the Constitution.” *INS v. Chadha*, [462 U.S. 919, 944, 103 S.Ct. 2764, 77 L.Ed.2d 317](#). In addition, the Court is not convinced that the practical consequences of such limitations are as significant as Vickie suggests. The framework Congress adopted in the 1984 Act already contemplates that certain state law matters in bankruptcy cases will be resolved by state courts and district courts, see [§§ 157\(c\), 1334\(c\)](#), and the Court does not think the removal of counterclaims such as Vickie's from core bankruptcy jurisdiction meaningfully changes the division of labor in the statute. Pp. 2619 – 2620.

[600 F.3d 1037](#), affirmed.

[ROBERTS](#), C.J., delivered the opinion of the Court, in which [SCALIA](#), [KENNEDY](#), [THOMAS](#), and [ALITO](#), JJ., joined. [SCALIA](#), J., filed a concurring opinion, *post*, pp. 2620 – 2621. [BREYER](#), J., filed a dissenting opinion, in which [GINSBURG](#), [SOTOMAYOR](#), and [KAGAN](#), JJ., joined, *post*, pp. 2621 – 2630.

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Opinion

CHIEF JUSTICE [ROBERTS](#) delivered the opinion of the Court.

***468** This “suit has, in course of time, become so complicated, that ... no two ... lawyers can talk about it for five minutes, without coming to a total disagreement as to all the premises. Innumerable children have been born into the cause: innumerable young people have married into it;” and, sadly, the original parties “have died out of it.” A “long procession of [judges] has come in and gone out” during that time, and still the suit “drags its weary length before the Court.”

Those words were not written about this case, see C. Dickens, *Bleak House*, in 1 Works of Charles Dickens 4–5 (1891), but they could have been. This is the second time we have had occasion to weigh in on this long-running dispute between Vickie Lynn Marshall and E. Pierce Marshall over the fortune of J. Howard Marshall II, a man believed to have been one of the richest people in Texas. The Marshalls' litigation has worked its way through state and federal courts in Louisiana, Texas, and California, and two of those courts—a Texas state probate court and the Bankruptcy Court for the Central District of California—have reached contrary decisions on its merits. The Court of Appeals below held that the Texas state decision controlled, after concluding that the Bankruptcy Court lacked the authority to enter final judgment on a counterclaim that Vickie brought against ***469** Pierce in her bankruptcy proceeding.¹ To determine whether the Court of Appeals was correct in that regard, we must resolve two issues: (1) whether the Bankruptcy Court had the statutory authority under 28 U.S.C. § 157(b) to issue a final judgment on Vickie's counterclaim; and (2) if so, whether conferring that authority on the Bankruptcy Court is constitutional.

Although the history of this litigation is complicated, its resolution ultimately turns on very basic principles. Article III, § 1, of the Constitution commands that “[t]he judicial Power of the United States, shall be vested in one supreme Court, and in such inferior Courts as the Congress may from time to time ordain and establish.” That Article further provides that the judges of those courts shall hold their offices during good behavior, without diminution of salary. *Ibid.* Those requirements ****2601** of Article III were not honored here. The Bankruptcy Court in this case exercised the judicial power of the United States by entering final judgment on a common law tort claim, even though the judges of such courts enjoy neither tenure during good behavior nor salary protection. We conclude that, although the Bankruptcy Court had the statutory authority to enter judgment on Vickie's counterclaim, it lacked the constitutional authority to do so.

I

Because we have already recounted the facts and procedural history of this case in detail, see *Marshall v. Marshall*, 547 U.S. 293, 300–305, 126 S.Ct. 1735, 164 L.Ed.2d 480 (2006), we do not repeat them in full here. Of current relevance are two claims Vickie filed in an attempt to secure half of J. Howard's fortune. Known to the public as Anna Nicole Smith, Vickie was J. Howard's third wife and married him

about a year before his death. ***470** *Id.*, at 300, 126 S.Ct. 1735; see *In re Marshall*, 392 F.3d 1118, 1122 (C.A.9 2004). Although J. Howard bestowed on Vickie many monetary and other gifts during their courtship and marriage, he did not include her in his will. 547 U.S., at 300, 126 S.Ct. 1735. Before J. Howard passed away, Vickie filed suit in Texas state probate court, asserting that Pierce—J. Howard's younger son—fraudulently induced J. Howard to sign a living trust that did not include her, even though J. Howard meant to give her half his property. Pierce denied any fraudulent activity and defended the validity of J. Howard's trust and, eventually, his will. 392 F.3d, at 1122–1123, 1125.

After J. Howard's death, Vickie filed a petition for bankruptcy in the Central District of California. Pierce filed a complaint in that bankruptcy proceeding, contending that Vickie had defamed him by inducing her lawyers to tell members of the press that he had engaged in fraud to gain control of his father's assets. 547 U.S., at 300–301, 126 S.Ct. 1735; *In re Marshall*, 600 F.3d 1037, 1043–1044 (C.A.9 2010). The complaint sought a declaration that Pierce's defamation claim was not dischargeable in the bankruptcy proceedings. *Ibid.*; see 11 U.S.C. § 523(a). Pierce subsequently filed a proof of claim for the defamation action, meaning that he sought to recover damages for it from Vickie's bankruptcy estate. See § 501(a). Vickie responded to Pierce's initial complaint by asserting truth as a defense to the alleged defamation and by filing a counterclaim for tortious interference with the gift she expected from J. Howard. As she had in state court, Vickie alleged that Pierce had wrongfully prevented J. Howard from taking the legal steps necessary to provide her with half his property. 547 U.S., at 301, 126 S.Ct. 1735.

On November 5, 1999, the Bankruptcy Court issued an order granting Vickie summary judgment on Pierce's claim for defamation. On September 27, 2000, after a bench trial, the Bankruptcy Court issued a judgment on Vickie's counterclaim in her favor. The court later awarded Vickie over \$400 million in compensatory damages and \$25 million in punitive ***471** damages. 600 F.3d, at 1045; see 253 B.R. 550, 561–562 (Bkrcty.Ct.C.D.Cal.2000); 257 B.R. 35, 39–40 (Bkrcty.Ct.C.D.Cal.2000).

In post-trial proceedings, Pierce argued that the Bankruptcy Court lacked jurisdiction over Vickie's counterclaim. In particular, Pierce renewed a claim he had made earlier in the litigation, asserting that the Bankruptcy Court's authority over the counterclaim was limited because Vickie's counterclaim was not a “core proceeding” under 28 U.S.C. § 157(b)(2)

(C). See 257 B.R., at 39. As explained below, bankruptcy courts may hear and enter final **2602 judgments in “core proceedings” in a bankruptcy case. In noncore proceedings, the bankruptcy courts instead submit proposed findings of fact and conclusions of law to the district court, for that court’s review and issuance of final judgment. The Bankruptcy Court in this case concluded that Vickie’s counterclaim was “a core proceeding” under § 157(b)(2)(C), and the court therefore had the “power to enter judgment” on the counterclaim under § 157(b)(1). *Id.*, at 40.

The District Court disagreed. It recognized that “Vickie’s counterclaim for tortious interference falls within the literal language” of the statute designating certain proceedings as “core,” see § 157(b)(2)(C), but understood this Court’s precedent to “suggest[] that it would be unconstitutional to hold that any and all counterclaims are core.” 264 B.R. 609, 629–630 (C.D.Cal.2001) (citing *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 79, n. 31, 102 S.Ct. 2858, 73 L.Ed.2d 598 (1982) (plurality opinion)). The District Court accordingly concluded that a “counterclaim should not be characterized as core” when it “is only somewhat related to the claim against which it is asserted, and when the unique characteristics and context of the counterclaim place it outside of the normal type of set-off or other counterclaims that customarily arise.” 264 B.R., at 632.

Because the District Court concluded that Vickie’s counterclaim was not core, the court determined that it was required *472 to treat the Bankruptcy Court’s judgment as “proposed[,] rather than final,” and engage in an “independent review” of the record. *Id.*, at 633; see 28 U.S.C. § 157(c)(1). Although the Texas state court had by that time conducted a jury trial on the merits of the parties’ dispute and entered a judgment in Pierce’s favor, the District Court declined to give that judgment preclusive effect and went on to decide the matter itself. 271 B.R. 858, 862–867 (C.D.Cal.2001); see 275 B.R. 5, 56–58 (C.D.Cal.2002). Like the Bankruptcy Court, the District Court found that Pierce had tortiously interfered with Vickie’s expectancy of a gift from J. Howard. The District Court awarded Vickie compensatory and punitive damages, each in the amount of \$44,292,767.33. *Id.*, at 58.

The Court of Appeals reversed the District Court on a different ground, 392 F.3d, at 1137, and we—in the first visit of the case to this Court—reversed the Court of Appeals on that issue. 547 U.S., at 314–315, 126 S.Ct. 1735. On remand from this Court, the Court of Appeals held that

§ 157 mandated “a two-step approach” under which a bankruptcy judge may issue a final judgment in a proceeding only if the matter both “meets Congress’ definition of a core proceeding *and* arises under or arises in title 11,” the Bankruptcy Code. 600 F.3d, at 1055. The court also reasoned that allowing a bankruptcy judge to enter final judgments on all counterclaims raised in bankruptcy proceedings “would certainly run afoul” of this Court’s decision in *Northern Pipeline*. 600 F.3d, at 1057. With those concerns in mind, the court concluded that “a counterclaim under § 157(b)(2)(C) is properly a ‘core’ proceeding ‘arising in a case under’ the [Bankruptcy] Code only if the counterclaim is so closely related to [a creditor’s] proof of claim that the resolution of the counterclaim is necessary to resolve the allowance or disallowance of the claim itself.” *Id.*, at 1058 (internal quotation marks omitted; second brackets added). The court ruled that Vickie’s counterclaim did not meet that test. *Id.*, at 1059. That holding made “the *473 Texas probate court’s judgment ... the earliest final judgment entered on matters relevant to this proceeding,” and therefore the Court of Appeals concluded that the District Court should have “afford[ed] **2603 preclusive effect” to the Texas “court’s determination of relevant legal and factual issues.” *Id.*, at 1064–1065.²

We again granted certiorari. 561 U.S. 1058, 131 S.Ct. 63, 177 L.Ed.2d 1152 (2010).

II

A

With certain exceptions not relevant here, the district courts of the United States have “original and exclusive jurisdiction of all cases under title 11.” 28 U.S.C. § 1334(a). Congress has divided bankruptcy proceedings into three categories: those that “aris[e] under title 11”; those that “aris[e] in” a Title 11 case; and those that are “related to a case under title 11.” § 157(a). District courts may refer any or all such proceedings to the bankruptcy judges of their district, *ibid.*, which is how the Bankruptcy Court in this case came to preside over Vickie’s bankruptcy proceedings. District courts also may withdraw a case or proceeding referred to the bankruptcy court “for cause shown.” § 157(d). Since Congress enacted the Bankruptcy Amendments and Federal Judgeship Act of 1984 (1984 Act), bankruptcy judges for each district have been appointed to

14-year terms by the courts of appeals for the circuits in which their district is located. § 152(a)(1).

The manner in which a bankruptcy judge may act on a referred matter depends on the type of proceeding involved. *474 Bankruptcy judges may hear and enter final judgments in “all core proceedings arising under title 11, or arising in a case under title 11.” § 157(b)(1). “Core proceedings include, but are not limited to,” 16 different types of matters, including “counterclaims by [a debtor’s] estate against persons filing claims against the estate.” § 157(b)(2)(C).³ Parties *475 may **2604 appeal final judgments of a bankruptcy court in core proceedings to the district court, which reviews them under traditional appellate standards. See § 158(a); Fed. Rule Bkrcty. Proc. 8013.

When a bankruptcy judge determines that a referred “proceeding ... is not a core proceeding but ... is otherwise related to a case under title 11,” the judge may only “submit proposed findings of fact and conclusions of law to the district court.” § 157(c)(1). It is the district court that enters final judgment in such cases after reviewing *de novo* any matter to which a party objects. *Ibid*.

B

Vickie’s counterclaim against Pierce for tortious interference is a “core proceeding” under the plain text of § 157(b)(2)(C). That provision specifies that core proceedings include “counterclaims by the estate against persons filing claims against the estate.” In past cases, we have suggested that a proceeding’s “core” status alone authorizes a bankruptcy judge, as a statutory matter, to enter final judgment in the proceeding. See, e.g., *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 50, 109 S.Ct. 2782, 106 L.Ed.2d 26 (1989) (explaining that Congress had designated certain actions as “‘core proceedings,’ which bankruptcy judges may adjudicate and in which they may issue final judgments, if a district court has referred the matter to them” (citations omitted)). We have not directly addressed the question, however, and Pierce argues that a bankruptcy judge may enter final judgment on a core proceeding only if that proceeding also “aris[es] in” a Title 11 case or “aris[es] under” Title 11 itself. Brief for Respondent 51 (internal quotation marks omitted).

Section 157(b)(1) authorizes bankruptcy courts to “hear and determine all cases under title 11 and all core proceedings arising under title 11, or arising in a case under title 11.”

As written, § 157(b)(1) is ambiguous. The “arising under” and “arising in” phrases might, as Pierce suggests, be read as referring to a limited category of those core proceedings *476 that are addressed in that section. On the other hand, the phrases might be read as simply describing what core proceedings are: matters arising under Title 11 or in a Title 11 case. In this case the structure and context of § 157 contradict Pierce’s interpretation of § 157(b)(1).

As an initial matter, Pierce’s reading of the statute necessarily assumes that there is a category of core proceedings that neither arise under Title 11 nor arise in a Title 11 case. The manner in which the statute delineates the bankruptcy courts’ authority, however, makes plain that no such category exists. Section 157(b)(1) authorizes bankruptcy judges to enter final judgments in “core proceedings arising under title 11, or arising in a case under title 11.” Section 157(c)(1) instructs bankruptcy judges to instead submit proposed findings in “a proceeding that is not a core proceeding but that is otherwise related to a case under title 11.” Nowhere does § 157 specify what bankruptcy courts are to do with respect to the category of matters that Pierce posits—core proceedings that do *not* arise under Title 11 or in a Title 11 case. To the contrary, § 157(b)(3) only instructs a bankruptcy judge to “determine, **2605 on the judge’s own motion or on timely motion of a party, whether a proceeding is a core proceeding under this subsection or is a proceeding that is otherwise related to a case under title 11.” Two options. The statute does not suggest that any other distinctions need be made.

Under our reading of the statute, core proceedings are those that arise in a bankruptcy case or under Title 11. The detailed list of core proceedings in § 157(b)(2) provides courts with ready examples of such matters. Pierce’s reading of § 157, in contrast, supposes that some core proceedings will arise in a Title 11 case or under Title 11 and some will not. Under that reading, the statute provides no guidance on how to tell which are which.

We think it significant that Congress failed to provide any framework for identifying or adjudicating the asserted category of core but not “arising” proceedings, given the otherwise *477 detailed provisions governing bankruptcy court authority. It is hard to believe that Congress would go to the trouble of cataloging 16 different types of proceedings that should receive “core” treatment, but then fail to specify how to determine whether those matters arise under Title 11 or in a bankruptcy case if—as Pierce asserts—the latter inquiry is determinative of the bankruptcy court’s authority.

Pierce argues that we should treat core matters that arise neither under Title 11 nor in a Title 11 case as proceedings “related to” a Title 11 case. Brief for Respondent 60 (internal quotation marks omitted). We think that a contradiction in terms. It does not make sense to describe a “core” bankruptcy proceeding as merely “related to” the bankruptcy case; oxymoron is not a typical feature of congressional drafting. See *Northern Pipeline*, 458 U.S., at 71, 102 S.Ct. 2858 (plurality opinion) (distinguishing “the restructuring of debtor-creditor relations, which is at the core of the federal bankruptcy power, ... from the adjudication of state-created private rights”); 1 Collier on Bankruptcy ¶ 3.02[2], p. 3–26, n. 5 (16th ed. 2010) (“The terms ‘non-core’ and ‘related’ are synonymous”); see also *id.*, at 3–26 (“The phraseology of section 157 leads to the conclusion that there is no such thing as a core matter that is ‘related to’ a case under title 11. Core proceedings are, at most, those that arise in title 11 cases or arise under title 11” (footnote omitted)). And, as already discussed, the statute simply does not provide for a proceeding that is simultaneously core and yet only related to the bankruptcy case. See § 157(c)(1) (providing only for “a proceeding that is not a core proceeding but that is otherwise related to a case under title 11”).

As we explain in Part III, we agree with Pierce that designating all counterclaims as “core” proceedings raises serious constitutional concerns. Pierce is also correct that we will, where possible, construe federal statutes so as “to avoid serious doubt of their constitutionality.” *Commodity Futures Trading Comm’n v. Schor*, 478 U.S. 833, 841, 106 S.Ct. 3245, 92 L.Ed.2d 675 (1986) (internal *478 quotation marks omitted). But that “canon of construction does not give [us] the prerogative to ignore the legislative will in order to avoid constitutional adjudication.” *Ibid.* In this case, we do not think the plain text of § 157(b)(2)(C) leaves any room for the canon of avoidance. We would have to “rewrit[e]” the statute, not interpret it, to bypass the constitutional issue § 157(b)(2)(C) presents. *Id.*, at 841, 106 S.Ct. 3245 (internal quotation marks omitted). That we may not do. We agree with Vickie that § 157(b)(2)(C) permits the bankruptcy court to enter a final judgment on her tortious interference counterclaim.

****2606 C**

Pierce argues, as another alternative to reaching the constitutional question, that the Bankruptcy Court lacked jurisdiction to enter final judgment on his defamation claim.

Section 157(b)(5) provides that “[t]he district court shall order that personal injury tort and wrongful death claims shall be tried in the district court in which the bankruptcy case is pending, or in the district court in the district in which the claim arose.” Pierce asserts that his defamation claim is a “personal injury tort,” that the Bankruptcy Court therefore had no jurisdiction over that claim, and that the court therefore necessarily lacked jurisdiction over Vickie’s counterclaim as well. Brief for Respondent 65–66.

Vickie objects to Pierce’s statutory analysis across the board. To begin, Vickie contends that § 157(b)(5) does not address subject matter jurisdiction at all, but simply specifies the venue in which “personal injury tort and wrongful death claims” should be tried. See Reply Brief for Petitioner 16–17, 19; see also Tr. of Oral Arg. 23 (Deputy Solicitor General) (Section “157(b)(5) is, in [the United States]’ view, not jurisdictional”). Given the limited scope of that provision, Vickie argues, a party may waive or forfeit any objections under § 157(b)(5), in the same way that a party may waive or forfeit an objection to the bankruptcy court finally resolving a noncore claim. Reply Brief for Petitioner 17–20; *479 see § 157(c)(2) (authorizing the district court, “with the consent of all the parties to the proceeding,” to refer a “related to” matter to the bankruptcy court for final judgment). Vickie asserts that in this case Pierce consented to the Bankruptcy Court’s adjudication of his defamation claim, and forfeited any argument to the contrary, by failing to seek withdrawal of the claim until he had litigated it before the Bankruptcy Court for 27 months. *Id.*, at 20–23. On the merits, Vickie contends that the statutory phrase “personal injury tort and wrongful death claims” does not include non-physical torts such as defamation. *Id.*, at 25–26.

We need not determine what constitutes a “personal injury tort” in this case because we agree with Vickie that § 157(b)(5) is not jurisdictional, and that Pierce consented to the Bankruptcy Court’s resolution of his defamation claim.⁴ Because “[b]randing a rule as going to a court’s subject-matter jurisdiction alters the normal operation of our adversarial *480 **2607 system,” *Henderson v. Shinseki*, 562 U.S. 428, 434, 131 S.Ct. 1197, 1201–03, 179 L.Ed.2d 159 (2011), we are not inclined to interpret statutes as creating a jurisdictional bar when they are not framed as such. See generally *Arbaugh v. Y & H Corp.*, 546 U.S. 500, 516, 126 S.Ct. 1235, 163 L.Ed.2d 1097 (2006) (“when Congress does not rank a statutory limitation on coverage as jurisdictional, courts should treat the restriction as nonjurisdictional in character”).

Section 157(b)(5) does not have the hallmarks of a jurisdictional decree. To begin, the statutory text does not refer to either district court or bankruptcy court “jurisdiction,” instead addressing only where personal injury tort claims “shall be tried.”

The statutory context also belies Pierce's jurisdictional claim. Section 157 allocates the authority to enter final judgment between the bankruptcy court and the district court. See §§ 157(b)(1), (c)(1). That allocation does not implicate questions of subject matter jurisdiction. See § 157(c)(2) (parties may consent to entry of final judgment by bankruptcy judge in noncore case). By the same token, § 157(b)(5) simply specifies where a particular category of cases should be tried. Pierce does not explain why that statutory limitation may not be similarly waived.

We agree with Vickie that Pierce not only could but did consent to the Bankruptcy Court's resolution of his defamation claim. Before the Bankruptcy Court, Vickie objected to Pierce's proof of claim for defamation, arguing that Pierce's claim was unenforceable and that Pierce should not receive any amount for it. See 29 Court of Appeals Supplemental Excerpts of Record 6031, 6035 (hereinafter Supplemental Record). Vickie also noted that the Bankruptcy Court could defer ruling on her objection, given the litigation posture of Pierce's claim before the Bankruptcy Court. See *id.*, at 6031. Vickie's filing prompted Pierce to advise the Bankruptcy Court that “[a]ll parties are in agreement that the amount of the contingent Proof of Claim filed by [Pierce] shall be determined by the adversary proceedings” that had *481 been commenced in the Bankruptcy Court. 31 *id.*, at 6801. Pierce asserted that Vickie's objection should be overruled or, alternatively, that any ruling on the objection “should be continued until the resolution of the pending adversary proceeding litigation.” *Ibid.* Pierce identifies no point in the record where he argued to the Bankruptcy Court that it lacked the authority to adjudicate his proof of claim because the claim sought recompense for a personal injury tort.

Indeed, Pierce apparently did not object to any court that § 157(b)(5) prohibited the Bankruptcy Court from resolving his defamation claim until over two years—and several adverse discovery rulings—after he filed that claim in June 1996. The first filing Pierce cites as raising that objection is his September 22, 1998 motion to the District Court to withdraw the reference of the case to the Bankruptcy Court. See

Brief for Respondent 26–27. The District Court did initially withdraw the reference as requested, but it then returned the proceeding to the Bankruptcy Court, observing that Pierce “implicated the jurisdiction of that bankruptcy court. He chose to be a party to that litigation.” App. 129. Although Pierce had objected in July 1996 to the Bankruptcy Court's exercise of jurisdiction over Vickie's counterclaim, he advised the court at that time that he was “happy to litigate [his] claim” there. 29 Supplemental Record 6101. Counsel stated that even though Pierce thought it was “probably cheaper for th[e] estate if [Pierce's claim] were sent back or joined back with the State Court litigation,” **2608 Pierce “did choose” the Bankruptcy Court forum and “would be more than pleased to do it [t]here.” *Id.*, at 6101–6102; see also App. to Pet. for Cert. 266, n. 17 (District Court referring to these statements).

Given Pierce's course of conduct before the Bankruptcy Court, we conclude that he consented to that court's resolution of his defamation claim (and forfeited any argument to the contrary). We have recognized “the value of waiver and forfeiture rules” in “complex” cases, *Exxon Shipping Co. v. Baker*, 554 U.S. 471, 487–488, n. 6, 128 S.Ct. 2605, 171 L.Ed.2d 570 (2008), and this case is no exception. In such cases, as here, the consequences of “a litigant ... ‘sandbagging’ the court—remaining silent about his objection and belatedly raising the error only if the case does not conclude in his favor,” *Puckett v. United States*, 556 U.S. 129, 134, 129 S.Ct. 1423, 1428–29, 173 L.Ed.2d 266 (2009) (some internal quotation marks omitted)—can be particularly severe. If Pierce believed that the Bankruptcy Court lacked the authority to decide his claim for defamation, then he should have said so—and said so promptly. See *United States v. Olano*, 507 U.S. 725, 731, 113 S.Ct. 1770, 123 L.Ed.2d 508 (1993) (“‘No procedural principle is more familiar to this Court than that a constitutional right,’ or a right of any other sort, ‘may be forfeited ... by the failure to make timely assertion of the right before a tribunal having jurisdiction to determine it’ ” (quoting *Yakus v. United States*, 321 U.S. 414, 444, 64 S.Ct. 660, 88 L.Ed. 834 (1944))). Instead, Pierce repeatedly stated to the Bankruptcy Court that he was happy to litigate there. We will not consider his claim to the contrary, now that he is sad.

III

Although we conclude that § 157(b)(2)(C) permits the Bankruptcy Court to enter final judgment on Vickie's counterclaim, Article III of the Constitution does not.

A

Article III, § 1, of the Constitution mandates that “[t]he judicial Power of the United States, shall be vested in one supreme Court, and in such inferior Courts as the Congress may from time to time ordain and establish.” The same section provides that the judges of those constitutional courts “shall hold their Offices during good Behaviour” and “receive for their Services[] a Compensation[] [that] shall not be diminished” during their tenure.

As its text and our precedent confirm, Article III is “an inseparable element of the constitutional system of checks *483 and balances” that “both defines the power and protects the independence of the Judicial Branch.” *Northern Pipeline*, 458 U.S., at 58, 102 S.Ct. 2858 (plurality opinion). Under “the basic concept of separation of powers ... that flow[s] from the scheme of a tripartite government” adopted in the Constitution, “the ‘judicial Power of the United States’ ... can no more be shared” with another branch than “the Chief Executive, for example, can share with the Judiciary the veto power, or the Congress share with the Judiciary the power to override a Presidential veto.” *United States v. Nixon*, 418 U.S. 683, 704, 94 S.Ct. 3090, 41 L.Ed.2d 1039 (1974) (quoting U.S. Const., Art. III, § 1).

In establishing the system of divided power in the Constitution, the Framers considered it essential that “the judiciary remain[] truly distinct from both the legislature and the executive.” The Federalist No. 78, p. 466 (C. Rossiter ed. 1961) (A. Hamilton). As Hamilton put it, quoting Montesquieu, “‘there is no liberty if the power of judging be not separated from the legislative and executive powers.’” **2609 *Ibid.* (quoting 1 Montesquieu, *Spirit of Laws* 181).

We have recognized that the three branches are not hermetically sealed from one another, see *Nixon v. Administrator of General Services*, 433 U.S. 425, 443, 97 S.Ct. 2777, 53 L.Ed.2d 867 (1977), but it remains true that Article III imposes some basic limitations that the other branches may not transgress. Those limitations serve two related purposes. “Separation-of-powers principles are intended, in part, to protect each branch of government from incursion by the others. Yet the dynamic between and among the branches is not the only object of the Constitution’s concern. The structural principles secured by the separation of

powers protect the individual as well.” *Bond v. United States*, ante, at 222, 131 S.Ct. 2355, 2365, 180 L.Ed.2d 269 (2011).

Article III protects liberty not only through its role in implementing the separation of powers, but also by specifying the defining characteristics of Article III judges. The colonists had been subjected to judicial abuses at the hand *484 of the Crown, and the Framers knew the main reasons why: because the King of Great Britain “made Judges dependent on his Will alone, for the tenure of their offices, and the amount and payment of their salaries.” The Declaration of Independence ¶ 11. The Framers undertook in Article III to protect citizens subject to the judicial power of the new Federal Government from a repeat of those abuses. By appointing judges to serve without term limits, and restricting the ability of the other branches to remove judges or diminish their salaries, the Framers sought to ensure that each judicial decision would be rendered, not with an eye toward currying favor with Congress or the Executive, but rather with the “[c]lear heads ... and honest hearts” deemed “essential to good judges.” 1 Works of James Wilson 363 (J. Andrews ed. 1896).

Article III could neither serve its purpose in the system of checks and balances nor preserve the integrity of judicial decisionmaking if the other branches of the Federal Government could confer the Government’s “judicial Power” on entities outside Article III. That is why we have long recognized that, in general, Congress may not “withdraw from judicial cognizance any matter which, from its nature, is the subject of a suit at the common law, or in equity, or admiralty.” *Murray’s Lessee v. Hoboken Land & Improvement Co.*, 59 U.S. 272, 18 How. 272, 284, 15 L.Ed. 372 (1856). When a suit is made of “the stuff of the traditional actions at common law tried by the courts at Westminster in 1789,” *Northern Pipeline*, 458 U.S., at 90, 102 S.Ct. 2858 (Rehnquist, J., concurring in judgment), and is brought within the bounds of federal jurisdiction, the responsibility for deciding that suit rests with Article III judges in Article III courts. The Constitution assigns that job—resolution of “the mundane as well as the glamorous, matters of common law and statute as well as constitutional law, issues of fact as well as issues of law”—to the Judiciary. *Id.*, at 86–87, n. 39, 102 S.Ct. 2858 (plurality opinion).

*485 B

This is not the first time we have faced an Article III challenge to a bankruptcy court’s resolution of a debtor’s suit. In

Northern Pipeline, we considered whether bankruptcy judges serving under the Bankruptcy Act of 1978—appointed by the President and confirmed by the Senate, but lacking the tenure and salary guarantees of Article III—could “constitutionally be vested with jurisdiction to decide [a] state-law contract claim” against an entity ****2610** that was not otherwise part of the bankruptcy proceedings. *Id.*, at 53, 87, n. 40, 102 S.Ct. 2858 (plurality opinion); see *id.*, at 89–92, 102 S.Ct. 2858 (Rehnquist, J., concurring in judgment). The Court concluded that assignment of such state law claims for resolution by those judges “violates Art. III of the Constitution.” *Id.*, at 52, 87, 102 S.Ct. 2858 (plurality opinion); *id.*, at 91, 102 S.Ct. 2858 (Rehnquist, J., concurring in judgment).

The plurality in *Northern Pipeline* recognized that there was a category of cases involving “public rights” that Congress could constitutionally assign to “legislative” courts for resolution. That opinion concluded that this “public rights” exception extended “only to matters arising between” individuals and the Government “in connection with the performance of the constitutional functions of the executive or legislative departments ... that historically could have been determined exclusively by those” branches. *Id.*, at 67–68, 102 S.Ct. 2858 (internal quotation marks omitted). A full majority of the Court, while not agreeing on the scope of the exception, concluded that the doctrine did not encompass adjudication of the state law claim at issue in that case. *Id.*, at 69–72, 102 S.Ct. 2858; see *id.*, at 90–91, 102 S.Ct. 2858 (Rehnquist, J., concurring in judgment) (“None of the [previous cases addressing Article III power] has gone so far as to sanction the type of adjudication to which Marathon will be subjected To whatever extent different powers granted under [the 1978] Act might be sustained under the ‘public rights’ doctrine of *Murray’s Lessee* ... ***486** and succeeding cases, I am satisfied that the adjudication of Northern’s lawsuit cannot be so sustained”).⁵

A full majority of Justices in *Northern Pipeline* also rejected the debtor’s argument that the bankruptcy court’s exercise of jurisdiction was constitutional because the bankruptcy judge was acting merely as an adjunct of the district court or court of appeals. *Id.*, at 71–72, 81–86, 102 S.Ct. 2858 (plurality opinion); *id.*, at 91, 102 S.Ct. 2858 (Rehnquist, J., concurring in judgment) (“the bankruptcy court is not an ‘adjunct’ of either the district court or the court of appeals”).

After our decision in *Northern Pipeline*, Congress revised the statutes governing bankruptcy jurisdiction and bankruptcy judges. In the 1984 Act, Congress provided that the judges of

the new bankruptcy courts would be appointed by the courts of appeals for the circuits in which their districts are located. **28 U.S.C. § 152(a)**. And, as we have explained, Congress permitted the newly constituted bankruptcy courts to enter final judgments only in “core” proceedings. See *supra*, at 2603 – 2604.

With respect to such “core” matters, however, the bankruptcy courts under the 1984 Act exercise the same powers they wielded under the Bankruptcy Act of 1978 (1978 Act), 92 Stat. 2549. As in *Northern Pipeline*, for example, the newly constituted bankruptcy courts are charged under **§ 157(b)(2) (C)** with resolving “[a]ll matters of fact and law in whatever domains of the law to which” a counterclaim may lead. **458 U.S.**, at 91, 102 S.Ct. 2858 (Rehnquist, J., concurring in judgment); see, e.g., **275 B.R.**, at 50–51 (noting that Vickie’s counterclaim required the bankruptcy court to determine whether Texas recognized a cause of action for tortious interference with an *inter vivos* gift—something the Supreme Court of Texas had yet to do). As in *Northern Pipeline*, the new courts in core proceedings “issue final judgments, ***487 **2611** which are binding and enforceable even in the absence of an appeal.” **458 U.S.**, at 85–86, 102 S.Ct. 2858 (plurality opinion). And, as in *Northern Pipeline*, the district courts review the judgments of the bankruptcy courts in core proceedings only under the usual limited appellate standards. That requires marked deference to, among other things, the bankruptcy judges’ findings of fact. See **§ 158(a)**; **Fed. Rule Bkrcty. Proc. 8013** (findings of fact “shall not be set aside unless clearly erroneous”).

C

Vickie and the dissent argue that the Bankruptcy Court’s entry of final judgment on her state common law counterclaim was constitutional, despite the similarities between the bankruptcy courts under the 1978 Act and those exercising core jurisdiction under the 1984 Act. We disagree. It is clear that the Bankruptcy Court in this case exercised the “judicial Power of the United States” in purporting to resolve and enter final judgment on a state common law claim, just as the court did in *Northern Pipeline*. No “public right” exception excuses the failure to comply with Article III in doing so, any more than in *Northern Pipeline*. Vickie argues that this case is different because the defendant is a creditor in the bankruptcy. But the debtors’ claims in the cases on which she relies were themselves federal claims under bankruptcy law, which would be completely resolved in the bankruptcy process of

allowing or disallowing claims. Here Vickie's claim is a state law action independent of the federal bankruptcy law and not necessarily resolvable by a ruling on the creditor's proof of claim in bankruptcy. *Northern Pipeline* and our subsequent decision in *Granfinanciera*, 492 U.S. 33, 109 S.Ct. 2782, rejected the application of the “public rights” exception in such cases.

Nor can the bankruptcy courts under the 1984 Act be dismissed as mere adjuncts of Article III courts, any more than could the bankruptcy courts under the 1978 Act. The judicial powers the courts exercise in cases such as this remain *488 the same, and a court exercising such broad powers is no mere adjunct of anyone.

1

Vickie's counterclaim cannot be deemed a matter of “public right” that can be decided outside the Judicial Branch. As explained above, in *Northern Pipeline* we rejected the argument that the public rights doctrine permitted a bankruptcy court to adjudicate a state law suit brought by a debtor against a company that had not filed a claim against the estate. See 458 U.S., at 69–72, 102 S.Ct. 2858 (plurality opinion); *id.*, at 90–91, 102 S.Ct. 2858 (Rehnquist, J., concurring in judgment). Although our discussion of the public rights exception since that time has not been entirely consistent, and the exception has been the subject of some debate, this case does not fall within any of the various formulations of the concept that appear in this Court's opinions.

We first recognized the category of public rights in *Murray's Lessee v. Hoboken Land & Improvement Co.*, 59 U.S. 272, 18 How. 272, 15 L.Ed. 372 (1856). That case involved the Treasury Department's sale of property belonging to a customs collector who had failed to transfer payments to the Federal Government that he had collected on its behalf. *Id.*, at 274, 275. The plaintiff, who claimed title to the same land through a different transfer, objected that the Treasury Department's calculation of the deficiency and sale of the property was void, because it was a judicial act that could not be assigned to the Executive under Article III. *Id.*, at 274–275, 282–283.

**2612 “To avoid misconstruction upon so grave a subject,” the Court laid out the principles guiding its analysis. *Id.*, at 284. It confirmed that Congress cannot “withdraw from

judicial cognizance any matter which, from its nature, is the subject of a suit at the common law, or in equity, or admiralty.” *Ibid.* The Court also recognized that “[a]t the same time there are matters, involving public rights, which may be presented in such form that the judicial power is capable of acting on them, and which are susceptible of judicial determination, *489 but which congress may or may not bring within the cognizance of the courts of the United States, as it may deem proper.” *Ibid.*

As an example of such matters, the Court referred to “[e]quitable claims to land by the inhabitants of ceded territories” and cited cases in which land issues were conclusively resolved by Executive Branch officials. *Ibid.* (citing *Foley v. Harrison*, 56 U.S. 433, 15 How. 433, 14 L.Ed. 761 (1854); *Burgess v. Gray*, 57 U.S. 48, 16 How. 48, 14 L.Ed. 839 (1854)). In those cases “it depends upon the will of congress whether a remedy in the courts shall be allowed at all,” so Congress could limit the extent to which a judicial forum was available. *Murray's Lessee*, 18 How., at 284. The challenge in *Murray's Lessee* to the Treasury Department's sale of the collector's land likewise fell within the “public rights” category of cases, because it could only be brought if the Federal Government chose to allow it by waiving sovereign immunity. *Id.*, at 283–284. The point of *Murray's Lessee* was simply that Congress may set the terms of adjudicating a suit when the suit could not otherwise proceed at all.

Subsequent decisions from this Court contrasted cases within the reach of the public rights exception—those arising “between the Government and persons subject to its authority in connection with the performance of the constitutional functions of the executive or legislative departments”—and those that were instead matters “of private right, that is, of the liability of one individual to another under the law as defined.” *Crowell v. Benson*, 285 U.S. 22, 50, 51, 52 S.Ct. 285, 76 L.Ed. 598 (1932).⁶ See *Atlas Roofing Co. v. Occupational Safety *490 and Health Review **2613 Comm'n*, 430 U.S. 442, 458, 97 S.Ct. 1261, 51 L.Ed.2d 464 (1977) (exception extends to cases “where the Government is involved in its sovereign capacity under ... [a] statute creating enforceable public rights,” while “[w]holly private tort, contract, and property cases, as well as a vast range of other cases ... are not at all implicated”); *Ex parte Bakelite Corp.*, 279 U.S. 438, 451–452, 49 S.Ct. 411, 73 L.Ed. 789 (1929). See also *Northern Pipeline*, 458 U.S., at 68, 102 S.Ct. 2858 (plurality opinion) (citing *Ex parte Bakelite Corp.* for the proposition that the doctrine extended “only to matters that historically

could have been determined exclusively by” the Executive and Legislative Branches).

Shortly after *Northern Pipeline*, the Court rejected the limitation of the public rights exception to actions involving the Government as a party. The Court has continued, however, to limit the exception to cases in which the claim at issue derives from a federal regulatory scheme, or in which resolution of the claim by an expert Government agency is deemed essential to a limited regulatory objective within the agency's authority. In other words, it is still the case that what makes a right “public” rather than private is that the right is integrally related to particular Federal Government ***491** action. See *United States v. Jicarilla Apache Nation*, ante, at 174, 131 S.Ct. 2313, 2323, 180 L.Ed.2d 187 (“The distinction between ‘public rights’ against the Government and ‘private rights’ between private parties is well established” (citing *Murray's Lessee* and *Crowell*)).

Our decision in *Thomas v. Union Carbide Agricultural Products Co.*, for example, involved a data-sharing arrangement between companies under a federal statute providing that disputes about compensation between the companies would be decided by binding arbitration. 473 U.S. 568, 571–575, 105 S.Ct. 3325, 87 L.Ed.2d 409 (1985). This Court held that the scheme did not violate Article III, explaining that “[a]ny right to compensation ... results from [the statute] and does not depend on or replace a right to such compensation under state law.” *Id.*, at 584, 105 S.Ct. 3325.

Commodity Futures Trading Comm'n v. Schor concerned a statutory scheme that created a procedure for customers injured by a broker's violation of the federal commodities law to seek reparations from the broker before the [Commodity Futures Trading Commission \(CFTC\)](#). 478 U.S., at 836, 106 S.Ct. 3245, 92 L.Ed.2d 675. A customer filed such a claim to recover a debit balance in his account, while the broker filed a lawsuit in Federal District Court to recover the same amount as lawfully due from the customer. The broker later submitted its claim to the CFTC, but after that agency ruled against the customer, the customer argued that agency jurisdiction over the broker's counterclaim violated Article III. *Id.*, at 837–838, 106 S.Ct. 3245. This Court disagreed, but only after observing that (1) the claim and the counterclaim concerned a “single dispute”—the same account balance; (2) the CFTC's assertion of authority involved only “a narrow class of common law claims” in a “‘particularized area of law’”; (3) the area of law in question was governed by “a specific and limited federal regulatory scheme” as to which the agency had “obvious

expertise”; (4) the parties had freely elected to resolve their differences before the CFTC; and (5) CFTC orders were “enforceable only by order of the district court.” *Id.*, at 844, 852 – 856, 106 S.Ct. 3245 (quoting *Northern Pipeline, supra*, at 85, 102 S.Ct. 2858); see ***492** 478 U.S., at 843–844, 849–857, 106 S.Ct. 3245. ****2614** Most significantly, given that the customer's reparations claim before the agency and the broker's counterclaim were competing claims to the same amount, the Court repeatedly emphasized that it was “necessary” to allow the agency to exercise jurisdiction over the broker's claim, or else “the reparations procedure would have been confounded.” *Id.*, at 856, 106 S.Ct. 3245.

The most recent case in which we considered application of the public rights exception—and the only case in which we have considered that doctrine in the bankruptcy context since *Northern Pipeline*—is *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 109 S.Ct. 2782, 106 L.Ed.2d 26 (1989). In *Granfinanciera* we rejected a bankruptcy trustee's argument that a fraudulent conveyance action filed on behalf of a bankruptcy estate against a noncreditor in a bankruptcy proceeding fell within the “public rights” exception. We explained that, “[i]f a statutory right is not closely intertwined with a federal regulatory program Congress has power to enact, and if that right neither belongs to nor exists against the Federal Government, then it must be adjudicated by an Article III court.” *Id.*, at 54–55, 109 S.Ct. 2782. We reasoned that fraudulent conveyance suits were “quintessentially suits at common law that more nearly resemble state law contract claims brought by a bankrupt corporation to augment the bankruptcy estate than they do creditors' hierarchically ordered claims to a pro rata share of the bankruptcy res.” *Id.*, at 56, 109 S.Ct. 2782. As a consequence, we concluded that fraudulent conveyance actions were “more accurately characterized as a private rather than a public right as we have used those terms in our Article III decisions.” *Id.*, at 55, 109 S.Ct. 2782.⁷

***493** Vickie's counterclaim—like the fraudulent conveyance claim at issue in *Granfinanciera*—does not fall within any of the varied formulations of the public rights exception in this Court's cases. It is not a matter that can be pursued only by grace of the other branches, as in *Murray's Lessee*, 18 How., at 284, or one that “historically could have been determined exclusively by” those branches, *Northern Pipeline, supra*, at 68, 102 S.Ct. 2858 (citing *Ex parte Bakelite Corp.*, *supra*, at 458, 49 S.Ct. 411). The claim is instead one under state common law between two private parties. It does

not “depend [] upon the will of congress,” *Murray's Lessee*, *supra*, at 284; Congress has nothing to do with it.

In addition, Vickie's claimed right to relief does not flow from a federal statutory scheme, as in *Thomas*, *supra*, at 584 – 585, 105 S.Ct. 3325, or *Atlas Roofing*, 430 U.S., at 458, 97 S.Ct. 1261. It is not “completely dependent upon” adjudication of a claim created by federal law, as in *Schor*, 478 U.S., at 856, 106 S.Ct. 3245. And in contrast to the objecting party in *Schor*, *id.*, at 855–856, 106 S.Ct. 3245, Pierce did not truly consent to resolution of Vickie's claim in the bankruptcy court proceedings. He had nowhere else to go if he wished to recover from Vickie's estate. See *Granfinanciera*, *supra*, at 59, n. 14, 109 S.Ct. 2782 (noting that “[p]arallel reasoning [to *Schor*] is unavailable in the context of bankruptcy proceedings, because creditors lack an alternative forum to the bankruptcy court in which to pursue their claims”).⁸

****2615** Furthermore, the asserted authority to decide Vickie's claim is not limited to a “particularized area of the law,” as in *Crowell*, *Thomas*, and *Schor*. *Northern Pipeline*, 458 U.S., at 85, 102 S.Ct. 2858 (plurality opinion). We deal here not with an ***494** agency but with a court, with substantive jurisdiction reaching any area of the *corpus juris*. See *ibid.*; *id.*, at 91, 102 S.Ct. 2858 (Rehnquist, J., concurring in judgment). This is not a situation in which Congress devised an “expert and inexpensive method for dealing with a class of questions of fact which are particularly suited to examination and determination by an administrative agency specially assigned to that task.” *Crowell*, 285 U.S., at 46, 52 S.Ct. 285; see *Schor*, *supra*, at 855–856, 106 S.Ct. 3245. The “experts” in the federal system at resolving common law counterclaims such as Vickie's are the Article III courts, and it is with those courts that her claim must stay.

The dissent reads our cases differently, and in particular contends that more recent cases view *Northern Pipeline* as “ ‘establish[ing] only that Congress may not vest in a non-Article III court the power to adjudicate, render final judgment, and issue binding orders in a traditional contract action arising under state law, without consent of the litigants, and subject only to ordinary appellate review.’ ” *Post*, at 2624 (quoting *Thomas*, 473 U.S., at 584, 105 S.Ct. 3325). Just so: Substitute “tort” for “contract,” and that statement directly covers this case.

We recognize that there may be instances in which the distinction between public and private rights—at least as

framed by some of our recent cases—fails to provide concrete guidance as to whether, for example, a particular agency can adjudicate legal issues under a substantive regulatory scheme. Given the extent to which this case is so markedly distinct from the agency cases discussing the public rights exception in the context of such a regime, however, we do not in this opinion express any view on how the doctrine might apply in that different context.

What is plain here is that this case involves the most prototypical exercise of judicial power: the entry of a final, binding judgment *by a court* with broad substantive jurisdiction, on a common law cause of action, when the action neither derives from nor depends upon any agency regulatory regime. ***495** If such an exercise of judicial power may nonetheless be taken from the Article III Judiciary simply by deeming it part of some amorphous “public right,” then Article III would be transformed from the guardian of individual liberty and separation of powers we have long recognized into mere wishful thinking.

2

Vickie and the dissent next attempt to distinguish *Northern Pipeline* and *Granfinanciera* on the ground that Pierce, unlike the defendants in those cases, had filed a proof of claim in the bankruptcy proceedings. Given Pierce's participation in those proceedings, Vickie argues, the Bankruptcy ****2616** Court had the authority to adjudicate her counterclaim under our decisions in *Katchen v. Landy*, 382 U.S. 323, 86 S.Ct. 467, 15 L.Ed.2d 391 (1966), and *Langenkamp v. Culp*, 498 U.S. 42, 111 S.Ct. 330, 112 L.Ed.2d 343 (1990) (*per curiam*).

We do not agree. As an initial matter, it is hard to see why Pierce's decision to file a claim should make any difference with respect to the characterization of Vickie's counterclaim. “ ‘[P]roperty interests are created and defined by state law,’ and ‘[u]nless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding.’ ” *Travelers Casualty & Surety Co. of America v. Pacific Gas & Elec. Co.*, 549 U.S. 443, 451, 127 S.Ct. 1199, 167 L.Ed.2d 178 (2007) (quoting *Butner v. United States*, 440 U.S. 48, 55, 99 S.Ct. 914, 59 L.Ed.2d 136 (1979)). Pierce's claim for defamation in no way affects the nature of Vickie's counterclaim for tortious interference as one at common law that simply attempts to augment the bankruptcy estate—the

very type of claim that we held in *Northern Pipeline* and *Granfinanciera* must be decided by an Article III court.

Contrary to Vickie's contention, moreover, our decisions in *Katchen* and *Langenkamp* do not suggest a different result. *Katchen* permitted a bankruptcy referee acting under the Bankruptcy Acts of 1898 and 1938 (akin to a bankruptcy court today) to exercise what was known as “summary jurisdiction” *496 over a voidable preference claim brought by the bankruptcy trustee against a creditor who had filed a proof of claim in the bankruptcy proceeding. See 382 U.S., at 325, 327–328, 86 S.Ct. 467. A voidable preference claim asserts that a debtor made a payment to a particular creditor in anticipation of bankruptcy, to in effect increase that creditor's proportionate share of the estate. The preferred creditor's claim in bankruptcy can be disallowed as a result of the preference, and the amounts paid to that creditor can be recovered by the trustee. See *id.*, at 330, 86 S.Ct. 467; see also 11 U.S.C. §§ 502(d), 547(b).

Although the creditor in *Katchen* objected that the preference issue should be resolved through a “plenary suit” in an Article III court, this Court concluded that summary adjudication in bankruptcy was appropriate, because it was not possible for the referee to rule on the creditor's proof of claim without first resolving the voidable preference issue. 382 U.S., at 329–330, 332–333, and n. 9, 334, 86 S.Ct. 467. There was no question that the bankruptcy referee could decide whether there had been a voidable preference in determining whether and to what extent to allow the creditor's claim. Once the referee did that, “nothing remains for adjudication in a plenary suit”; such a suit “would be a meaningless gesture.” *Id.*, at 334, 86 S.Ct. 467. The plenary proceeding the creditor sought could be brought into the bankruptcy court because “the same issue [arose] as part of the process of allowance and disallowance of claims.” *Id.*, at 336, 86 S.Ct. 467.

It was in that sense that the Court stated that “he who invokes the aid of the bankruptcy court by offering a proof of claim and demanding its allowance must abide the consequences of that procedure.” *Id.*, at 333, n. 9, 86 S.Ct. 467. In *Katchen* one of those consequences was resolution of the preference issue as part of the process of allowing or disallowing claims, and accordingly there was no basis for the creditor to insist that the issue be resolved in an Article III court. See *id.*, at 334, 86 S.Ct. 467. Indeed, the *Katchen* Court expressly noted that it “intimate[d] no opinion concerning whether” the bankruptcy *497 **2617 referee would have had “summary jurisdiction to adjudicate a demand by

the [bankruptcy] trustee for affirmative relief, all of the substantial factual and legal bases for which ha[d] not been disposed of in passing on objections to the [creditor's proof of] claim.” *Id.*, at 333, n. 9, 86 S.Ct. 467.

Our *per curiam* opinion in *Langenkamp* is to the same effect. We explained there that a preferential transfer claim can be heard in bankruptcy when the allegedly favored creditor has filed a claim, because *then* “the ensuing preference action by the trustee become[s] integral to the restructuring of the debtor-creditor relationship.” 498 U.S., at 44, 111 S.Ct. 330. If, in contrast, the creditor has not filed a proof of claim, the trustee's preference action does *not* “become[] part of the claims-allowance process” subject to resolution by the bankruptcy court. *Ibid.*; see *id.*, at 45, 111 S.Ct. 330.

In ruling on Vickie's counterclaim, the Bankruptcy Court was required to and did make several factual and legal determinations that were not “disposed of in passing on objections” to Pierce's proof of claim for defamation, which the court had denied almost a year earlier. *Katchen*, *supra*, at 332, n. 9., 86 S.Ct. 467. There was some overlap between Vickie's counterclaim and Pierce's defamation claim that led the courts below to conclude that the counterclaim was compulsory, 600 F.3d, at 1057, or at least in an “attenuated” sense related to Pierce's claim, 264 B.R., at 631. But there was never any reason to believe that the process of adjudicating Pierce's proof of claim would necessarily resolve Vickie's counterclaim. See *id.*, at 631, 632 (explaining that “the primary facts at issue on Pierce's claim were the relationship between Vickie and her attorneys and her knowledge or approval of their statements,” and “the counterclaim raises issues of law entirely different from those raise[d] on the defamation claim”). The United States acknowledges the point. See Brief for United States as *Amicus Curiae*, p. (I) (question presented concerns authority of a bankruptcy court to enter final judgment on a compulsory counterclaim “when adjudication *498 of the counterclaim requires resolution of issues that are not implicated by the claim against the estate”); *id.*, at 26.

The only overlap between the two claims in this case was the question whether Pierce had in fact tortiously taken control of his father's estate in the manner alleged by Vickie in her counterclaim and described in the allegedly defamatory statements. From the outset, it was clear that, even assuming the Bankruptcy Court would (as it did) rule in Vickie's favor on that question, the court could not enter judgment for Vickie unless the court additionally ruled on the questions whether

Texas recognized tortious interference with an expected gift as a valid cause of action, what the elements of that action were, and whether those elements were met in this case. 275 B.R., at 50–53. Assuming Texas accepted the elements adopted by other jurisdictions, that meant Vickie would need to prove, above and beyond Pierce's tortious interference, (1) the existence of an expectancy of a gift; (2) a reasonable certainty that the expectancy would have been realized but for the interference; and (3) damages. *Id.*, at 51; see 253 B.R., at 558–561. Also, because Vickie sought punitive damages in connection with her counterclaim, the Bankruptcy Court could not finally dispose of the case in Vickie's favor without determining whether to subject Pierce to the sort of “retribution,” “punishment[,] and deterrence,” *Exxon Shipping Co.*, 554 U.S., at 492, 504, 128 S.Ct. 2605 (internal quotation marks omitted), those damages are designed to impose. There thus was never reason to believe that the process of ruling **2618 on Pierce's proof of claim would necessarily result in the resolution of Vickie's counterclaim.

In both *Katchen* and *Langenkamp*, moreover, the trustee bringing the preference action was asserting a right of recovery created by federal bankruptcy law. In *Langenkamp*, we noted that “the trustee instituted adversary proceedings under 11 U.S.C. § 547(b) to recover, as avoidable preferences,” payments respondents received from the debtor before the bankruptcy filings. 498 U.S., at 43, 111 S.Ct. 330; see, *499 *e.g.*, § 547(b)(1) (“the trustee may avoid any transfer of an interest of the debtor in property—(1) to or for the benefit of a creditor”). In *Katchen*, “[t]he Trustee ... [asserted] that the payments made [to the creditor] were preferences inhibited by Section 60a of the Bankruptcy Act.” Memorandum Opinion (Feb. 8, 1963), Tr. of Record in O.T.1965, No. 28, p. 3; see 382 U.S., at 334, 86 S.Ct. 467 (considering impact of the claims allowance process on “action by the trustee under § 60 to recover the preference”); 11 U.S.C. § 96(b) (1964 ed.) (§ 60(b) of the then-applicable Bankruptcy Act) (“preference may be avoided by the trustee if the creditor receiving it or to be benefited thereby ... has, at the time when the transfer is made, reasonable cause to believe that the debtor is insolvent”). Vickie's claim, in contrast, is in no way derived from or dependent upon bankruptcy law; it is a state tort action that exists without regard to any bankruptcy proceeding.

In light of all the foregoing, we disagree with the dissent that there are no “relevant distinction[s]” between Pierce's claim in this case and the claim at issue in *Langenkamp*. *Post*, at 2628. We see no reason to treat Vickie's counterclaim

any differently from the fraudulent conveyance action in *Granfinanciera*. 492 U.S., at 56, 109 S.Ct. 2782. *Granfinanciera*'s distinction between actions that seek “to augment the bankruptcy estate” and those that seek “a pro rata share of the bankruptcy res,” *ibid.*, reaffirms that Congress may not bypass Article III simply because a proceeding may have *some* bearing on a bankruptcy case; the question is whether the action at issue stems from the bankruptcy itself or would necessarily be resolved in the claims allowance process. Vickie has failed to demonstrate that her counterclaim falls within one of the “limited circumstances” covered by the public rights exception, particularly given our conclusion that, “even with respect to matters that arguably fall within the scope of the ‘public rights’ doctrine, the presumption is in favor of Art. III courts.” *Northern Pipeline*, 458 U.S., at 69, n. 23, 77, n. 29, 102 S.Ct. 2858 (plurality opinion).

*500 3

Vickie additionally argues that the Bankruptcy Court's final judgment was constitutional because bankruptcy courts under the 1984 Act are properly deemed “adjuncts” of the district courts. Brief for Petitioner 61–64. We rejected a similar argument in *Northern Pipeline*, see 458 U.S., at 84–86, 102 S.Ct. 2858 (plurality opinion); *id.*, at 91, 102 S.Ct. 2858 (Rehnquist, J., concurring in judgment), and our reasoning there holds true today.

To begin, as explained above, it is still the bankruptcy court itself that exercises the essential attributes of judicial power over a matter such as Vickie's counterclaim. See *supra*, at 2610. The new bankruptcy courts, like the old, do not “ma[k]e only specialized, narrowly confined factual determinations regarding a particularized area of law” or engage in “statutorily channeled factfinding functions.” *Northern Pipeline*, 458 U.S., at 85, 102 S.Ct. 2858 (plurality opinion). Instead, bankruptcy courts under the 1984 Act resolve **2619 “[a]ll matters of fact and law in whatever domains of the law to which” the parties' counterclaims might lead. *Id.*, at 91, 102 S.Ct. 2858 (Rehnquist, J., concurring in judgment).

In addition, whereas the adjunct agency in *Crowell v. Benson* “possessed only a limited power to issue compensation orders ... [that] could be enforced only by order of the district court,” *Northern Pipeline*, *supra*, at 85, 102 S.Ct. 2858, a bankruptcy court resolving a counterclaim under 28 U.S.C. §

157(b)(2)(C) has the power to enter “appropriate orders and judgments”—including final judgments—subject to review only if a party chooses to appeal, see §§ 157(b)(1), 158(a)-(b). It is thus no less the case here than it was in *Northern Pipeline* that “[t]he authority—and the responsibility—to make an informed, final determination ... remains with” the bankruptcy judge, not the district court. 458 U.S., at 81, 102 S.Ct. 2858 (plurality opinion) (internal quotation marks omitted). Given that authority, a bankruptcy court can no more be deemed a mere “adjunct” of the district court than a district court can be deemed such an “adjunct” of the court of appeals. We certainly *501 cannot accept the dissent’s notion that judges who have the power to enter final, binding orders are the “functional []” equivalent of “law clerks [] and the Judiciary’s administrative officials.” *Post*, at 2627. And even were we wrong in this regard, that would only confirm that such judges should not be in the business of entering final judgments in the first place.

It does not affect our analysis that, as Vickie notes, bankruptcy judges under the current Act are appointed by the Article III courts, rather than the President. See Brief for Petitioner 59. If—as we have concluded—the bankruptcy court itself exercises “the essential attributes of judicial power [that] are reserved to Article III courts,” *Schor*, 478 U.S., at 851, 106 S.Ct. 3245 (internal quotation marks omitted), it does not matter who appointed the bankruptcy judge or authorized the judge to render final judgments in such proceedings. The constitutional bar remains. See *The Federalist* No. 78, at 471 (“Periodical appointments, however regulated, or by whomsoever made, would, in some way or other, be fatal to [a judge’s] necessary independence”).

D

Finally, Vickie and her *amici* predict as a practical matter that restrictions on a bankruptcy court’s ability to hear and finally resolve compulsory counterclaims will create significant delays and impose additional costs on the bankruptcy process. See, e.g., Brief for Petitioner 34–36, 57–58; Brief for United States as *Amicus Curiae* 29–30. It goes without saying that “the fact that a given law or procedure is efficient, convenient, and useful in facilitating functions of government, standing alone, will not save it if it is contrary to the Constitution.” *INS v. Chadha*, 462 U.S. 919, 944, 103 S.Ct. 2764, 77 L.Ed.2d 317 (1983).

In addition, we are not convinced that the practical consequences of such limitations on the authority of bankruptcy courts to enter final judgments are as significant as Vickie and the dissent suggest. See *post*, at 2630. The dissent *502 asserts that it is important that counterclaims such as Vickie’s be resolved “in a bankruptcy court,” and that, “to be effective, a single tribunal must have broad authority to restructure [debtor-creditor] relations.” *Post*, at 2628, 2629 (emphasis deleted). But the framework Congress adopted in the 1984 Act already contemplates that certain state law matters in bankruptcy cases will be resolved by judges other than those of the bankruptcy courts. **2620 Section 1334(c)(2), for example, requires that bankruptcy courts abstain from hearing specified noncore, state law claims that “can be timely adjudicated [] in a State forum of appropriate jurisdiction.” Section 1334(c)(1) similarly provides that bankruptcy courts may abstain from hearing any proceeding, including core matters, “in the interest of comity with State courts or respect for State law.”

As described above, the current bankruptcy system also requires the district court to review *de novo* and enter final judgment on any matters that are “related to” the bankruptcy proceedings, § 157(c)(1), and permits the district court to withdraw from the bankruptcy court any referred case, proceeding, or part thereof, § 157(d). Pierce has not argued that the bankruptcy courts “are barred from ‘hearing’ all counterclaims” or proposing findings of fact and conclusions of law on those matters, but rather that it must be the district court that “finally decide[s]” them. Brief for Respondent 61. We do not think the removal of counterclaims such as Vickie’s from core bankruptcy jurisdiction meaningfully changes the division of labor in the current statute; we agree with the United States that the question presented here is a “narrow” one. Brief for United States as *Amicus Curiae* 23.

If our decision today does not change all that much, then why the fuss? Is there really a threat to the separation of powers where Congress has conferred the judicial power outside Article III only over certain counterclaims in bankruptcy? The short but emphatic answer is yes. A statute *503 may no more lawfully chip away at the authority of the Judicial Branch than it may eliminate it entirely. “Slight encroachments create new boundaries from which legions of power can seek new territory to capture.” *Reid v. Covert*, 354 U.S. 1, 39, 77 S.Ct. 1222, 1 L.Ed.2d 1148 (1957) (plurality opinion). Although “[i]t may be that it is the obnoxious thing in its mildest and least repulsive form,” we cannot overlook the intrusion: “illegitimate and unconstitutional practices get

their first footing in that way, namely, by silent approaches and slight deviations from legal modes of procedure.” *Boyd v. United States*, 116 U.S. 616, 635, 6 S.Ct. 524, 29 L.Ed. 746 (1886). We cannot compromise the integrity of the system of separated powers and the role of the Judiciary in that system, even with respect to challenges that may seem innocuous at first blush.

* * *

Article III of the Constitution provides that the judicial power of the United States may be vested only in courts whose judges enjoy the protections set forth in that Article. We conclude today that Congress, in one isolated respect, exceeded that limitation in the Bankruptcy Act of 1984. The Bankruptcy Court below lacked the constitutional authority to enter a final judgment on a state law counterclaim that is not resolved in the process of ruling on a creditor's proof of claim. Accordingly, the judgment of the Court of Appeals is affirmed.

It is so ordered.

Justice SCALIA, concurring.

I agree with the Court's interpretation of our Article III precedents, and I accordingly join its opinion. I adhere to my view, however, that—our contrary precedents notwithstanding—“a matter of public rights ... must at a minimum arise between the government and others,” *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 65, 109 S.Ct. 2782, 106 L.Ed.2d 26 (1989) (SCALIA, J., concurring in part and concurring in judgment) (internal quotation marks omitted).

***504 **2621** The sheer surfeit of factors that the Court was required to consider in this case should arouse the suspicion that something is seriously amiss with our jurisprudence in this area. I count at least seven different reasons given in the Court's opinion for concluding that an Article III judge was required to adjudicate this lawsuit: that it was one “under state common law” which was “not a matter that can be pursued only by grace of the other branches,” *ante*, at 2614; that it was “not ‘completely dependent upon’ adjudication of a claim created by federal law,” *ibid.*; that “Pierce did not truly consent to resolution of Vickie's claim in the bankruptcy court proceedings,” *ibid.*; that “the asserted authority to decide Vickie's claim is not limited to a ‘particularized area

of the law,” ” *ibid.*; that “there was never any reason to believe that the process of adjudicating Pierce's proof of claim would necessarily resolve Vickie's counterclaim,” *ante*, at 2617; that the trustee was not “asserting a right of recovery created by federal bankruptcy law,” *ante*, at 2618; and that the Bankruptcy Judge “ha[d] the power to enter ‘appropriate orders and judgments’—including final judgments—subject to review only if a party chooses to appeal,” *ante*, at 2619.

Apart from their sheer numerosity, the more fundamental flaw in the many tests suggested by our jurisprudence is that they have nothing to do with the text or tradition of Article III. For example, Article III gives no indication that state-law claims have preferential entitlement to an Article III judge; nor does it make pertinent the extent to which the area of the law is “particularized.” The multifactors relied upon today seem to have entered our jurisprudence almost randomly.

Leaving aside certain adjudications by federal administrative agencies, which are governed (for better or worse) by our landmark decision in *Crowell v. Benson*, 285 U.S. 22, 52 S.Ct. 285, 76 L.Ed. 598 (1932), in my view an Article III judge is required in *all* federal adjudications, unless there is a firmly established historical ***505** practice to the contrary. For that reason—and not because of some intuitive balancing of benefits and harms—I agree that Article III judges are not required in the context of territorial courts, courts-martial, or true “public rights” cases. See *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 71, 102 S.Ct. 2858, 73 L.Ed.2d 598 (1982) (plurality opinion). Perhaps historical practice permits non-Article III judges to process claims against the bankruptcy estate, see, e.g., Plank, *Why Bankruptcy Judges Need Not and Should Not Be Article III Judges*, 72 Am. Bankr.L.J. 567, 607–609 (1998); the subject has not been briefed, and so I state no position on the matter. But Vickie points to no historical practice that authorizes a non-Article III judge to adjudicate a counterclaim of the sort at issue here.

Justice BREYER, with whom Justice GINSBURG, Justice SOTOMAYOR, and Justice KAGAN join, dissenting.

Pierce Marshall filed a claim in Federal Bankruptcy Court against the estate of Vickie Marshall. His claim asserted that Vickie Marshall had, through her lawyers, accused him of trying to prevent her from obtaining money that his father had wanted her to have; that her accusations violated state defamation law; and that she consequently owed Pierce Marshall damages. Vickie Marshall filed a

compulsory counterclaim in which she asserted that Pierce Marshall had unlawfully interfered with her husband's efforts to grant her an *inter vivos* gift and that he consequently owed her damages.

The Bankruptcy Court adjudicated the claim and the counterclaim. In doing so, ****2622** the court followed statutory procedures applicable to “core” bankruptcy proceedings. See 28 U.S.C. § 157(b). And ultimately the Bankruptcy Court entered judgment in favor of Vickie Marshall. The question before us is whether the Bankruptcy Court possessed jurisdiction to adjudicate Vickie Marshall's counterclaim. I agree with the Court that the bankruptcy statute, ***506** § 157(b)(2)(C), authorizes a bankruptcy court to adjudicate the counterclaim. But I do not agree with the majority about the statute's constitutionality. I believe the statute is consistent with the Constitution's delegation of the “judicial Power of the United States” to the Judicial Branch of Government. Art. III, § 1. Consequently, it is constitutional.

I

My disagreement with the majority's conclusion stems in part from my disagreement about the way in which it interprets, or at least emphasizes, certain precedents. In my view, the majority overstates the current relevance of statements this Court made in an 1856 case, *Murray's Lessee v. Hoboken Land & Improvement Co.*, 59 U.S. 272, 18 How. 272, 15 L.Ed. 372, and it overstates the importance of an analysis that did not command a Court majority in *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 102 S.Ct. 2858, 73 L.Ed.2d 598 (1982), and that was subsequently disavowed. At the same time, I fear the Court understates the importance of a watershed opinion widely thought to demonstrate the constitutional basis for the current authority of administrative agencies to adjudicate private disputes, namely, *Crowell v. Benson*, 285 U.S. 22, 52 S.Ct. 285, 76 L.Ed. 598 (1932). And it fails to follow the analysis that this Court more recently has held applicable to the evaluation of claims of a kind before us here, namely, claims that a congressional delegation of adjudicatory authority violates separation-of-powers principles derived from Article III. See *Thomas v. Union Carbide Agricultural Products Co.*, 473 U.S. 568, 105 S.Ct. 3325, 87 L.Ed.2d 409 (1985); *Commodity Futures Trading Comm'n v. Schor*, 478 U.S. 833, 106 S.Ct. 3245, 92 L.Ed.2d 675 (1986).

I shall describe these cases in some detail in order to explain why I believe we should put less weight than does the majority upon the statement in *Murray's Lessee* and the analysis followed by the *Northern Pipeline* plurality and instead should apply the approach this Court has applied in *Crowell*, *Thomas*, and *Schor*.

***507** A

In *Murray's Lessee*, the Court held that the Constitution permitted an executive official, through summary, nonjudicial proceedings, to attach the assets of a customs collector whose account was deficient. The Court found evidence in common law of “summary method[s] for the recovery of debts due to the crown, and especially those due from receivers of the revenues,” 18 How., at 277, and it analogized the Government's summary attachment process to the kind of self-help remedies available to private parties, *id.*, at 283. In the course of its opinion, the Court wrote:

“[W]e do not consider congress can either withdraw from judicial cognizance any matter which, from its nature, is the subject of a suit at the common law, or in equity, or admiralty; nor, on the other hand, can it bring under the judicial power a matter which, from its nature, is not a subject for judicial determination. At the same time there are matters, involving public rights, which may be presented in such form that the judicial power is capable of acting on them, and which are susceptible of judicial determination, but which congress may or may not bring within the cognizance of ****2623** the courts of the United States, as it may deem proper.” *Id.*, at 284.

The majority reads the first part of the statement's first sentence as authoritatively defining the boundaries of Article III. *Ante*, at 2609. I would read the statement in a less absolute way. For one thing, the statement is in effect dictum. For another, it is the remainder of the statement, announcing a distinction between “public rights” and “private rights,” that has had the more lasting impact. Later Courts have seized on that distinction when *upholding* non-Article III adjudication, not when striking it down. See *Ex parte Bakelite Corp.*, 279 U.S. 438, 451–452, 49 S.Ct. 411, 73 L.Ed. 789 (1929) (Court of Customs Appeals); *Williams v. United States*, 289 U.S. 553, 579–580, 53 S.Ct. 751, 77 L.Ed. 1372 (1933) (Court of Claims). The one exception is *Northern* ***508** *Pipeline*, where the Court struck down the Bankruptcy Act of 1978. But in that case there was no majority. And a plurality, not

a majority, read the statement roughly in the way the Court does today. See [458 U.S., at 67–70](#), [102 S.Ct. 2858](#).

B

At the same time, I believe the majority places insufficient weight on *Crowell*, a seminal case that clarified the scope of the dictum in *Murray's Lessee*. In that case, the Court considered whether Congress could grant to an Article I administrative agency the power to adjudicate an employee's workers' compensation claim against his employer. The Court assumed that an Article III court would review the agency's decision *de novo* in respect to questions of law but it would conduct a less searching review (looking to see only if the agency's award was “supported by evidence in the record”) in respect to questions of fact. [Crowell](#), 285 U.S., at 48–50, [52 S.Ct. 285](#). The Court pointed out that the case involved a dispute between private persons (a matter of “private rights”) and (with one exception not relevant here) it upheld Congress' delegation of primary factfinding authority to the agency.

Justice Brandeis, dissenting (from a here-irrelevant portion of the Court's holding), wrote that the adjudicatory scheme raised only a due process question: When does due process require decision by an Article III judge? He answered that question by finding constitutional the statute's delegation of adjudicatory authority to an agency. *Id.*, at 87, [52 S.Ct. 285](#).

Crowell has been hailed as “the greatest of the cases validating administrative adjudication.” Bator, [The Constitution as Architecture: Legislative and Administrative Courts Under Article III](#), 65 Ind. L.J. 233, 251 (1990). Yet, in a footnote, the majority distinguishes *Crowell* as a case in which the Court upheld the delegation of adjudicatory authority to an administrative agency simply because the agency's power to make the “specialized, narrowly confined *509 factual determinations” at issue arising in a “particularized area of law” made the agency a “true ‘adjunct’ of the District Court.” *Ante*, at 2612, n. 6. Were *Crowell*'s holding as narrow as the majority suggests, one could question the validity of Congress' delegation of authority to adjudicate disputes among private parties to other agencies such as the National Labor Relations Board, the Commodity Futures Trading Commission, the Surface Transportation Board, and the Department of Housing and Urban Development, thereby resurrecting important legal questions previously thought to have been decided. See [29 U.S.C. § 160](#); [7 U.S.C. § 18](#); [49 U.S.C. § 10704](#); [42 U.S.C. § 3612\(b\)](#).

C

The majority, in my view, overemphasizes the precedential effect of the plurality **2624 opinion in *Northern Pipeline*. *Ante*, at 2609 – 2610. There, the Court held unconstitutional the jurisdictional provisions of the Bankruptcy Act of 1978 granting adjudicatory authority to bankruptcy judges who lack the protections of tenure and compensation that Article III provides. Four Members of the Court wrote that Congress could grant adjudicatory authority to a non-Article III judge only where (1) the judge sits on a “territorial cour[t],” (2) the judge conducts a “courts-martial,” or (3) the case involves a “public right,” namely, a “matter” that “at a minimum arise[s] ‘between the government and others.’ ” [458 U.S., at 64–70](#), [102 S.Ct. 2858](#) (plurality opinion) (quoting *Ex parte Bakelite Corp.*, *supra*, at 451, [49 S.Ct. 411](#)). Two other Members of the Court, without accepting these limitations, agreed with the result because the case involved a breach-of-contract claim brought by the bankruptcy trustee on behalf of the bankruptcy estate against a third party who was not part of the bankruptcy proceeding, and none of the Court's preceding cases (which, the two Members wrote, “do not admit of easy synthesis”) had “gone so far as to sanction th[is] type of adjudication.” [458 U.S., at 90–91](#), [102 S.Ct. 2858](#) (Rehnquist, J. concurring in judgment).

*510 Three years later, the Court held that *Northern Pipeline*

“establishes only that Congress may not vest in a non-Article III court the power to adjudicate, render final judgment, and issue binding orders in a traditional contract action arising under state law, without consent of the litigants, and subject only to ordinary appellate review.” [Thomas](#), [473 U.S., at 584](#), [105 S.Ct. 3325](#).

D

Rather than leaning so heavily on the approach taken by the plurality in *Northern Pipeline*, I would look to this Court's more recent Article III cases *Thomas* and *Schor*—cases that commanded a clear majority. In both cases the Court took a more pragmatic approach to the constitutional question. It sought to determine whether, in the particular instance, the challenged delegation of adjudicatory authority posed a genuine and serious threat that one branch of Government sought to aggrandize its own constitutionally

delegated authority by encroaching upon a field of authority that the Constitution assigns exclusively to another branch.

1

In *Thomas*, the Court focused directly upon the nature of the Article III problem, illustrating how the Court should determine whether a delegation of adjudicatory authority to a non-Article III judge violates the Constitution. The statute in question required pesticide manufacturers to submit to binding arbitration claims for compensation owed for the use by one manufacturer of the data of another to support its federal pesticide registration. After describing *Northern Pipeline*'s holding in the language I have set forth above, *supra* this page, the Court stated that “*practical attention to substance* rather than doctrinaire reliance on formal categories should inform application of Article III.” *Thomas*, 473 U.S., at 587, 105 S.Ct. 3325 (emphasis added). It indicated that Article III's requirements could not be “determined” by “the identity of the parties alone,” *ibid.*, or by the “private rights”/“public *511 rights” distinction, *id.*, at 585–586, 105 S.Ct. 3325. And it upheld the arbitration provision of the statute.

The Court pointed out that the right in question was created by a federal statute, it “represent[s] a pragmatic solution to the difficult problem of spreading [certain] costs,” and the statute “does not preclude review of the arbitration proceeding by an **2625 Article III court.” *Id.*, at 589–592, 105 S.Ct. 3325. The Court concluded:

“Given the nature of the right at issue and the concerns motivating the Legislature, we do not think this system threatens the independent role of the Judiciary in our constitutional scheme.” *Id.*, at 590, 105 S.Ct. 3325.

2

Most recently, in *Schor*, the Court described in greater detail how this Court should analyze this kind of Article III question. The question at issue in *Schor* involved a delegation of authority to an agency to adjudicate a counterclaim. A customer brought before the Commodity Futures Trading Commission (CFTC) a claim for reparations against his commodity futures broker. The customer noted that his brokerage account showed that he owed the broker money, but he said that the broker's unlawful actions had produced that

debit balance, and he sought damages. The broker brought a counterclaim seeking the money that the account showed the customer owed. This Court had to decide whether agency adjudication of such a counterclaim is consistent with Article III.

In doing so, the Court expressly “declined to adopt formalistic and unbending rules.” *Schor*, 478 U.S., at 851, 106 S.Ct. 3245. Rather, it “weighed a number of factors, none of which has been deemed determinative, with an eye to the practical effect that the congressional action will have on the constitutionally assigned role of the federal judiciary.” *Ibid.* Those relevant factors include (1) “the origins and importance of the right to be adjudicated”; (2) “the extent to which *512 the non-Article III forum exercises the range of jurisdiction and powers normally vested only in Article III courts”; (3) the extent to which the delegation nonetheless reserves judicial power for exercise by Article III courts; (4) the presence or “absence of consent to an initial adjudication before a non-Article III tribunal”; and (5) “the concerns that drove Congress to depart from” adjudication in an Article III court. *Id.*, at 849, 851, 106 S.Ct. 3245.

The Court added that where “private rights,” rather than “public rights,” are involved, the “danger of encroaching on the judicial powers” is greater. *Id.*, at 853–854, 106 S.Ct. 3245 (internal quotation marks omitted). Thus, while non-Article III adjudication of “private rights” is not necessarily unconstitutional, the Court's constitutional “examination” of such a scheme must be more “searching.” *Ibid.*

Applying this analysis, the Court upheld the agency's authority to adjudicate the counterclaim. The Court conceded that the adjudication might be of a kind traditionally decided by a court and that the rights at issue were “private,” not “public.” *Id.*, at 853, 106 S.Ct. 3245. But, the Court said, the CFTC deals only with a “‘particularized area of law’”; the decision to invoke the CFTC forum is “left entirely to the parties”; Article III courts can review the agency's findings of fact under “the same ‘weight of the evidence’ standard sustained in *Crowell*” and review its “legal determinations ... *de novo*”; and the agency's “counterclaim jurisdiction” was necessary to make “workable” a “reparations procedure,” which constitutes an important part of a congressionally enacted “regulatory scheme.” *Id.*, at 852–856, 106 S.Ct. 3245. The Court concluded that for these and other reasons “the magnitude of any intrusion on the Judicial Branch can only be termed *de minimis*.” *Id.*, at 856, 106 S.Ct. 3245.

II

A

This case law, as applied in *Thomas* and *Schor*, requires us to determine pragmatically **2626 whether a congressional delegation *513 of adjudicatory authority to a non-Article III judge violates the separation-of-powers principles inherent in Article III. That is to say, we must determine through an examination of certain relevant factors whether that delegation constitutes a significant encroachment by the Legislative or Executive Branches of Government upon the realm of authority that Article III reserves for exercise by the Judicial Branch of Government. Those factors include (1) the nature of the claim to be adjudicated; (2) the nature of the non-Article III tribunal; (3) the extent to which Article III courts exercise control over the proceeding; (4) the presence or absence of the parties' consent; and (5) the nature and importance of the legislative purpose served by the grant of adjudicatory authority to a tribunal with judges who lack Article III's tenure and compensation protections. The presence of "private rights" does not automatically determine the outcome of the question but requires a more "searching" examination of the relevant factors. *Schor*, *supra*, at 854, 106 S.Ct. 3245.

Insofar as the majority would apply more formal standards, it simply disregards recent, controlling precedent. *Thomas*, 473 U.S., at 587, 105 S.Ct. 3325 ("[P]ractical attention to substance rather than doctrinaire reliance on formal categories should inform application of Article III"); *Schor*, *supra*, at 851, 106 S.Ct. 3245 ("[T]he Court has declined to adopt formalistic and unbending rules" for deciding Article III cases).

B

Applying *Schor*'s approach here, I conclude that the delegation of adjudicatory authority before us is constitutional. A grant of authority to a bankruptcy court to adjudicate compulsory counterclaims does not violate any constitutional separation-of-powers principle related to Article III.

First, I concede that *the nature of the claim to be adjudicated* argues against my conclusion. Vickie Marshall's counterclaim

—a kind of tort suit—resembles “a suit at the common law.” *Murray's Lessee*, 18 How., at 284. Although not *514 determinative of the question, see *Schor*, 478 U.S., at 853, 106 S.Ct. 3245, a delegation of authority to a non-Article III judge to adjudicate a claim of that kind poses a heightened risk of encroachment on the Federal Judiciary, *id.*, at 854, 106 S.Ct. 3245.

At the same time the significance of this factor is mitigated here by the fact that bankruptcy courts often decide claims that similarly resemble various common-law actions. Suppose, for example, that ownership of 40 acres of land in the bankruptcy debtor's possession is disputed by a creditor. If that creditor brings a claim in the bankruptcy court, resolution of that dispute requires the bankruptcy court to apply the same state property law that would govern in a state-court proceeding. This kind of dispute arises with regularity in bankruptcy proceedings.

Of course, in this instance the state-law question is embedded in a debtor's counterclaim, not a creditor's claim. But the counterclaim is “compulsory.” It “arises out of the transaction or occurrence that is the subject matter of the opposing party's claim.” Fed. Rule Civ. Proc. 13(a); Fed. Rule Bkrcty. Proc. 7013. Thus, resolution of the counterclaim will often turn on facts identical to, or at least related to, those at issue in a creditor's claim that is undisputedly proper for the bankruptcy court to decide.

Second, *the nature of the non-Article III tribunal* argues in favor of constitutionality. That is because the tribunal is made up of judges who enjoy considerable protection **2627 from improper political influence. Unlike the 1978 Act which provided for the appointment of bankruptcy judges by the President with the advice and consent of the Senate, 28 U.S.C. § 152 (1976 ed., Supp. IV), current law provides that the federal courts of appeals appoint federal bankruptcy judges, § 152(a)(1) (2006 ed.). Bankruptcy judges are removable by the circuit judicial council (made up of federal court of appeals and district court judges) and only for cause. § 152(e). Their salaries are pegged to those of federal district court judges, § 153(a), and the cost of their courthouses and other *515 work-related expenses are paid by the Judiciary, § 156. Thus, although Congress technically exercised its Article I power when it created bankruptcy courts, functionally, bankruptcy judges can be compared to magistrate judges, law clerks, and the Judiciary's administrative officials, whose lack of Article III tenure and compensation protections do not endanger the independence of the Judicial Branch.

Third, *the control exercised by Article III judges over bankruptcy proceedings* argues in favor of constitutionality. Article III judges control and supervise the bankruptcy court's determinations—at least to the same degree that Article III judges supervised the agency's determinations in *Crowell*, if not more so. Any party may appeal those determinations to the federal district court, where the federal judge will review all determinations of fact for clear error and will review all determinations of law *de novo*. [Fed. Rule Bkrcty. Proc. 8013](#); 10 Collier on Bankruptcy ¶ 8013.04 (16th ed.2011). But for the here-irrelevant matter of what *Crowell* considered to be special “constitutional” facts, the standard of review for factual findings here (“clearly erroneous”) is more stringent than the standard at issue in *Crowell* (whether the agency's factfinding was “supported by evidence in the record”). 285 U.S., at 48, 52 S.Ct. 285; see [Dickinson v. Zurko](#), 527 U.S. 150, 152, 153, 119 S.Ct. 1816, 144 L.Ed.2d 143 (1999) (“unsupported by substantial evidence” more deferential than “clearly erroneous” (internal quotation marks omitted)). And, as *Crowell* noted, “there is no requirement that, in order to maintain the essential attributes of the judicial power, all determinations of fact in constitutional courts shall be made by judges.” 285 U.S., at 51, 52 S.Ct. 285.

Moreover, in one important respect Article III judges maintain greater control over the bankruptcy court proceedings at issue here than they did over the relevant proceedings in any of the previous cases in which this Court has upheld a delegation of adjudicatory power. The District Court here may “withdraw, in whole or in part, any case or *516 proceeding referred [to the Bankruptcy Court] ... on its own motion or on timely motion of any party, for cause shown.” 28 U.S.C. § 157(d); cf. [Northern Pipeline](#), 458 U.S., at 80, n. 31, 102 S.Ct. 2858 (plurality opinion) (contrasting pre-1978 law where “power to withdraw the case from the [bankruptcy] referee” gave district courts “control” over case with the unconstitutional 1978 statute, which provided no such district court authority).

Fourth, the fact that *the parties have consented* to Bankruptcy Court jurisdiction argues in favor of constitutionality, and strongly so. Pierce Marshall, the counterclaim defendant, is not a stranger to the litigation, forced to appear in Bankruptcy Court against his will. Cf. [id.](#), at 91, 102 S.Ct. 2858 (Rehnquist, J., concurring in judgment) (suit was litigated in Bankruptcy Court “over [the defendant's] objection”). Rather, he appeared voluntarily in Bankruptcy Court as one of Vickie Marshall's creditors, seeking a favorable resolution of his claim against Vickie Marshall to the detriment of her other

creditors. **2628 He need not have filed a claim, perhaps not even at the cost of bringing it in the future, for he says his claim is “nondischargeable,” in which case he could have litigated it in a state or federal court after distribution. See 11 U.S.C. § 523(a)(6). Thus, Pierce Marshall likely had “an alternative forum to the bankruptcy court in which to pursue [his] clai[m].” [Granfinanciera, S.A. v. Nordberg](#), 492 U.S. 33, 59, n. 14, 109 S.Ct. 2782, 106 L.Ed.2d 26 (1989).

The Court has held, in a highly analogous context, that this type of consent argues strongly in favor of using ordinary bankruptcy court proceedings. In *Granfinanciera*, the Court held that when a bankruptcy trustee seeks to void a transfer of assets from the debtor to an individual on the ground that the transfer to that individual constitutes an unlawful “preference,” the question whether the individual has a right to a jury trial “depends upon whether the creditor has submitted a claim against the estate.” *Id.*, at 58, 109 S.Ct. 2782. The following year, in *517 [Langenkamp v. Culp](#), 498 U.S. 42, 111 S.Ct. 330, 112 L.Ed.2d 343 (1990) (*per curiam*), the Court emphasized that when the individual files a claim against the estate, that individual has

“trigger[ed] the process of ‘allowance and disallowance of claims,’ thereby subjecting himself to the bankruptcy court's equitable power. If the creditor is met, in turn, with a preference action from the trustee, that action becomes part of the claims-allowance process which is triable only in equity. In other words, the creditor's claim and the ensuing preference action by the trustee become integral to the restructuring of the debtor-creditor relationship through the bankruptcy court's *equity jurisdiction*.” *Id.*, at 44, 111 S.Ct. 330 (quoting [Granfinanciera](#), 492 U.S., at 58, 109 S.Ct. 2782; citations omitted).

As we have recognized, the jury trial question and the Article III question are highly analogous. See [id.](#), at 52–53, 111 S.Ct. 330. And to that extent, *Granfinanciera*'s and *Langenkamp*'s basic reasoning and conclusion apply here: Even when private rights are at issue, non-Article III adjudication may be appropriate when both parties consent. Cf. [Northern Pipeline](#), *supra*, at 80, n. 31, 102 S.Ct. 2858 (plurality opinion) (noting the importance of consent to bankruptcy jurisdiction). See also [Schor](#), 478 U.S., at 849, 106 S.Ct. 3245 (“[A]bsence of consent to an initial adjudication before a non-Article III tribunal was relied on [in *Northern Pipeline*] as a significant factor in determining that Article III forbade such adjudication”). The majority argues that Pierce Marshall “did not truly consent” to bankruptcy jurisdiction, *ante*, at 2614 – 2615, but filing a proof of claim was sufficient in *Langenkamp* and *Granfinanciera*, and there is no relevant

distinction between the claims filed in those cases and the claim filed here.

Fifth, *the nature and importance of the legislative purpose served* by the grant of adjudicatory authority to bankruptcy tribunals argues strongly in favor of constitutionality. Congress' delegation of adjudicatory powers over counterclaims ***518** asserted against bankruptcy claimants constitutes an important means of securing a constitutionally authorized end. Article I, § 8, of the Constitution explicitly grants Congress the "Power To ... establish ... uniform Laws on the subject of Bankruptcies throughout the United States." James Madison wrote in the Federalist Papers that the

"power of establishing uniform laws of bankruptcy is so intimately connected with the regulation of commerce, and will prevent so many frauds where the ****2629** parties or their property may lie or be removed into different States, that the expediency of it seems not likely to be drawn into question." The Federalist No. 42, p. 271 (C. Rossiter ed.1961).

Congress established the first Bankruptcy Act in 1800. 2 Stat. 19. From the beginning, the "core" of federal bankruptcy proceedings has been "the restructuring of debtor-creditor relations." *Northern Pipeline, supra*, at 71, 102 S.Ct. 2858 (plurality opinion). And, to be effective, a single tribunal must have broad authority to restructure those relations, "having jurisdiction of the parties to controversies brought before them," "decid[ing] all matters in dispute," and "decree[ing] complete relief." *Katchen v. Landy*, 382 U.S. 323, 335, 86 S.Ct. 467, 15 L.Ed.2d 391 (1966) (internal quotation marks omitted).

The restructuring process requires a creditor to file a proof of claim in the bankruptcy court. 11 U.S.C. § 501; *Fed. Rule Bkrcty. Proc.* 3002(a). In doing so, the creditor "triggers the process of 'allowance and disallowance of claims,' thereby subjecting himself to the bankruptcy court's equitable power." *Langenkamp, supra*, at 44, 111 S.Ct. 330 (quoting *Granfinanciera, supra*, at 58, 109 S.Ct. 2782). By filing a proof of claim, the creditor agrees to the bankruptcy court's resolution of that claim, and if the creditor wins, the creditor will receive a share of the distribution of the bankruptcy estate. When the bankruptcy estate has a related claim against that creditor, that counterclaim may offset the creditor's claim, or even ***519** yield additional damages that augment the estate and may be distributed to the other creditors.

The consequent importance to the total bankruptcy scheme of permitting the trustee in bankruptcy to assert counterclaims against claimants, *and resolving those counterclaims in a bankruptcy court*, is reflected in the fact that Congress included "counterclaims by the estate against persons filing claims against the estate" on its list of "[c]ore proceedings." 28 U.S.C. § 157(b)(2)(C). And it explains the difference, reflected in this Court's opinions, between a claimant's and a nonclaimant's constitutional right to a jury trial. Compare *Granfinanciera*, 492 U.S., at 58–59, 109 S.Ct. 2782 ("Because petitioners ... have not filed claims against the estate" they retain "their Seventh Amendment right to a trial by jury"), with *Langenkamp*, 498 U.S., at 45, 111 S.Ct. 330 ("Respondents filed claims against the bankruptcy estate" and "[c]onsequently, they were not entitled to a jury trial").

Consequently a bankruptcy court's determination of such matters has more than "some bearing on a bankruptcy case." *Ante*, at 2618 (emphasis deleted). It plays a critical role in Congress' constitutionally based effort to create an efficient, effective federal bankruptcy system. At the least, that is what Congress concluded. We owe deference to that determination, which shows the absence of any legislative or executive motive, intent, purpose, or desire to encroach upon areas that Article III reserves to judges to whom it grants tenure and compensation protections.

Considering these factors together, I conclude that, as in *Schor*, "the magnitude of any intrusion on the Judicial Branch can only be termed *de minimis*." 478 U.S., at 856, 106 S.Ct. 3245. I would similarly find the statute before us constitutional.

III

The majority predicts that as a "practical matter" today's decision "does not change all that much." *Ante*, at 2619 – 2620. But I doubt that is so. Consider a typical case: A tenant ***520** files for bankruptcy. The landlord files a claim for unpaid rent. The tenant asserts a counterclaim ****2630** for damages suffered by the landlord's (1) failing to fulfill his obligations as lessor, and (2) improperly recovering possession of the premises by misrepresenting the facts in housing court. (These are close to the facts presented in *In re Beugen*, 81 B.R. 994 (Bkrcty.Ct.N.D.Cal.1988).) This state-law counterclaim does not "ste[m] from the bankruptcy itself," *ante*, at 2618, it would not "necessarily be resolved in the claims allowance process," *ibid.*, and it would require

the debtor to prove damages suffered by the lessor's failures, the extent to which the landlord's representations to the housing court were untrue, and damages suffered by improper recovery of possession of the premises, cf. *ante*, at 2617 – 2618. Thus, under the majority's holding, the federal district judge, not the bankruptcy judge, would have to hear and resolve the counterclaim.

Why is that a problem? Because these types of disputes arise in bankruptcy court with some frequency. See, e.g., *In re CBI Holding Co.*, 529 F.3d 432 (C.A.2 2008) (state-law claims and counterclaims); *In re Winstar Communications, Inc.*, 348 B.R. 234 (Bkrty.Ct.Del.2005) (same); *In re Ascher*, 128 B.R. 639 (Bkrty.Ct.N.D.Ill.1991) (same); *In re Sun West Distributors, Inc.*, 69 B.R. 861 (Bkrty.Ct.S.D.Cal.1987) (same). Because the volume of bankruptcy cases is staggering, involving almost 1.6 million filings last year, compared to a federal district court docket of around 280,000 civil cases and 78,000 criminal cases. Administrative Office of the United States Courts, J. Duff, Judicial Business of the United

States Courts: Annual Report of the Director 14 (2010). Because unlike the “related” noncore state-law claims that bankruptcy courts must abstain from hearing, see *ante*, at 2619, compulsory counterclaims involve the same factual disputes as the claims that may be finally adjudicated by the bankruptcy courts. Because under these circumstances, a constitutionally required game of jurisdictional *521 ping-pong between courts would lead to inefficiency, increased cost, delay, and needless additional suffering among those faced with bankruptcy.

For these reasons, with respect, I dissent.

All Citations

564 U.S. 462, 131 S.Ct. 2594, 180 L.Ed.2d 475, 79 USLW 4564, 65 Collier Bankr.Cas.2d 827, 55 Bankr.Ct.Dec. 1, Bankr. L. Rep. P 82,032, 11 Cal. Daily Op. Serv. 7728, 2011 Daily Journal D.A.R. 9305, 22 Fla. L. Weekly Fed. S 1232

Footnotes

* The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States v. Detroit Timber & Lumber Co.*, 200 U.S. 321, 337, 26 S.Ct. 282, 50 L.Ed. 499.

1 Because both Vickie and Pierce passed away during this litigation, the parties in this case are Vickie's estate and Pierce's estate. We continue to refer to them as “Vickie” and “Pierce.”

2 One judge wrote a separate concurring opinion. He concluded that “Vickie's counterclaim ... [wa]s not a core proceeding, so the Texas probate court judgment preceded the district court judgment and controls.” 600 F.3d, at 1065 (Kleinfeld, J.). The concurring judge also “offer[ed] additional grounds” that he believed required judgment in Pierce's favor. *Ibid*. Pierce presses only one of those additional grounds here; it is discussed below, in Part II–C.

3 In full, §§ 157(b)(1)–(2) provides:

“(1) Bankruptcy judges may hear and determine all cases under title 11 and all core proceedings arising under title 11, or arising in a case under title 11, referred under subsection (a) of this section, and may enter appropriate orders and judgments, subject to review under section 158 of this title.

“(2) Core proceedings include, but are not limited to—

“(A) matters concerning the administration of the estate;

“(B) allowance or disallowance of claims against the estate or exemptions from property of the estate, and estimation of claims or interests for the purposes of confirming a plan under chapter 11, 12, or 13 of title 11 but not the liquidation or estimation of contingent or unliquidated personal injury tort or wrongful death claims against the estate for purposes of distribution in a case under title 11;

“(C) counterclaims by the estate against persons filing claims against the estate;

“(D) orders in respect to obtaining credit;

“(E) orders to turn over property of the estate;

“(F) proceedings to determine, avoid, or recover preferences;

“(G) motions to terminate, annul, or modify the automatic stay;

“(H) proceedings to determine, avoid, or recover fraudulent conveyances;

“(I) determinations as to the dischargeability of particular debts;

“(J) objections to discharges;

“(K) determinations of the validity, extent, or priority of liens;

“(L) confirmations of plans;

“(M) orders approving the use or lease of property, including the use of cash collateral;

“(N) orders approving the sale of property other than property resulting from claims brought by the estate against persons who have not filed claims against the estate;

“(O) other proceedings affecting the liquidation of the assets of the estate or the adjustment of the debtor-creditor or the equity security holder relationship, except personal injury tort or wrongful death claims; and

“(P) recognition of foreign proceedings and other matters under chapter 15 of title 11.”

4 Although Pierce suggests that consideration of “the 157(b)(5) issue” would facilitate an “easy” resolution of the case, Tr. of Oral Arg. 47–48, he is mistaken. Had Pierce preserved his argument under that provision, we would have been confronted with several questions on which there is little consensus or precedent. Those issues include: (1) the scope of the phrase “personal injury tort”—a question over which there is at least a three-way divide, see *In re Arnold*, 407 B.R. 849, 851–853 (Bkrtcy.Ct.M.D.N.C.2009); (2) whether, as Vickie argued in the Court of Appeals, the requirement that a personal injury tort claim be “tried” in the district court nonetheless permits the bankruptcy court to resolve the claim short of trial, see Appellee’s/Cross–Appellant’s Supplemental Brief in No. 02–56002 etc. (CA9), p. 24; see also *In re Dow Corning Corp.*, 215 B.R. 346, 349–351 (Bkrtcy.Ct.E.D.Mich.1997) (noting divide over whether, and on what grounds, a bankruptcy court may resolve a claim pretrial); and (3) even if Pierce’s defamation claim could be considered only by the District Court, whether the Bankruptcy Court might retain jurisdiction over the counterclaim, cf. *Arbaugh v. Y & H Corp.*, 546 U.S. 500, 514, 126 S.Ct. 1235, 163 L.Ed.2d 1097 (2006) (“when a court grants a motion to dismiss for failure to state a federal claim, the court generally retains discretion to exercise supplemental jurisdiction, pursuant to 28 U.S.C. § 1367, over pendent state-law claims”). We express no opinion on any of these issues and simply note that the § 157(b)(5) question is not as straightforward as Pierce would have it.

5 The dissent is thus wrong in suggesting that less than a full Court agreed on the points pertinent to this case. *Post*, at 2622 (opinion of BREYER, J.).

6 Although the Court in *Crowell* went on to decide that the facts of the private dispute before it could be determined by a non-Article III tribunal in the first instance, subject to judicial review, the Court did so only after observing that the administrative adjudicator had only limited authority to make specialized, narrowly confined factual determinations regarding a particularized area of law and to issue orders that could be enforced only by action of the District Court. 285 U.S., at 38, 44–45, 54, 52 S.Ct. 285; see *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 78, 102 S.Ct. 2858, 73 L.Ed.2d 598 (1982) (plurality opinion). In other words, the agency in *Crowell* functioned as a true “adjunct” of the District Court. That is not the case here. See *infra*, at 2618 – 2619.

Although the dissent suggests that we understate the import of *Crowell* in this regard, the dissent itself recognizes—repeatedly—that *Crowell* by its terms addresses the determination of facts outside Article III. See *post*, at 2623 (*Crowell* “upheld Congress’ delegation of primary factfinding authority to the agency”); *post*, at 2627 (quoting *Crowell*, 285 U.S., at 51, 52 S.Ct. 285, for the proposition that “ ‘there is no requirement that, in order to maintain the essential attributes of

the judicial power, all determinations of fact in constitutional courts shall be made by judges' "). *Crowell* may well have additional significance in the context of expert administrative agencies that oversee particular substantive federal regimes, but we have no occasion to and do not address those issues today. See *infra*, at 2615. The United States apparently agrees that any broader significance of *Crowell* is not pertinent in this case, citing to *Crowell* in its brief only once, in the last footnote, again for the limited proposition discussed above. Brief for United States as *Amicus Curiae* 32, n. 5.

- 7 We noted that we did not mean to "suggest that the restructuring of debtor-creditor relations is in fact a public right." 492 U.S., at 56, n. 11, 109 S.Ct. 2782. Our conclusion was that, "even if one accepts this thesis," Congress could not constitutionally assign resolution of the fraudulent conveyance action to a non-Article III court. *Ibid*. Because neither party asks us to reconsider the public rights framework for bankruptcy, we follow the same approach here.
- 8 Contrary to the claims of the dissent, see *post*, at 2627 – 2628, Pierce did not have another forum in which to pursue his claim to recover from Vickie's prebankruptcy assets, rather than take his chances with whatever funds might remain after the Title 11 proceedings. Creditors who possess claims that do not satisfy the requirements for nondischargeability under 11 U.S.C. § 523 have no choice but to file their claims in bankruptcy proceedings if they want to pursue the claims at all. That is why, as we recognized in *Granfinanciera*, the notion of "consent" does not apply in bankruptcy proceedings as it might in other contexts.

102 S.Ct. 2858

Supreme Court of the United States

NORTHERN PIPELINE
CONSTRUCTION CO., Appellant,

v.

MARATHON PIPE LINE
COMPANY and United States.
UNITED STATES, Appellant,

v.

MARATHON PIPE LINE CO. et al.

Nos. 81–150, 81–546.

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Argued April 27, 1982.

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Decided June 28, 1982.

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Judgment Stayed Oct. 4, 1982.

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See 459 U.S. 813, 103 S.Ct. 199, 200.

Synopsis

Debtor in proceeding for reorganization under Chapter 11 brought suit against creditor, seeking damages for breaches of contract and warranty, misrepresentation, coercion and duress. [The Bankruptcy Court](#), 6 B.R. 928, denied creditor's motion to dismiss, and creditor appealed. [The District Court for the District of Minnesota](#), Miles W. Lord, J., 12 B.R. 946, entered an order granting the motion to dismiss, and both the debtor and the United States, which had intervened to defend the validity of the Bankruptcy Reform Act, appealed. The Supreme Court, in a plurality opinion delivered by Justice Brennan, held that: (1) the Bankruptcy Reform Act's broad grant of jurisdiction to bankruptcy judges, to wit, “ * * * jurisdiction of all civil proceedings arising under Title 11 or arising in or related to cases under Title 11,” violates Article III of the Constitution; (2) this determination shall not apply retroactively but only prospectively; and (3) the judgment would be stayed until October 4, 1982, thereby affording Congress an opportunity to reconstitute the bankruptcy courts or to adopt other valid means of adjudication, without impairing the interim administration of the bankruptcy laws.

Affirmed.

Justice Rehnquist, with whom Justice O'Connor joined, concurred in the judgment, with opinion.

Chief Justice Burger filed a dissenting opinion.

Justice White, with whom Chief Justice Burger and Justice Powell joined, filed a dissenting opinion.

Procedural Posture(s): On Appeal; Motion to Dismiss.

****2860** *Syllabus*^{*}

50** The Bankruptcy Act of 1978 (Act) established a United States bankruptcy court in each judicial district as an adjunct to the district court for such district. The bankruptcy court judges are appointed for 14-year terms, subject to removal by the judicial council of the circuit in which they serve on grounds of incompetence, misconduct, neglect of duty, or disability. Their salaries are set by statute and are subject to adjustment. The Act grants the bankruptcy courts jurisdiction over “all civil proceedings arising under [title 11](#) [bankruptcy] [of the United States Code] or arising in or related to cases under [title 11](#).” See [28 U.S.C. § 1471\(b\)](#) (1976 ed., Supp.IV). After it had filed a petition for reorganization in a Bankruptcy Court, appellant Northern Pipeline Construction Co. (Northern) filed in that court a suit against appellee Marathon Pipe Line Co. (Marathon) seeking damages for an alleged breach of contract and warranty, as well as for misrepresentation, coercion, and duress. Marathon sought dismissal of the suit on the ground that the Act unconstitutionally conferred [Art. III](#) judicial power upon judges who lacked life tenure and protection against salary diminution. The Bankruptcy Court *2861** denied the motion to dismiss, but on appeal the District Court granted the motion.

Held: The judgment is affirmed.

[D.C.](#), 12 B.R. 946, affirmed.

Justice BRENNAN, joined by Justice MARSHALL, Justice BLACKMUN, and Justice STEVENS, concluded that:

1. [Section 1471](#)'s broad grant of jurisdiction to bankruptcy judges violates [Art. III](#). Pp. 2864–2880.

(a) The judicial power of the United States must be exercised by judges who have the attributes of life tenure and protection against salary diminution specified by [Art. III](#).

These attributes were incorporated into the Constitution to ensure the independence of the Judiciary from the control of the Executive and Legislative Branches. There is *51 no doubt that bankruptcy judges created by the Act are not Art. III judges. Pp. 2864–2867.

(b) Article III bars Congress from establishing under its Art. I powers legislative courts to exercise jurisdiction over all matters arising under the bankruptcy laws. The establishment of such courts does not fall within any of the historically recognized situations—non-Art. III courts of the Territories or of the District of Columbia, courts-martial, and resolution of “public rights” issues—in which the principle of independent adjudication commanded by Art. III does not apply. The bankruptcy courts do not lie exclusively outside the States, like the courts of the Territories or of the District of Columbia, or bear any resemblance to courts-martial, nor can the substantive legal rights at issue in the present action—the right to recover contract damages to augment Northern's estate—be deemed “public rights.” There is no persuasive reason in logic, history, or the Constitution, why bankruptcy courts lie beyond the reach of Art. III. Pp. 2867–2874.

(c) Section 1471 impermissibly removed most, if not all, of the essential attributes of the judicial power from the Art. III district court and vested those attributes in a non-Art. III adjunct. *Crowell v. Benson*, 285 U.S. 22, 52 S.Ct. 285, 76 L.Ed. 598 and *United States v. Raddatz*, 447 U.S. 667, 100 S.Ct. 2406, 65 L.Ed.2d 424 distinguished. Congress does not have the same power to create adjuncts to adjudicate constitutionally recognized rights and state-created rights as it does to adjudicate rights that it creates. The grant of jurisdiction to bankruptcy courts cannot be sustained as an exercise of Congress' power to create adjuncts to Art. III courts. Pp. 2874–2880.

2. The above holding that the broad grant of jurisdiction in § 1471 is unconstitutional shall not apply retroactively but only prospectively. Such grant of jurisdiction presents an unprecedented question of interpretation of Art. III, and retroactive application would not further the operation of the holding but would visit substantial injustice and hardship upon those litigants who relied upon the Act's vesting of jurisdiction in the bankruptcy courts. P. 2880.

Justice REHNQUIST, joined by Justice O'CONNOR, concluded that where appellee Marathon Pipe Line Co. has simply been named defendant in appellant Northern Pipeline Construction Co.'s suit on a contract claim arising under state

law, the constitutionality of the Bankruptcy Court's exercise of jurisdiction over that kind of suit is all that need be decided in this case; that resolution of any objections Marathon might make to the exercise of authority conferred on bankruptcy courts by the Bankruptcy Act of 1978, on the ground that the suit must be decided by an Art. III court, should await the exercise of such authority; that so much of that Act as enables a Bankruptcy Court to entertain and decide *52 Northern's suit over Marathon's objection violates Art. III; and that the Court's judgment should not be applied retroactively. Pp. 2880–2882.

Attorneys and Law Firms

John L. Devney argued the cause for appellant in No. 81-150. With him on the briefs was *Jeffrey F. Shaw*. *Solicitor General Lee* argued the cause for the United States in both cases. With him on the briefs were *Assistant Attorney General McGrath*, *Deputy Solicitor General Shapiro*, *Alan I. Horowitz*, *William Kanter*, and *Michael F. Hertz*.

**2862 *Melvin I. Orenstein* argued the cause for appellee Marathon Pipe Line Co. With him on the brief were *Charles S. Cassis*, *John E. Compson*, and *Kenneth J. Orlowski*.†

† Briefs of *amici curiae* urging reversal were filed by *Louis W. Levit* for the Commercial Law League of America; and by *Helen Davis Chaitman*, *Joel B. Zweibel*, *Theodore Gewertz*, and *Peter Buscemi* for the Committee on Bankruptcy and Corporate Reorganization of the Association of the Bar of the City of New York.

Abe Fortas, *Henry F. Field*, *Phil C. Neal*, and *Joseph M. Berl* filed a brief for Beneficial Corp. as *amicus curiae*.

Opinion

Justice BRENNAN announced the judgment of the Court and delivered an opinion in which Justice MARSHALL, Justice BLACKMUN, and Justice STEVENS joined.

The question presented is whether the assignment by Congress to bankruptcy judges of the jurisdiction granted in 28 U.S.C. § 1471 (1976 ed., Supp.IV) by § 241(a) of the Bankruptcy Act of 1978 violates Art. III of the Constitution.

I

A

In 1978, after almost 10 years of study and investigation, Congress enacted a comprehensive revision of the bankruptcy laws. The Bankruptcy Act of 1978 (Act)¹ made significant changes in both the substantive and procedural law of bankruptcy. It is the changes in the latter that are at issue in this case.

Before the Act, federal district courts served as bankruptcy courts and employed a “referee” system. Bankruptcy proceedings were generally conducted before referees,² except in those instances in which the district court elected to withdraw a case from a referee. See Bkrty. Rule 102. The referee’s final order was appealable to the district court. Bkrty. Rule 801. The bankruptcy courts were vested with “summary jurisdiction”—that is, with jurisdiction over controversies involving property in the actual or constructive possession of the court. And, with consent, the bankruptcy court also had jurisdiction over some “plenary” matters—such as disputes involving property in the possession of a third person.

The Act eliminates the referee system and establishes “in each judicial district, as an adjunct to the district court for such district, a bankruptcy court which shall be a court of record known as the United States Bankruptcy Court for the district.” 28 U.S.C. § 151(a) (1976 ed., Supp.IV). The judges of these courts are appointed to office for 14-year terms by the President, with the advice and consent of the Senate. §§ 152, 153(a) (1976 ed., Supp.IV). They are subject to removal by the “judicial council of the circuit” on account of “incompetency, misconduct, neglect of duty or physical or mental disability.” § 153(b) (1976 ed., Supp.IV). In addition, the salaries of the bankruptcy judges are set by statute and are subject to adjustment under the Federal Salary Act, 2 U.S.C. §§ 351–361 (1976 ed. and Supp.IV). 28 U.S.C. § 154 (1976 ed., Supp.IV).

*54 The jurisdiction of the bankruptcy courts created by the Act is much broader than that exercised under the former referee system. Eliminating the distinction between “summary” and “plenary” jurisdiction, the Act grants the new courts jurisdiction over all “civil proceedings arising under title 11 [the Bankruptcy title] or arising in or related to cases under title 11.” 28 U.S.C. § 1471(b) (1976 ed., Supp.IV) (emphasis added).³ This jurisdictional grant

empowers bankruptcy courts to entertain a wide variety of cases involving claims that may affect the property of the estate once a petition has been filed under Title 11. Included within the bankruptcy courts’ jurisdiction are suits to recover accounts, controversies involving exempt property, actions **2863 to avoid transfers and payments as preferences or fraudulent conveyances, and causes of action owned by the debtor at the time of the petition for bankruptcy. The bankruptcy courts can hear claims based on state law as well as those based on federal law. See 1 W. Collier, Bankruptcy ¶ 3.01, pp. 3–47 to 3–48 (15th ed. 1982).⁴

*55 The judges of the bankruptcy courts are vested with all of the “powers of a court of equity, law, and admiralty,” except that they “may not enjoin another court or punish a criminal contempt not committed in the presence of the judge of the court or warranting a punishment of imprisonment.” 28 U.S.C. § 1481 (1976 ed., Supp.IV). In addition to this broad grant of power, Congress has allowed bankruptcy judges the power to hold jury trials, § 1480; to issue declaratory judgments, § 2201; to issue writs of habeas corpus under certain circumstances, § 2256; to issue all writs necessary in aid of the bankruptcy court’s expanded jurisdiction, § 451 (1976 ed. and Supp.IV); see 28 U.S.C. § 1651; and to issue any order, process or judgment that is necessary or appropriate to carry out the provisions of Title 11, 11 U.S.C. § 105(a) (1976 ed., Supp.IV).

The Act also establishes a special procedure for appeals from orders of bankruptcy courts. The circuit council is empowered to direct the chief judge of the circuit to designate panels of three bankruptcy judges to hear appeals. 28 U.S.C. § 160 (1976 ed., Supp.IV). These panels have jurisdiction of all appeals from final judgments, orders, and decrees of bankruptcy courts, and, with leave of the panel, of interlocutory appeals. § 1482. If no such appeals panel is designated, the district court is empowered to exercise appellate jurisdiction. § 1334. The court of appeals is given jurisdiction over appeals from the appellate panels or from the district court. § 1293. If the parties agree, a direct appeal to the court of appeals may be taken from a final judgment of a bankruptcy court. § 1293(b).⁵

*56 The Act provides for a transition period before the new provisions take full effect in April 1984. §§ 401–411, 92 Stat. 2682–2688. During the transition period, previously existing bankruptcy courts continue in existence. § 404(a), 92 Stat. 2683. Incumbent bankruptcy referees, who served 6-year terms for compensation subject to adjustment by Congress,

are to serve as bankruptcy judges until March 31, 1984, or until their successors take office. § 404(b), 92 Stat. 2683.⁶ During this period they are empowered to exercise essentially all of the jurisdiction and powers discussed above. See §§ 404, 405, 92 Stat. 2683–2685. See generally 1 Collier, *supra*, ¶¶ 7.04–7.05, pp. 7–23 to 7–65. The procedure for taking appeals is similar to that provided after the **2864 transition period. See § 405(c)(1), 92 Stat. 2685.⁷

B

This case arises out of proceedings initiated in the United States Bankruptcy Court for the District of Minnesota after appellant Northern Pipeline Construction Co. (Northern) filed a petition for reorganization in January 1980. In March 1980 Northern, pursuant to the Act, filed in that court a suit against appellee Marathon Pipe Line Co. (Marathon). Appellant sought damages for alleged breaches of contract and warranty, as well as for alleged misrepresentation, coercion, and duress. Marathon sought dismissal of the suit, on the ground that the Act unconstitutionally conferred Art. III judicial *57 power upon judges who lacked life tenure and protection against salary diminution. The United States intervened to defend the validity of the statute.

The Bankruptcy Judge denied the motion to dismiss. 6 B.R. 928 (1980). But on appeal the District Court entered an order granting the motion, on the ground that “the delegation of authority in 28 U.S.C. § 1471 to the Bankruptcy Judges to try cases which are otherwise relegated under the Constitution to Article III judges” was unconstitutional. Both the United States and Northern filed notices of appeal in this Court.⁸ We noted probable jurisdiction. 454 U.S. 1029, 102 S.Ct. 564, 70 L.Ed.2d 472 (1981).⁹

II

A

Basic to the constitutional structure established by the Framers was their recognition that “[t]he accumulation of all powers, legislative, executive, and judiciary, in the same hands, whether of one, a few, or many, and whether hereditary, self-appointed, or elective, may justly be pronounced the very definition of tyranny.” The Federalist No. 47, p. 300 (H. Lodge ed. 1888) (J. Madison). To ensure against such

tyranny, the Framers provided that the Federal Government would consist of three distinct Branches, each to exercise one of the governmental powers recognized by the Framers as inherently distinct. “The Framers regarded the checks and balances that they had built into the tripartite Federal Government as a self-executing safeguard against the encroachment or aggrandizement of one branch at the *58 expense of the other.” *Buckley v. Valeo*, 424 U.S. 1, 122, 96 S.Ct. 612, 683, 46 L.Ed.2d 659 (1976) (*per curiam*).

The Federal Judiciary was therefore designed by the Framers to stand independent of the Executive and Legislature—to maintain the checks and balances of the constitutional structure, and also to guarantee that the process of adjudication itself remained impartial. Hamilton explained the importance of an independent Judiciary:

“Periodical appointments, however regulated, or by whomsoever made, would, in some way or other, be fatal to [the courts’] necessary independence. If the power of making them was committed either to the Executive or legislature, there would be danger of an improper complaisance to the branch which possessed it; if to both, there would be an unwillingness to hazard the displeasure of either; if to the people, or to persons chosen by them for the special purpose, there would be too great a disposition to consult popularity, to justify a reliance **2865 that nothing would be consulted but the Constitution and the laws.” The Federalist No. 78, p. 489 (H. Lodge ed. 1888).

The Court has only recently reaffirmed the significance of this feature of the Framers’ design: “A Judiciary free from control by the Executive and Legislature is essential if there is a right to have claims decided by judges who are free from potential domination by other branches of government.” *United States v. Will*, 449 U.S. 200, 217–218, 101 S.Ct. 471, 481–482, 66 L.Ed.2d 392 (1980).

As an inseparable element of the constitutional system of checks and balances, and as a guarantee of judicial impartiality, Art. III both defines the power and protects the independence of the Judicial Branch. It provides that “The judicial Power of the United States, shall be vested in one supreme Court, and in such inferior Courts as the Congress may from time to time ordain and establish.” Art. III, § 1. The inexorable command of this provision is clear and defines *59 The judicial power of the United States must be exercised by courts having the attributes prescribed in Art. III. Those attributes are also clearly set forth:

“The Judges, both of the supreme and inferior Courts, shall hold their Offices during good Behaviour, and shall, at stated Times, receive for their Services, a Compensation, which shall not be diminished during their Continuance in Office.” [Art. III, § 1](#).

The “good Behaviour” Clause guarantees that [Art. III](#) judges shall enjoy life tenure, subject only to removal by impeachment. *United States ex rel. Toth v. Quarles*, 350 U.S. 11, 16, 76 S.Ct. 1, 4, 100 L.Ed. 8 (1955). The Compensation Clause guarantees [Art. III](#) judges a fixed and irreducible compensation for their services. *United States v. Will*, *supra*, 449 U.S., at 218–221, 101 S.Ct., at 482–483. Both of these provisions were incorporated into the Constitution to ensure the independence of the Judiciary from the control of the Executive and Legislative Branches of government.¹⁰ As we have only recently emphasized, “[t]he Compensation Clause has its roots in the longstanding Anglo-American tradition of an independent Judiciary,” 449 U.S., at 217, 101 S.Ct. at 482, while the principle of life tenure can be traced back at least as far as the Act of Settlement in 1701, *id.*, at 218, 101 S.Ct., at 482. To be sure, both principles were eroded during the late colonial period, but that departure did not escape notice and indignant rejection by the Revolutionary generation. Indeed, the guarantees eventually included ***60** in [Art. III](#) were clearly foreshadowed in the Declaration of Independence, “which, among the injuries and usurpations recited against the King of Great Britain, declared that he had ‘made judges dependent on his will alone, for the tenure of their offices, and the amount and payment of their salaries.’” *O’Donoghue v. United States*, 289 U.S. 516, 531, 53 S.Ct. 740, 743, 77 L.Ed. 1356 (1933). The Framers thus recognized:

“Next to permanency in office, nothing can contribute more to the independence of the judges than a fixed provision for their support.... In the general course of human nature, *a power over a man's subsistence amounts to a power over his will.*” The Federalist No. 79, p. 491 (H. Lodge ed. 1888) (A. Hamilton) (emphasis in original).¹¹

****2866** In sum, our Constitution unambiguously enunciates a fundamental principle—that the “judicial Power of the United States” must be reposed in an independent Judiciary. It commands that the independence of the Judiciary be jealously guarded, and it provides clear institutional protections for that independence.

B

It is undisputed that the bankruptcy judges whose offices were created by the Bankruptcy Act of 1978 do not enjoy the protections constitutionally afforded to [Art. III](#) judges. The bankruptcy judges do not serve for life subject to their continued “good Behaviour.” Rather, they are appointed for ***61** 14-year terms, and can be removed by the judicial council of the circuit in which they serve on grounds of “incompetency, misconduct, neglect of duty, or physical or mental disability.” Second, the salaries of the bankruptcy judges are not immune from diminution by Congress. See *supra*, at 2862. In short, there is no doubt that the bankruptcy judges created by the Act are not [Art. III](#) judges.

That Congress chose to vest such broad jurisdiction in non-[Art. III](#) bankruptcy courts, after giving substantial consideration to the constitutionality of the Act, is of course reason to respect the congressional conclusion. See *Fullilove v. Klutznick*, 448 U.S. 448, 472–473, 100 S.Ct. 2758, 2771–2772, 65 L.Ed.2d 902 (1980) (opinion of BURGER, C. J.); *Palmore v. United States*, 411 U.S. 389, 409, 93 S.Ct. 1670, 1682, 36 L.Ed.2d 342 (1973). See also *National Ins. Co. v. Tidewater Co.*, 337 U.S. 582, 655, 69 S.Ct. 1173, 1199, 93 L.Ed. 1556 (1949) (Frankfurter, J., dissenting).¹² But at the same time,

62** “[d]eciding whether a matter has in any measure been committed by the Constitution to another branch of government, or whether the action of that branch exceeds whatever authority has been committed, is itself a delicate exercise in constitutional interpretation, and is a responsibility of this Court as ultimate interpreter of the *2867** Constitution.” *Baker v. Carr*, 369 U.S. 186, 211, 82 S.Ct. 691, 706, 7 L.Ed.2d 663 (1962).

With these principles in mind, we turn to the question presented for decision: whether the Bankruptcy Act of 1978 violates the command of [Art. III](#) that the judicial power of the United States must be vested in courts whose judges enjoy the protections and safeguards specified in that Article.

Appellants suggest two grounds for upholding the Act's conferral of broad adjudicative powers upon judges unprotected by [Art. III](#). First, it is urged that “pursuant to its enumerated [Article I](#) powers, Congress may establish legislative courts that have jurisdiction to decide cases to which the [Article III](#) judicial power of the United States extends.” Brief for United States 9. Referring to our

precedents upholding the validity of “legislative courts,” appellants suggest that “the plenary grants of power in [Article I](#) permit Congress to establish non-[Article III](#) tribunals in ‘specialized areas having particularized needs and warranting distinctive treatment,’ ” such as the area of bankruptcy law. *Ibid.*, quoting *Palmore v. United States*, *supra*, at 389, 408, 93 S.Ct., at 1681. Second, appellants contend that even if the Constitution does require that this bankruptcy-related action be adjudicated in an [Art. III](#) court, the Act in fact satisfies that requirement. “Bankruptcy *63 jurisdiction was vested in the district court” of the judicial district in which the bankruptcy court is located, “and the exercise of that jurisdiction by the adjunct bankruptcy court was made subject to appeal as of right to an [Article III](#) court.” Brief for United States 12. Analogizing the role of the bankruptcy court to that of a special master, appellants urge us to conclude that this “adjunct” system established by Congress satisfies the requirements of [Art. III](#). We consider these arguments in turn.

III

Congress did not constitute the bankruptcy courts as legislative courts.¹³ Appellants contend, however, that the bankruptcy courts could have been so constituted, and that as a result the “adjunct” system in fact chosen by Congress does not impermissibly encroach upon the judicial power. In advancing this argument, appellants rely upon cases in which we have identified certain matters that “congress may or may not bring within the cognizance of [[Art. III](#) courts], as it may deem proper.” *Murray's Lessee v. Hoboken Land & Improvement Co.*, 18 How. 272, 284, 15 L.Ed. 372 (1856).¹⁴ But when properly understood, these precedents represent no broad departure from the constitutional command that the judicial power of the United States must be vested in [Art. III](#) *64 courts.¹⁵ Rather, they reduce to three **2868 narrow situations not subject to that command, each recognizing a circumstance in which the grant of power to the Legislative and Executive Branches was historically and constitutionally so exceptional that the congressional assertion of a power to create legislative courts was consistent with, rather than threatening to, the constitutional mandate of separation of powers. These precedents simply acknowledge that the literal command of [Art. III](#), assigning the judicial power of the United States to courts insulated from Legislative or Executive interference, must be interpreted in light of the historical context in which the Constitution was written, and of the structural imperatives of the Constitution as a whole.

Appellants first rely upon a series of cases in which this Court has upheld the creation by Congress of non-[Art. III](#) “territorial courts.” This exception from the general prescription of [Art. III](#) dates from the earliest days of the Republic, when it was perceived that the Framers intended that as to certain geographical areas, in which no State operated as sovereign, Congress was to exercise the general powers of government. For example, in *American Ins. Co. v. Canter*, 1 Pet. 511, 7 L.Ed. 242 (1828), the Court observed that [Art. IV](#) bestowed upon Congress alone a complete power of government over *65 territories not within the States that constituted the United States. The Court then acknowledged Congress' authority to create courts for those territories that were not in conformity with [Art. III](#). Such courts were

“created in virtue of the general right of sovereignty which exists in the government, or in virtue of that clause which enables Congress to make all needful rules and regulations, respecting the territory belonging to the United States. The jurisdiction with which they are invested ... is conferred by Congress, in the execution of those general powers which that body possesses over the territories of the United States. Although admiralty jurisdiction can be exercised in the states in those Courts, only, which are established in pursuance of the third article of the Constitution; the same limitation does not extend to the territories. In legislating for them, Congress exercises the combined powers of the general, and of a state government.” 1 Pet., at 546.

The Court followed the same reasoning when it reviewed Congress' creation of non-[Art. III](#) courts in the District of Columbia. It noted that there was in the District

“no division of powers between the general and state governments. Congress has the entire control over the district for every purpose of government; and it is reasonable to suppose, that in organizing a judicial department here, all judicial power necessary for the purposes of government would be vested in the courts of justice.” *Kendall v. United States*, 12 Pet. 524, 619, 9 L.Ed. 1181 (1838).¹⁶

*66 Appellants next advert to a second class of cases—those in which this Court has sustained the exercise by Congress and the Executive of the power to establish and **2869 administer courts-martial. The situation in these cases strongly resembles the situation with respect to territorial courts: It too involves a constitutional grant of power that has been historically understood as giving

the political Branches of Government extraordinary control over the precise subject matter at issue. [Article I, § 8, cls. 13, 14](#), confer upon Congress the power “[t]o provide and maintain a Navy,” and “[t]o make Rules for the Government and Regulation of the land and naval Forces.” The Fifth Amendment, which requires a presentment or indictment of a grand jury before a person may be held to answer for a capital or otherwise infamous crime, contains an express exception for “cases arising in the land or naval forces.” And Art. II, § 2, cl. 1, provides that “The President shall be Commander in Chief of the Army and Navy of the United States, and of the Militia of the several States, when called into the actual Service of the United States.” Noting these constitutional directives, the Court in [Dynes v. Hoover](#), 20 How. 65, 15 L.Ed. 838 (1857), explained:

“These provisions show that Congress has the power to provide for the trial and punishment of military and naval offences in the manner then and now practiced by civilized nations; and that the power to do so is given without any connection between it and the 3d article of the Constitution defining the judicial power of the United States; indeed, that the two powers are entirely independent of each other.”

[Id.](#), at 79.¹⁷

*67 Finally, appellants rely on a third group of cases, in which this Court has upheld the constitutionality of legislative courts and administrative agencies created by Congress to adjudicate cases involving “public rights.”¹⁸ The “public rights” doctrine was first set forth in [Murray's Lessee v. Hoboken Land & Improvement Co.](#), 18 How. 272, 15 L.Ed. 372 (1856):

“[W]e do not consider congress can either withdraw from judicial cognizance any matter which, from its nature, is the subject of a suit at the common law, or in equity, or admiralty; nor, on the other hand, can it bring under the judicial power a matter which, from its nature, is not a subject for judicial determination. At the same time there are matters, *involving public rights*, which may be presented in such form that the judicial power is capable of acting on them, and which are susceptible of judicial determination, but which congress may or may not bring within the cognizance of the courts of the United States, as it may deem proper.” [Id.](#), at 284 (emphasis added).

This doctrine may be explained in part by reference to the traditional principle of sovereign immunity, which recognizes that the Government may attach conditions to its consent to be sued. See [id.](#), at 283–285; see also [Ex parte Bakelite](#)

[Corp.](#), 279 U.S. 438, 452, 49 S.Ct. 411, 413, 73 L.Ed. 789 (1929). But the public-rights doctrine also draws upon the principle of separation of powers, and a historical understanding that certain prerogatives were reserved to the political Branches of Government. The doctrine extends only to matters arising “between the Government *68 and persons subject to its authority in connection with the performance of the constitutional functions of the executive or legislative departments,” [Crowell v. Benson](#), 285 U.S. 22, 50, 52 S.Ct. 285, 292, 76 L.Ed. 598 (1932), and only to matters that historically could have been determined exclusively by those departments, **2870 see [Ex parte Bakelite Corp.](#), *supra*, 279 U.S., at 458, 49 S.Ct., at 416. The understanding of these cases is that the Framers expected that Congress would be free to commit such matters completely to nonjudicial executive determination, and that as a result there can be no constitutional objection to Congress' employing the less drastic expedient of committing their determination to a legislative court or an administrative agency. [Crowell v. Benson](#), *supra*, 285 U.S., at 50, 52 S.Ct., at 292.¹⁹

The public-rights doctrine is grounded in a historically recognized distinction between matters that could be conclusively determined by the Executive and Legislative Branches and matters that are “inherently ... judicial.” [Ex parte Bakelite Corp.](#), *supra*, 279 U.S., at 458, 49 S.Ct., at 416. See [Murray's Lessee v. Hoboken Land & Improvement Co.](#), 18 How., at 280–282. For example, the Court in [Murray's Lessee](#) looked to the law of England and the States at the time the Constitution was adopted, in order to determine whether the issue presented was customarily cognizable in the courts. *Ibid.* Concluding that the matter had not traditionally been one for judicial determination, the Court perceived no bar to Congress' establishment of summary procedures, outside of [Art. III](#) courts, to collect a debt due to the Government from one of its customs agents.²⁰ On the same premise, the Court in [Ex *69 parte Bakelite Corp.](#), *supra*, held that the Court of Customs Appeals had been properly constituted by Congress as a legislative court:

“The *full* province of the court under the act creating it is that of determining matters arising between the Government and others in the executive administration and application of the customs laws.... The appeals include nothing which inherently or necessarily requires judicial determination, but only matters the determination of *which may be, and at times has been, committed exclusively to*

executive officers.” 279 U.S., at 458, 49 S.Ct., at 416 (emphasis added).²¹

The distinction between public rights and private rights has not been definitively explained in our precedents.²² Nor is it necessary to do so in the present cases, for it suffices to observe that a matter of public rights must at a minimum arise “between the government and others.” *Ex parte Bakelite Corp.*, *supra*, at 451, 49 S.Ct., at 413.²³ In contrast, “the liability of *70 one **2871 individual to another under the law as defined,” *Crowell v. Benson*, *supra*, at 51, 52 S.Ct., at 292, is a matter of private rights. Our precedents clearly establish that *only* controversies in the former category may be removed from Art. III courts and delegated to legislative courts or administrative agencies for their determination. See *Atlas Roofing Co. v. Occupational Safety and Health Review Comm’n*, 430 U.S. 442, 450, n. 7, 97 S.Ct. 1261, 1266, n. 7, 51 L.Ed.2d 464 (1977); *Crowell v. Benson*, *supra*, 285 U.S., at 50–51, 52 S.Ct., at 292. See also Katz, *Federal Legislative Courts*, 43 Harv.L.Rev. 894, 917–918 (1930).²⁴ Private-rights disputes, on the other hand, lie at the core of the historically recognized judicial power.

In sum, this Court has identified three situations in which Art. III does not bar the creation of legislative courts. In each of these situations, the Court has recognized certain exceptional powers bestowed upon Congress by the Constitution or by historical consensus. Only in the face of such an exceptional grant of power has the Court declined to hold the authority of Congress subject to the general prescriptions of Art. III.²⁵

*71 We discern no such exceptional grant of power applicable in the cases before us. The courts created by the Bankruptcy Act of 1978 do not lie exclusively outside the States of the Federal Union, like those in the District of Columbia and the Territories. Nor do the bankruptcy courts bear any resemblance to courts-martial, which are founded upon the Constitution’s grant of plenary authority over the Nation’s military forces to the Legislative and Executive Branches. Finally, the substantive legal rights at issue in the present action cannot be deemed “public rights.” Appellants argue that a discharge in bankruptcy is indeed a “public right,” similar to such congressionally created benefits as “radio station licenses, pilot licenses, or certificates for common carriers” granted by administrative agencies. See Brief for United States 34. But the restructuring of debtor-creditor relations, which is at the core of the federal bankruptcy power, must be distinguished from the adjudication of state-created

private rights, such as the right to recover contract damages that is at issue in this case. The former may well be a “public right,” but the latter obviously is not. Appellant Northern’s right to recover **2872 contract damages to augment its estate is “one of private right, that is, of the liability of one *72 individual to another under the law as defined.” *Crowell v. Benson*, 285 U.S., at 51, 52 S.Ct., at 292.²⁶

Recognizing that the present cases may not fall within the scope of any of our prior cases permitting the establishment of legislative courts, appellants argue that we should recognize an additional situation beyond the command of Art. III, sufficiently broad to sustain the Act. Appellants contend that Congress’ constitutional authority to establish “uniform Laws on the subject of Bankruptcies throughout the United States,” Art. I, § 8, cl. 4, carries with it an inherent power to establish legislative courts capable of adjudicating “bankruptcy-related controversies.” Brief for United States 14. In support of this argument, appellants rely primarily upon a quotation from the opinion in *Palmore v. United States*, 411 U.S. 389, 93 S.Ct. 1670, 36 L.Ed.2d 342 (1973), in which we stated that

“both Congress and this Court have recognized that ... the requirements of Art. III, which are applicable where laws of national applicability and affairs of national concern are at stake, must in proper circumstances give way to accommodate plenary grants of power to Congress to legislate with respect to specialized areas having particularized needs and warranting distinctive treatment.” *Id.*, 407–408, 93 S.Ct., at 1681.

Appellants cite this language to support their proposition that a bankruptcy court created by Congress under its Art. I *73 powers is constitutional, because the law of bankruptcy is a “specialized area,” and Congress has found a “particularized need” that warrants “distinctive treatment.” Brief for United States 20–33.

Appellants’ contention, in essence, is that pursuant to any of its Art. I powers, Congress may create courts free of Art. III’s requirements whenever it finds that course expedient. This contention has been rejected in previous cases. See, e.g., *Atlas Roofing Co. v. Occupational Safety and Health Review Comm’n*, 430 U.S., at 450, n. 7, 97 S.Ct., at 1266, n. 7; *United States ex rel. Toth v. Quarles*, 350 U.S. 11, 76 S.Ct. 1, 100 L.Ed. 8 (1955). Although the cases relied upon by appellants demonstrate that independent courts are not required for *all* federal adjudications, those cases also make it clear that where Art. III does apply, all of the legislative powers specified in Art. I and elsewhere are subject to it. See, e.g., *Ex parte Bakelite Corp.*, 279 U.S., at 449, 49 S.Ct., at 412; *United*

States ex rel. Toth v. Quarles, *supra*; *American Ins. Co. v. Canter*, 1 Pet., at 546; *Murray's Lessee*, 18 How., at 284. Cf. *Crowell v. Benson*, *supra*, 285 U.S., at 51, 52 S.Ct., at 292.

The flaw in appellants' analysis is that it provides no limiting principle. It thus threatens to supplant completely our system of adjudication in independent Art. III tribunals and replace it with a system of "specialized" legislative courts. True, appellants argue that under their analysis Congress could create legislative courts pursuant only to some "specific" Art. I power, and "only when there is a particularized need for distinctive treatment." Brief for United States 22–23. They therefore assert that their analysis would not permit Congress to replace the independent Art. III Judiciary through a "wholesale assignment of federal judicial business to **2873 legislative courts." *Ibid*. But these "limitations" are wholly illusory. For example, Art. I, § 8, empowers Congress to enact laws, *inter alia*, regulating interstate commerce and punishing certain crimes. Art. I, § 8, cls. 3, 6. On appellants' reasoning Congress could provide for the adjudication of these and "related" matters by judges and *74 courts within Congress' exclusive control.²⁷ The potential for encroachment upon powers reserved to the Judicial Branch through the device of "specialized" legislative courts is dramatically evidenced in the jurisdiction granted to the courts created by the Act before us. The broad range of questions that can be brought into a bankruptcy court because they are "related to cases under title 11," 28 U.S.C. § 1471(b) (1976 ed., Supp.IV), see *supra*, at 2862–2863, is the clearest proof that even when Congress acts through a "specialized" court, and pursuant to only one of its many Art. I powers, appellants' analysis fails to provide any real protection against the erosion of Art. III jurisdiction by the unilateral action of the political Branches. In short, to accept appellants' reasoning, would require that we replace the principles delineated in our precedents, rooted in history and the Constitution, with a rule of broad legislative discretion that could effectively eviscerate the constitutional guarantee of an independent Judicial Branch of the Federal Government.²⁸

*75 **2874 Appellants' reliance upon *Palmore* for such broad legislative discretion is misplaced. In the context of the issue decided in that case, the language quoted from the *Palmore* opinion, *supra*, at 2872, offers no substantial support for appellants' argument. *Palmore* was concerned with the courts of the District of Columbia, a unique federal enclave over which "Congress has ... entire control ... for

every purpose of government." *Kendall v. United States*, 12 Pet., at 619. *76 The "plenary authority" under the District of Columbia Clause, Art. I, § 8, cl. 17, was the subject of the quoted passage and the powers granted under that Clause are obviously different in kind from the other broad powers conferred on Congress: Congress' power over the District of Columbia encompasses the *full* authority of government, and thus, necessarily, the Executive and Judicial powers as well as the Legislative. This is a power that is clearly possessed by Congress only in limited geographic areas. *Palmore* itself makes this limitation clear. The quoted passage distinguishes the congressional powers at issue in *Palmore* from those in which the Art. III command of an independent Judiciary must be honored: where "laws of national applicability and affairs of national concern are at stake." 411 U.S., at 408, 93 S.Ct., at 1681. Laws respecting bankruptcy, like most laws enacted pursuant to the national powers cataloged in Art. I, § 8, are clearly laws of national applicability and affairs of national concern. Thus our reference in *Palmore* to "specialized areas having particularized needs" referred only to *geographic* areas, such as the District of Columbia or territories outside the States of the Federal Union. In light of the clear commands of Art. III, nothing held or said in *Palmore* can be taken to mean that in every area in which Congress may legislate, it may also create non-Art. III courts with Art. III powers.

In sum, Art. III bars Congress from establishing legislative courts to exercise jurisdiction over all matters related to those arising under the bankruptcy laws. The establishment of such courts does not fall within any of the historically recognized situations in which the general principle of independent adjudication commanded by Art. III does not apply. Nor can we discern any persuasive reason, in logic, history, or the Constitution, why the bankruptcy courts here established lie beyond the reach of Art. III.

IV

Appellants advance a second argument for upholding the constitutionality of the Act: that "viewed within the entire judicial framework *77 set up by Congress," the bankruptcy court is merely an "adjunct" to the district court, and that the delegation of certain adjudicative functions to the bankruptcy court is accordingly consistent with the principle that the judicial power of the United States must be vested in Art. III courts. See Brief for United States 11–13, 37–45. As support for their argument, appellants rely principally upon *Crowell v. Benson*, 285 U.S. 22, 52 S.Ct. 285, 76 L.Ed. 598 (1932),

and *United States v. Raddatz*, 447 U.S. 667, 100 S.Ct. 2406, 65 L.Ed.2d 424 (1980), cases in which we approved the use of administrative agencies and magistrates as adjuncts to Art. III courts. Brief for United States 40–42. The question to which we turn, therefore, is whether the Act has retained “the essential attributes of the judicial power,” *Crowell v. Benson*, *supra*, 285 U.S., at 51, 52 S.Ct., at 292, in Art. III tribunals.²⁹

****2875** The essential premise underlying appellants’ argument is that even where the Constitution denies Congress the power to establish legislative courts, Congress possesses the authority to assign certain factfinding functions to adjunct tribunals. It is, of course, true that while the power to adjudicate “private rights” must be vested in an Art. III court, see Part III, *supra*,

“this Court has accepted factfinding by an administrative agency, ... as an adjunct to the Art. III court, analogizing the agency to a jury or a special master and permitting it in admiralty cases to perform the function of the special master. ***78** *Crowell v. Benson*, 285 U.S. 22, 51–65 [52 S.Ct. 285, 292–298, 76 L.Ed. 598] (1932).” *Atlas Roofing Co. v. Occupational Safety and Health Review Comm’n*, 430 U.S., at 450, n. 7, 97 S.Ct., at 1266, n. 7.

The use of administrative agencies as adjuncts was first upheld in *Crowell v. Benson*, *supra*. The congressional scheme challenged in *Crowell* empowered an administrative agency, the United States Employees’ Compensation Commission, to make initial factual determinations pursuant to a federal statute requiring employers to compensate their employees for work-related injuries occurring upon the navigable waters of the United States. The Court began its analysis by noting that the federal statute administered by the Compensation Commission provided for compensation of injured employees “irrespective of fault,” and that the statute also prescribed a fixed and mandatory schedule of compensation. *Id.*, 285 U.S., at 38, 52 S.Ct., at 287. The agency was thus left with the limited role of determining “questions of fact as to the circumstances, nature, extent and consequences of the injuries sustained by the employee for which compensation is to be made.” *Id.*, at 54, 52 S.Ct., at 293. The agency did not possess the power to enforce any of its compensation orders: On the contrary, every compensation order was appealable to the appropriate federal district court, which had the sole power to enforce it or set it aside, depending upon whether the court determined it to be “in accordance with law” and supported by evidence in the record. *Id.*, at 44–45, 48, 52 S.Ct., at 289–290, 291. The Court

found that in view of these limitations upon the Compensation Commission’s functions and powers, its determinations were “closely analogous to findings of the amount of damages that are made, according to familiar practice, by commissioners or assessors.” *Id.*, at 54, 52 S.Ct., at 293. Observing that “there is no requirement that, in order to maintain the essential attributes of the judicial power, all determinations of fact in constitutional courts shall be made by judges,” *id.*, at 51, 52 S.Ct., at 292, the Court held that Art. III imposed no bar to the scheme enacted by Congress, *id.*, at 54, 52 S.Ct., at 293.

Crowell involved the adjudication of congressionally created rights. But this Court has sustained the use of adjunct factfinders even in the adjudication of constitutional rights—so ***79** long as those adjuncts were subject to sufficient control by an Art. III district court. In *United States v. Raddatz*, *supra*, the Court upheld the 1978 Federal Magistrates Act, which permitted district court judges to refer certain pretrial motions, including suppression motions based on alleged violations of constitutional rights, to a magistrate for initial determination. The Court observed that the magistrate’s proposed findings and recommendations were subject to *de novo* review by the district court, which was free to rehear the evidence or to call for additional evidence. *Id.*, 447 U.S., at 676–677, 681–683, 100 S.Ct., at 2412–2413, 2415–2416. Moreover, it was noted that the magistrate considered motions only upon reference from the district court, and that the magistrates were appointed, and subject to removal, by the district court. *Id.*, at 685, 100 S.Ct., at 2417 (BLACKMUN, J., concurring).³⁰ In short, the ultimate decisionmaking ****2876** authority respecting all pretrial motions clearly remained with the district court. *Id.*, at 682, 100 S.Ct., at 2415. Under these circumstances, the Court held that the Act did not violate the constraints of Art. III. *Id.*, at 683–684, 100 S.Ct., at 2416.³¹

***80** Together these cases establish two principles that aid us in determining the extent to which Congress may constitutionally vest traditionally judicial functions in non-Art. III officers. First, it is clear that when Congress creates a substantive federal right, it possesses substantial discretion to prescribe the manner in which that right may be adjudicated—including the assignment to an adjunct of some functions historically performed by judges.³² Thus *Crowell* recognized that ***81** Art. III does not require “all determinations of fact [to] be made by judges,” 285 U.S., at 51, 52 S.Ct., at 292; with respect to congressionally created rights, some factual determinations may be made by a specialized factfinding tribunal designed by Congress,

without constitutional bar, *id.*, at 54, 52 S.Ct., at 293. Second, the functions of the adjunct must be limited in such a way that “the essential attributes” of judicial power are retained in the Art. III court. Thus in upholding the adjunct scheme challenged in *Crowell*, the Court emphasized that “the reservation of full authority to the court to **2877 deal with matters of law provides for the appropriate exercise of the judicial function in this class of cases.” *Ibid.* And in refusing to invalidate the Magistrates Act at issue in *Raddatz*, the Court stressed that under the congressional scheme “‘[t]he authority—and the responsibility—to make an informed, final determination ... remains with the judge,’ ” 447 U.S., at 682, 100 S.Ct., at 2415, quoting *Mathews v. Weber*, 423 U.S. 261, 271, 96 S.Ct. 549, 554, 46 L.Ed.2d 483 (1976); the statute's delegation of power was therefore permissible, since “the ultimate decision is made by the district court,” 447 U.S., at 683, 100 S.Ct., at 2416.

These two principles assist us in evaluating the “adjunct” scheme presented in these cases. Appellants assume that Congress' power to create “adjuncts” to consider all cases related to those arising under Title 11 is as great as it was in the circumstances of *Crowell*. But while *Crowell* certainly endorsed the proposition that Congress possesses broad discretion to assign factfinding functions to an adjunct created to aid in the adjudication of congressionally created statutory rights, *Crowell* does not support the further proposition necessary to appellants' argument—that Congress possesses the same degree of discretion in assigning traditionally judicial power to adjuncts engaged in the adjudication of rights *not* *82 created by Congress. Indeed, the validity of this proposition was expressly denied in *Crowell*, when the Court rejected “the untenable assumption that the constitutional courts may be deprived in all cases of the determination of facts upon evidence even though a constitutional right may be involved,” 285 U.S., at 60–61, 52 S.Ct., at 296 (emphasis added),³³ and stated that

“the essential independence of the exercise of the judicial power of the United States in the enforcement of constitutional rights requires that the Federal court should determine ... an issue [of agency jurisdiction] upon its own record and the facts elicited before it.” *Id.*, at 64, 52 S.Ct., at 297 (emphasis added).³⁴

Appellants' proposition was also implicitly rejected in *Raddatz*. Congress' assignment of adjunct functions under the Federal Magistrates Act was substantially narrower than under the statute challenged in *Crowell*. Yet the Court's

scrutiny of the adjunct scheme in *Raddatz*—which played a *83 role in the adjudication of constitutional rights—was far stricter than it had been in *Crowell*. Critical to the Court's decision to uphold the Magistrates Act was the fact that the ultimate decision was made by the district court. 447 U.S., at 683, 100 S.Ct., at 2416.

Although *Crowell* and *Raddatz* do not explicitly distinguish between rights created by Congress and other rights, such a distinction underlies in part *Crowell*'s and *Raddatz*' recognition of a critical difference between rights created by federal statute and rights recognized by the Constitution. **2878 Moreover, such a distinction seems to us to be necessary in light of the delicate accommodations required by the principle of separation of powers reflected in Art. III. The constitutional system of checks and balances is designed to guard against “encroachment or aggrandizement” by Congress at the expense of the other branches of government. *Buckley v. Valeo*, 424 U.S., at 122, 96 S.Ct., at 683. But when Congress creates a statutory right, it clearly has the discretion, in defining that right, to create presumptions, or assign burdens of proof, or prescribe remedies; it may also provide that persons seeking to vindicate that right must do so before particularized tribunals created to perform the specialized adjudicative tasks related to that right.³⁵ Such provisions do, in a sense, affect the exercise of judicial power, but they are also incidental to Congress' power to define the right that it has created. No *84 comparable justification exists, however, when the right being adjudicated is not of congressional creation. In such a situation, substantial inroads into functions that have traditionally been performed by the Judiciary cannot be characterized merely as incidental extensions of Congress' power to define rights that it has created. Rather, such inroads suggest unwarranted encroachments upon the judicial power of the United States, which our Constitution reserves for Art. III courts.

We hold that the Bankruptcy Act of 1978 carries the possibility of such an unwarranted encroachment. Many of the rights subject to adjudication by the Act's bankruptcy courts, like the rights implicated in *Raddatz*, are not of Congress' creation. Indeed, the cases before us, which center upon appellant Northern's claim for damages for breach of contract and misrepresentation, involve a right created by state law, a right independent of and antecedent to the reorganization petition that conferred jurisdiction upon the Bankruptcy Court.³⁶ Accordingly, Congress' authority to control the manner in which that right is adjudicated,

through assignment of historically judicial functions to a non-Art. III “adjunct,” plainly must be deemed at a minimum. Yet it is equally plain that Congress has vested the “adjunct” bankruptcy judges with powers over Northern’s state-created right that far exceed the powers that it has vested in administrative agencies that adjudicate only rights of Congress’ own creation.

Unlike the administrative scheme that we reviewed in *Crowell*, the Act vests all “essential attributes” of the judicial ***85** power of the United States in the “adjunct” bankruptcy court. First, the agency in *Crowell* made only specialized, narrowly confined factual determinations regarding a particularized area of law. In contrast, the subject-matter jurisdiction of the bankruptcy courts encompasses not only traditional matters of bankruptcy, but also “all civil proceedings arising under title 11 or arising in or related to cases under title 11.” 28 U.S.C. § 1471(c) (1976 ed., Supp.IV) (emphasis added). Second, while the agency in *Crowell* engaged in statutorily channeled ****2879** factfinding functions, the bankruptcy courts exercise “all of the jurisdiction” conferred by the Act on the district courts, § 1471(c) (emphasis added). Third, the agency in *Crowell* possessed only a limited power to issue compensation orders pursuant to specialized procedures, and its orders could be enforced only by order of the district court. By contrast, the bankruptcy courts exercise all ordinary powers of district courts, including the power to preside over jury trials, 28 U.S.C. § 1480 (1976 ed., Supp.IV), the power to issue declaratory judgments, § 2201, the power to issue writs of habeas corpus, § 2256, and the power to issue any order, process, or judgment appropriate for the enforcement of the provisions of Title 11, 11 U.S.C. § 105(a) (1976 ed., Supp.IV).³⁷ Fourth, while orders issued by the agency in *Crowell* were to be set aside if “not supported by the evidence,” the judgments of the bankruptcy courts are apparently subject to review only under the more deferential “clearly erroneous” standard. See n. 5, *supra*. Finally, the agency in *Crowell* was required by law to seek enforcement of its compensation orders in the district court. In contrast, the bankruptcy courts issue final judgments, which are binding ***86** and enforceable even in the absence of an appeal.³⁸ In short, the “adjunct” bankruptcy courts created by the Act exercise jurisdiction behind the facade of a grant to the district courts, and are exercising powers far greater than those lodged in the adjuncts approved in either *Crowell* or *Raddatz*.³⁹

****2880** ***87** We conclude that 28 U.S.C. § 1471 (1976 ed., Supp.IV), as added by § 241(a) of the Bankruptcy Act

of 1978, has impermissibly removed most, if not all, of “the essential attributes of the judicial power” from the Art. III district court, and has vested those attributes in a non-Art. III adjunct. Such a grant of jurisdiction cannot be sustained as an exercise of Congress’ power to create adjuncts to Art. III courts.

V

Having concluded that the broad grant of jurisdiction to the bankruptcy courts contained in 28 U.S.C. § 1471 (1976 ed., Supp.IV) is unconstitutional, we must now determine whether our holding should be applied retroactively to the effective date of the Act.⁴⁰ Our decision in ***88** *Chevron Oil Co. v. Huson*, 404 U.S. 97, 92 S.Ct. 349, 30 L.Ed.2d 296 (1971), sets forth the three considerations recognized by our precedents as properly bearing upon the issue of retroactivity. They are, first, whether the holding in question “decid[ed] an issue of first impression whose resolution was not clearly foreshadowed” by earlier cases, *id.*, at 106, 92 S.Ct., at 355; second, “whether retrospective operation will further or retard [the] operation” of the holding in question, *id.*, at 107, 92 S.Ct., at 355; and third, whether retroactive application “could produce substantial inequitable results” in individual cases, *ibid*. In the present cases, all of these considerations militate against the retroactive application of our holding today. It is plain that Congress’ broad grant of judicial power to non-Art. III bankruptcy judges presents an unprecedented question of interpretation of Art. III. It is equally plain that retroactive application would not further the operation of our holding, and would surely visit substantial injustice and hardship upon those litigants who relied upon the Act’s vesting of jurisdiction in the bankruptcy courts. We hold, therefore, that our decision today shall apply only prospectively.⁴¹

The judgment of the District Court is affirmed. However, we stay our judgment until October 4, 1982. This limited stay will afford Congress an opportunity to reconstitute the bankruptcy courts or to adopt other valid means of adjudication, without impairing the interim administration of the bankruptcy laws. See *Buckley v. Valeo*, 424 U.S., at 143, 96 S.Ct., at 693; ***89** cf. *Georgia v. United States*, 411 U.S. 526, 541, 93 S.Ct. 1702, 1711, 36 L.Ed.2d 472 (1973); *Fortson v. Morris*, 385 U.S. 231, 235, 87 S.Ct. 446, 449, 17 L.Ed.2d 330 (1966); *Maryland Committee for Fair Representation v. Tawes*, 377 U.S. 656, 675–676, 84 S.Ct. 1429, 1439–1440, 12 L.Ed.2d 595 (1964).

It is so ordered.

****2881** Justice REHNQUIST, with whom Justice O'CONNOR joins, concurring in the judgment.

Were I to agree with the plurality that the question presented by these cases is “whether the assignment by Congress to bankruptcy judges of the jurisdiction granted in [28 U.S.C. § 1471](#) (1976 ed., Supp.IV) by § 241(a) of the Bankruptcy Act of 1978 violates Art. III of the Constitution,” *ante*, at 2862, I would with considerable reluctance embark on the duty of deciding this broad question. But appellee Marathon Pipe Line Co. has not been subjected to the full range of authority granted bankruptcy courts by [§ 1471](#). It was named as a defendant in a suit brought by appellant Northern Pipeline Construction Co. in a United States Bankruptcy Court. The suit sought damages for, *inter alia*, breaches of contract and warranty. Marathon moved to dismiss the action on the grounds that the Bankruptcy Act of 1978, which authorized the suit, violated Art. III of the Constitution insofar as it established bankruptcy judges whose tenure and salary protection do not conform to the requirements of Art. III.

With the cases in this posture, Marathon has simply been named defendant in a lawsuit about a contract, a lawsuit initiated by appellant Northern after having previously filed a petition for reorganization under the Bankruptcy Act. Marathon may object to proceeding further with this lawsuit on the grounds that if it is to be resolved by an agency of the United States, it may be resolved only by an agency which exercises “[t]he judicial power of the United States” described by Art. III of the Constitution. But resolution of ***90** any objections it may make on this ground to the exercise of a different authority conferred on bankruptcy courts by the 1978 Act, see *ante*, at 2862–2863, should await the exercise of such authority.

“This Court, as is the case with all federal courts, ‘has no jurisdiction to pronounce any statute, either of a State or of the United States, void, because irreconcilable with the Constitution, except as it is called upon to adjudge the legal rights of litigants in actual controversies. In the exercise of that jurisdiction, it is bound by two rules, to which it has rigidly adhered, one, never to anticipate a question of constitutional law in advance of the necessity of deciding it; the other never to formulate a rule of constitutional law broader than is required by the precise facts to which it is to be applied.’ *Liverpool, New York & Philadelphia S.S. Co. v. Commissioners of Emigration*, 113 U.S. 33, 39 [5 S.Ct. 352, 355, 28 L.Ed. 899].” *United States v. Raines*, 362 U.S. 17, 21, 80 S.Ct. 519, 522, 4 L.Ed.2d 524 (1960).

Particularly in an area of constitutional law such as that of “Art. III Courts,” with its frequently arcane distinctions and confusing precedents, rigorous adherence to the principle that this Court should decide no more of a constitutional question than is absolutely necessary accords with both our decided cases and with sound judicial policy.

From the record before us, the lawsuit in which Marathon was named defendant seeks damages for breach of contract, misrepresentation, and other counts which are the stuff of the traditional actions at common law tried by the courts at Westminster in 1789. There is apparently no federal rule of decision provided for any of the issues in the lawsuit; the claims of Northern arise entirely under state law. No method of adjudication is hinted, other than the traditional common-law mode of judge and jury. The lawsuit is before the Bankruptcy Court only because the plaintiff has previously filed a petition for reorganization in that court.

91** The cases dealing with the authority of Congress to create courts other than by use of its power under Art. III do not admit of easy synthesis. In the interval of nearly 150 years between *American Insurance Co. v. Canter*, 1 Pet. 511, 7 L.Ed. 242 (1828), and *Palmore v. United States*, 411 U.S. 389, 93 S.Ct. 1670, 36 L.Ed.2d 342 (1973), the Court addressed the question *2882** infrequently. I need not decide whether these cases in fact support a general proposition and three tidy exceptions, as the plurality believes, or whether instead they are but landmarks on a judicial “darkling plain” where ignorant armies have clashed by night, as JUSTICE WHITE apparently believes them to be. None of the cases has gone so far as to sanction the type of adjudication to which Marathon will be subjected against its will under the provisions of the 1978 Act. To whatever extent different powers granted under that Act might be sustained under the “public rights” doctrine of *Murray's Lessee v. Hoboken Land & Improvement Co.*, 18 How. 272, 15 L.Ed. 372 (1856), and succeeding cases, I am satisfied that the adjudication of Northern's lawsuit cannot be so sustained.

I am likewise of the opinion that the extent of review by Art. III courts provided on appeal from a decision of the bankruptcy court in a case such as Northern's does not save the grant of authority to the latter under the rule espoused in *Crowell v. Benson*, 285 U.S. 22, 52 S.Ct. 285, 76 L.Ed. 598 (1932). All matters of fact and law in whatever domains of the law to which the parties' dispute may lead are to be resolved by the bankruptcy court in the first instance, with only traditional appellate review by Art. III courts apparently contemplated. Acting in this manner the bankruptcy court is

not an “adjunct” of either the district court or the court of appeals.

I would, therefore, hold so much of the Bankruptcy Act of 1978 as enables a Bankruptcy Court to entertain and decide Northern's lawsuit over Marathon's objection to be violative of Art. III of the United States Constitution. Because I agree with the plurality that this grant of authority is not readily severable from the remaining grant of authority to *92 bankruptcy courts under § 1471, see *ante*, at 2880, n. 40, I concur in the judgment. I also agree with the discussion in Part V of the plurality opinion respecting retroactivity and the staying of the judgment of this Court.

Chief Justice BURGER, dissenting.

I join Justice WHITE's dissenting opinion, but I write separately to emphasize that, notwithstanding the plurality opinion, the Court does *not* hold today that Congress' broad grant of jurisdiction to the new bankruptcy courts is generally inconsistent with Art. III of the Constitution. Rather, the Court's holding is limited to the proposition stated by Justice REHNQUIST in his concurrence in the judgment—that a “traditional” state common-law action, not made subject to a federal rule of decision, and related only peripherally to an adjudication of bankruptcy under federal law, must, absent the consent of the litigants, be heard by an “Art. III court” if it is to be heard by any court or agency of the United States. This limited holding, of course, does not suggest that there is something inherently unconstitutional about the new bankruptcy courts; nor does it preclude such courts from adjudicating all but a relatively narrow category of claims “arising under” or “arising in or related to cases under” the Bankruptcy Act.

It will not be necessary for Congress, in order to meet the requirements of the Court's holding, to undertake a radical restructuring of the present system of bankruptcy adjudication. The problems arising from today's judgment can be resolved simply by providing that ancillary common-law actions, such as the one involved in these cases, be routed to the United States district court of which the bankruptcy court is an adjunct.

Justice WHITE, with whom THE CHIEF JUSTICE and Justice POWELL join, dissenting.

Article III, § 1, of the Constitution is straightforward and uncomplicated on its face:

*93 “The judicial Power of the United States, shall be vested in one supreme Court, and in such inferior Courts as the Congress may from time to time ordain and establish. The Judges, both of the supreme and inferior Courts, shall hold **2883 their Offices during good Behaviour, and shall at stated Times, receive for their Services, a Compensation, which shall not be diminished during their Continuance in Office.”

Any reader could easily take this provision to mean that although Congress was free to establish such lower courts as it saw fit, any court that it did establish would be an “inferior” court exercising “judicial Power of the United States” and so must be manned by judges possessing both life tenure and a guaranteed minimal income. This would be an eminently sensible reading and one that, as the plurality shows, is well founded in both the documentary sources and the political doctrine of separation of powers that stands behind much of our constitutional structure. *Ante*, at 2864–2866.

If this simple reading were correct and we were free to disregard 150 years of history, these would be easy cases and the plurality opinion could end with its observation that “[i]t is undisputed that the bankruptcy judges whose offices were created by the Bankruptcy Act of 1978 do not enjoy the protections constitutionally afforded to Art. III judges.” *Ante*, at 2866. The fact that the plurality must go on to deal with what has been characterized as one of the most confusing and controversial areas of constitutional law¹ itself indicates the gross oversimplification implicit in the plurality's claim that “our Constitution unambiguously enunciates a fundamental principle—that the ‘judicial Power of the United States’ must be reposed in an independent Judiciary [and] provides clear institutional protections for that independence.” *Ibid*. While this is fine rhetoric, analytically it serves only to put a distracting and superficial gloss on a difficult question.

*94 That question is what limits Art. III places on Congress' ability to create adjudicative institutions designed to carry out federal policy established pursuant to the substantive authority given Congress elsewhere in the Constitution. Whether fortunate or unfortunate, at this point in the history of constitutional law that question can no longer be answered by looking only to the constitutional text. This Court's cases construing that text must also be considered. In its attempt to pigeonhole these cases, the plurality does violence to their

meaning and creates an artificial structure that itself lacks coherence.

I

There are, I believe, two separate grounds for today's decision. First, non-Art. III judges, regardless of whether they are labeled "adjuncts" to Art. III courts or "Art. I judges," may consider only controversies arising out of federal law. Because the immediate controversy in these cases—Northern Pipeline's claim against Marathon—arises out of state law, it may only be adjudicated, within the federal system, by an Art. III court.² Second, regardless of the source of law that governs the controversy, Congress is prohibited by Art. III from establishing Art. I courts, with three narrow exceptions. Adjudication of bankruptcy proceedings does not fall within any of these exceptions. I shall deal with the first of these contentions in this section.

The plurality concedes that Congress may provide for initial adjudications by Art. I courts or administrative judges of all rights and duties arising under otherwise valid federal laws. *Ante*, at 2876. There is no apparent reason why this principle should not extend to matters arising in federal bankruptcy proceedings. The plurality attempts to escape the reach of prior decisions by contending that the bankrupt's claim against Marathon arose under state law. Non-Article III *95 judges, in its view, cannot be vested with authority to adjudicate such issues. It then proceeds to strike down 28 U.S.C. § 1471 (1976 ed., Supp.IV) **2884 on this ground. For several reasons, the Court's judgment is unsupportable.

First, clearly this ground alone cannot support the Court's invalidation of § 1471 on its face. The plurality concedes that in adjudications and discharges in bankruptcy, "the restructuring of debtor-creditor relations, which is at the core of the federal bankruptcy power," *ante*, at 2871, and "the manner in which the rights of debtors and creditors are adjusted," *ante*, at 2878, n. 36, are matters of federal law. Under the plurality's own interpretation of the cases, therefore, these matters could be heard and decided by Art. I judges. But because the bankruptcy judge is also given authority to hear a case like that of appellant Northern against Marathon, which the Court says is founded on state law, the Court holds that the section must be stricken down on its face. This is a grossly unwarranted emasculation of the scheme Congress has adopted. Even if the Court is correct that such a state-law claim cannot be heard by a bankruptcy judge, there is no basis for doing more than declaring the section

unconstitutional as applied to the claim against Marathon, leaving the section otherwise intact. In that event, cases such as these would have to be heard by Art. III judges or by state courts—unless the defendant consents to suit before the bankruptcy judge—just as they were before the 1978 Act was adopted. But this would remove from the jurisdiction of the bankruptcy judge only a tiny fraction of the cases he is now empowered to adjudicate and would not otherwise limit his jurisdiction.³

*96 Second, the distinction between claims based on state law and those based on federal law disregards the real character of bankruptcy proceedings. The routine in ordinary bankruptcy cases now, as it was before 1978, is to stay actions against the bankrupt, collect the bankrupt's assets, require creditors to file claims or be forever barred, allow or disallow claims that are filed, adjudicate preferences and fraudulent transfers, and make pro rata distributions to creditors, who will be barred by the discharge from taking further actions against the bankrupt. The crucial point to be made is that in the ordinary bankruptcy proceeding the great bulk of creditor claims are claims that have accrued under state law prior to bankruptcy—claims for goods sold, wages, rent, utilities, and the like. "[T]he word debt as used by the Act is not confined to its technical common law meaning but ... extends to liabilities arising out of breach of contract ... to torts ... and to taxes owing to the United States or state or local governments." 1 W. Collier, *Bankruptcy* ¶ 1.14, p. 88 (14th ed. 1976). Every such claim must be filed and its validity is subject *97 to adjudication by the **2885 bankruptcy court. The existence and validity of such claims recurringly depend on state law. Hence, the bankruptcy judge is constantly enmeshed in state-law issues.

The new aspect of the Bankruptcy Act of 1978, in this regard, therefore, is not the extension of federal jurisdiction to state law claims, but its extension to particular kinds of state-law claims, such as contract cases against third parties or disputes involving property in the possession of a third person.⁴ Prior to 1978, a claim of a bankrupt against a third party, such as the claim against Marathon in this case, was not within the jurisdiction of the bankruptcy judge. The old limits were based, of course, on the restrictions implicit within the concept of *in rem* jurisdiction; the new extension is based on the concept of *in personam* jurisdiction. "The bankruptcy court is given in personam jurisdiction as well as in rem jurisdiction to handle everything that arises in a bankruptcy case." H.R.Rep.No. 95-595, p. 445 (1977), U.S.Code Cong. & Admin.News 1978, p. 6400. The difference between the

new and old Acts, therefore, is not to be found in a distinction between state-law and federal-law matters; rather, it is in a distinction between *in rem* and *in personam* jurisdiction. The majority at no place explains why this distinction should have constitutional implications.

Third, all that can be left of the majority's argument in this regard is that state-law claims adjudicated within the federal system must be heard in the first instance by Art. III judges. I shall argue below that any such attempt to distinguish Art. I from Art. III courts by the character of the controversies they may adjudicate fundamentally misunderstands the historical *98 and constitutional significance of Art. I courts. Initially, however, the majority's proposal seems to turn the separation-of-powers doctrine, upon which the majority relies, on its head: Since state-law claims would ordinarily not be heard by Art. III judges—*i.e.*, they would be heard by state judges—one would think that there is little danger of a diminution of, or intrusion upon, the power of Art. III courts, when such claims are assigned to a non-Art. III court. The plurality misses this obvious point because it concentrates on explaining how it is that federally created rights can ever be adjudicated in Art. I courts—a far more difficult problem under the separation-of-powers doctrine. The plurality fumbles when it assumes that the rationale it develops to deal with the latter problem must also govern the former problem. In fact, the two are simply unrelated and the majority never really explains the separation-of-powers problem that would be created by assigning state law questions to legislative courts or to adjuncts of Art. III courts.

One need not contemplate the intricacies of the separation-of-powers doctrine, however, to realize that the majority's position on adjudication of state-law claims is based on an abstract theory that has little to do with the reality of bankruptcy proceedings. Even prior to the present Act, bankruptcy cases were generally referred to bankruptcy judges, previously called referees. Bkrcty.Rule 102(a). Title 11 U.S.C. § 66 described the jurisdiction of the referees. Their powers included the authority to

“consider all petitions referred to them and make the adjudications or dismiss the petitions ... grant, deny or revoke discharges, determine the dischargeability of debts, and render judgments thereon [and] perform such of the duties as are by this title conferred on courts of bankruptcy, including those incidental to ancillary jurisdiction, and as shall be prescribed by rules or orders of the courts of bankruptcy of their respective districts, **2886 except as herein otherwise provided.”

*99 The bankruptcy judge possessed “complete jurisdiction of the proceedings.” 1 W. Collier, Bankruptcy ¶ 1.09, p. 65 (14th ed. 1976). The referee would initially hear and decide practically all matters arising in the proceedings, including the allowance and disallowance of the claims of creditors.⁵ If a claim was disallowed by the bankruptcy judge and the decision was not reversed on appeal, the creditor was forever barred from further action against the bankrupt. As pointed out above, all of these matters could and usually did involve state-law issues. Initial adjudication of state-law issues by non-Art. III judges is, then, hardly a new aspect of the 1978 Act.

Furthermore, I take it that the Court does not condemn as inconsistent with Art. III the assignment of these functions—*i.e.*, those within the summary jurisdiction of the old bankruptcy courts—to a non-Art. III judge, since, as the plurality says, they lie at the core of the federal bankruptcy power. *Ante*, at 2871. They also happen to be functions that have been performed by referees or bankruptcy judges for a very long time and without constitutional objection. Indeed, we approved the authority of the referee to allow or disallow claims in *Katchen v. Landy*, 382 U.S. 323, 86 S.Ct. 467, 15 L.Ed.2d 391 (1966). There, the referee held that a creditor had received a preference and that his claim could therefore not be allowed. We agreed that the referee had the authority not only to adjudicate the existence of the preference, but also to order that the preference be disgorged. We also recognized that the referee could adjudicate counterclaims against a creditor who files his claim against the estate. The 1973 Bankruptcy Rules make similar provision. See Rule 306(c), Rule 701, and Advisory Committee Note to Rule 701, 11 U.S.C., p. 1340. Hence, if Marathon had filed a claim against the bankrupt in this case, the trustee could have filed and the bankruptcy judge *100 could have adjudicated a counterclaim seeking the relief that is involved in these cases.

Of course, all such adjudications by a bankruptcy judge or referee were subject to review in the district court, on the record. See 11 U.S.C. § 67(c). Bankruptcy Rule 810, transmitted to Congress by this Court, provided that the district court “shall accept the referee's findings of fact unless they are clearly-erroneous.” As the plurality recognizes, *ante*, at 2863, the 1978 Act provides for appellate review in Art. III courts and presumably under the same “clearly erroneous standard.” In other words, under both the old and new Acts, initial determinations of state-law questions were to be made by non-Art. III judges, subject to review by Art. III judges. Why the differences in the provisions for appeal in the

two Acts are of unconstitutional dimension remains entirely unclear.

In theory and fact, therefore, I can find no basis for that part of the majority's argument that rests on the state-law character of the claim involved here. Even if, prior to 1978, the referee could not generally participate in cases aimed at collecting the assets of a bankrupt estate, he nevertheless repeatedly adjudicated issues controlled by state law. There is very little reason to strike down § 1471 on its face on the ground that it extends, in a comparatively minimal way, the referees' authority to deal with state-law questions. To do so is to lose all sense of proportion.

II

The plurality unpersuasively attempts to bolster its case for facial invalidity by asserting that the bankruptcy courts are now "exercising powers far greater than those lodged in the adjuncts approved in either *Crowell* or *Raddatz*." *Ante*, at 2879. In support of this proposition it makes five arguments in addition to the "state-law" **2887 issue. Preliminarily, I see no basis for according standing to *Marathon* to raise any of these additional points. The state-law objection applies to *101 the *Marathon* case. Only that objection should now be adjudicated.⁶

I also believe that the major premise of the plurality's argument is wholly unsupported: There is no explanation of why *Crowell v. Benson*, 285 U.S. 22, 52 S.Ct. 285, 76 L.Ed. 598 (1932), and *United States v. Raddatz*, 447 U.S. 667, 100 S.Ct. 2406, 65 L.Ed.2d 424 (1980), define the outer limits of constitutional authority. Much more relevant to today's decision are, first, the practice in bankruptcy prior to 1978, which neither the majority nor any authoritative case has questioned, and, second, the practice of today's administrative agencies. Considered from this perspective, all of the plurality's arguments are unsupportable abstractions, divorced from the realities of modern practice.

The first three arguments offered by the plurality, *ante*, at 2878–2879, focus on the narrowly defined task and authority of the agency considered in *Crowell*: The agency made only "specialized, narrowly confined factual determinations" and could issue only a narrow class of orders. Regardless of whether this was true of the Compensation Board at issue in *Crowell*, it certainly was not true of the old bankruptcy courts, nor does it even vaguely resemble current administrative

practice. As I have already said, general references to bankruptcy judges, which was the usual practice prior to 1978, permitted bankruptcy judges to perform almost all of the functions of a bankruptcy court. Referees or bankruptcy judges not only exercised summary jurisdiction but could also conduct adversary proceedings to

"(1) recover money or property (2) determine the validity, priority, or extent of a lien or other interest in property, (3) sell property free of a lien or other interest for which the holder can be compelled to make a money satisfaction, (4) object to or revoke a discharge, (5) obtain an injunction, (6) obtain relief from a stay ... (7) determine the dischargeability of a debt." Bkrty.Rule 701.

*102 Although there were some exceptions to the referees' authority, which have been removed by the 1978 Act, the additions to the jurisdiction of the bankruptcy judges were of marginal significance when examined in the light of the overall functions of those judges before and after 1978. In my view, those changes are not sufficient to work a qualitative change in the character of the bankruptcy judge.

The plurality's fourth argument fails to point to any difference between the new and old Bankruptcy Acts. While the administrative orders in *Crowell* may have been set aside by a court if "not supported by the evidence," under both the new and old Acts at issue here, orders of the bankruptcy judge are reviewed under the "clearly-erroneous standard." See Bkrty.Rule 810. Indeed, judicial review of the orders of bankruptcy judges is more stringent than that of many modern administrative agencies. Generally courts are not free to set aside the findings of administrative agencies, if supported by substantial evidence. But more importantly, courts are also admonished to give substantial deference to the agency's interpretation of the statute it is enforcing. No such deference is required with respect to decisions on the law made by bankruptcy judges.

Finally, the plurality suggests that, unlike the agency considered in *Crowell*, the orders of a post-1978 bankruptcy judge are final and binding even though not appealed. *Ante*, at 2879. To attribute any constitutional significance to this, unless the plurality intends to throw into question a large body of administrative law, is strange. More directly, this simply does not represent any change in bankruptcy practice. It was hornbook law prior to 1978 that the authorized judgments and orders of referees, including turnover orders, **2888 were final and binding and *res judicata* unless appealed and overturned:

“The practice before the referee should not differ from that before the judge of the court of bankruptcy and, apart from direct review within the limitation of § 39(c), *103 the orders of the referee are entitled to the same presumption of validity, conclusiveness and recognition in the court of bankruptcy or other courts.” 1 W. Collier, Bankruptcy ¶ 1.09, pp. 65–66 (14th ed. 1976).

Even if there are specific powers now vested in bankruptcy judges that should be performed by Art. III judges, the great bulk of their functions are unexceptionable and should be left intact. Whatever is invalid should be declared to be such; the rest of the 1978 Act should be left alone. I can account for the majority's inexplicably heavy hand in this case only by assuming that the Court has once again lost its conceptual bearings when confronted with the difficult problem of the nature and role of Art. I courts. To that question I now turn.

III

A

The plurality contends that the precedents upholding Art. I courts can be reduced to three categories. First, there are territorial courts, which need not satisfy Art. III constraints because “the Framers intended that as to certain geographical areas ... Congress was to exercise the general powers of government.”⁷ *Ante*, at 2868. Second, there are courts martial, which are exempt from Art. III limits because of a constitutional grant of power that has been “historically understood as giving the political Branches of Government extraordinary control over the precise subject matter at issue.” *Ante*, at 2869. Finally, there are those legislative courts and administrative agencies that adjudicate cases involving public rights—controversies between the Government and private parties—which are not covered by Art. III because the controversy could have been resolved by the executive *104 alone without judicial review. See *ante*, at 2870. Despite the plurality's attempt to cabin the domain of Art. I courts, it is quite unrealistic to consider these to be only three “narrow,” *ante*, at 2867, limitations on or exceptions to the reach of Art. III. In fact, the plurality itself breaks the mold in its discussion of “adjuncts” in Part IV, when it announces that “when Congress creates a substantive federal right, it possesses substantial discretion to prescribe the manner in which that right may be adjudicated.” *Ante*, at 2876. Adjudications of federal rights may, according to the plurality, be committed

to administrative agencies, as long as provision is made for judicial review.

The first principle introduced by the plurality is geographical: Art. I courts presumably are not permitted within the States.⁸ The problem, of course, is that both of the other exceptions recognize that Art. I courts can indeed operate within the States. The second category relies upon a new principle: Art. I courts are permissible in areas in which the Constitution grants Congress “extraordinary control over the precise subject matter.” *Ante*, at 2869. Preliminarily, I do not know how we are to distinguish those areas in which Congress' control is “extraordinary” from those in which it is not. Congress' power over the Armed Forces is established in Art. I, § 8, cls. 13, 14. There is nothing in those Clauses that creates congressional authority different in kind from the authority granted **2889 to legislate with respect to bankruptcy. But more importantly, in its third category, and in its treatment of “adjuncts,” the plurality itself recognizes that Congress can create Art. I courts in virtually all the areas in which Congress is authorized to act, regardless of the quality of the constitutional grant of authority. At the same time, *105 territorial courts or the courts of the District of Columbia, which are Art. I courts, adjudicate private, just as much as public or federal, rights.

Instead of telling us what it is Art. I courts can and cannot do, the plurality presents us with a list of Art. I courts. When we try to distinguish those courts from their Art. III counterparts, we find—apart from the obvious lack of Art. III judges—a series of nondistinctions. By the plurality's own admission, Art. I courts can operate throughout the country, they can adjudicate both private and public rights, and they can adjudicate matters arising from congressional actions in those areas in which congressional control is “extraordinary.” I cannot distinguish this last category from the general “arising under” jurisdiction of Art. III courts.

The plurality opinion has the appearance of limiting Art. I courts only because it fails to add together the sum of its parts. Rather than limiting each other, the principles relied upon complement each other; together they cover virtually the whole domain of possible areas of adjudication. Without a unifying principle, the plurality's argument reduces to the proposition that because bankruptcy courts are not sufficiently like any of these three exceptions, they may not be either Art. I courts or adjuncts to Art. III courts. But we need to know why bankruptcy courts cannot qualify as Art. I courts in their own right.

B

The plurality opinion is not the first unsuccessful attempt to articulate a principled ground by which to distinguish Article I from Article III courts. The concept of a legislative, or Article I, court was introduced by an opinion authored by Chief Justice Marshall. Not only did he create the concept, but at the same time he started the theoretical controversy that has ever since surrounded the concept:

“The Judges of the Superior Courts of Florida hold their offices for four years. These Courts, then, are not constitutional Courts, in which the judicial power conferred *106 by the Constitution on the general government, can be deposited. They are incapable of receiving it. They are legislative Courts, created in virtue of the general right of sovereignty which exists in the government, or in virtue of that clause which enables Congress to make all needful rules and regulations, respecting the territory belonging to the United States. The jurisdiction with which they are invested, is not a part of that judicial power which is defined in the 3d article of the Constitution, but is conferred by Congress, in the execution of those general powers which that body possesses over the territories of the United States.” *American Insurance Co. v. Canter*, 1 Pet. 511, 546, 7 L.Ed. 242 (1828).

The proposition was simple enough: Constitutional courts exercise the judicial power described in Art. III of the Constitution; legislative courts do not and cannot.

There were only two problems with this proposition. First, *Canter* itself involved a case in admiralty jurisdiction, which is specifically included within the “judicial power of the United States” delineated in Art. III. How, then, could the territorial court not be exercising Art. III judicial power? Second, and no less troubling, if the territorial courts could not exercise Art. III power, how could their decisions be subject to appellate review in Art. III courts, including this one, that can exercise only Art. III “judicial” power? Yet from early on this Court has exercised such appellate jurisdiction. *Benner v. Porter*, 9 How. 235, 243, 13 L.Ed. 119 (1850); *Clinton v. Englebrecht*, 13 Wall. 434, 20 L.Ed. 659 (1872); *Reynolds v. United States*, 98 U.S. 145, 154, 25 L.Ed. 244 (1879); *United States v. Coe*, *2890 155 U.S. 76, 86, 15 S.Ct. 16, 19, 39 L.Ed. 76 (1894); *Balzac v. Porto Rico*, 258 U.S. 298, 312–313, 42 S.Ct. 343, 348–49, 66 L.Ed. 627 (1922). The attempt to understand the seemingly unexplainable was

bound to generate “confusion and controversy.” This analytic framework, however—the search for a principled distinction—has continued to burden the Court.

The first major elaboration on the *Canter* principle was in *Murray's Les see v. *107 Hoboken Land & Improvement Co.*, 18 How. 272, 15 L.Ed. 372 (1856). The plaintiff in that case argued that a proceeding against a customs collector for the collection of moneys claimed to be due to the United States was an exercise of “judicial power” and therefore had to be carried out by Art. III judges. The Court accepted this premise: “It must be admitted that, if the auditing of this account, and the ascertainment of its balance, and the issuing of this process, was an exercise of the judicial power of the United States, the proceeding was void; for the officers who performed these acts could exercise no part of that judicial power.” *Id.*, at 275. Having accepted this premise, the Court went on to delineate those matters which could be determined only by an Art. III court, *i.e.*, those matters that fall within the nondelegable “judicial power” of the United States. The Court's response to this was twofold. First, it suggested that there are certain matters which are inherently “judicial”: “[W]e do not consider congress can either withdraw from judicial cognizance any matter which, from its nature, is the subject of a suit at the common law, or in equity, or admiralty.” *Id.*, at 284. Second, it suggested that there is another class of issues that, depending upon the form in which Congress structures the decisionmaking process, may or may not fall within “the cognizance of the courts of the United States.” *Ibid.* This latter category consisted of the so-called “public rights.” Apparently, the idea was that Congress was free to structure the adjudication of “public rights” without regard to Art. III.

Having accepted the plaintiff's premise, it is hard to see how the Court could have taken too seriously its first contention. The Court presented no examples of such issues that are judicial “by nature” and simply failed to acknowledge that Art. I courts already sanctioned by the Court—*e.g.*, territorial courts—were deciding such issues all the time. The second point, however, contains implicitly a critical insight; one that if openly acknowledged would have undermined the entire structure. That insight follows from the Court's earlier *108 recognition that the term “judicial act” is broad enough to encompass all administrative action involving inquiry into facts and the application of law to those facts. *Id.*, at 280. If administrative action can be characterized as “judicial” in nature, then obviously the Court's subsequent attempt to distinguish administrative from judicial action on the basis

of the manner in which Congress structures the decision cannot succeed. There need be no Art. III court involvement in any adjudication of a “public right,” which the majority now interprets as any civil matter arising between the Federal Government and a citizen. In that area, whether an issue is to be decided by an Art. III court depends, finally, on congressional intent.

Although *Murray's Lessee* implicitly undermined Chief Justice Marshall's suggestion that there is a difference in kind between the work of Art. I and that of Art. III courts, it did not contend that the Court must always defer to congressional desire in this regard. The Court considered the plaintiff's contention that removal of the issue from an Art. III court must be justified by “necessity.” Although not entirely clear, the Court seems to have accepted this proposition: “[I]t seems to us that the just inference from the entire law is, that there was such a necessity for the warrant.” *Id.*, at 285.⁹

****2891** The Court in *Murray's Lessee* was precisely right: Whether an issue can be decided by a non-Art. III court does not depend upon the judicial or nonjudicial character of the issue, but on the will of Congress and the reasons Congress offers for not using an Art. III court. This insight, however, was completely disavowed in the next major case to consider ***109** the distinction between Art. I and Art. III courts, *Ex parte Bakelite Corp.*, 279 U.S. 438, 49 S.Ct. 411, 73 L.Ed. 789 (1929), in which the Court concluded that the Court of Customs Appeals was a legislative court. The Court there directly embraced the principle also articulated in *Murray's Lessee* that Art. I courts may not consider any matter “which inherently or necessarily requires judicial determination,” but only such matters as are “susceptible of legislative or executive determination.” 279 U.S., at 453, 49 S.Ct., at 414. It then went on effectively to bury the critical insight of *Murray's Lessee*, labeling as “fallacious” any argument that “assumes that whether a court is of one class or the other depends on the intention of Congress, whereas the true test lies in the power under which the court was created and in the jurisdiction conferred.” 279 U.S., at 459, 49 S.Ct., at 416.¹⁰

The distinction between public and private rights as the principle delineating the proper domains of legislative and constitutional courts respectively received its death blow, I had believed, in *Crowell v. Benson*, 285 U.S. 22, 52 S.Ct. 285, 76 L.Ed. 598 (1932). In that case, the Court approved an administrative scheme for the determination, in the first instance, of maritime employee compensation claims. Although acknowledging the framework set out in *Murray's*

Lessee and *Ex parte Bakelite Corp.*, the Court specifically distinguished the case before it: “The present case does not fall within the categories just described but is one of private right, that is, of the liability of one individual to another under the law as defined.”¹¹ 285 U.S., at 51, 52 S.Ct., at 292. Nevertheless, the Court approved of the use of an Art. I adjudication mechanism on the new theory that “there is no requirement that, in order to maintain the essential ***110** attributes of the judicial power, all determinations of fact in constitutional courts shall be made by judges.” *Ibid.* Article I courts could deal not only with public rights, but also, to an extent, with private rights. The Court now established a distinction between questions of fact and law: “[T]he reservation of full authority to the court to deal with matters of law provides for the appropriate exercise of the judicial function in this class of cases.”¹² *Id.*, at 54, 52 S.Ct., at 293.

Whatever sense *Crowell* may have seemed to give to this subject was exceedingly short-lived. One year later, the Court returned to this subject, abandoning both the public/private and the fact/law distinction and replacing both with a simple literalism. In *O'Donoghue v. United States*, 289 U.S. 516, 53 S.Ct. 740, 77 L.Ed. 1356 (1933), considering the courts of the District of Columbia, and in *Williams v. United States*, 289 U.S. 553, 53 S.Ct. 751, 77 L.Ed. 1372 (1933), considering the Court of Claims, the Court adopted the principle that if a federal court exercises jurisdiction over cases of the type listed in Art. III, § 2, as falling within the “judicial power of the United States,” then that court must be an Art. III court:

“The provision of this section of the article is that the ‘judicial power shall extend’ to the cases enumerated, and it logically follows that where jurisdiction over these cases is conferred upon the courts of the District, the judicial power, since they are capable of receiving it, is *ipso facto*, vested in such courts as inferior courts of the United States.” *O'Donoghue, supra*, 289 U.S., at 545, 53 S.Ct., at 748.¹³

***111** In order to apply this same principle and yet hold the Court of Claims to be a legislative court, the Court found it necessary in *Williams, supra*, to conclude that the phrase “Controversies to which the United States shall be a party” in Art. III must be read as if it said “controversies to which the United States shall be a party plaintiff or petitioner.”¹⁴

By the time of the *Williams* decision, this area of the law was mystifying to say the least. What followed helped very

little, if at all. In the next two major cases the Court could not agree internally on a majority position. In *National Insurance Co. v. Tidewater Co.*, 337 U.S. 582, 69 S.Ct. 1173, 93 L.Ed. 1556 (1949), the Court upheld a statute giving federal district courts jurisdiction over suits between citizens of the District of Columbia and citizens of a State. A majority of the Court, however, rejected the plurality position that Congress had the authority to assign Art. I powers to Art. III courts, at least outside of the District of Columbia. Only Chief Justice Vinson in dissent reflected on the other side of this problem: whether Art. I courts could be assigned Art. III powers. He entirely disagreed with the conceptual basis for *Williams* and *O'Donoghue*, noting that to the extent that Art. I courts consider non-Art. III matters, appellate review by an Art. III court would be precluded. Or conversely, since appellate review is exercised by this Court over Art. I courts, Art. I courts must “exercise federal question jurisdiction.” 337 U.S., at 643, 69 S.Ct., at 1208. Having gone this far, the Chief Justice was confronted with the obvious question of whether in fact “the distinction between constitutional and legislative courts is meaningless.” *Id.*, at 644, 69 S.Ct., at 1208–09. Although suggesting that outside *112 of the Territories or the District of Columbia there may be some limits on assignment to Art. I courts of matters that fall within Art. III jurisdiction—apart from federal-question jurisdiction—for the most part the Chief Justice ended up relying on the good will of Congress: “[W]e cannot impute to Congress an intent now or in the future to transfer jurisdiction from constitutional to legislative courts for the purpose of emasculating the former.” *Ibid.*

Another chapter in this somewhat dense history of a constitutional quandary was provided by Justice Harlan's plurality opinion in *Glidden Co. v. Zdanok*, 370 U.S. 530, 82 S.Ct. 1459, 8 L.Ed.2d 671 (1962), in which the Court, despite *Bakelite* and *Williams*—and relying on an Act of Congress enacted since those decisions—held the Court of Claims and the Court of Customs and Patent Appeals to be Art. III courts. Justice Harlan continued the process of intellectual repudiation begun by Chief Justice Vinson in *Tidewater*. First, it was clear to him that Chief Justice Marshall **2893 could not have meant what he said in *Canter* on the inability of Art. I courts to consider issues within the jurisdiction of Art. III courts: “Far from being ‘incapable of receiving’ federal-question jurisdiction, the territorial courts have long exercised a jurisdiction commensurate in this regard with that of the regular federal courts and have been subjected to the appellate jurisdiction of this Court precisely because they do so.” 370 U.S., at 545, n. 13, 82 S.Ct., at 1470, n. 13. Second,

exceptions to the requirements of Art. III, he thought, have not been founded on any principled distinction between Art. I issues and Art. III issues; rather, a “confluence of practical considerations,” *id.*, at 547, 82 S.Ct., at 1471, accounts for this Court's sanctioning of Art. I courts:

“The touchstone of decision in all these cases has been the need to exercise the jurisdiction then and there and for a transitory period. Whether constitutional limitations on the exercise of judicial power have been held inapplicable has depended on the particular local setting, the practical necessities, and the possible alternatives.” *Id.*, at 547–548, 82 S.Ct., at 1471–72.

*113 Finally, recognizing that there is frequently no way to distinguish Art. I and Art. III courts on the basis of the work they do, Justice Harlan suggested that the only way to tell them apart is to examine the “establishing legislation” to see if it complies with the requirements of Art. III. This, however, comes dangerously close to saying that Art. III courts are those with Art. III judges; Art. I courts are those without such judges. One hundred and fifty years of constitutional history, in other words, had led to a simple tautology.

IV

The complicated and contradictory history of the issue before us leads me to conclude that Chief Justice Vinson and Justice Harlan reached the correct conclusion: There is no difference in principle between the work that Congress may assign to an Art. I court and that which the Constitution assigns to Art. III courts. Unless we want to overrule a large number of our precedents upholding a variety of Art. I courts—not to speak of those Art. I courts that go by the contemporary name of “administrative agencies”—this conclusion is inevitable. It is too late to go back that far; too late to return to the simplicity of the principle pronounced in Art. III and defended so vigorously and persuasively by Hamilton in *The Federalist* Nos. 78–82.

To say that the Court has failed to articulate a principle by which we can test the constitutionality of a putative Art. I court, or that there is no such abstract principle, is not to say that this Court must always defer to the legislative decision to create Art. I, rather than Art. III, courts. Article III is not to be read out of the Constitution; rather, it should be read as expressing one value that must be balanced against competing constitutional values and legislative responsibilities. This

Court retains the final word on how that balance is to be struck.

Despite the principled, although largely mistaken, rhetoric expanded by the Court in this area over the years, such a balancing approach stands behind many of the decisions *114 holding Art. I courts. Justice Harlan suggested as much in *Glidden*, although he needlessly limited his consideration to the “temporary” courts that Congress has had to set up on a variety of occasions. In each of these instances, this Court has implicitly concluded that the legislative interest in creating an adjudicative institution of temporary duration outweighed the values furthered by a strict adherence to Art. III. Besides the territorial courts approved in *American Insurance Co. v. Canter*, 1 Pet. 511, 7 L.Ed. 242 (1828), these courts have included the Court of Private Land Claims, *United States v. Coe*, 155 U.S. 76, 15 S.Ct. 16, 39 L.Ed. 76 (1894), the Choctaw and Chickasaw Citizenship Court, *Stephens v. Cherokee Nation*, 174 U.S. 445, 19 S.Ct. 722, 43 L.Ed. 1041 (1899), and consular courts established in foreign countries, **2894 *In re Ross*, 140 U.S. 453, 11 S.Ct. 897, 35 L.Ed. 581 (1891). This same sort of “practical” judgment was voiced, even if not relied upon, in *Crowell* with respect to the Employees' Compensation Claims Commission, which was not meant to be of limited duration: “[W]e are unable to find any constitutional obstacle to the action of the Congress in availing itself of a method shown by experience to be essential in order to apply its standards to the thousands of cases involved.” 285 U.S., at 54, 52 S.Ct., at 293. And even in *Murray's Lessee*, there was a discussion of the “necessity” of Congress' adopting an approach that avoided adjudication in an Art. III court. 18 How., at 285.

This was precisely the approach taken to this problem in *Palmore v. United States*, 411 U.S. 389, 93 S.Ct. 1670, 36 L.Ed.2d 342 (1973), which, contrary to the suggestion of the plurality, did not rest on any theory of territorial or geographical control. *Ante*, at 2874. Rather, it rested on an evaluation of the strength of the legislative interest in pursuing in this manner one of its constitutionally assigned responsibilities—a responsibility not different in kind from numerous other legislative responsibilities. Thus, *Palmore* referred to the wide variety of Art. I courts, not just territorial courts. It is in this light that the critical statement of the case must be understood:

*115 “[T]he requirements of Art. . III, which are applicable where laws of national applicability and affairs of national concern are at stake, must in proper circumstances give way to accommodate plenary

grants of power to Congress to legislate with respect to specialized areas having particularized needs and warranting distinctive treatment.” 411 U.S., at 407–408, 93 S.Ct., at 1681–1682.

I do not suggest that the Court should simply look to the strength of the legislative interest and ask itself if that interest is more compelling than the values furthered by Art. III. The inquiry should, rather, focus equally on those Art. III values and ask whether and to what extent the legislative scheme accommodates them or, conversely, substantially undermines them. The burden on Art. III values should then be measured against the values Congress hopes to serve through the use of Art. I courts.

To be more concrete: *Crowell*, *supra*, suggests that the presence of appellate review by an Art. III court will go a long way toward insuring a proper separation of powers. Appellate review of the decisions of legislative courts, like appellate review of state-court decisions, provides a firm check on the ability of the political institutions of government to ignore or transgress constitutional limits on their own authority. Obviously, therefore, a scheme of Art. I courts that provides for appellate review by Art. III courts should be substantially less controversial than a legislative attempt entirely to avoid judicial review in a constitutional court.

Similarly, as long as the proposed Art. I courts are designed to deal with issues likely to be of little interest to the political branches, there is less reason to fear that such courts represent a dangerous accumulation of power in one of the political branches of government. Chief Justice Vinson suggested as much when he stated that the Court should guard against any congressional attempt “to transfer jurisdiction *116 . . . for the purpose of emasculating” constitutional courts. *National Insurance Co. v. Tidewater Co.*, 337 U.S., at 644, 69 S.Ct., at 1208–1209.

V

I believe that the new bankruptcy courts established by the Bankruptcy Act of 1978, 28 U.S.C. § 1471 (1976 ed., Supp.IV), satisfy this standard.

First, ample provision is made for appellate review by Art. III courts. Appeals may in some circumstances be brought directly to the district courts. 28 U.S.C. § 1334 (1976 ed., Supp.IV). Decisions of the district courts are

further appealable to the court of appeals. § 1293. In other circumstances, appeals go first to a panel of bankruptcy judges, § 1482, and then to ****2895** the court of appeals. § 1293. In still other circumstances—when the parties agree—appeals may go directly to the court of appeals. In sum, there is in every instance a right of appeal to at least one Art. III court. Had Congress decided to assign all bankruptcy matters to the state courts, a power it clearly possesses, no greater review in an Art. III court would exist. Although I do not suggest that this analogy means that Congress may establish an Art. I court wherever it could have chosen to rely upon the state courts, it does suggest that the critical function of judicial review is being met in a manner that the Constitution suggests is sufficient.

Second, no one seriously argues that the Bankruptcy Act of 1978 represents an attempt by the political branches of government to aggrandize themselves at the expense of the third branch or an attempt to undermine the authority of constitutional courts in general. Indeed, the congressional perception of a lack of judicial interest in bankruptcy matters was one of the factors that led to the establishment of the bankruptcy courts: Congress feared that this lack of interest would lead to a failure by federal district courts to deal with bankruptcy matters in an expeditious manner. [H.R.Rep.No. 95-595, p. 14 \(1977\)](#). Bankruptcy matters are, for the most part, private adjudications of little political significance.

***117** Although some bankruptcies may indeed present politically controversial circumstances or issues, Congress has far more direct ways to involve itself in such matters than through some sort of subtle, or not so subtle, influence on bankruptcy judges. Furthermore, were such circumstances to arise, the Due Process Clause might very well require that the matter be considered by an Art. III judge: Bankruptcy proceedings remain, after all, subject to all of the strictures of that constitutional provision.¹⁵

Finally, I have no doubt that the ends that Congress sought to accomplish by creating a system of non-Art. III bankruptcy courts were at least as compelling as the ends found to be satisfactory in *Palmore v. United States*, 411 U.S. 389, 83 S.Ct. 1670, 36 L.Ed.2d 342 (1973), or the ends that have traditionally justified the creation of legislative courts. The stresses placed upon the old bankruptcy system by the tremendous increase in bankruptcy cases were well documented and were clearly a matter to which Congress

could respond.¹⁶ I do not believe it is possible to challenge Congress' further determination that it was necessary to create a specialized court to deal with bankruptcy matters. This was the nearly uniform conclusion of all those that testified before Congress on the question of reform of the bankruptcy system, as well as the conclusion of the Commission on Bankruptcy Laws established by Congress in 1970 to explore possible improvements in the system.¹⁷

The real question is not whether Congress was justified ***118** in establishing a specialized bankruptcy court, but rather whether it was justified in failing to create a specialized, Art. III bankruptcy court. My own view is that the very fact of extreme specialization may be enough, and certainly has been enough in the past,¹⁸ to ****2896** justify the creation of a legislative court. Congress may legitimately consider the effect on the federal judiciary of the addition of several hundred specialized judges: We are, on the whole, a body of generalists.¹⁹ The addition of several hundred specialists may substantially change, whether for good or bad, the character of the federal bench. Moreover, Congress may have desired to maintain some flexibility in its possible future responses to the general problem of bankruptcy. There is no question that the existence of several hundred bankruptcy judges with life tenure would have severely limited Congress' future options. Furthermore, the number of bankruptcies may fluctuate, producing a substantially reduced need for bankruptcy judges. Congress may have thought that, in that event, a bankruptcy specialist should not as a general matter serve as a judge in the countless nonspecialized cases that come before the federal district courts. It would then face the prospect of large numbers of idle federal judges. Finally, Congress may have believed that the change from bankruptcy referees to Art. I judges was far less dramatic, and so less disruptive of the existing bankruptcy and constitutional court systems, than would be a change to Art. III judges.

For all of these reasons, I would defer to the congressional judgment. Accordingly, I dissent.

All Citations

458 U.S. 50, 102 S.Ct. 2858, 73 L.Ed.2d 598, 6 Collier Bankr.Cas.2d 785, Bankr. L. Rep. P 68,698

Footnotes

- * The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States v. Detroit Lumber Co.*, 200 U.S. 321, 337, 26 S.Ct. 282, 287, 50 L.Ed. 499.
- 1 Pub.L. 95–598, 92 Stat. 2549, U.S.Code Cong. & Admin.News 1978, p. 5787. The Act became effective October 1, 1979.
- 2 Bankruptcy referees were redesignated as “judges” in 1973. Bkrtcy.Rule 901(7). For purposes of clarity, however, we refer to all judges under the old Act as “referees.”
- 3 Although the Act initially vests this jurisdiction in district courts, 28 U.S.C. § 1471(a) (1976 ed., Supp.IV), it subsequently provides that “[t]he bankruptcy court for the district in which a case under title 11 is commenced shall exercise *all* of the jurisdiction conferred by this section on the district courts,” § 1471(c) (1976 ed., Supp.IV) (emphasis added). Thus the ultimate repository of the Act’s broad jurisdictional grant is the bankruptcy courts. See 1 W. Collier, Bankruptcy ¶ 3.01, pp. 3–37, 3–44 to 3–49 (15th ed. 1982).
- 4 With respect to both personal jurisdiction and venue, the scope of the Act is also expansive. Although the Act does not in terms indicate the extent to which bankruptcy judges may exercise personal jurisdiction, it has been construed to allow the constitutional maximum. See, e.g., *In re Whippary Paper Board Co.*, 15 B.R. 312, 314–315 (Bkrtcy. NJ 1981). With two exceptions not relevant here, the venue of “a proceeding arising in or related to a case under title 11 [is] in the bankruptcy court in which such case is pending.” 28 U.S.C. § 1473(a) (1976 ed., Supp.IV). Furthermore, the Act permits parties to remove many kinds of actions to the bankruptcy court. Parties “may remove any claim or cause of action in a civil action, other than a proceeding before the United States Tax Court or a civil action by a Government unit to enforce such governmental unit’s police or regulatory power.” § 1478(a) (1976 ed., Supp.IV). The bankruptcy court may, however, remand such actions “on any equitable ground”; the decision to remand or retain an action is unreviewable. § 1478(b).
- 5 Although no particular standard of review is specified in the Act, the parties in the present cases seem to agree that the appropriate one is the clearly-erroneous standard, employed in old Bankruptcy Rule 810 for review of findings of fact made by a referee. See Brief for United States 41; Tr. of Oral Arg. 27. See also *In re Rivers*, 19 B.R. 438 (Bkrtcy. ED Tenn.1982); 1 Collier, *supra* n. 3, ¶ 3.03, p. 3–315.
- 6 Under the old Bankruptcy Act, referees could be removed by the district court for “incompetency, misconduct, or neglect of duty,” 11 U.S.C. § 62(b) (repealed); the same grounds for removal apply during the transition period, see § 404(d), 92 Stat. 2684.
- 7 It appears, however, that during the transition period an appeal of a bankruptcy judge’s decision may be taken to the district court even if an appellate panel of bankruptcy judges has been established.
- 8 After Northern docketed an appeal in this Court, the District Court supplemented its order with an opinion. 12 B.R. 946, 947 (1981).
- 9 Two other Bankruptcy Courts have considered the constitutionality of § 1471: The Bankruptcy Court for the District of Puerto Rico determined it to be constitutional, *In re Segarra*, 14 B.R. 870 (1981), while the Bankruptcy Court for the Eastern District of Tennessee reached the opposite conclusion, *In re Rivers*, *supra*.
- 10 These provisions serve other institutional values as well. The independence from political forces that they guarantee helps to promote public confidence in judicial determinations. See The Federalist No. 78 (A. Hamilton). The security that they provide to members of the Judicial Branch helps to attract well-qualified persons to the federal bench. *Ibid*. The guarantee of life tenure insulates the individual judge from improper influences not only by other branches but by colleagues as well, and thus promotes judicial individualism. See Kaufman, Chilling Judicial Independence, 88 Yale L.J. 681, 713 (1979). See generally Note, Article III Limits on Article I Courts: The Constitutionality of the Bankruptcy Court and the 1979 Magistrate Act, 80 Colum.L.Rev. 560, 583–585 (1980).
- 11 Further evidence of the Framers’ concern for assuring the independence of the Judicial Branch may be found in the fact that the Constitutional Convention soundly defeated a proposal to allow the removal of judges by the Executive and Legislative Branches. See 2 M. Farrand, Records of the Federal Convention of 1787, pp. 428–429 (1911); P. Bator, P. Mishkin, D. Shapiro, & H. Wechsler, Hart and Wechsler’s The Federal Courts and the Federal System 7 (2d ed. 1973).

Mr. Wilson, of Pennsylvania, commented that “[t]he Judges would be in a bad situation if made to depend on every gust of faction which might prevail in the two branches of our Govt.” 2 Farrand, *supra*, at 429.

- 12 It should be noted, however, that the House of Representatives expressed substantial doubts respecting the constitutionality of the provisions eventually included in the Act. The House Judiciary Committee and its Subcommittee on Civil and Constitutional Rights gave lengthy consideration to the constitutional issues surrounding the conferral of broad powers upon the new bankruptcy courts. The Committee, the Subcommittee, and the House as a whole initially concluded that Art. III courts were constitutionally required for bankruptcy adjudications. See H.R. 8200, 95th Cong., 1st Sess. (1977); Hearings on H.R. 31 and H.R. 32 before the Subcommittee on Civil and Constitutional Rights of the House Committee on the Judiciary, 94th Cong., 2d Sess., 2081–2084 (1976); *id.*, at 2682–2706; H.R.Rep.No. 95–595, p. 39 (1977), U.S.Code Cong. & Admin.News 1978, p. 5787, 6000 (“Article III is the constitutional norm, and the limited circumstances in which the courts have permitted departure from the requirements of Article III are not present in the bankruptcy context”); *id.*, at 21–38; Subcommittee on Civil and Constitutional Rights of the House Committee on the Judiciary, Constitutional Bankruptcy Courts, 95th Cong., 1st Sess., 33 (Comm.Print No. 3, 1977) (concluding that the proposed bankruptcy courts should be established “under Article III, with all of the protection that the Framers intended for an independent judiciary”); Subcommittee on Civil and Constitutional Rights of the House Committee on the Judiciary, Report on Hearings on the Court Administrative Structure for Bankruptcy Cases, 95th Cong., 2d Sess., 5 (Comm.Print No. 13, 1978) (same); see generally Klee, Legislative History of the New Bankruptcy Law, 28 De Paul L.Rev. 941, 945–949, 951 (1979). The Senate bankruptcy bill did not provide for life tenure or a guaranteed salary, instead adopting the concept of a bankruptcy court with similarly broad powers but as an “adjunct” to an Art. III court. S. 2266, 95th Cong., 2d Sess. (1978). The bill that was finally enacted, denying bankruptcy judges the tenure and compensation protections of Art. III, was the result of a series of last-minute conferences and compromises between the managers of both Houses. See Klee, *supra*, at 952–956.
- 13 The Act designates the bankruptcy court in each district as an “adjunct” to the district court. 28 U.S.C. § 151(a) (1976 ed., Supp.IV). Neither House of Congress concluded that the bankruptcy courts should be established as independent legislative courts. See n. 12, *supra*.
- 14 At one time, this Court suggested a rigid distinction between those subjects that could be considered only in Art. III courts and those that could be considered only in legislative courts. See *Williams v. United States*, 289 U.S. 553, 53 S.Ct. 751, 77 L.Ed. 1372 (1933). But this suggested dichotomy has not withstood analysis. See C. Wright, Law of the Federal Courts 33–35 (3d ed. 1976). Our more recent cases clearly recognize that legislative courts may be granted jurisdiction over some cases and controversies to which the Art. III judicial power might also be extended. *E.g.*, *Palmore v. United States*, 411 U.S. 389, 93 S.Ct. 1670, 36 L.Ed.2d 342 (1973). See *Glidden Co. v. Zdanok*, 370 U.S. 530, 549–551, 82 S.Ct. 1459, 1472–1473, 8 L.Ed.2d 671 (1962) (opinion of Harlan, J.).
- 15 Justice WHITE’s dissent finds particular significance in the fact that Congress could have assigned all bankruptcy matters to the state courts. *Post*, at 2894. But, of course, virtually all matters that might be heard in Art. III courts could also be left by Congress to state courts. This fact is simply irrelevant to the question before us. Congress has no control over state-court judges; accordingly the principle of separation of powers is not threatened by leaving the adjudication of federal disputes to such judges. See Krattenmaker, Article III and Judicial Independence: Why the New Bankruptcy Courts are Unconstitutional, 70 Geo.L.J. 297, 304–305 (1981). The Framers chose to leave to Congress the precise role to be played by the lower federal courts in the administration of justice. See Hart and Wechsler’s The Federal Courts and the Federal System, *supra*, n. 11, at 11. But the Framers did not leave it to Congress to define the character of those courts—they were to be independent of the political branches and presided over by judges with guaranteed salary and life tenure.
- 16 We recently reaffirmed the principle, expressed in these early cases, that Art. I, § 8, cl. 17, provides that Congress shall have power “[t]o exercise exclusive Legislation in all Cases whatsoever, over” the District of Columbia. *Palmore v. United States*, 411 U.S., at 397, 93 S.Ct., at 1676. See also *Wallace v. Adams*, 204 U.S. 415, 423, 27 S.Ct. 363, 365, 51 L.Ed. 547 (1907) (recognizing Congress’ authority to establish legislative courts to determine questions of tribal membership relevant to property claims within Indian territory); *In re Ross*, 140 U.S. 453, 11 S.Ct. 897, 35 L.Ed. 581 (1891) (same, respecting consular courts established by concession from foreign countries). See generally 1 J. Moore, J. Lucas, H.

Fink, D. Weckstein, & J. Wicker, Moore's Federal Practice 46–49, 53–54 (1982). But see *Reid v. Covert*, 354 U.S. 1, 77 S.Ct. 1222, 1 L.Ed.2d 1148 (1957).

- 17 See also *Burns v. Wilson*, 346 U.S. 137, 139–140, 73 S.Ct. 1045, 1047, 97 L.Ed. 1508 (1953). But this Court has been alert to ensure that Congress does not exceed the constitutional bounds and bring within the jurisdiction of the military courts matters beyond that jurisdiction, and properly within the realm of “judicial power.” See, e.g., *Reid v. Covert*, *supra*; *United States ex rel. Toth v. Quarles*, 350 U.S. 11, 76 S.Ct. 1, 100 L.Ed. 8 (1955).
- 18 Congress' power to create legislative courts to adjudicate public rights carries with it the lesser power to create administrative agencies for the same purpose, and to provide for review of those agency decisions in Art. III courts. See, e.g., *Atlas Roofing Co. v. Occupational Safety and Health Review Comm'n*, 430 U.S. 442, 450, 97 S.Ct. 1261, 1266, 51 L.Ed.2d 464 (1977).
- 19 See *Oceanic Steam Navigation Co. v. Stranahan*, 214 U.S. 320, 339, 29 S.Ct. 671, 676, 53 L.Ed. 1013 (1909); Katz, *Federal Legislative Courts*, 43 Harv.L.Rev. 894, 915 (1930).
- 20 Doubtless it could be argued that the need for independent judicial determination is greatest in cases arising between the Government and an individual. But the rationale for the public-rights line of cases lies not in political theory, but rather in Congress' and this Court's understanding of what power was reserved to the Judiciary by the Constitution as a matter of historical fact.
- 21 See also *Williams v. United States*, 289 U.S. 553, 53 S.Ct. 751, 77 L.Ed. 1372 (1933) (holding that Court of Claims was a legislative court and that salary of a judge of that court could therefore be reduced by Congress).
- 22 *Crowell v. Benson*, 285 U.S. 22, 52 S.Ct. 285, 76 L.Ed. 598 (1932), attempted to catalog some of the matters that fall within the public-rights doctrine:

“Familiar illustrations of administrative agencies created for the determination of such matters are found in connection with the exercise of the congressional power as to interstate and foreign commerce, taxation, immigration, the public lands, public health, the facilities of the post office, pensions and payments to veterans.” *Id.*, at 51, 52 S.Ct., at 292 (footnote omitted).
- 23 Congress cannot “withdraw from [Art. III] judicial cognizance any matter which, from its nature, is the subject of a suit at the common law, or in equity, or admiralty.” *Murray's Lessee v. Hoboken Land & Improvement Co.*, 18 How. 272, 284 (1856) (emphasis added). It is thus clear that the presence of the United States as a proper party to the proceeding is a necessary but not sufficient means of distinguishing “private rights” from “public rights.” And it is also clear that even with respect to matters that arguably fall within the scope of the “public rights” doctrine, the presumption is in favor of Art. III courts. See *Glidden Co. v. Zdanok*, 370 U.S., at 548–549, and n. 21, 82 S.Ct., at 1471–1472, and n. 21 (opinion of Harlan, J.). See also Currie, *The Federal Courts and the American Law Institute*, Part 1, 36 U.Chi.L.Rev. 1, 13–14, n. 67 (1968). Moreover, when Congress assigns these matters to administrative agencies, or to legislative courts, it has generally provided, and we have suggested that it may be required to provide, for Art. III judicial review. See *Atlas Roofing Co. v. Occupational Safety and Health Review Comm'n*, 430 U.S., at 455, n. 13, 97 S.Ct., at 1269, n. 13.
- 24 Of course, the public-rights doctrine does not extend to any criminal matters, although the Government is a proper party. See, e.g., *United States ex rel. Toth v. Quarles*, 350 U.S. 11, 76 S.Ct. 1, 100 L.Ed. 8 (1955).
- 25 The “unifying principle” that Justice WHITE's dissent finds lacking in all of these cases, see *post*, at 2889, is to be found in the exceptional constitutional grants of power to Congress with respect to certain matters. Although the dissent is correct that these grants are not explicit in the language of the Constitution, they are nonetheless firmly established in our historical understanding of the constitutional structure. When these three exceptional grants are properly constrained, they do not threaten the Framers' vision of an independent Federal Judiciary. What clearly remains subject to Art. III are all private adjudications in federal courts within the States—matters from their nature subject to “a suit at common law or in equity or admiralty”—and all criminal matters, with the narrow exception of military crimes. There is no doubt that when the Framers assigned the “judicial Power” to an independent Art. III Branch, these matters lay at what they perceived to be the protected core of that power.

Although the dissent recognizes that the Framers had something important in mind when they assigned the judicial power of the United States to Art. III courts, it concludes that our cases and subsequent practice have eroded this conception. Unable to find a satisfactory theme in our precedents for analyzing these cases, the dissent rejects all of them, as well as the historical understanding upon which they were based, in favor of an ad hoc balancing approach in which Congress can essentially determine for itself whether Art. III courts are required. See *post*, at 2889–2894. But even the dissent recognizes that the notion that Congress rather than the Constitution should determine whether there is a need for independent federal courts cannot be what the Framers had in mind. See *post*, at 2893.

- 26 This claim may be adjudicated in federal court on the basis of its relationship to the petition for reorganization. See *Williams v. Austrian*, 331 U.S. 642, 67 S.Ct. 1443, 91 L.Ed. 1718 (1947); *Schumacher v. Beeler*, 293 U.S. 367, 55 S.Ct. 230, 79 L.Ed. 433 (1934). See also *National Ins. Co. v. Tidewater Co.*, 337 U.S. 582, 611–613, 69 S.Ct. 1173, 1187–1188, 93 L.Ed. 1556 (1949) (Rutledge, J., concurring); *Textile Workers v. Lincoln Mills*, 353 U.S. 448, 472, 77 S.Ct. 912, 929, 1 L.Ed.2d 972 (1957) (Frankfurter, J., dissenting). Cf. *Osborn v. Bank of the United States*, 9 Wheat. 738, 6 L.Ed. 204 (1824). But this relationship does not transform the state-created right into a matter between the Government and the petitioner for reorganization. Even in the absence of the federal scheme, the plaintiff would be able to proceed against the defendant on the state-law contractual claims.
- 27 Nor can appellants' analysis logically be limited to Congress' Art. I powers. For example, appellants' reasoning relies in part upon analogy to our approval of territorial courts in *American Ins. Co. v. Canter*, 1 Pet. 511, 7 L.Ed. 242 (1828), and of the use of an administrative agency in *Crowell v. Benson*, 285 U.S. 22, 52 S.Ct. 285, 76 L.Ed. 598 (1932). Brief for United States 15; Brief for Northern Pipeline Construction Co. 10. In those cases the Court recognized the right of Congress to create territorial courts pursuant to the authority granted under Art. IV, § 3, cl. 2, and to create administrative tribunals to adjudicate rights in admiralty pursuant to the federal authority in Art. III, § 2, over admiralty jurisdiction. See *American Ins. Co. v. Canter*, *supra*, at 546; *Crowell v. Benson*, *supra*, 285 U.S., at 39, 52 S.Ct., at 287. This reliance underscores the fact that appellants offer no principled means of distinguishing between Congress' Art. I powers and any of Congress' other powers—including, for example, those conferred by the various amendments to the Constitution, e.g., U.S.Const., Amdts. 13–16, 19, 23, 24, 26.
- 28 Justice WHITE's suggested "limitations" on Congress' power to create Art. I courts are even more transparent. Justice WHITE's dissent suggests that Art. III "should be read as expressing one value that must be balanced against competing constitutional values and legislative responsibilities," and that the Court retains the final word on how the balance is to be struck. *Post*, at 2893–2894. The dissent would find the Art. III "value" accommodated where appellate review by Art. III courts is provided and where the Art. I courts are "designed to deal with issues likely to be of little interest to the political branches." *Post*, at 2894. But the dissent's view that appellate review is sufficient to satisfy either the command or the purpose of Art. III is incorrect. See n. 39, *infra*. And the suggestion that we should consider whether the Art. I courts are designed to deal with issues likely to be of interest to the political Branches would undermine the validity of the adjudications performed by most of the administrative agencies, on which validity the dissent so heavily relies.

In applying its ad hoc balancing approach to the facts of this case, the dissent rests on the justification that these courts differ from standard Art. III courts because of their "extreme specialization." As noted above, "extreme specialization" is hardly an accurate description of bankruptcy courts designed to adjudicate the entire range of federal and state controversies. See *infra*, at 2878–2879. Moreover, the special nature of bankruptcy adjudications is in no sense incompatible with performance of such functions in a tribunal afforded the protection of Art. III. As one witness pointed out to Congress:

"Relevant to that question of need, it seems worth noting that Article III itself permits much flexibility; so long as tenure during good behavior is granted, much room exists as regards other conditions. Thus it would certainly be possible to create a special bankruptcy court under Article III and there is no reason why the judges of that court would have to be paid the same salary as district judges or any other existing judges. It would also be permissible to provide that when a judge of that court retired pursuant to statute, a vacancy for a new appointment would not automatically be created. And it would be entirely valid to specify that the judges of that court could not be assigned to sit, even temporarily, on the general district courts or courts of appeals." Hearings on H.R. 31 and H.R. 32 before the Subcommittee on Civil and Constitutional Rights of the House Committee on the Judiciary, 94th Cong., 2d Sess., 2697 (1976) (letter of Paul Mishkin).

29 Justice WHITE's dissent fails to distinguish between Congress' power to create adjuncts to Art. III courts, and Congress' power to create Art. I courts in limited circumstances. See *post*, at 2888. Congress' power to create adjuncts and assign them limited adjudicatory functions is in no sense an "exception" to Art. III. Rather, such an assignment is consistent with Art. III, so long as "the essential attributes of the judicial power" are retained in the Art. III court, *Crowell v. Benson*, 285 U.S., at 51, 52 S.Ct., at 292, and so long as Congress' adjustment of the traditional manner of adjudication can be sufficiently linked to its legislative power to define substantive rights, see *infra*, at 2877–2878. Cf. *Atlas Roofing Co. v. Occupational Safety and Health Review Comm'n*, 430 U.S., at 450, n. 7, 97 S.Ct., at 1266, n. 7.

30 Thus in *Raddatz* there was no serious threat that the exercise of the judicial power would be subject to incursion by other branches. "[T]he only conceivable danger of a 'threat' to the 'independence' of the magistrate comes from within, rather than without the judicial department." 447 U.S., at 685, 100 S.Ct., at 2417 (BLACKMUN, J., concurring).

31 Appellants and Justice WHITE's dissent also rely on the broad powers exercised by the bankruptcy referees immediately before the Bankruptcy Act of 1978. See *post*, at 2885–2888. But those particular adjunct functions, which represent the culmination of years of gradual expansion of the power and authority of the bankruptcy referee, see 1 Collier, *supra* n. 3, ¶ 1.02, have never been explicitly endorsed by this Court. In *Katchen v. Landy*, 382 U.S. 323, 86 S.Ct. 467, 15 L.Ed.2d 391 (1966), on which the dissent relies, there was no discussion of the Art. III issue. Moreover, when *Katchen* was decided the 1973 Bankruptcy Rules had not yet been adopted, and the district judge, after hearing the report of magistrate, was free to "modify it or ... reject it in whole or in part or ... receive further evidence or ... recommit it with instructions." General Order in Bankruptcy No. 47, 305 U.S. 702 (1939).

We note, moreover, that the 1978 Act made at least three significant changes from the bankruptcy practice that immediately preceded it. First, of course, the jurisdiction of the bankruptcy courts was "substantially expanded" by the Act. H.R.Rep.No. 95–595, p. 13 (1977). Before the Act the referee had no jurisdiction, except with consent, over controversies beyond those involving property in the actual or constructive possession of the court. 11 U.S.C. § 46(b) (repealed). See *MacDonald v. Plymouth Trust Co.*, 286 U.S. 263, 266, 52 S.Ct. 505, 506, 76 L.Ed. 1093 (1932). It cannot be doubted that the new bankruptcy judges, unlike the referees, have jurisdiction far beyond that which can be even arguably characterized as merely incidental to the discharge in bankruptcy or a plan for reorganization. Second, the bankruptcy judges have broader powers than those exercised by the referees. See *infra* at 2878–2879; H.R.Rep. No. 95–595, *supra*, at 12, and nn. 63–68. Finally, and perhaps most significantly, the relationship between the district court and the bankruptcy court was changed under the 1978 Act. Before the Act, bankruptcy referees were "subordinate adjuncts of the district courts." *Id.*, at 7, U.S.Code Cong. & Admin.News 1978, p. 5968. In contrast, the new bankruptcy courts are "independent of the United States district courts." *Ibid.*; 1 Collier, *supra* n. 3, ¶ 1.03, p. 1–9. Before the Act, bankruptcy referees were appointed and removable only by the district court. 11 U.S.C. § 62 (repealed). And the district court retained control over the reference by his power to withdraw the case from the referee. Bkrpty.Rule 102. Thus even at the trial stage, the parties had access to an independent judicial officer. Although Congress could still lower the salary of referees, they were not dependent on the political Branches of Government for their appointment. To paraphrase Justice BLACKMUN's observation in *Raddatz*, *supra*, the primary "danger of a 'threat' to the 'independence' of the [adjunct came] from within, rather than without, the judicial department." 447 U.S., at 685, 100 S.Ct., at 2417 (concurring opinion).

32 Contrary to Justice WHITE's suggestion, we do not concede that "Congress may provide for initial adjudications by Art. I courts or administrative judges of all rights and duties arising under otherwise valid federal laws." See *post*, at 2883. Rather we simply reaffirm the holding of *Crowell*—that Congress may assign to non-Art. III bodies some adjudicatory functions. *Crowell* itself spoke of "specialized" functions. These cases do not require us to specify further any limitations that may exist with respect to Congress' power to create adjuncts to assist in the adjudication of federal statutory rights.

33 The Court in *Crowell* found that the requirement of *de novo* review as to certain facts was not "simply the question of due process in relation to notice and hearing," but was "rather a question of the appropriate maintenance of the Federal judicial power." 285 U.S., at 56, 52 S.Ct., at 294. The dissent agreed that some factual findings cannot be made by adjuncts, on the ground that "under certain circumstances, the constitutional requirement of due process is a requirement of [Art. III] judicial process." *Id.*, at 87, 52 S.Ct., at 306 (Brandeis, J., dissenting).

34 *Crowell*'s precise holding, with respect to the review of "jurisdictional" and "constitutional" facts that arise within ordinary administrative proceedings, has been undermined by later cases. See *St. Joseph Stock Yards Co. v. United States*, 298

U.S. 38, 53, 56 S.Ct. 720, 726, 80 L.Ed. 1033 (1936). See generally 4 K. Davis, *Administrative Law Treatise* §§ 29.08, 29.09 (1st ed. 1958). But the general principle of *Crowell*—distinguishing between congressionally created rights and constitutionally recognized rights—remains valid, as evidenced by the Court's recent approval of *Ng Fung Ho v. White*, 259 U.S. 276, 42 S.Ct. 492, 66 L.Ed. 938 (1922), on which *Crowell* relied. See *Agosto v. INS*, 436 U.S. 748, 753, 98 S.Ct. 2081, 2085, 56 L.Ed.2d 677 (1978) (*de novo* judicial determination required for claims of American citizenship in deportation proceedings). See also *United States v. Raddatz*, 447 U.S., at 682–684, 100 S.Ct., at 2415–2416; *id.*, at 707–712, 100 S.Ct., at 2426–2431 (MARSHALL, J., dissenting).

- 35 Drawing the line between permissible extensions of legislative power and impermissible incursions into judicial power is a delicate undertaking, for the powers of the Judicial and Legislative Branches are often overlapping. As Justice Frankfurter noted in a similar context: “To be sure the content of the three authorities of government is not to be derived from an abstract analysis. The areas are partly interacting, not wholly disjointed.” *Youngstown Sheet & Tube Co. v. Sawyer*, 343 U.S. 579, 610, 72 S.Ct. 863, 897, 96 L.Ed. 1153 (1952) (concurring opinion). The interaction between the Legislative and Judicial Branches is at its height where courts are adjudicating rights wholly of Congress' creation. Thus where Congress creates a substantive right, pursuant to one of its broad powers to make laws, Congress may have something to say about the proper manner of adjudicating that right.
- 36 Of course, bankruptcy adjudications themselves, as well as the manner in which the rights of debtors and creditors are adjusted, are matters of federal law. Appellant Northern's state-law contract claim is now in federal court because of its relationship to Northern's reorganization petition. See n. 26, *supra*. But Congress has not purported to prescribe a rule of decision for the resolution of Northern's contractual claims.
- 37 The limitations that the judges “may not enjoin another court or punish a criminal contempt not committed in the presence of the judge of the court or warranting a punishment of imprisonment,” 28 U.S.C. § 1481 (1976 ed., Supp.IV), are also denied to Art. III judges under certain circumstances. See 18 U.S.C. §§ 401, 402, 3691; 28 U.S.C. § 2283.
- 38 Although the entry of an enforcement order is in some respects merely formal, it has long been recognized that
- “ [t]he award of execution ... is a part, and an essential part of every judgment passed by a court exercising judicial power. It is no judgment in the legal sense of the term, without it.” *ICC v. Brimson*, 154 U.S. 447, 484, 14 S.Ct. 1125, 1136, 38 L.Ed. 1047 (1894), quoting Chief Justice Taney's memorandum in *Gordon v. United States*, 117 U.S. 697, 702 (1864).
- 39 Appellants suggest that *Crowell* and *Raddatz* stand for the proposition that Art. III is satisfied so long as some degree of appellate review is provided. But that suggestion is directly contrary to the text of our Constitution: “The Judges, *both* of the supreme and inferior Courts, shall hold their Offices during good Behaviour, and shall ... receive [undiminished] Compensation.” Art. III, § 1 (emphasis added). Our precedents make it clear that the constitutional requirements for the exercise of the judicial power must be met at all stages of adjudication, and not only on appeal, where the court is restricted to considerations of law, as well as the nature of the case as it has been shaped at the trial level. The Court responded to a similar suggestion in *Crowell* by stating that to accept such a regime,
- “would be to sap the judicial power as it exists under the Federal Constitution, and to establish a government of bureaucratic character alien to our system, wherever fundamental rights depend, as not infrequently they do depend, upon the facts, and finality as to facts becomes in effect finality in law.” 285 U.S., at 57, 52 S.Ct., at 295.
- Cf. *Ward v. Village of Monroeville*, 409 U.S. 57, 61–62, 93 S.Ct. 80, 83–84, 34 L.Ed.2d 267 (1972); *Osborn v. Bank of the United States*, 9 Wheat. 738, 883, 6 L.Ed. 204 (1824).
- Justice WHITE's dissent views the function of the Third Branch as interpreting the Constitution in order to keep the other two Branches in check, and would accordingly find the purpose, if not the language, of Art. III satisfied where there is an appeal to an Art. III court. See *post*, at 2894. But in the Framers' view, Art. III courts would do a great deal more than, in an abstract way, announce guidelines for the other two Branches. While “expounding” the Constitution was surely one vital function of the Art. III courts in the Framers' view, the tasks of those courts, for which independence was an important safeguard, included the mundane as well as the glamorous, matters of common law and statute as well as constitutional law, issues of fact as well as issues of law. As Hamilton noted, “it is not with a view to infractions of the Constitution only, that the independence of the judges may be an essential safeguard against the effects of occasional

ill humors in the society.” The Federalist No. 78, p. 488 (H. Lodge ed. 1888). In order to promote the independence and improve the quality of federal judicial decisionmaking in all of these areas, the Framers created a system of independent federal courts. See The Federalist Nos. 78–82.

- 40 It is clear that, at the least, the new bankruptcy judges cannot constitutionally be vested with jurisdiction to decide this state-law contract claim against Marathon. As part of a comprehensive restructuring of the bankruptcy laws, Congress has vested jurisdiction over this and all matters related to cases under Title 11 in a single non-Art. III court, and has done so pursuant to a single statutory grant of jurisdiction. In these circumstances we cannot conclude that if Congress were aware that the grant of jurisdiction could not constitutionally encompass this and similar claims, it would simply remove the jurisdiction of the bankruptcy court over these matters, leaving the jurisdictional provision and adjudicatory structure intact with respect to other types of claims, and thus subject to Art. III constitutional challenge on a claim-by-claim basis. Indeed, we note that one of the express purposes of the Act was to ensure adjudication of all claims in a single forum and to avoid the delay and expense of jurisdictional disputes. See H.R.Rep.No. 95–595, pp. 43–48 (1977); S.Rep.No. 95–989, p. 17 (1978). Nor can we assume, as THE CHIEF JUSTICE suggests, *post*, at 2882, that Congress’ choice would be to have these cases “routed to the United States district court of which the bankruptcy court is an adjunct.” We think that it is for Congress to determine the proper manner of restructuring the Bankruptcy Act of 1978 to conform to the requirements of Art. III in the way that will best effectuate the legislative purpose.
- 41 See also *Buckley v. Valeo*, 424 U.S., 1, 142, 96 S.Ct. 612, 692, 46 L.Ed.2d 659 (1976); *Chicot County Drainage Dist. v. Baxter State Bank*, 308 U.S. 371, 376–377, 60 S.Ct. 317, 319–320, 84 L.Ed. 329 (1940); *Insurance Corp. of Ireland v. Compagnie des Bauxites de Guinee*, 456 U.S. 694, 702, n. 9, 102 S.Ct. 2099, 2104, n.9, 72 L.Ed.2d 492 (1982).
- 1 *Glidden Co. v. Zdanok*, 370 U.S. 530, 534, 82 S.Ct. 1459, 1464, 8 L.Ed.2d 671 (1962) (plurality opinion of Harlan, J.).
- 2 Because this is the sole ground relied upon by the Justices concurring in the judgment, this is the effective basis for today’s decision.
- 3 The plurality attempts to justify its sweeping invalidation of § 1471, because of its inclusion of state-law claims, by suggesting that this statutory provision is nonseverable. *Ante*, at 2880, n. 40. The Justices concurring in the judgment specifically adopt this argument as the reason for their decision to join the judgment of the Court. The basis for the conclusion of nonseverability, however, is nothing more than a presumption: “Congress has vested jurisdiction over this and all matters related to cases under Title 11 in a single non-Art. III court, and has done so pursuant to a single statutory grant of jurisdiction. In these circumstances, we cannot conclude that if Congress were aware that the grant of jurisdiction could not constitutionally encompass this and similar claims, it would simply remove the jurisdiction of the bankruptcy court over these matters.” *Ante*, at 2880, n. 40. Although it is possible, as a historical matter, to find cases of this Court supporting this presumption, see, e.g., *Williams v. Standard Oil Co.*, 278 U.S. 235, 242, 49 S.Ct. 115, 117, 73 L.Ed. 287 (1929), I had not thought this to be the contemporary approach to the problem of severability, particularly when dealing with federal statutes. I would follow the approach taken by the Court in *Buckley v. Valeo*, 424 U.S. 1, 108, 96 S.Ct. 612, 677, 46 L.Ed.2d 659 (1976): “ ‘Unless it is evident that the Legislature would not have enacted those provisions which are within its power, independently of that which is not, the invalid part may be dropped if what is left is fully operative as a law.’ ” Quoting *Champlin Refining Co. v. Corporation Comm’n*, 286 U.S. 210, 234, 52 S.Ct. 559, 565, 76 L.Ed. 1062 (1932). This presumption seems particularly strong when Congress has already “enacted those provisions which are within its power, independently of that which is not”—i.e., in the old Bankruptcy Act.
- 4 Even this is not entirely new. Under the old Act, in certain circumstances, the referee could actually adjudicate and order the payment of a claim of the bankrupt estate against another. In *Katchen v. Landy*, 382 U.S. 323, 86 S.Ct. 467, 15 L.Ed.2d 391 (1966), for example, we recognized that when a creditor files a claim, the referee is empowered to hear and decide a counterclaim against that creditor arising out of the same transaction. A similar situation could arise in adjudicating setoffs under former § 68 of the Bankruptcy Act.
- 5 “The judicial act of allowance or disallowance is one, of course, that is performed by the referee where the proceedings have been generally referred.” 3 W. Collier, Bankruptcy ¶ 57.14, p. 229, n.3 (14th ed. 1977).
- 6 On this point I am in agreement with the Justices concurring in the judgment.

- 7 The majority does not explain why the constitutional grant of power over the Territories to Congress is sufficient to overcome the strictures of [Art. III](#), but presumably not sufficient to overcome the strictures of the Presentment Clause or other executive limits on congressional authority.
- 8 Had the plurality cited only the territorial courts, the principle relied on perhaps could have been the fact that power over the Territories is provided Congress in Art. IV. However, Congress' power over the District of Columbia is an Art. I power. As such, it does not seem to have any greater status than any of the other powers enumerated in Art. I, § 8.
- 9 By stating that “of this necessity congress alone is the judge,” [18 How., at 285](#), the Court added some serious ambiguity to the standard it applied. Because this statement ends the Court's analysis of the merits of the claim, it does not seem to mean that the Court will simply defer to congressional judgment. Rather, it appears to mean that the Court will review the legislative record to determine whether there appeared to Congress to be compelling reasons for not establishing an Art. III court.
- 10 The Court did not, however, entirely follow this principle, for it stated elsewhere that “there is propriety in mentioning the fact that [Congress always has treated \[the Court of Claims as an Art. I court\].](#)” [279 U.S., at 454](#), [49 S.Ct., at 414](#).
- 11 The plurality is clearly wrong in citing *Crowell* in support of the proposition that matters involving private, as opposed to public, rights may not be considered in a non-Art. III court. *Ante*, at 2871.
- 12 *Crowell* also suggests that certain facts—constitutional or jurisdictional—must also be subject to *de novo* review in an Art. III court. I agree with the plurality that this aspect of *Crowell* has been “undermined by later cases,” *ante*, at 2877, n.34. As a matter of historical interest, however, I would contend that *Crowell*'s holding with respect to these “facts” turned more on the questions of law that were inseparably tied to them, than on some notion of the inadequacy of a non-Art. III factfinder.
- 13 *O'Donoghue* does not apply this principle wholly consistently: It still recognizes a territorial court exception to Art. III's requirements. It now bases this exception, however, not on any theoretical difference in principle, but simply on the “transitory character of the territorial governments.” [289 U.S., at 536](#), [53 S.Ct., at 745](#).
- 14 See P. Bator, P. Mishkin, D. Shapiro, & H. Wechsler, *Hart and Wechsler's The Federal Courts and The Federal System* 399 (2d ed. 1973) (reviewing the problems of the *Williams* case and characterizing it as an “intellectual disaster”).
- 15 See [Crowell v. Benson](#), [285 U.S. 22](#), [87, 52 S.Ct. 285](#), [306](#), [76 L.Ed. 598](#) (1932) (Brandeis, J., dissenting) (“If there be any controversy to which the judicial power extends that may not be subjected to the conclusive determination of administrative bodies or federal legislative courts, it is not because of any prohibition against the diminution of the jurisdiction of the federal district courts as such, but because, under the circumstances, the constitutional requirement of due process is a requirement of judicial process”).
- 16 “During the past 30 years, the number of bankruptcy cases filed annually has increased steadily from 10,000 to over 254,000.” [H.R.Rep.No. 95–595, p. 21](#) (1977); *U.S.Code Cong. & Admin.News* 1978, p. 5982.
- 17 See *H.R.Doc.No. 93–137*, pt. 1, pp. 85–96 (1973).
- 18 Consider, for example, the Court of Customs Appeals involved in [Ex parte Bakelite Corp.](#), [279 U.S. 438](#), [49 S.Ct. 411](#), [73 L.Ed. 789](#) (1929), or the variety of specialized administrative agencies that engage in some form of adjudication.
- 19 In 1977, there were approximately 190 full-time and 30 part-time bankruptcy judges throughout the country. [H.R.Rep.No. 95–595, at 9](#).

135 B.R. 204
United States District Court,
N.D. New York.

WIDEWATERS ROSELAND
CENTER COMPANY, Plaintiff,

v.

The TJX COMPANIES, INC., Defendant.

No. 91–CV–1068.

I

Dec. 20, 1991.

Synopsis

Lessor brought suit in state court against alleged guarantor of allegedly breached lease, and nondebtor guarantor removed the case to federal court and moved for referral to bankruptcy forum where bankruptcy case of debtor that nondebtor claimed was liable as guarantor was pending. The District Court, [McCurn](#), Chief Judge, held that: (1) alleged fact that amount of lessor's guaranty claim against debtor was too insignificant in relation to bankruptcy estate to make material impact on estate did not establish lack of "significant connection" of dispute between lessor and nondebtor to bankruptcy proceeding, for purposes of determining whether case should be removed from state court and referred to bankruptcy forum as "related to" bankruptcy, and (2) lessor's suit against nondebtor had "significant connection" with bankruptcy case of debtor that nondebtor claimed was liable on guaranty as result of sale of business, and lessor's suit was accordingly removable from state court for referral to bankruptcy forum as suit "related to" bankruptcy case.

Suit transferred.

Attorneys and Law Firms

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Melvin & Melvin, Syracuse, N.Y. (James Barr Haines, of counsel), Ropes & Gray, Boston, Mass., for defendant.

MEMORANDUM–DECISION AND ORDER

[McCURN](#), Chief Judge.

I.

INTRODUCTION

Plaintiff, Widewaters Roseland Center Co. ("Widewaters"), commenced this action against The TJX Companies, Inc. ("TJX") in New York State Supreme Court, Onondaga County in August 1991. Widewaters seeks money damages against TJX due to an alleged breach of a lease guaranteed by TJX. *See* Plaintiff's Complaint at ¶¶ 7, 11, 12. TJX removed this case to this court pursuant to [28 U.S.C. section 1452\(a\)](#) and [Fed.R.Bank.Proc. 9027](#) in September 1991.¹

*205 Based on its contention that this case is "related to" bankruptcy, TJX now moves for referral of this action to the Bankruptcy Court for the Northern District of New York and for an extension of its time to respond to the complaint.

II.

BACKGROUND

The facts which underlie this action are not seriously in dispute. Plaintiff contends that it, as landlord, entered into a 20 year lease with Gaylords National Corporation ("Gaylords"), as tenant, covering certain real estate in Canandaigua, New York. *See* Plaintiff's Complaint at ¶¶ 4, 5. TJX guaranteed the payment of rent, as well as the performance and observance of all agreements and conditions required of Gaylords under this lease. *See* Plaintiff's Complaint at ¶ 7. Plaintiff contends that Gaylords defaulted on the lease. *See* Plaintiff's Complaint at ¶ 10. As a result, Widewaters seeks to collect the rent owing under the lease from TJX pursuant to TJX's guaranty. *See* Plaintiff's Complaint at ¶ 12.

In September 1988, Ames Department Stores, Inc. ("Ames") purchased substantially all of the assets and business of the Zayre Stores Division of TJX. *See* Meltzer Affidavit at ¶ 5. Pursuant to the Acquisition Agreement involved in this sale, Ames agreed ... to assume all liabilities, obligations, costs, and expenses—whenever arising—from the ownership, possession, use or operation of the assets or the business of the Zayre Stores Division." *See* Meltzer Affidavit at ¶ 5 (citing Acquisition Agreement at 5–8). Moreover, "Ames agreed to indemnify TJX against, and to hold TJX

harmless from, any loss, liability, claim, damage, or expense suffered or incurred by TJX to the extent arising from any of the liabilities and obligations assumed by Ames.” See Meltzer Affidavit at ¶ 5 (citing Acquisition Agreement at 42–43). Gaylords was part of the Zayre Stores Division and thus, according to TJX, constituted an asset subject to the acquisition agreement. See Meltzer Affidavit at ¶ 6. Therefore, pursuant to the terms of this agreement, TJX contends that Ames agreed to assume and to indemnify TJX in respect of any liability arising out of, or incurred by reason of, this lease. See Meltzer Affidavit at ¶ 8.

On April 25, 1990, Ames commenced voluntary proceedings under Chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court for the Southern District of New York, Case No. 90–B–11233. See Meltzer Affidavit at ¶ 7. TJX contends that Widewaters’ commencement of this action violates the automatic stay which resulted from Ames filing its petition in bankruptcy. Accordingly, TJX has filed a notice of bankruptcy and a notice of automatic stay as well as this motion for referral of this civil action to the Bankruptcy Court for the Northern District of New York and for an extension of its time to respond to the complaint. See Defendant’s Memorandum of Law at 1.

III.

DISCUSSION

TJX contends that this court should refer this case to the Bankruptcy Court for the Northern District of New York pursuant to 28 U.S.C. section 157(a). This statute reads in pertinent part: “[e]ach district court may provide that any or all cases under title 11 and any or all proceedings arising under title 11 or arising in or *related to* a case under title 11 shall be referred to the bankruptcy judges for the district.” 28 U.S.C.A. § 157(a) (West 1991 Supp.) (emphasis added). Pursuant to this authority, this court adopted an order dated July 20, 1984, that provides as follows:

***206** [a]ll cases under Title 11, U.S.C. and all proceedings arising under Title 11, U.S.C. or arising in or *related to* a case under Title 11, U.S.C. pending on June 27, 1984 or filed on or after June 28, 1984 are *referred to the bankruptcy judges for this district*, to be assigned in accordance with their assignment rules.

See Defendant’s Memorandum of Law, Exhibit A (emphasis added).

Before this court can refer this matter to the Bankruptcy Court, it must determine, as a threshold matter, whether this case falls within its bankruptcy jurisdiction. Title 28 section 1334(b) governs this court’s bankruptcy jurisdiction. This statute provides that “[t]he district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or *related to* cases under title 11.” 28 U.S.C. § 1334(b) (West 1991 Supp.) (emphasis added). Both parties assert, and this court agrees, that this court’s determination of this motion turns on whether or not this case is “related to” the Ames bankruptcy proceeding.

TJX asserts that this case is related to the Ames bankruptcy proceeding which is pending in the Bankruptcy Court for the Southern District of New York. As support for this position, TJX relies primarily on the Third Circuit’s interpretation of the “related to” language of 28 U.S.C. section 1334(b). The leading case in this regard is the Third Circuit’s decision in *Pacor Inc. v. Higgins*, 743 F.2d 984 (3d Cir.1984). In *Pacor*, the Third Circuit stated that the test for determining whether a civil proceeding was related to bankruptcy was

[w]hether the outcome of that proceeding could conceivably have any effect on the estate being administered in bankruptcy (citations omitted) ... Thus, the proceeding need not necessarily be against the debtor or against the debtor’s property. An action is related to bankruptcy if the outcome could alter the debtor’s rights, liabilities, options, or freedom of action (either positively or negatively) and which in any way impacts upon the handling and administration of the bankrupt estate.

Id. at 994 (emphasis in the original).

Numerous other circuits have endorsed *Pacor*’s “related to” test including the Fourth, Fifth, Eighth, and Ninth Circuits.² On the other hand, as Widewaters correctly points out, the Second Circuit has adopted a narrower test; and this court is bound by this narrower interpretation.

The Second Circuit adopted its “related to” test in *Turner v. Ermiger*, 724 F.2d 338 (2d Cir.1983). In *Turner*, plaintiff had filed a voluntary petition in bankruptcy in which she claimed as exempt property a “[c]ontingent cause of action against landlord for conversion of restaurant equipment.” *Id.* at 339. Two months after she had exempted this cause of action, plaintiff filed an action against defendant in the bankruptcy court. The bankruptcy judge rendered a decision in favor of plaintiff and defendant appealed to this court. In finding that the district court had jurisdiction over the action, this

court interpreted “related proceeding” as used in the Northern District’s Emergency Resolution to include “civil proceedings that, in the absence of a petition in bankruptcy, could have been brought in a district court or state court.”³ *Id.* at 340 (quoting *In re Turner*, 29 B.R. 419, 421 (N.D.N.Y.1983)).

In reversing the district court, the Second Circuit stated that while it had no difficulty with the Emergency Resolution, it believed that the district judge had given the Resolution an overly literal application. *Id.* at 340. In contrast, the Second Circuit held that because there was “no showing that Turner’s action against Ermiger had any ‘significant connection’ with her bankruptcy case ... it [fell] outside the scope of § 1471(b), which allow [ed] the district courts to conduct civil proceedings ‘related to’ cases under Title 11.” *207 *Turner*, 724 F.2d at 341; see also *In re Lencoke Trucking, Inc.*, 99 B.R. 200 (W.D.N.Y.1989) (citing *Turner*, 724 F.2d at 341) (“[a] case is ‘related’ to a Title 11 case if there is a ‘significant connection’ or nexus between the case at issue and the bankruptcy proceeding”); *In re Holland Indus., Inc.*, 103 B.R. 461 (Bankr., S.D.N.Y.1989) (citing *Turner*, 724 F.2d at 341) (“*Turner* requires the litigation to have a ‘significant connection with bankruptcy.’ ”).⁴

Widewaters contends that TJX has failed to establish a significant connection between this civil action and the Ames bankruptcy proceeding as required by *Turner*. Plaintiff advances two theories in support of this position. First, it argues that “Widewaters’ \$16,633.71 claim is much too insignificant in relation to the bankruptcy estate to make any impact whatsoever, let alone a material impact, on the estate.” See Plaintiff’s Memorandum of Law at 4. Secondly, plaintiff contends that this action has no significant connection to the Ames bankruptcy proceeding because

the outcome of this litigation will neither add to nor reduce the assets of the estate. Widewaters has filed a Notice of Claim with the Bankruptcy Court for the Southern District of New York against Ames’ bankruptcy estate in the amount of \$16,633.71. Should Widewaters be permitted to proceed against TJX, a judgment against TJX would result in a withdrawal by Widewaters of the aforementioned Notice of Claim which would undoubtedly be replaced by a claim from TJX for the same amount by virtue of the indemnity agreement. In the event Widewaters’ litigation against TJX does not succeed, its Notice of Claim will remain in place. The net result is that Ames’ bankruptcy estate will be unaffected regardless of the outcome of the litigation. See Plaintiff’s Memorandum of Law at 4.

With regard to plaintiff’s first theory, Widewaters cites no case law, and this court could find none, that defines “significant connection” by comparing the amount of the claim in the civil action to the total amount of assets in the bankrupt’s estate. Rather, the cases appear to turn on the relationship between the subject matter of the two suits. For example, the court in *Turner* found no “significant connection” where the civil action involved an attempt to recover on a cause of action which plaintiff had previously exempted from her bankrupt estate. Likewise, the court in *In re Holland Indus., Inc.* found no “significant connection” where the civil action sought to vacate liens filed by the IRS against property owned by non-debtors. The facts in *Turner* and *In re Holland Indus., Inc.* are so dissimilar to the ones present here that the court concludes that these cases are not dispositive of the issues before this court.

Likewise, this court finds plaintiff’s second argument in support of its position to be totally without merit. In *In re Holland Indus., Inc.*, the Bankruptcy Court reviewed the types of cases which would and would not be related to bankruptcy in light of *Turner*’s “significant connection” test. In this regard, the court stated that “[i]t is this concern for limits defined by bankruptcy purposes that defines related jurisdiction, under 28 U.S.C. §§ 157, 1334(a), to exclude proceedings between third parties that do not bind a debtor, do not involve estate property and do not concern the debtor-creditor or inter-creditor relationships.” *Id.* at 470. By implication, therefore, it is logical to conclude that those actions involving third parties that bind a debtor, involve estate property, or concern the debtor-creditor or inter-creditor relationships are “related to” bankruptcy proceedings.

In this case, Widewaters’ statement that its success in this action would result in its *208 removing its Notice of Claim against Ames’ bankrupt estate, is in effect an admission that the amount in question affects the property of the debtor, Ames. In addition, the relationship between Widewaters and TJX, both of whom may have claims against Ames’ bankrupt estate, would undoubtedly be affected by the outcome of this litigation. Whether the bankrupt estate ultimately pays Widewaters or TJX the \$16,633.71 is irrelevant. The fact remains that whomever it pays, the monies will come out of the bankrupt estate. This is exactly the type of situation the court in *In re Holland Indus., Inc.* had in mind when it defined “related to” jurisdiction; and there is no doubt that

such an action constitutes a “significant connection” with the bankruptcy proceeding.

Moreover, plaintiff completely ignores the court's holding in *In re Brentano's Inc.*, 27 B.R. 90 (Bankr.S.D.N.Y.1983). In *Brentano's* the Bankruptcy Court was faced with a situation almost identical to the present one. Brentano was a chapter 11 debtor and tenant, Pine Realty was a landlord, and MacMillan was a guarantor for Brentano's obligations under a lease. Pine Realty commenced a state court suit against MacMillan based on its guaranty. MacMillan moved to stay Pine Realty from proceeding in any court other than the bankruptcy court against MacMillan in connection with the lease entered into by Brentano. *Id.* at 90. In holding that it had subject matter jurisdiction over this suit, the court stated that “the bankruptcy court has jurisdiction over a non-debtor third party guarantor of a debt.” *Id.* at 91 (citing *In re Lucasa Int'l, Ltd.*, 6 B.R. 717 (Bankr.S.D.N.Y.1980)). The court then went on to hold that the state court action was clearly “related to” Brentano's reorganization case because “[u]nderlying the entire matter is Brentano's lease. If Pine Realty prevails against MacMillan, MacMillan can recover from Brentano's under its indemnification agreement. The disposition of this claim ... will ultimately determine the fact of this reorganization effort.” *Id.* at 92.⁵ Plaintiff has made no attempt to distinguish *Brentano's* from its own situation, and the court finds this decision compelling given the similarity of the issues.

Furthermore, in a very recent case in the Eastern District of New York, Judge Weinstein was presented with precisely the same situation as that which is before this court today. *See* Transcript of Hearing on Motion in *Bond Street Assoc. v. The TJX Cos.*, CV-91-1290 (S.D.N.Y. November 15, 1991). There, Bond Street Associates, as landlord, sued TJX, as tenant, in New York state court for rent allegedly owing under a lease Ames had acquired from TJX pursuant to the same acquisition agreement at issue here. TJX removed the case to the Eastern District of New York and then moved to have the case referred to the Bankruptcy Court for the Eastern District. Judge Weinstein appeared to have no trouble finding that the District Court had “related to” jurisdiction. In fact, he seemed to assume the existence of this relationship and moved quickly to a discussion of whether he should refer the case to the Bankruptcy Court for the Eastern District of New York or transfer the case to the Southern District of New York pursuant to 28 U.S.C. section 1404 for “further transfer to the bankruptcy court in connection with the Ames

related bankruptcies.” *See* Transcript of Hearing on Motion in *Bond Street Assoc. v. The TJX Cos.*, CV-91-1290, at 21; *see also* *Commonwealth Life Ins. Co. v. Oakes*, 91-CV-1782 (N.D. Ohio, December 9, 1991).⁶ After hearing oral argument *209 Judge Weinstein transferred the case to the Southern District of New York pursuant to 28 U.S.C. § 1404.

Finally, although not binding on this court, the court finds persuasive the decisions of other courts which have been faced with similar motions by TJX involving other leases which Ames assumed as part of the same acquisition agreement at issue here. These courts have unanimously referred these actions to the bankruptcy courts in their districts. *See Krafchick v. Zayre of East Providence, Inc.*, 91-11866-N, 1991 WL 325535 (D.Mass. September 18, 1991); *Dollar Bank, Federal Sav. Bank*, 90-1278, 1991 WL 328464 (W.D.Penn. Aug. 30, 1991); *Johnston the Florist, Inc. v. Zayre Corp.*, 90-495 (W.D.Penn. July 29, 1991); *Kossman v. The TJX Cos.*, 136 B.R. 640 (W.D.Penn.1991); *Douglas Corp. v. The TJX Cos.*, 90-C-4492 (N.D.Ill. Dec. 14, 1990).

IV.

CONCLUSION

For the foregoing reasons, the court concludes that this action is “significantly connected” to the Ames bankruptcy proceeding currently pending in the Bankruptcy Court for the Southern District of New York. Accordingly, in the interest of justice the court transfers this case to the District Court for the Southern District of New York pursuant to 28 U.S.C. sections 1404 and 1412 for further referral to the Bankruptcy Court for the Southern District of New York pursuant to 28 U.S.C. section 157(a) and that district court's standing order promulgated thereunder. Having transferred this case to the District Court for the Southern District of New York, the court need not address defendant's additional request for an extension of time to respond to the complaint. This issue is more appropriately left either to that court or to the bankruptcy judge to decide.

IT IS SO ORDERED.

All Citations

135 B.R. 204

Footnotes

1 Section 1452 states in pertinent part:

(a) A party may remove any claim or cause of action in a civil action ... to the district court for the district where such civil action is pending, if such district court has jurisdiction of such claim or cause of action under section 1334 [Bankruptcy cases and proceedings] of this title.

28 U.S.C.A. § 1452(a) (West 1991 Supp.).

Fed.R.Bankr. 9027 states in pertinent part:

(1) *Where filed; form and content.* An application for removal shall be filed with the clerk for the district and division within which is located the state or federal court where the civil action is pending....

Fed.R.Bankr. 9027 (Lawyer's Ed. June 1991 Supp.).

2 See, for example, *In re American Hardwoods, Inc.*, 885 F.2d 621, 623 (9th Cir.1989); *In re Wood*, 825 F.2d 90, 93 (5th Cir.1987); *In re Dogpatch U.S.A., Inc.*, 810 F.2d 782, 786 (8th Cir.1987); *A.H. Robins Co. v. Piccinin*, 788 F.2d 994, 1002 n. 11 (4th Cir.), *cert. denied*, 479 U.S. 876, 107 S.Ct. 251, 93 L.Ed.2d 177 (1986).

3 This Emergency Resolution is the same as the Order dated July 20, 1984, quoted above.

4 It is interesting to note that nowhere in *Turner* did the Second Circuit specifically hold that "related to" meant "significant connection with." Nor did the court discuss what would or would not constitute a significant connection. In effect, it would appear that *Turner* constitutes a very narrow holding with little, if any, precedential value. Nevertheless, the district courts in this circuit have interpreted *Turner* to require that a civil action be significantly connected with a bankruptcy proceeding in order to be considered related to that proceeding.

5 Although *Brentano's* was decided before *Turner*, it has not been overruled. Nor did the Second Circuit make any mention of *Brentano's* in reaching its decision in *Turner*. Therefore, *Brentano's* is still good law; and although not binding on this court, its reasoning is very persuasive.

6 Although 28 U.S.C. section 1404 permits a district court to transfer a case to a different venue, transfer must be to a district "where it [the civil action] might have been brought." 28 U.S.C.A. § 1404(a) (West 1976). In this case, pursuant to 28 U.S.C. section 1409(a), "[a] proceeding arising under title 11 or arising in or related to a case under title 11 may be commenced in the district court in which such case is pending." 28 U.S.C.A. § 1409(a) (West 1991 Supp.). Moreover, pursuant to 28 U.S.C. section 1412 "[a] district court may transfer a case or proceeding under title 11 to a district court for another district in the interest of justice ..." 28 U.S.C.A. § 1412 (West 1991 Supp.). Accordingly, transfer of this case to the District Court for the Southern District of New York would be proper because the suit could have been commenced in that forum.

80 F.3d 207

United States Court of Appeals,
Seventh Circuit.In the Matter of **FEDPAK SYSTEMS,
INCORPORATED**, Debtor–Appellant.

No. 95–1427.

|

Submitted Sept. 19, 1995.*

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Decided April 1, 1996.

Synopsis

Chapter 11 debtor sought clarification of respective rights of creditor and purchaser in intellectual property rights to frozen dessert machine. The bankruptcy court limited creditor's property rights under agreement with debtor and found creditor's distributorships to be nonexclusive. Creditor appealed. The United States District Court for the Southern District of Indiana, [Sarah Evans Barker](#), Chief Judge, ruled that debtor lacked standing to seek clarification order. Debtor appealed. The Court of Appeals, [Coffey](#), Circuit Judge, held that bankruptcy court lacked jurisdiction to issue clarification order because debtor did not have standing and order did not fall within scope of bankruptcy court's statutorily granted jurisdiction.

Affirmed.

Procedural Posture(s): On Appeal.

*209 Appeal from the United States District Court for the Southern District of Indiana, Indianapolis Division. No. 94 C 483—[Sarah Evans Barker](#), Chief Judge.

Attorneys and Law Firms

[Thomas D. Titsworth](#) (submitted), [Mary L. Titsworth](#), Wooden, McLaughlin & Sterner, Indianapolis, IN, for appellee.

[Christopher E. Baker](#), [Elliott D. Levin](#), Rubin & Levin, Indianapolis, IN, for debtor-appellant.

Before [CUMMINGS](#), [BAUER](#) and [COFFEY](#), Circuit Judges.

Opinion[COFFEY](#), Circuit Judge.

The debtor-appellant, FedPak Systems, Inc. (“FedPak”), challenges the district court's decision to vacate an order of the bankruptcy court for lack of jurisdiction. We hold that because FedPak did not have standing to seek the order, the bankruptcy court lacked jurisdiction as a matter of constitutional law. Additionally, we hold that the proceeding initiated by FedPak fell outside the scope of the bankruptcy court's statutory jurisdiction under [Title 28 U.S.C. §§ 157\(a\) and 1334\(b\)](#). The decision of the district court is affirmed.

I. BACKGROUND*A. The 1990 Agreement Between FedPak, Jones et al.*

FedPak, an Indiana corporation, successfully developed and patented a machine that dispenses ice cream, frozen yogurt, and other frozen confections. On July 28, 1990, FedPak entered into a written agreement with Ventura, Inc. (a yet-to-be-formed company¹ whose role would be to develop further patentable technology for FedPak's benefit), Donald Thomas, Sr., and the appellee Stanley R. Jones, a patent attorney and entrepreneur from Hallowell, Maine. Under the agreement, Jones agreed to finance Ventura's research and development costs (at a level not to exceed \$10,000 a month for 12.5 months beginning August 1, 1990) and agreed to acquire a 25% interest in Ventura (250 shares of its common stock). Jones pledged to purchase twenty FedPak machines immediately, for placement in retail outlets. FedPak agreed to “fabricate” these machines “using parts and techniques reflecting current art and [to] deliver same by August 15, 1990.” The agreement further specified that “[i]f these machines are placed in retail outlets by September 1, 1990, Stan [Jones] agrees to order at that time an additional 80 FedPak machines, and FedPak agrees to deliver same by November 1, 1990.” The agreement made Jones a distributor for FedPak in Texas and Maine² and declared that additional distributorship territories would become “irrevocably vested” after Jones ordered the additional 80 machines specified in the agreement. Additionally, the agreement authorized Jones to manufacture frozen dessert machines according to FedPak's “patents, drawings, know-how, and other confidential information,” provided that Jones kept this information confidential and paid FedPak a one-time

royalty of \$500 for each machine manufactured pursuant to the licensing agreement.

B. Litigation in the Bankruptcy Court Between FedPak and Jones

In February of 1991, shortly after filing for bankruptcy under Chapter 11, FedPak brought an adversary proceeding against Jones in the bankruptcy court and alleged in its complaint that while it had delivered the initial 20 machines as required by the July 1990 agreement, “only a few [had] been *210 placed in retail outlets.” According to FedPak, Jones also breached the agreement by failing to order an additional 80 machines after September 1, 1990 (as called for in the agreement), and by not entering into the distributorship arrangements required by the agreement. FedPak asked the court to declare that Jones had breached the agreement prior to the institution of bankruptcy proceedings (thus releasing FedPak from its contractual obligations) and to enjoin Jones from using FedPak’s intellectual property.

Jones filed an answer and counter-claim, alleging that he had performed all of his obligations under the agreement, and that FedPak had breached the agreement by failing to supply him with the specified “know-how” information and by failing to deliver the 20 initial machines called for in the agreement.³ Jones asked the court to declare that the agreement was valid and binding and to rule that he was entitled to make use of the intellectual property specified in the agreement, including the “know-how” information withheld by FedPak.

The bankruptcy court conducted a trial June 3–4, 1991 and announced its findings of fact and conclusions of law on November 7, 1991, entering judgment in favor of Jones. The court concluded that FedPak (and not Jones) had breached the agreement, and that the agreement was valid and binding. Enforcing the contract, the court ruled that Jones was entitled to the distributorship territories in Maine and Texas as well as “the patent and know-how license to be an authorized manufacturer of frozen dessert machines designed by [FedPak].” FedPak appealed this order to the district court, but later voluntarily dismissed the appeal after determining that it was “in the best interests of all parties involved to resolve this matter outside the judicial system.”

On January 16, 1992, with the authorization of the bankruptcy court, FedPak transferred all of its intellectual property rights in the FedPak frozen dessert machines to Polar Express

Systems International, Inc. (“Polar Express”), in exchange for royalty payments to the bankruptcy estate.⁴

More than two years later, in February of 1994 (at the behest of Polar Express), FedPak filed a motion with the bankruptcy court seeking clarification of the court’s 1991 findings of fact and conclusions of law regarding the dispute between FedPak and Jones.⁵ According to FedPak, the respective intellectual property rights of Jones and Polar Express were unclear because the bankruptcy court’s 1991 order had failed to resolve matters such as (1) the extent of Jones’s entitlement to certain technological enhancements and patent improvements made by FedPak (and Polar Express) subsequent to FedPak’s filing for bankruptcy, and (2) whether Jones’s distributorships in Maine and Texas were intended to be exclusive under the July 1990 agreement. The bankruptcy court granted FedPak’s motion on March 1, 1994, issuing the order that is the subject of this appeal. The court’s order: (1) limited Jones’s intellectual property rights under the agreement to the single patent and related know-how in existence at the time FedPak filed for bankruptcy, and (2) provided that the distributorships in Maine and Texas were nonexclusive. Jones appealed this ruling to the district court.

On January 10, 1995, following extensive briefing of the issues by FedPak and Jones, the district court vacated the bankruptcy court’s clarification order for want of subject matter jurisdiction. The district court held that FedPak, having sold its intellectual property interest in the frozen dessert machines to Polar Express in early 1992, lacked standing to seek the clarification order from *211 the bankruptcy court in 1994. FedPak appeals the January 10, 1995 order and asks this court either to affirm the bankruptcy court’s clarification order or to remand the case for further proceedings.

C. Postscript: Bankruptcy Court Litigation Brought By Polar Express

On March 31, 1995, after FedPak had filed this appeal, Polar Express instituted an adversary proceeding in the bankruptcy court, joining FedPak and Jones as defendants. Polar Express requested a declaratory judgment determining the respective rights of itself and Jones in the intellectual property. Jones filed a motion to dismiss, arguing that Polar Express’s lawsuit was not a proceeding “related to” a case under [Title 11](#) because the bankruptcy estate had no interest in a controversy that involved Jones and Polar Express, not FedPak (the

debtor). On July 31, 1995, the bankruptcy judge granted Jones's motion to dismiss.⁶

II. ISSUES

Although the underlying facts and procedural history of this case are somewhat complex, the sole legal issue in this appeal is relatively straightforward. The question presented —“Did the bankruptcy court have jurisdiction over the proceeding initiated by FedPak in 1994?”—may be analyzed in one of two ways. The district court approached this question by inquiring whether FedPak had standing to seek the clarification order, i.e., whether FedPak was “entitled to have the court decide the merits of the dispute or of particular issues.” *Warth v. Seldin*, 422 U.S. 490, 498, 95 S.Ct. 2197, 2205, 45 L.Ed.2d 343 (1975). If FedPak lacked standing to bring the proceeding, then there was no justiciable controversy and the bankruptcy court lacked jurisdiction as a matter of constitutional law. U.S. Const. art III; *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560, 112 S.Ct. 2130, 2136, 119 L.Ed.2d 351 (1992).

An alternative approach to the question presented in this appeal is to ascertain whether the proceeding initiated by FedPak fell within the statutory grant of jurisdiction to the bankruptcy courts under sections 157(a) and 1334(b) of Title 28, which empower a bankruptcy court to entertain proceedings “arising in,” “arising under,” or “related to” a case under Title 11 of the United States Code.

III. DISCUSSION

A. Standard of Review

Appellate review of a bankruptcy court's factual findings is for clear error, while review of its legal conclusions is plenary. *Matter of Yonikus*, 996 F.2d 866, 868 (7th Cir.1993) (both the district court and the court of appeals apply the same standard of review). Whether FedPak had standing to seek the clarification order from the bankruptcy court is a question of federal statutory and constitutional law that we review *de novo*. *Indemnified Capital Inv. v. R.J. O'Brien & Assoc.*, 12 F.3d 1406, 1409 (7th Cir.1993).

B. Jurisdiction of the Bankruptcy Court

1. The Constitutional Requirement of Standing

The requirement of standing is both a “constitutional limitation [] on federal-court jurisdiction and [a] prudential limitation [] on its exercise.” *Warth*, 422 U.S. at 498, 95 S.Ct. at 2205; *Lujan*, 504 U.S. at 560, 112 S.Ct. at 2136. The United States Constitution restricts the jurisdiction of the federal courts to actual controversies in which the litigants have a personal stake. U.S. Const. art. III § 2; *Holstein v. City of Chicago*, 29 F.3d 1145, 1147 (7th Cir.1994). A bankruptcy court, like any other federal court, lacks the constitutional power to render advisory opinions or to decide “abstract, academic, or *212 hypothetical questions.” *In re Inn on the Bay, Ltd.*, 154 B.R. 364, 367 (Bankr.S.D.Fla.1993). In addition to being a constitutional imperative, the standing requirement enhances the effectiveness of the judicial process. As the United States Supreme Court has observed, requiring the parties in a lawsuit to have “a personal stake in the outcome of [a] controversy” ensures a “concrete adverseness” that “sharpens the presentation of issues upon which the court so largely depends ... [.]” *Baker v. Carr*, 369 U.S. 186, 204, 82 S.Ct. 691, 703, 7 L.Ed.2d 663 (1962).

Does FedPak have standing to seek a clarification order? According to the Supreme Court, standing has three components:

First, the plaintiff must have suffered an injury in fact—an invasion of a legally-protected interest which is (a) concrete and particularized, and (b) actual or imminent, not conjectural or hypothetical. Second, there must be a causal connection between the injury and the conduct complained of.... Third, it must be likely ... that the injury will be redressed by a favorable decision.

Lujan, 504 U.S. at 560–61, 112 S.Ct. at 2136 (quotations and citations omitted). Obviously, FedPak's standing (or lack thereof) turns on the “injury in fact” element. FedPak argues that it does have an interest in a judicial determination of the respective rights of Jones and Polar Express, and that this interest is sufficient to confer standing *even though it no longer owns any intellectual property rights in the frozen dessert machines*. Specifically, FedPak maintains that it has an interest in the issuance of a clarification order because:

(1) Uncertainty surrounding Jones's intellectual property rights could lead Polar Express to cease making royalty

payments (described in FedPak's brief as the "main source of income to the estate");

- (2) Jones could owe payments to the bankruptcy estate pursuant to the July 1990 agreement if he manufactured and sold FedPak machines;

and

- (3) Jones might have a claim against the bankruptcy estate if FedPak and Polar Express failed to provide him with the "know-how" information to which he is entitled under the November 7, 1991 judgment.

We agree with the appellee that these propositions are "hypothetical and unsupported by the record." Consequently, FedPak has failed to establish the "injury in fact" element of standing, which requires an "invasion of a legally-protected interest" that is "concrete and particularized" and "actual or imminent, not conjectural or hypothetical." *Lujan*, 504 U.S. at 560, 112 S.Ct. at 2136.

If we uphold the district court's vacation of the clarification order and Polar Express becomes anxious about its rights vis a vis Jones, it may sue Jones directly, or it may opt to modify or rescind its purchase of FedPak's interest in the machines. If it chooses the latter course, the bankruptcy court would have jurisdiction because it authorized the sale in the first place and the matter would therefore be "related to" the bankruptcy proceeding (see discussion of bankruptcy court's statutory jurisdiction *infra*). However, the record does not reflect that Polar Express has instituted any such proceedings, and, as of the filing of this appeal, Polar Express has continued to make payments. We therefore view with skepticism the claim that payments to the bankruptcy estate are in peril.

Similarly, there is no basis for suggesting that Jones is obligated to make payments to the bankruptcy estate pursuant to the July 1990 agreement because there is no evidence that he has manufactured any FedPak machines. If Jones manufactured any such machines *after* the sale to Polar Express, then of course any payments for those units belong to Polar Express and not to FedPak. If Jones manufactured any machines *prior* to the sale, then FedPak is indeed entitled to payment under the July 1990 agreement, but presumably could seek reimbursement in the bankruptcy court without seeking a broad clarification order.

Finally, although FedPak insists that a clarification order is necessary because it is potentially liable to Jones for failure

to provide the "know-how" information specified in *213 the July 1990 agreement, we note that Jones has not asserted this claim and, in his appellate brief, explicitly "waives any right to demand that FedPak or Polar [Express] turn over any additional "know-how" or other intellectual property."

In summary, FedPak lacks standing to seek a clarification order from the bankruptcy court because (1) it no longer owns any intellectual property rights in the frozen dessert machines, and (2) it can assert only a remote and unsubstantiated interest in a judicial pronouncement concerning the respective rights of Jones and Polar Express in those machines. The rights of *Polar Express* and *Jones* may in fact be uncertain, ambiguous and in need of clarification. However, this does not mean that *FedPak* has standing to ask for a clarification. At this juncture, we believe that FedPak's interest in a clarification order can only be described as "conjectural or hypothetical" and not "actual or imminent." *Lujan*, 504 U.S. at 560, 112 S.Ct. at 2136. Because FedPak lacks standing, there is no justiciable controversy and the bankruptcy court, under Article III of the Constitution, is without jurisdiction to issue a clarification order.

2. "Related To" Jurisdiction Under 28 U.S.C. §§ 157(a) and 1334(b)

Another way of analyzing the issue presented in this appeal is not to focus on the constitutional requirement of standing, but to consider the scope of the bankruptcy court's jurisdiction under the federal statutes conferring such jurisdiction. As the U.S. Supreme Court explained recently, "[t]he jurisdiction of the bankruptcy courts, like that of other federal courts, is grounded in and limited by statute." *Celotex Corp. v. Edwards*, 514 U.S. 300, —, 115 S.Ct. 1493, 1498, 131 L.Ed.2d 403 (1995).

We begin with the bankruptcy jurisdiction of the district courts, which extends to "all civil proceedings arising under title 11, or arising in *or related to* cases under title 11." 28 U.S.C. § 1334(b) (emphasis added). Bankruptcy judges "constitute a unit of the district court," 28 U.S.C. § 151, and the district court may refer to them "any or all proceedings arising under title 11 or arising in or related to a case under title 11." 28 U.S.C. § 157(a). The jurisdiction of the bankruptcy courts is thus "derivative" because it flows from the statutory grant of jurisdiction to the district courts. *In re K & L, Ltd.*, 741 F.2d 1023, 1028 (7th Cir.1984). To summarize, this jurisdiction includes the power to adjudicate proceedings

“arising in,” “arising under,” or “related to” a case under title 11. *Zerand–Bernal Group, Inc. v. Cox*, 23 F.3d 159, 161 (7th Cir.1994).

Whether FedPak's seeking of a clarification order falls within the jurisdiction of the bankruptcy court depends in part upon how one interprets the “related to” language in 28 U.S.C. §§ 157(a) and 1334(b).⁷ The circuits are split on how best to interpret this statutory language. Michael L. Cook, *Overview of Bankruptcy Procedure: Jurisdiction, Venue and Appeals*, Practising Law Institute (April–May 1995); *Celotex*, 514 U.S. at — n. 6, 115 S.Ct. at 1499 n. 6. Some courts have adopted a sweeping test which holds that whenever a proceeding “could conceivably have any effect on the [bankruptcy] estate,” it is “related to” a case under title 11 and the bankruptcy court has jurisdiction. See, e.g., *Pacor, Inc. v. Higgins*, 743 F.2d 984, 994 (3rd Cir.1984) (emphasis in original).⁸

This circuit has articulated a more limited and, we believe, more helpful definition of the bankruptcy court's “related to” jurisdiction. Our precedents hold that “[a] case is ‘related’ to a bankruptcy when the dispute ‘affects the amount of property for distribution [i.e., the *214 debtor's estate] or the allocation of property among creditors.’ ” *In re Memorial Estates, Inc.*, 950 F.2d 1364, 1368 (7th Cir.), cert. denied, 504 U.S. 986, 112 S.Ct. 2969, 119 L.Ed.2d 589 (1992) (quoting *In re Xonics, Inc.*, 813 F.2d 127, 131 (7th Cir.1987)). As we explained recently:

[T]he [‘related to’] language should not be read ... broadly. [It] is primarily intended to encompass tort, contract, and other legal claims by and against the debtor, *claims that, were it not for bankruptcy, would be ordinary stand-alone lawsuits between the debtor and others* but that section 1334(b) allows to be forced into bankruptcy court so that all claims by and against the debtor can be determined in the same forum.

Zerand–Bernal, 23 F.3d at 161 (emphasis added, citation omitted).

We have interpreted “related to” jurisdiction narrowly “out of respect for Article III” (see discussion *supra*) as well as to prevent the expansion of federal jurisdiction over disputes that are best resolved by the state courts. *Home Ins. Co. v. Cooper & Cooper, Ltd.*, 889 F.2d 746, 749 (7th Cir.1989); see also *In re Kubly*, 818 F.2d 643, 645 (7th Cir.1987) (the “limited jurisdiction” of the bankruptcy court “may not be enlarged by the judiciary because the judge believes it

wise to resolve the dispute.”). Additionally, we believe that common sense cautions against an open-ended interpretation of the “related to” statutory language “in a universe where everything is related to everything else.” Gerald T. Dunne, *The Bottomless Pit of Bankruptcy Jurisdiction*, 112 Banking L.J. 957 (Nov.–Dec.1995).

Does FedPak's request for a clarification order fall within the limited jurisdiction of a bankruptcy court to adjudicate matters “related to” a Title 11 case? In other words, would an order⁹ clarifying the respective intellectual property rights of Jones and Polar Express “affect [] the amount of property for distribution or the allocation of property among creditors[?]” *Xonics*, 813 F.2d at 131. In our opinion, the answer is “No.” As previously discussed, FedPak's assertions about its need for (or interest in) a clarification order are at best speculative and hypothetical. It is by no means certain that an order clarifying the respective rights of Polar Express and Jones will have *any* effect whatsoever on the bankruptcy estate. FedPak argues, *inter alia*, that a clarification order would put Polar Express at ease concerning its rights in the frozen dessert machines and thus protect the flow of royalty payments from Polar Express to the bankruptcy estate. However, as discussed above, this record is barren of any evidence that Polar Express is so troubled by the ambiguity of the current situation that it will cease making payments to the bankruptcy estate.

More fundamentally, we do not agree that the bankruptcy court has “related to” jurisdiction because FedPak seeks a determination of the rights of Jones and Polar Express in property that “passed outside of [the] court's control when the property was sold [in 1992.]” *In re Edwards*, 962 F.2d 641, 643 (7th Cir.1992). “[A] bankruptcy court has jurisdiction over property owned by or in the actual or constructive possession of the debtor.” *In re K & L*, 741 F.2d at 1029 (citation omitted). However, as this court has observed on more than one occasion, “[bankruptcy court] jurisdiction does not follow ... property [that is sold]”; rather, that jurisdiction “lapses when property leaves the estate.” *Xonics*, 813 F.2d at 131; *Edwards*, 962 F.2d at 643; *In re Chicago, Rock Island and Pacific Railroad Co.*, 794 F.2d 1182, 1186 (7th Cir.1986). FedPak transferred all of its rights in the frozen dessert machines to Polar Express in 1992, pursuant to an order of the bankruptcy court, and the terms of that sale “are inviolate in the absence of fraud or collusion.” *Chicago, Rock Island and Pacific R.R.*, 794 F.2d at 1186 (citations omitted). “Since the property [is] no longer part of the bankrupt[cy] estate and since a determination of rights to it would not affect any dispute by creditors over property that was part of the ...

estate, the bankruptcy court [has] no *215 jurisdiction to determine rights to the property.” *Edwards*, 962 F.2d at 643.

CONCLUSION

“A court cannot write its own jurisdictional ticket,” *Zerand-Bernal*, 23 F.3d at 164, but must act within the confines of constitutional as well as statutory limits on its jurisdiction. We hold that the bankruptcy judge in this case exceeded the bounds of his jurisdiction when, at FedPak’s insistence, he asserted the power to “clarify” the respective rights of Polar Express and Jones in property that no longer belonged to the bankruptcy estate.

We hold that the bankruptcy court lacked jurisdiction to issue the clarification order because (1) FedPak did not have the constitutionally-required standing to seek the order, and (2) the order sought by FedPak did not fall within the scope of the bankruptcy court’s “related to” jurisdiction under 28 U.S.C. §§ 157(a) and 1334(b). Because we hold that the bankruptcy court lacked jurisdiction, we need not address the merits of the clarification order, or remand the case for further proceedings. The district court’s order vacating the bankruptcy court’s clarification order is Affirmed.

All Citations

80 F.3d 207, 64 USLW 2691, 35 Collier Bankr.Cas.2d 934, Bankr. L. Rep. P 76,996, 38 U.S.P.Q.2d 1411

Footnotes

- * The court granted the parties’ joint motion to waive oral argument, pursuant to Fed.R.App.P. 34(a) and Circuit Rule 34(f), and the appeal was submitted on the briefs and the record.
- 1 Ventura was incorporated on September 6, 1990.
- 2 The agreement did not state whether these distributorships were exclusive or otherwise.
- 3 Jones alleged that at the time of the agreement, he paid \$85,000 “cash up front” as “partial consideration” for the 20 state-of-the-art machines specified in the agreement. He further claimed that: (1) FedPak failed to meet the delivery schedule set forth in the agreement (by August 15, 1990), and (2) the machines finally delivered to him were “older models, used machines, were missing vital operating parts, were shoddy and were not commercially fit for the[ir] intended purpose.”
- 4 Polar Express acquired the intellectual property rights of FedPak subject to the rights of Jones under the July 1990 licensing agreement.
- 5 FedPak sought this order pursuant to 11 U.S.C. § 105 and Bankr.Rule 3008.
- 6 Jones argues that the July 31, 1995 order of the bankruptcy court (which was not appealed) is “preclusive of the issues before this Court.” We do not agree and deny Jones’s motion to dismiss the appeal. The fact that the bankruptcy court (correctly or incorrectly) dismissed the Polar Express proceeding for lack of subject matter jurisdiction has no preclusive effect on this appeal, which involves the jurisdiction of the bankruptcy court over a separate and distinct proceeding brought by FedPak.
- 7 For reasons discussed below, we believe that there was only a remote connection between FedPak’s request for a clarification order and the administration of the bankruptcy estate. Therefore, if the bankruptcy court had jurisdiction at all, it was by virtue of the “related to” language quoted above and not the narrower “arising in” or “arising under” language.
- 8 While the United States Supreme Court appears to favor a broad interpretation, it has not mandated such an approach. *Celotex*, 514 U.S. at —, 115 S.Ct. at 1499. Indeed, the Court has recently acknowledged that “a bankruptcy court’s ‘related to’ jurisdiction cannot be limitless.” *Id.*
- 9 Either the order actually granted by the bankruptcy court or, presumably, a hypothetical order that might be issued if we were to remand this case.

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743 F.2d 984
United States Court of Appeals,
Third Circuit.

In re PACOR, INC., Appellant,

v.

John HIGGINS, Jr. and
Louise Higgins, Appellees.

No. 83-1704.

|
Argued May 25, 1984.

|
Decided Aug. 27, 1984.

Synopsis

Supplier of asbestos products appealed from order of the United States District Court for the Eastern District of Pennsylvania, James T. Giles, J., which remanded products liability action to Pennsylvania state court. The Court of Appeals, Garth, Circuit Judge, held that: (1) Court had appellate jurisdiction, and (2) the action was not a proceeding “related to” third-party defendant asbestos manufacturer’s bankruptcy proceedings as required for federal jurisdiction.

Affirmed.

Procedural Posture(s): On Appeal.

Attorneys and Law Firms

*985 W. Jeffrey Garson (Argued), John H. McCarthy, Rawle & Henderson, Philadelphia, Pa., for appellant.

Robert E. Paul (Argued), Joseph D. Shein, Shein & Brookman, Philadelphia, Pa., for appellees.

Before GARTH and SLOVITER, Circuit Judges, and FISHER, District Judge.*

OPINION OF THE COURT

GARTH, Circuit Judge.

Philadelphia Asbestos Co. (trading as “Pacor, Inc.”) appeals from a district court order which remanded a products liability action, brought against Pacor by John Higgins and his wife,

to Pennsylvania state court. This case, as well as *Hanna v. Philadelphia Asbestos Co.*, 743 F.2d 996 (3rd Cir.1984) also decided this day, requires a determination of the limits to federal bankruptcy jurisdiction in proceedings “related to” bankruptcy under 28 U.S.C. § 1471(b).

While on its face, this appeal appears superficially simple, it nevertheless presents us with a complex of jurisdictional hurdles which must be surmounted before we may confront the merits of the controversy. The jurisdictional questions to be considered are: (1) Does an order of the district court in a bankruptcy context, which order remanded an earlier state court proceeding to the state court, satisfy the final order criteria of *Cohen v. Beneficial Industrial Loan Corp.*, 337 U.S. 541, 69 S.Ct. 1221, 93 L.Ed. 1528 (1949)? (2) Did Congress intend that appeal from such a remand order be controlled by the removal provisions of statutes pertaining to the district court, 28 U.S.C. §§ 1441-1447 (1982), or be controlled by 28 U.S.C. § 1478 (1982), the bankruptcy remand statute? (3) If governed by section 1478(b), is review authorized where the proceeding is *not* “related to” bankruptcy, and thus is an action in which no jurisdiction can attach? Only after answering those questions and finding that appellate jurisdiction inheres, and that appeal is not proscribed,¹ do we reach the merits of this action.

Because we decide that we have appellate jurisdiction, and because we agree with *986 the district court that the action between Higgins and Pacor was not a proceeding “related to” bankruptcy, we will affirm the judgment below which remanded the Higgins-Pacor action to state court.

I.

John and Louise Higgins initially brought suit against Pacor in the Pennsylvania Court of Common Pleas. They sought damages allegedly caused by Mr. Higgins' work-related exposure to asbestos supplied by Pacor, a distributor of chemical supplies. In response, Pacor filed a third party complaint impleading the Johns-Manville Corporation, which Pacor claims was the original manufacturer of the asbestos.

On August 26, 1982, Johns-Manville filed a chapter 11 petition in bankruptcy in the United States Bankruptcy Court for the Southern District of New York. *In re Johns-Manville Corp.*, Nos. 82 B 11656 to 82 B 11676 (Bankr.S.D.N.Y. filed Aug. 26, 1982). In September, 1982, however, the Court of Common Pleas severed the third party action (Pacor against

Johns-Manville) from the Higgins action against Pacor. On February 16, 1983, as the Court of Common Pleas was preparing to bring to trial the Higgins-Pacor claim, Pacor filed a Petition for Removal in the Bankruptcy Court for the Eastern District of Pennsylvania, seeking to remove the entire Higgins-Pacor-Manville controversy to federal bankruptcy court. Simultaneously, Pacor moved the Eastern District bankruptcy court to transfer the matter(s) to the Southern District of New York, where it would be joined with the rest of the Johns-Manville bankruptcy administration.

The bankruptcy court in the Eastern District of Pennsylvania, upon considering Pacor's removal application, was of the opinion that the entire Higgins-Pacor-Manville matter should be remanded back to the Court of Common Pleas. It reasoned that Pacor's removal petition was filed beyond the thirty day time limit prescribed by Interim Bankruptcy Rule 7004(a),² and therefore was fatally defective. Although that time limit had been extended by Bankruptcy Judge Lifland, who is handling the Manville bankruptcy administration in the Southern District of New York, the bankruptcy court below held that the time limit was mandatory and could not be extended.

Upon "appeal"³ to the district court, Pacor argued that the bankruptcy judge administering the Manville chapter 11 proceedings was empowered to grant a motion to enlarge the time for filing removal petitions in matters related to the Manville case. It further contended that the entire Higgins-Pacor-Manville dispute, including the original action between Higgins and Pacor, was "related to" bankruptcy and therefore should be joined with all other Manville matters in the Southern District of New York.

The district court agreed with Pacor that the thirty day limit on filing petitions for removal could be extended by an appropriate order of the Manville chapter 11 court, and therefore Pacor was not time-barred from attempting to remove the actions to federal bankruptcy court. The district judge also ruled, however, that the original suit by Higgins against Pacor was not "related to" the Manville bankruptcy proceedings, and therefore there was no jurisdiction in the bankruptcy court to hear the matter under 28 U.S.C. § 1471(b). Thus, it ordered the Higgins-Pacor action remanded to state court.

*987 The district court did agree, on the other hand, that the Pacor-Manville third party claim was a proceeding "related to" bankruptcy, and it remanded that portion of the action to

the bankruptcy court for consideration of the transfer of venue motion made by Pacor. Pacor now appeals to this court from that portion of the district court's order which remanded the Higgins-Pacor lawsuit to state court.

II.

Our first concern on this appeal is whether we have appellate jurisdiction to review the district court's order. Because of the complex statutory provisions involved, and the interrelationship between the roles of the bankruptcy court and the district court, it is necessary to analyze our jurisdiction in a three step mode.

First, we must determine whether the district court's order entered in a bankruptcy context and which granted remand to the state court satisfies the requirements of "finality" for general purposes of appealability. This determination, in turn, rests upon a "collateral order" analysis. See *Cohen v. Beneficial Industrial Loan Corp.*, 337 U.S. 541, 69 S.Ct. 1221, 93 L.Ed. 1528 (1949).

Second, assuming that we conclude (as we do) that such a remand order is a final collateral order, we next examine whether our appellate jurisdiction has nevertheless been affirmatively precluded by Congress, pursuant to 28 U.S.C. § 1447(d).

Third, holding as we do that our answers to the first two inquiries permit appellate review of the remand order in question here, we must then consider whether our jurisdiction has been proscribed by the provisions of 28 U.S.C. § 1478(b) (1982).⁴ We hold that it has not.

A.

Under both 28 U.S.C. § 1291 (general final appeals from district court) and 28 U.S.C. § 1293 (bankruptcy appeals), for an order to be reviewable in this court, it must be "final."⁵ While, in this case, it is *988 true that there is no final judgment on the merits over all claims and parties, we believe that the remand order falls within the small class of orders, collateral to the rest of the litigation, which are appealable under the doctrine of *Cohen v. Beneficial Industrial Loan Corp.*, 337 U.S. 541, 69 S.Ct. 1221, 93 L.Ed. 1528 (1949). For an order to be appealable under the *Cohen*

collateral order doctrine, three requirements must be met: (1) it must conclusively determine the disputed question; (2) it must resolve an important question completely separate from the merits of the action; and (3) it must be effectively unreviewable on appeal from final judgment. *Coopers & Lybrand v. Livesay*, 437 U.S. 463, 468, 98 S.Ct. 2454, 2457, 57 L.Ed.2d 351 (1978). We find that these conditions have been satisfied.

It is first apparent that the remand order conclusively determines the disputed question of whether the Higgins-Pacor claim is “related to” bankruptcy for purposes of 28 U.S.C. § 1471(b) (1982).⁶ Indeed, the very fact that the district court remanded to the state court, indicates that it will not alter its determination that there is no jurisdiction under section 1471(b).

Secondly, the district court's determination that there was no section 1471(b) jurisdiction is easily separable from the remainder of the litigation. It does not involve consideration of the merits of Higgins' products liability-personal injury claim against Pacor (or indeed of Pacor's third party claim against Manville). It merely determined the collateral issue of whether that claim could properly be litigated in federal bankruptcy court. As is discussed *infra*, this jurisdictional question involves no more than a threshold determination of whether any judgment which might result from the Higgins-Pacor action could have a tangible effect on the Manville bankruptcy estate, such that it is “related to” that proceeding. It does not, however, involve any inquiry into how that judgment was reached, or whether that judgment was correct, and therefore does not implicate the merits of the claim itself.

Thirdly, the remand order would be effectively unreviewable if Pacor were forced to wait until a final judgment is entered in order to appeal.⁷ It is true that a portion of the removed litigation still remains for adjudication in the federal courts, i.e. the original Pacor-Manville third party action. In this case, however, we believe that Pacor's opportunity to appeal might be irretrievably lost should review be withheld pending the outcome of the remaining third party claim. Here, the results of the district court's remand order would be felt immediately. Upon remand, the state court would continue to adjudicate the Higgins-Pacor *989 claim, since even if we were to rule that the district court improperly remanded to the state court, the jurisdiction of the state court to proceed with the Higgins-Pacor claim would not be affected. At the very latest, jurisdiction was revested in the Court of Common Pleas at the time the district court, rightly or wrongly, issued

its remand order, if indeed jurisdiction was ever lost by the state court.⁸ See *Chandler v. O'Bryan*, 445 F.2d 1045, 1058 (10th Cir.1971), *cert. denied*, 405 U.S. 964, 92 S.Ct. 1176, 31 L.Ed.2d 241 (1972).

Thus, the state court would be free to proceed and actually litigate the dispute on the merits. Indeed (especially if the Pacor-Manville claim is transferred to the Manville bankruptcy administration), the likelihood is great that the state court will actually enter a judgment before the remainder of this litigation is completed in the federal courts. Pacor could therefore be confronted with a judgment which was entered by a court of competent jurisdiction, and which could be afforded res judicata effect. If a valid state court judgment were actually entered against Pacor by the Court of Common Pleas, then the remand order would be a *fait accompli*, and a later appeal challenging its correctness would come too late to be of utility in vindicating any alleged right to have a federal forum.

Our conclusion in this regard is supported, if indeed not required, by the Supreme Court's decision in *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 103 S.Ct. 927, 74 L.Ed.2d 765 (1983), which also employed a *Cohen* collateral order analysis. In *Moses H. Cone*, the Court held that a district court order, which stayed an action pending resolution of a parallel state proceeding, was final for purposes of jurisdiction. The Court noted that:

a stay of the federal suit pending resolution of the state suit mean[s] that there would be no further litigation in the federal forum; the state court's judgment on the issue would be res judicata. Thus, here, ... [the plaintiff] was “effectively out of court.” Hence, as the Court of Appeals held, this stay order amounts to a dismissal of the suit.

Id. 103 S.Ct. at 934 (quoting *Idlewild Liquor Corp. v. Epstein*, 370 U.S. 713, 82 S.Ct. 1294, 8 L.Ed.2d 794 (1962)); see also *990 *Hovsons v. Secretary of the Interior*, 711 F.2d 1208, 1211 (3d Cir.1983); *id.* at 1214–16 (Garth, J. concurring and dissenting) (*Pullman* abstention orders appealable).

We therefore conclude that the district court's order remanding the Higgins-Pacor action is a final collateral order, and would therefore be appealable under 28 U.S.C. § 1291, absent some other jurisdictional barrier. See 15 Wright & Miller, *Federal Practice & Procedure* § 3914 at p. 548–49 (1976).⁹

B.

We next consider whether, given our holding that a remand order before us would normally be immediately appealable under 28 U.S.C. § 1291, Congress has nevertheless affirmatively precluded such review by special statute. Our analysis centers on two particular provisions: 28 U.S.C. § 1447(d), and 28 U.S.C. § 1478(b). We discuss each in turn.

The general provisions of the Judicial Code¹⁰ contain the following sections:

§ 1441 Actions removable generally

(a) Except as otherwise expressly provided by Act of Congress, any civil action brought in a State court of which the district courts of the United States have original jurisdiction, may be removed by the defendants, to the district court of the United States for the district and division embracing the place where such action is pending.

....

§ 1447 Procedures after removal generally

....

(c) If at any time before final judgment it appears that the case was removed improvidently and without jurisdiction, the district court shall remand the case, and may order the payment of just costs. A certified copy of the order of remand shall be mailed by its clerk to the clerk of the State court. The State court may thereupon proceed with such case.

(d) *An order remanding a case to the State court from which it was removed is not reviewable on appeal or otherwise, except that an order remanding a case to the State court from which it was removed pursuant to section 1443 [civil rights cases] of this title shall be reviewable by appeal or otherwise.*

*991 (Emphasis added). Higgins contends that section 1447(d) divests this court of jurisdiction to review the remand order. See *Thermtron Products, Inc. v. Hermansdorfer*, 423 U.S. 336, 343, 96 S.Ct. 584, 589, 46 L.Ed.2d 542 (1976) (§ 1447(d) normally prohibits review of remands pursuant to § 1447(c), whether by appeal or otherwise), but see also *supra* note 9. Pacor contends, on

the other hand, that the general removal provisions of 28 U.S.C. §§ 1441–1447, including the prohibition of section 1447(d), do not apply to bankruptcy removals authorized by 28 U.S.C. § 1478. We must agree.

Since the relevant portions of sections 1441–1447 were all enacted together within the 1948 Judicial Code, a cardinal rule of construction requires that we read them as a whole. See, e.g., *NLRB v. Lion Oil Co.*, 352 U.S. 282, 288, 77 S.Ct. 330, 333, 1 L.Ed.2d 331 (1957) (in expounding a statute, court must not be guided by single sentence, but rather should look to whole law). We first examine the statutory framework.

Section 1441 authorizes removals from state court to the district court of all actions over which the district court has original jurisdiction. Section 1446(c) then dictates that any case over which the district court determines that it does not have jurisdiction shall be remanded to the state court. Thus, the proscription of section 1447(d) against review of remand orders is applicable to proceedings conducted pursuant to these provisions, i.e. cases which were removed from state court pursuant to section 1441 and which were then remanded pursuant to section 1447(c).

In this case, however, removal was not made from state court to the district court under the general provision of section 1441. Rather, removal was effected to the bankruptcy court pursuant to 28 U.S.C. § 1478(a), enacted as part of the Bankruptcy Reform Act of 1978, Pub.L. No. 95–598, § 241(a), 92 Stat. 2670 (1978), which provides:

§ 1478 Removal to the bankruptcy courts

(a) A party may remove any claim or cause of action in a civil action, other than a proceeding before the United States Tax Court or a civil action by a Government unit to enforce such governmental unit's police or regulatory power, to the bankruptcy court for the district where such civil action is pending, if the bankruptcy courts have jurisdiction over such claim or cause of action.

Section 1478(a) thus authorizes a very different type of removal than does section 1441. Under its provisions, a proceeding from *any* other court (including another federal court) may be removed to the *bankruptcy* court, provided the bankruptcy court has jurisdiction of the action under 28 U.S.C. § 1471. We find that, at the time the Bankruptcy Reform Act was passed, section 1478 removals simply could not be included within the general framework of sections 1441–1447.¹¹ By its own terms, section 1478 deals with removals to the bankruptcy court, which—at least at the

time the 1978 Act was enacted—was an entirely separate entity from the district court.¹² On the other hand, it allows removals *992 not only from a state court, but from other federal courts as well, thus permitting removals which sections 1441–1447 do not. A double incongruity with sections 1441–1447 would therefore arise if we were to construe the two sets of statutes as embracing the exact same circumstances.

The fact that any attempt to apply the general removal provisions to removals brought under section 1478 would create a number of statutory conflicts and inconsistencies, supports the conclusion that the provisions of sections 1441–1447 were never meant to be read into the procedures for bankruptcy removals. Since, by their own terms, sections 1441–1447 can only apply to removal from *state* courts, while bankruptcy removals may come both from state and *federal* courts, an inexplicable hiatus would develop if the two statutes were engrafted onto each other, whereby some removed bankruptcy cases would be covered by the procedures of sections 1441–1447, while others would not. Similarly, section 1441 allows only a defendant to seek removal, whereas section 1478 allows *any party* to remove. Sections 1441–1447, again by their own terms, could not apply to matters removed by a plaintiff, creating another statutory limbo. We decline to read such incongruous results into the legislation. *See generally, Commissioner v. Bilder*, 289 F.2d 291, 298 (3d Cir.1961) (court should avoid incongruous interpretations of statute).

It is a “well-established principle that a court will not construe a statute to restrict access to judicial review unless Congress manifests its intent to do so by ‘clear and convincing evidence.’ ” *South Windsor Convalescent Home, Inc. v. Mathews*, 541 F.2d 910, 914 (2d Cir.1976) (quoting *Johnson v. Robison*, 415 U.S. 361, 373–74, 94 S.Ct. 1160, 1168–69, 39 L.Ed.2d 389 (1974)). Because we do not believe Congress could have intended to apply the general provisions of 28 U.S.C. §§ 1441–1447 to bankruptcy removals under section 1478, given the needless conflict and inconsistencies such an interpretation would raise, we conclude that the prohibition on review contained in section 1447(d) is inapplicable in this case.

C.

We next consider whether review of the district court's remand order is specifically precluded by 28 U.S.C. § 1478(b) (1982)

(re-enacted as amended in 28 U.S.C. § 1452). In its entirety, section 1478 provides:

§ 1478 Removal to the bankruptcy courts

(a) A party may remove any claim or cause of action in a civil action, other than a proceeding before the United States Tax Court or a civil action by a Government unit to enforce such governmental unit's police or regulatory power, to the bankruptcy court for the district where such civil action is pending, if the bankruptcy courts have jurisdiction over such a claim or cause of action.

(b) *The court to which such claim or cause of action is removed may remand such claim or cause of action on any equitable ground. An order under this *993 subsection remanding a claim or cause of action, or a decision not so remanding, is not reviewable by appeal or otherwise.*

(Emphasis added). Subsection (b) of section 1478 thus provides that, unlike regular removals to the district court, if a case has been properly removed pursuant to subsection (a), the bankruptcy court may nevertheless remand the matter based on equitable considerations. *Cf. Thermtron*, 423 U.S. 336, 96 S.Ct. 584 (in removals under §§ 1441–1447, district court may *not* remand on grounds other than lack of jurisdiction). Congress apparently realized that, in some instances, a case over which the bankruptcy court has jurisdiction may nevertheless be more expeditiously litigated in another forum. *See H.Rep. No. 95–595*, 95th Cong., 2d Sess., at 51, reprinted in 1978 U.S.Code Cong. & Ad.News 5963, 6012. *See also* Levin, *Bankruptcy Appeals*, 58 N.C.L.Rev. 967, 993 (1980). To reinforce the bankruptcy court's discretion as to which of two permissible forums will more efficiently adjudicate the removed matter, the statute also provides that an “order under this subsection” (i.e. subsection (b)) which grants, *or* which refuses to grant remand on any equitable ground is not reviewable by appeal or otherwise.

The dispute in this case, however, does not involve a decision by the bankruptcy court,¹³ in the exercise of its discretion, to remand the Higgins-Pacor actions on an equitable ground. Rather, the district court found that removal was flatly impermissible *ab initio* as a matter of law and it upheld Higgins' contention that subsection (a) of section 1478 did not permit removal of this action in the first place due to lack of jurisdiction. If this interpretation is correct, then discretion and “equitable grounds” are simply not involved, since removal would be statutorily prohibited.

Equitable action by the bankruptcy court based on subsection (b) must first presume that removal was legally proper under subsection (a). If subsection (a) does not permit the removal, then subsection (b) never comes into play, and the absolute prohibition on appellate review over equitable remands which were granted or denied *under this subsection* [section 1478(b)] never becomes operative.¹⁴

We therefore conclude that section 1478(b) precludes appellate review only of orders remanding cases on equitable grounds, and does not forbid our examination of whether there is a statutory and constitutional basis for assuming jurisdiction over a particular matter in a federal court. See Kennedy, *The Bankruptcy Court Under the New Bankruptcy Law: Its Structure, Jurisdiction, Venue, and Procedure*, 11 St. Mary's L.J. 251, 288–89 (1979). Coupled with our previous holdings, therefore, we conclude that appellate jurisdiction properly lies to review the order remanding the Higgins-Pacor action to state court.

*994 III.

We turn now to the merits of this case, i.e. whether the Higgins-Pacor action is “related to” the Manville bankruptcy action, such that jurisdiction exists to entertain the matter in federal courts.

We must focus once more on 28 U.S.C. § 1471 (1982), which provides in part:

(b) Notwithstanding any Act of Congress that confers exclusive jurisdiction on a court or courts other than the district courts, the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11 or arising in or related to cases under title 11.

(c) The bankruptcy court for the district in which a case under title 11 is commenced shall exercise all the jurisdiction conferred by this section on the district courts. In enacting section 1471(b), Congress intended to grant comprehensive jurisdiction to the bankruptcy courts so that they might deal efficiently and expeditiously with all matters connected with the bankruptcy estate. See H.Rep. No. 598, 95th Cong., 2d Sess., 43–48, *reprinted in* 1978 U.S.Code Cong. & Ad.News 5963, 6004–08. See also *Young v. Sultan, Ltd. (In re Lucasa International, Ltd.)*, 6 B.R. 717, 719 (Bankr.S.D.N.Y.1980) (§ 1471(b) jurisdiction is “pervasive”); *Westinghouse Credit Corp. v. Yeary (In re Brothers Coal*

Co.), 6 B.R. 567, 570–71 (Bankr.W.D.Va.1980) (§ 1471(b) jurisdiction is “broad.”). The jurisdiction of the bankruptcy courts to hear cases related to bankruptcy is not without limit, however, and there is a statutory, and eventually constitutional, limitation to the power of a bankruptcy court. For subject matter jurisdiction to exist, therefore, there must be some nexus between the “related” civil proceeding and the title 11 case. See *In re Hall*, 30 B.R. 799, 802 (M.D.Tenn.1983); 1 *Collier on Bankruptcy* ¶ 3.01, at 3–48 to 3–49 (15th ed. 1982). We find that nexus to be absent here.

As a threshold matter, it should be noted that the Higgins-Pacor suit is one between two parties, neither of which has filed in bankruptcy, in contrast to the Pacor-Manville third party claim, where the defendant Manville is engaged in bankruptcy proceedings and which is therefore clearly “related to” bankruptcy. It must therefore be determined whether the primary action between Higgins and Pacor, although not one directly involving the debtor Manville, is still sufficiently connected with the Manville bankruptcy estate, such that jurisdiction lies under 28 U.S.C. § 1471(b).

The usual articulation of the test for determining whether a civil proceeding is related to bankruptcy is whether *the outcome of that proceeding could conceivably have any effect on the estate being administered in bankruptcy*. E.g., *In re Hall*, 30 B.R. at 802; *In re General Oil Distributors, Inc.*, 21 B.R. 888, 892 n. 13 (Bankr.E.D.N.Y.1982); *In re U.S. Air Duct Corp.*, 8 B.R. 848, 851 (Bankr.N.D.N.Y.1981); 1 *Collier on Bankruptcy* ¶ 3.01 at 3–49. Thus, the proceeding need not necessarily be against the debtor or against the debtor's property. An action is related to bankruptcy if the outcome could alter the debtor's rights, liabilities, options, or freedom of action (either positively or negatively) and which in any way impacts upon the handling and administration of the bankrupt estate.

On the other hand, the mere fact that there may be common issues of fact between a civil proceeding and a controversy involving the bankruptcy estate does not bring the matter within the scope of section 1471(b). Judicial economy itself does not justify federal jurisdiction. See generally *Aldinger v. Howard*, 427 U.S. 1, 15, 96 S.Ct. 2413, 2420, 49 L.Ed.2d 276 (1976). “[J]urisdiction over nonbankruptcy controversies with third parties who are otherwise strangers to the civil proceeding and to the parent bankruptcy does not exist.” *In re Haug*, 19 B.R. 223, 224–25 (Bankr.D.Ore.1982); See also *In re McConaghy*, 15 B.R. 480, 481 (Bankr.E.D.Va.1981) (Bankruptcy court lacks jurisdiction to decide disputes

between third parties in which the estate of the debtor has no interest).

***995** Our examination of the Higgins-Pacor-Manville controversy leads us to conclude that the primary action between Higgins and Pacor would have no effect on the Manville bankruptcy estate, and therefore is not “related to” bankruptcy within the meaning of [section 1471\(b\)](#). At best, it is a mere precursor to the potential third party claim for indemnification by Pacor against Manville. Yet the outcome of the Higgins-Pacor action would in no way bind Manville, in that it could not determine any rights, liabilities, or course of action of the debtor. Since Manville is not a party to the Higgins-Pacor action, it could not be bound by res judicata or collateral estoppel. See *Borough of West View v. North Hills School District*, 274 Pa.Super. 519, 418 A.2d 527 (1980); see generally *Schubach v. Silver*, 461 Pa. 366, 375, 336 A.2d 328, 332 (1978) (res judicata); *Vanderveer v. Erie Malleable Iron Co.*, 238 F.2d 510 (3d Cir.1956) (collateral estoppel). Even if the Higgins-Pacor dispute is resolved in favor of Higgins (thereby keeping open the possibility of a third party claim), Manville would still be able to relitigate any issue, or adopt any position, in response to a subsequent claim by Pacor. Thus, the bankruptcy estate could not be affected in any way until the Pacor-Manville third party action is actually brought and tried.

Pacor stresses that the Higgins-Pacor claim would affect the Manville bankruptcy estate, in that *without* a judgment for plaintiff Higgins in that action, there could never be a third party indemnification claim against Manville. This argument does not alter our conclusion. At best, one could say that a judgment against the plaintiff on the primary claim would make absolutely certain that the Manville estate could never be adversely affected. This does not prove the converse, however, that a judgment in favor of the plaintiff Higgins necessarily does affect the estate. The fact remains that any judgment received by the plaintiff Higgins could not itself result in even a contingent claim against Manville, since Pacor would still be obligated to bring an entirely separate proceeding to receive indemnification.

We believe the circumstances here are readily distinguishable from those cases cited by Pacor. In *In re Brentano's*, 27 B.R. 90 (Bankr.S.D.N.Y.1983), MacMillan, (a nondebtor) agreed to act as guarantor of Brentano's (the debtor's) obligations under a lease. In turn, Brentano's contractually agreed to indemnify MacMillan for any liability or judgments incurred as a result of this guarantee agreement. When Brentano's

defaulted on the lease, the landlord sued MacMillan to enforce the guarantee. MacMillan successfully removed the action to bankruptcy court as a proceeding “related to” bankruptcy.

In *Brentano's*, however, it is clear that the action between the landlord and MacMillan could and would affect the estate in bankruptcy. By virtue of the indemnification agreement between Brentano's and MacMillan, a judgment in favor of the landlord on the guarantee action would automatically result in indemnification liability against Brentano's. See also *In re Johnnie T. Patton, Inc.*, 12 B.R. 470 (Bankr.D.Nev.1981); *In re Lucasa International, Ltd.*, 6 B.R. 717 (Bankr.S.D.N.Y.1980); *In re Brothers Coal Co.*, 6 B.R. 567 (Bankr.W.D.Va.1980) (all involving guarantors of debtor's obligations). Moreover, even in the absence of an explicit indemnification agreement, an action by a creditor against a guarantor of a debtor's obligations will necessarily affect that that creditor's status vis a vis other creditors, and administration of the estate therefore depends upon the outcome of that litigation.

In this case, however, there would be no automatic creation of liability against Manville on account of a judgment against Pacor. Pacor is not a contractual guarantor of Manville, nor has Manville agreed to indemnify Pacor, and thus a judgment in the Higgins-Pacor action could not give rise to any automatic liability on the part of the estate. All issues regarding Manville's possible liability would be resolved in the subsequent third party impleader action. Furthermore, Higgins is not a creditor of Manville and has filed no claim against Manville. Any judgment obtained would thus have no effect on the arrangement, ***996** standing, or priorities of Manville's creditors. There would therefore be no effect on administration of the estate, until such time as Pacor may choose to pursue its third party claim.

We recognize that this situation could work a hardship upon distributors such as Pacor, since in practical terms, it may make it more difficult for them to recover from the ultimate manufacturer of a defective product. Middlemen always face the possibility, however, that attempts to recoup such losses from their manufacturers or suppliers will be hindered, or even unsuccessful, and there is never a guarantee that the original manufacturers will not be judgment proof or found not susceptible to process. Bankruptcy jurisdiction, however, was not conferred for the convenience of those not in bankruptcy to enlarge the possibility of recovery over and above that which they otherwise may have had.

We therefore conclude that the action brought by Higgins against Pacor is not “related to” bankruptcy, and that therefore there was no jurisdiction to remove the matter to federal court.¹⁵ There being no federal jurisdiction, the district court had no alternative but to remand the Higgins-Pacor action to the state court.¹⁶

IV.

The judgment of the district court, remanding the Higgins-Pacor action to state court, will be affirmed.¹⁷

All Citations

743 F.2d 984, 12 Bankr.Ct.Dec. 285, Bankr. L. Rep. P 70,002

Footnotes

* Honorable Clarkson S. Fisher, Chief Judge of the United States District Court for the District of New Jersey, sitting by designation.

1 Cf. *Firestone Tire & Rubber Co. v. Risjord* 449 U.S. 368, 379–80, 101 S.Ct. 669, 676–77, 66 L.Ed.2d 571 (1981) (if court of appeals has no jurisdiction, it cannot reach merits but must dismiss the appeal).

2 The Interim Bankruptcy Rules were presented to the district courts in 1979 by the Supreme Court's Advisory Committee on Bankruptcy Rules, as suggested additions to each court's local rules, and were in fact adopted by most district courts. They were intended to serve until the Committee could draft the comprehensive Rules of Bankruptcy Procedure for approval by the Supreme Court and by Congress. On August 1, 1983, the Rules of Bankruptcy Procedure became effective for all districts pursuant to 28 U.S.C. § 2075, and the Interim Rules became obsolete.

3 Whether this was a true “appeal,” or a “review” of the bankruptcy judge's recommendation, is discussed in *Hanna v. Philadelphia Asbestos Co.*, 743 F.2d 996 (3d Cir.1984).

4 We recognize that, effective July 10, 1984, Congress enacted into law the Bankruptcy Amendments and Federal Judgeship Act of 1984. Pub.L. No. 98–353 (1984). While the instant controversy arose prior to that date and thus is not governed by the provisions of the new Act, we call attention to it because certain of its provisions recast, in slightly different form, those statutes which we discuss *infra*. Thus, as amended, 28 U.S.C. § 1471 (1982) is contained in the new Act as § 1334; § 1478 has become § 1452; and § 1293 is contained in § 158. We do not believe that the particular changes, terminology, and renumbering of sections make substantive changes in the statutes as we interpret them in this opinion. However, we do not decide this question, as the new Act is not before us.

It appears that the new Act (without consideration of the consequences and reasoning which we set forth in text), in order to accommodate *Northern Pipeline Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 102 S.Ct. 2858, 73 L.Ed.2d 598 (1982), has done no more than to make reference to the “district court” instead of the “bankruptcy court” in relevant sections. It has done so, however, without an intent to disturb the essential differences that existed prior to July 10, 1984, between district court provisions, such as 28 U.S.C. §§ 1441–1447, and bankruptcy provisions such as 28 U.S.C. § 1478 (1982) (renumbered as modified at 28 U.S.C. § 1452). Our belief in this respect is fortified by the legislative history, which reveals, the 1984 Act “re-enact[s], with minor technical amendments, [the] provisions of the 1978 Act relating to venue and removal of bankruptcy cases and proceedings.” 130 Cong.Rec. E 1001 (Mar. 14, 1984); 130 Cong.Rec. S 6084 (May 21, 1984).

5 In *Coastal Steel v. Tilghman Wheelabrator, Ltd.*, 709 F.2d 190 (3d Cir.), cert. denied, 464 U.S. 938, 104 S.Ct. 349, 78 L.Ed.2d 315 (1983), we found in a different context that bankruptcy appeals from matters “related to” bankruptcy which were brought after the Supreme Court's decision in *Northern Pipeline Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 102 S.Ct. 2858, 73 L.Ed.2d 598 (1982), would be treated as general appeals from the district court under 28 U.S.C. §§ 1291, 1292, and not as appeals brought under 28 U.S.C. § 1293. *Coastal*, 709 F.2d at 199–200. Section 1293 essentially provides for review in the court of appeals of final judgments and orders of the district or bankruptcy court. Because § 1291 and § 1293 both provide for review of “final orders,” however, there is no need at this point to differentiate between these two statutes.

We do note, however, that 28 U.S.C. § 1292(a) (appeals from certain district court interlocutory orders) would not provide jurisdiction for our review of the district court action. Even if § 1292 is applicable in this bankruptcy context (see *Coastal*, 709 F.2d at 200), orders granting or denying removal are not appealable as orders granting or denying injunctive relief. See *Thaysen v. Lumbermen's Mut. Casualty Co.*, 329 F.2d 149 (3d Cir.1964) (per curiam); accord, *Polyplastics, Inc. v. Transconex, Inc.*, 713 F.2d 875, 880 (1st Cir.1983). The only way in which we may review the instant remand order, therefore, is as a “final order.”

6 28 U.S.C. § 1471 provides in part:

....

(b) Notwithstanding any Act of Congress that confers exclusive jurisdiction on a court or courts other than the district courts, the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11 or arising in or related to cases under title 11.

(c) The bankruptcy court for the district in which a case under title 11 is commenced shall exercise all the jurisdiction conferred by this section on the district courts.

7 Indeed, as far as the Higgins-Pacor claim itself is concerned, we question what more would be needed in order to comprise a “final judgment” beyond the remand order itself. If the litigation were allowed to proceed, then it would be the Pennsylvania Court of Common Pleas which enters judgment on the merits of the Higgins-Pacor action. The federal courts will have no further involvement, and we fail to see how the *district court's* order would be made any more or less final for purposes of § 1291 by reference to what a *state* court has subsequently done. As far as the federal courts are concerned, the Higgins-Pacor action ended when it was remanded, and to put off an appeal until some later time would be meaningless. In this regard, the remand is similar to any order which dismisses an action for lack of federal question jurisdiction. Such an order of dismissal is of course final and appealable, even though the claims might later be renewed in state court.

8 Normally, in removals from state court to the district court under 28 U.S.C. § 1441, a petition for removal divests the state court of jurisdiction to proceed further, even if the removal is later found to have been improper. See *Arango v. Guzman Travel Advisors Corp.*, 621 F.2d 1371, 1374, 1375 n. 4 (5th Cir.1980), *Medrano v. Texas*, 580 F.2d 803 (5th Cir.1978); *United States ex rel. Echevarria v. Silbergliitt*, 441 F.2d 225, 227 (2d Cir.1971); *Chesimard v. Kuhlthau*, 370 F.Supp. 473 (D.N.J.1974). This conclusion is derived from the language of 28 U.S.C. § 1446(e), which provides that, upon completion of the procedures required for removal, “the state court shall proceed no further unless and until the case is remanded.”

As is discussed *infra* in Part II.B., however, the general removal provisions of the 1948 Judicial Code, 28 U.S.C. §§ 1441–1447, are not applicable to bankruptcy removals under 28 U.S.C. § 1478. Section 1446(e) has no statutory corollary in the context of bankruptcy removals. Rather, the Interim Bankruptcy Rules, which were in effect when Pacor's removal petition was filed, provided only that, upon completion of removal procedures, “the parties shall proceed no further in that court [from which removal was taken], unless and until the case is remanded.” Interim Bankr.R. 7004(c); see also R. Bankr.P. 9027(d) (providing the same language in new bankruptcy rules). Thus, the language of § 1446(e), which divested state courts of jurisdiction, was changed in the Interim Rules in its most critical elements, to provide only for a prohibition against the parties, and thus does not evince an intention to affect the raw power of the state courts to act after a bankruptcy removal. This distinction is fortified by the fact that a district court could enjoin a state court from proceeding further in a removed action (28 U.S.C. § 2283), whereas a bankruptcy court could not. 28 U.S.C. § 1481 (bankruptcy court may not enjoin another court).

Moreover, the Interim Bankruptcy Rules, being only the equivalent of local rules of court (see *supra* note 1), could not have limited a federal court's own jurisdiction (see Fed.R.Civ.P. 82, 83), much less the jurisdiction of another sovereignty's courts, even if it intended to do so. Such a rule would go beyond the statutory mandate Congress gave (or possibly could have given) to the courts (see 28 U.S.C. 2071, 2072, 2075) in formulating their rules. See generally *Penn Terra Ltd. v. DER*, 733 F.2d 267, 272–73 (3d Cir.1984) (congressional intent to preempt state authority must be explicit).

9 In *Thermtron Products, Inc. v. Hermansdorfer*, 423 U.S. 336, 96 S.Ct. 584, 46 L.Ed.2d 542 (1976), the Supreme Court held, as we do here, that unless Congress has affirmatively precluded appellate review by statute, an order remanding

to state court is immediately reviewable. *Id.* at 352–53, 96 S.Ct. at 593–94. Relying on cases decided before the *Cohen* collateral order doctrine was developed, however, *Thermtron* noted without further discussion that a remand order was not a “final judgment” reviewable by appeal as of right, and thus the proper remedy was to issue a writ of mandamus to compel the district court to reassume jurisdiction.

Given the absence of any discussion of *Cohen*, and in light of the subsequent decision in *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 103 S.Ct. 927, 74 L.Ed.2d 765 (1983) (discussed *supra* in text), we do not believe *Thermtron* precludes our foregoing analysis. See 15 Wright & Miller, *Federal Practice & Procedure* § 3914 at p. 549 (1976). Moreover, *Thermtron* was decided in the context of a general appeal from the district court in a case removed under 28 U.S.C. § 1446–1447. Here, of course, we have an appeal brought in a bankruptcy context, and as this court has noted, considerations of finality are somewhat different in bankruptcy situations. See, e.g., *In re Comer*, 716 F.2d 168, 171 (3d Cir.1983). Whatever *Thermtron* may have held with regard to finality, therefore, is not necessarily applicable here.

It is therefore unnecessary for us to treat this appeal as a miscast petition for mandamus. *Cf. Nascone v. Spudnuts, Inc.*, 735 F.2d 763 at 773 (3d Cir.1984); *Gold v. Johns-Manville Corp.*, 723 F.2d 1068, 1074 (3d Cir.1983) (treating faulty appeal as petition for writ of mandamus). “[A] court of appeals has no occasion to engage in extraordinary review by mandamus in aid of its jurisdiction ... when it can exercise the same review by a contemporaneous ordinary appeal.” *Moses H. Cone*, 103 S.Ct. at 933 n. 6. At any rate, whether through appeal or mandamus, it is evident that the remand order considered here is reviewable, absent affirmative statutory prohibition.

10 The original Judicial Code was adopted as the comprehensive statutory framework for the federal courts in 1948. Pub.L. No. 80–773, 62 Stat. 869 (1948), *codified as amended in* Title 28, United States Code.

11 This conclusion is buttressed by the fact that, as is discussed *infra* in Part II.C., § 1478(b) contains its own independent provisions on the reviewability of remand orders, which would be partially redundant if § 1447(d) were also held to be applicable, thus leading us to conclude that § 1478(b) contains the exclusive scheme for regulating review of remands in bankruptcy removals. See also *supra* note 4 (referring to the 1984 Bankruptcy Amendments, enacted subsequent to this proceeding).

12 It is true that, in the aftermath of *Northern Pipeline Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 102 S.Ct. 2858, 73 L.Ed.2d 598 (1982), the district courts have taken over responsibility for matters “related to” bankruptcy pursuant to local emergency rules, and have, in some ways, become “bankruptcy courts.” See *Hanna v. Philadelphia Asbestos Co.*, 743 F.2d 996 at 999 (3d Cir.1984). A removal under § 1478, therefore, may now, in a technical sense, lie to the district courts.

It would be straining congressional intent, however, to say that the provisions of the 1948 Judicial Code, §§ 1441–1447, which were clearly inapplicable to bankruptcy removals before *Marathon*, are now applicable because of emergency court rules promulgated in response to *Marathon*. Congress, of course, could not have anticipated the subsequent Supreme Court ruling, and the essence of our holding is that Congress did not intend the terms of § 1447(d) to apply to bankruptcy removals under § 1478. A subsequent court decision, therefore, or mere local court rules, cannot create congressional intent where none existed before.

Section 1478 has been re-enacted as new 28 U.S.C. § 1452, as part of the 1984 Bankruptcy Amendments. See *supra* note 4. The new section, however, changes the references to the “bankruptcy court” into references to the “district court,” and the new provisions of the Act place the district court in charge of all proceedings “related to” bankruptcy. It is clear, however, that Congress intended these alterations to be merely a response to the *Northern Pipeline* decision, and we find no indication that it meant to alter the applicability, or nonapplicability, of the procedural provisions of §§ 1441–1447 to bankruptcy matters. As the captions of the various sections (as designated by Congress itself) themselves reveal, §§ 1441–1447 deal with “Actions Removable Generally” and “Procedures After Removal Generally,” while new § 1452 deals with “Removal of Claims Related to Bankruptcy Cases.” *Cf.* 28 U.S.C. § 1478 (1982) (“Removal to the Bankruptcy Court”).

13 Although § 1478 refers to the “bankruptcy court,” the district court, as we have noted, now retains ultimate control of matters “related to” bankruptcy. See *supra* note 12. To the extent that § 1478 refers to remand orders by the “bankruptcy court,” therefore, those orders are now issued by the district court, as was done here. See *Hanna v. Philadelphia Asbestos Co.*, 743 F.2d 996.

We do not believe that equating the district court with the bankruptcy court in this context is inconsistent with our earlier holding that the general provisions of 28 U.S.C. §§ 1441–1447 do not apply to bankruptcy removals, even though the district court has taken control of proceedings “related to” bankruptcy. The guideline we follow is that statutes intended to regulate the district courts as district courts do not apply to proceedings in bankruptcy, whereas statutes which were intended to control bankruptcy matters do apply, even though it is the district court which is now acting in place of the bankruptcy court.

- 14 Were we to hold otherwise, such a conclusion would also forbid review of an order *denying* remand, even if the basis for contesting the order was that there was no federal jurisdiction by which to entertain the action. This, in turn, would lead to the anomalous result that, if a bankruptcy court assumed jurisdiction over a case that was utterly unrelated to any proceeding arising under title 11, the courts of appeals and the Supreme Court would be powerless to act. We decline to construe section 1478(b) in such a fashion.
- 15 Other cases cited by Pacor are also inapposite. See *Hurt v. Cypress Bank*, 9 B.R. 749 (Bankr.N.D.Ga.1981) (action alleging fraudulent inducement which sought to void sale of stock to debtor); *In re Zamost*, 7 B.R. 859 (Bankr.S.D.Cal.1980) (action for fraud seeking to rescind loan in which proceeds went to debtors); *In re Bazan*, 6 B.R. 937 (Bankr.N.D.Ill.1980) (action by creditor of debtor seeking recovery of property which secured debtor's obligations); *In re General Oil Distributors, Inc.*, 21 B.R. 888 (Bankr.E.D.N.Y.1982) (action by creditor against nondebtor to recover gasoline entrusted to debtor on bailment contract). In each of these cases, it is clear that the action sought to affect property of the estate, or would rearrange the standing of creditors, and thus was “related to” bankruptcy.
- 16 We note that, under new 28 U.S.C. § 1334, enacted as part of the 1984 Bankruptcy Amendments, the Higgins-Pacor matter could not have been heard in federal court without Higgins' consent. Rather, the district court under the new Act would be mandated to abstain from any such controversy at request of a party, because of the “mandatory abstention” provision of § 1334(c)(2). The legislative history reveals that Congress was concerned about the *constitutionality* of granting to the federal courts “related to” jurisdiction in cases where no independent basis for federal jurisdiction existed. See 130 Cong.Rec. S 6088–89 (May 21, 1984) (remarks of Sen. Dole).
- 17 Neither party has raised the issue passed upon by the bankruptcy court, i.e. whether the time limit for removal can be extended by court order under the Interim Rules. For our purposes, therefore, it is sufficient to note that the time limit of an Interim Rule is clearly not jurisdictional. See *infra* note 5; see also *In re Gurney*, 20 B.R. 91, 96 (Bankr.W.D.Mo.1982). For cases supporting the view that the court may extend the time period for removal, see *Stamm v. Rapco Foam, Inc.*, 21 B.R. 715, 718 (Bankr.W.D.Pa.1982); *In re Circle Litho, Inc.*, 12 B.R. 752 (Bankr.D.Conn.1981); *Contra*, *In re McCallum*, 7 B.R. 76 (Bankr.C.D.Cal.1980). Under the new Rules of Bankruptcy Procedure, it is clear that the court may grant such an extension. R.Bankr.P. 9006(b).

In re NRG Energy, Inc., 294 B.R. 71 (2003)

294 B.R. 71

United States Bankruptcy Court,
D. Minnesota, Third Division.

In re NRG ENERGY, INC., Alleged Debtor.

No. 02–33483.

I

May 12, 2003.

Synopsis

Involuntary Chapter 11 petition was filed against energy company currently in process of negotiating restructuring agreements with its various creditor constituencies, and company moved for abstention. The Bankruptcy Court, Gregory F. Kishel, Chief Judge, held that court would exercise its discretion to abstain from hearing involuntary Chapter 11 case, despite possibility that, if and when debtor ultimately chose to pursue its prepackaged reorganization, it might file in another judicial district that was less “connected” to debtor and its creditors.

Case dismissed.

*72 ORDER GRANTING MOTION OF ALLEGED DEBTOR FOR ABSTENTION

GREGORY F. KISHEL, Chief Judge.

This case was commenced by an involuntary petition under Chapter 11. At a hearing on April 10, 2003, the Court received evidence on the motion of NRG Energy, Inc. (“NRG”) for abstention under 11 U.S.C. § 305(a)(1) or dismissal under 11 U.S.C. § 303(j)(2). Appearances were as follows: for NRG, David J. Zott, Brett A. Bakke, and Matthew A. Cantor, of Kirkland & Ellis, Chicago and New York, and James L. Baillie, of Fredrikson & Byron, *73 P.A., Minneapolis; for Shaw Constructors Group and Stone & Webster, Inc. (collectively “Shaw”), Brent B. Barriere, of Phelps Dunbar, LLP, New Orleans, and Peter B. Stein and Eric J. Sherburne, of Stein & Moore, P.A., St. Paul; and for John A. Noer, David H. Peterson, Brian Bird, Leonard A. Bluhm, Craig A. Mataczynski, James Bender, and Roy R. Hewitt (collectively “the Original Petitioning Creditors”), William I. Kampf,

of Kampf & Associates, P.A., Minneapolis, and Maurice W. O'Brien, of Miller–O'Brien, PLLP, Minneapolis. Other appearances were noted in the record. Upon the evidence received and the memoranda and argument of counsel, the Court memorializes the following order pursuant to Fed.R.Civ.P. 52(a) and Fed. R. Bankr.P. 9014.

PARTIES TO MOTION AT BAR

NRG is a business corporation, organized in the State of Delaware. It produces and markets electric power on a non-regulated basis. It is a subsidiary of Xcel Energy, Inc. (“Xcel”), a major regional utility provider that historically serviced customers in the Upper Midwest. NRG and Xcel maintain their principal corporate offices in Minneapolis, Minnesota. NRG has some 3,600 employees in Minnesota. It has numerous subsidiaries in various forms of corporate organization, which do business in electric power generation across the United States and in Europe and in Asia.

LSP–Pike Energy, LLC (“Pike Energy”) is a subsidiary of NRG. Pike Energy contracted with Shaw to construct an electric power plant in Pike County, Mississippi. In August, 2002, Shaw commenced suit against Pike Energy, NRG, and various other NRG affiliates in the United States District Court for the Southern District of Mississippi, alleging breach of the construction contract, a right to relief in quasi-contract, and tortious infliction of injury. In its complaint, it sought to affix liability in NRG under various theories, including alter ego, piercing of the corporate veil, and breach of a guaranty of Pike Energy's obligations to Shaw. This lawsuit is still pending.

The Original Petitioning Creditors are all former executives and officers of NRG. NRG's Board of Directors terminated their employment in May and June, 2002. Within three months of the terminations, NRG ceased making payments to them under their various employment agreements and non-qualified benefit plans. In October, 2002, they collectively brought suit against NRG in the United States District Court for the District of Minnesota, alleging breach of contract and seeking awards of damages to compensate them for the cessation of the post-termination payments. This lawsuit was settled during the pendency of this bankruptcy case.

PROCEDURAL HISTORY OF THIS CASE

On November 22, 2002, the Original Petitioning Creditors filed a petition under 11 U.S.C. § 303(a) against NRG, praying for entry of an order for relief under Chapter 11. As the basis for their petition, they alleged that NRG was generally not paying its debts as they became due.

On December 16, 2002, NRG filed an answer and a statement of affirmative defenses to the involuntary petition. It disputed that the Original Petitioning Creditors had standing to commence an involuntary case, and it denied that it was generally not paying its debts as they became due. Styling further allegations as affirmative defenses, NRG stated that the involuntary petition had been filed in bad faith; that the Original Petitioning Creditors may have been recipients of transfers avoidable in a bankruptcy *74 case; and that abstention under 11 U.S.C. § 305 was warranted. It requested dismissal of this case, and an award of costs, attorney fees, and actual and punitive damages against the Original Petitioning Creditors.

On the same date, NRG filed a motion seeking abstention and dismissal of the case under 11 U.S.C. §§ 305(a) and 303(j). As alternate relief, it requested a mandate to the Original Petitioning Creditors to post a bond pursuant to 11 U.S.C. § 303(e).

Over the ensuing three months, the Court conducted several status conferences on the contested petition and NRG's motion.¹ In the meantime, on February 28, 2003, Shaw filed a document through which it purported to join in the involuntary petition. NRG objected to the joinder, though it did not set its objection on for hearing. At one of the status conferences, the Court ruled that a decision could be made on NRG's motion for abstention before the issues on the contested involuntary petition were presented.

Counsel for NRG and the Original Petitioning Creditors commenced discovery proceedings, and their clients entered negotiations. At a second status conference on February 25, 2003, counsel for NRG and the Original Petitioning Creditors announced that their clients had just reached a settlement of the underlying claims in litigation against NRG, in consequence of which the Original Petitioning Creditors

were to withdraw their opposition to the Debtor's motion for abstention. The resolution was to be effected by those parties requesting the United States District Court to approve the settlement of the claims, in the context of the Original Petitioning Creditors' lawsuit; by the Debtor depositing a sum of money into escrow, to be paid eventually to the Original Petitioning Creditors on account of their claims; and by the Debtor giving notice to all of NRG's creditors, of the date and time of a hearing on the motion for abstention.

The Court approved NRG's proposed form for that notice; it also fixed the scope of the issues to be presented, directed a form of pre-trial disclosure of NRG's case in chief, and defined the format of the evidentiary presentation. The parties went on with discovery. After several calendar adjustments made at the parties' request, NRG's motion for abstention came on in open court on April 10, 2003.²

In the meantime, NRG and the Original Petitioning Creditors had presented their settlement to the United States District Court. There was no objection; on March 12, 2003, that court (Montgomery, J.) approved the settlement.

By April 10, Shaw was the only creditor or party in interest that continued to object to NRG's motion.³ The only parties *75 that participated in the development of evidence were NRG, Shaw, and the Original Petitioning Creditors.

ISSUES PRESENTED

Via the present motion, NRG requests relief in the alternative. Its motion poses two issues:

1. Should the Court abstain from exercising jurisdiction over NRG's relationships with its creditors, and allow it to proceed with negotiations for a comprehensive debt restructuring or reorganization plan outside the strictures of a bankruptcy case?
2. In the alternative, should the Court dismiss this case because NRG is requesting it and the Original Petitioning Creditors that commenced the case now consent to that?

FINDINGS OF FACT⁴

As noted earlier, NRG is a producer of electric power. It does business over a large area of the United States and the world, with generating capacity that it owns in its own right and with the assets of its subsidiaries. For several years in the late 1990s, it pursued an aggressive program of growth, which it executed through the purchase of existing, smaller utilities or their assets, and the formation of some 450 subsidiaries for the holding of these acquisitions or the construction of new generating facilities. NRG and its subsidiaries financed the growth in a number of ways, including issuances of publicly-traded bonds and debt securities. Between 1998 and the end of 2001, the total of the outstanding long-term debt of the Debtor and its subsidiaries increased from approximately \$626,000,000 to approximately \$8,300,000,000.

When the Debtor initiated this program, prevailing prices for electric power were relatively high, which justified and supported the expansion. In the second half of 2001, however, there was a world-wide slackening of demand for electricity, due to general economic slowdown, mild winter weather conditions in North America, an oversupply of generating capacity, and other reasons. Prices dropped precipitately. Utilities' revenues dropped, synergistically. Locked into substantial debt servicing requirements by the structures of its bond issues and other financing, NRG was experiencing a "severe liquidity squeeze" by the summer of 2002. The investment ratings of its public debt issues were downgraded. This triggered requirements under financing agreements and indentures to post additional liquid collateral, which NRG could not meet. In mid-2002, NRG and its subsidiaries began to default on payment obligations on bond issues and other financing.⁵ In consequence of all this, sources of operating capital for NRG dwindled.

In July and August, 2002, NRG's management recognized that it needed major restructuring of its debt to its lenders and its bond- and note-holders. By Davido's estimate, the outstanding debt burden that *76 NRG had to contend with in its own right and through its subsidiaries approached \$11,000,000,000, arrayed in two tiers. The debt as to which the Debtor acknowledged direct or indirect liability totaled approximately \$5,000,000,000, divided among operating credit facilities from banks (approximately

\$1,000,000,000); revolving credit facilities for subsidiary projects (approximately \$1,000,000,000); a line of credit (approximately \$125,000,000); and outstanding obligations to note-holders (approximately \$3,000,000,000). The balance of the debt structure facing NRG, some \$5,000,000,000 to \$6,000,000,000 more, is attributable to its subsidiaries, for bank loans and private or public bond issues for the subsidiaries' individual projects.⁶

NRG's management began the restructuring effort by engaging Davido, an attorney with a total of 15 years of experience in complex Chapter 11 practice and in the direct management of a large financially-troubled business concern. After a brief period as a "consultant," Davido entered NRG's employ in October, 2002.

Under Davido's direction, NRG embarked on a complex of activity that intentionally mimicked many of the functions of a debtor in the opening stages of a Chapter 11 case. It identified several constituencies among its creditors, groups of them that had common interests under similar forms of financing or credit, and it enlisted members of these constituencies to form unofficial committees for the purposes of communication and negotiation.⁷ It prevailed on these committees to hire counsel, financial advisers, and other professionals, and made their maintenance palatable by agreeing to pay the fees of such professionals "in most cases."⁸

While these committees were in formation, NRG's management addressed its lenders' collateral calls. After substantial negotiations, NRG obtained "stand-still" agreements on this issue, under which the lenders have forborne from enforcing their rights to require NRG to post additional cash as collateral. Starting in the late summer of 2002, this enabled NRG to use revenues for the maintenance of current operations, rather than locking them into the illiquid form of supplementary collateral. These agreements were memorialized into "collateral call extension letters" for successive periods of time. The second such expired on November 15, 2002, and the parties to it did not execute a second extension. However, all of the participants in this accord have continued to operate with each other and NRG on the same terms, based on NRG's compliance with the original two agreements.

In re NRG Energy, Inc., 294 B.R. 71 (2003)

The consequence of this arrangement is that NRG has had the benefit of a general forbearance by its major lenders, under which none of them have taken any action that would affect any other's rights or those of the Debtor. The Debtor, in turn, *77 is subject to ongoing requirements to disclose information on its current operations, cash flow and financial posture, and to comply with various fiscal standards.

The record is not as precise as to the other organized constituencies in NRG's debt structure. However, it appears that NRG and its subsidiaries have had the benefit of similar stand-still agreements or understandings with them, since the late summer of 2002.

At the same time, to respond to these disclosure requirements and to enable further planning for a restructuring, NRG developed and implemented internal systems to track its cash flow and to direct it in accordance with its understandings with creditors.

By mid-fall, 2002, the several months of this effort resulted in a stabilization of NRG's immediate situation, under which it was in no immediate jeopardy of any creditor enforcing contractual or legal rights against it directly. As part of the underlying accords, NRG agreed on a series of deadlines for its formulation of a business plan and a plan for the restructuring of its capitalization and debt. It met the deadlines for the preparation of those documents. In early November, 2002, it commenced negotiations toward the terms of restructuring, in which Xcel was a central participant. It appears that the filing of the involuntary petition in this case did not seriously affect the progress of the negotiations. They continued on a confidential basis for five months, through various levels and groupings of the creditors that were in privity with NRG itself.

By the end of March, 2003, NRG and Xcel reached a "preliminary settlement" with the Global Bank Steering Committee and the Note-holders' Committee. This accord identified the "principal elements of a restructuring at the NRG corporate level" and it included a "general understanding as to NRG's balance sheet and capitalization" after the contemplated restructuring. Xcel committed to putting \$752,000,000 of new capital into NRG, to effectuate the restructuring.

It was clear as of mid-April, 2003, that substantial work remained to be done to arrive at the details under this broad structure. Those matters included what Davido broadly termed "mechanical and technical issues;" this apparently denoted the specific terms under which any particular creditor's or constituency's claims would be paid, rights and mechanisms to govern collateral security, terms of default and enforcement, application of the funds from the recapitalization, and the like. Counsel had circulated drafts of various component agreements, but as of mid-April, 2003, the parties had not negotiated final and definitive language to memorialize the broad settlement.

Davido expected NRG to address and finalize the details of the restructuring of its own debt, as to which it had already begun "extremely sensitive" negotiations. He opined that Xcel's announced commitment to a substantial capital infusion had been an essential prerequisite to that process, which would make its completion much easier than before. He did note, however, that the accord with the institutional lenders left approximately \$6,800,000,000 in debt to restructure, which was held by creditors that numbered at least in the hundreds, and into the thousands if the subsidiaries' full debt structures were factored in.

On the level of its subsidiaries' debt structures, NRG had made "some significant contact" of an undefined nature with the major creditors of each. Teams within NRG's management had been assigned to each subsidiary's project; they were to continue to negotiate with the involved *78 creditors toward restructurings for subsidiaries that needed them. Davido anticipated that the process at the subsidiaries' level would also require great effort and much time. As to the scope of the demand that this would put on NRG's resources, he could only say that it was unclear at the time whether all of the subsidiaries required restructuring, or precisely which among them would. The clear implication of his testimony was that NRG had given higher priority to the resolution of its own issues with creditors, which were of several levels of magnitude greater than those of any individual subsidiary. However, it also was clear that NRG planned to redirect substantial resources to the subsidiary level in the near future.

As for the outcome of the restructuring process, Davido forecast that it was "likely" that NRG would use the reorganization process of Chapter 11 to implement a negotiated restructuring. He stated that, in his and other

In re NRG Energy, Inc., 294 B.R. 71 (2003)

managers' estimation, NRG was not ready to initiate a voluntary filing under Chapter 11, premised on a comprehensive negotiated restructuring, as of mid-April, 2003; there simply was no such integrated structure at hand, to incorporate into a plan that could be put before the court soon after the filing.⁹

Despite the fact that NRG would have the full options afforded to a debtor-in-possession in this case, were an order for relief to be entered here, it maintains its motion for abstention, and seeks to have this case dismissed. Its rationale is expressed in terms of an interaction between timing and cost.

In Davido's view, the negotiation of a comprehensive restructuring, as the main framework of a plan of reorganization, is best and least expensively done before a debtor-business entity is subject to the formal and relatively inflexible duties of periodic disclosure and reporting, court oversight, and complicated accountability in form and substance that are required in an ongoing case under Chapter 11. He predicted that, were an order for relief to be entered in this case, NRG would have to immediately cease discussions on the terms of restructuring on multiple fronts. Managerial and professional resources would be redirected to meeting the multiple obligations of reporting and compliance that are imposed on a debtor-in-possession newly-arrived in Chapter 11. He pointed to the need to finalize and present complex arrangements on the use of cash collateral, requests for authority to meet payroll and maintain ordinary payments, and other such "first day" issues as only one example of the sort of procedural, financial, and administrative burdens that NRG has avoided by making private arrangements with committees and creditors to date. He noted that it would be necessary to give substantial attention to the anticipated reactions of "critical vendors," those suppliers that NRG depended on for supplies, service, and power on a wholesale basis to maintain daily business; to avoid interruptions in provision, NRG would have to reach accommodations with them under the framework of bankruptcy law. Finally, he opined that existing relationships of relative trust among NRG, the committees, and individual creditors, would be upset to some degree by the interposition of oversight by the United States Trustee and the appointment of formal committees under Chapter 11's principles. This, Davido said, would require some duplication of *79 effort

in reestablishing working relationships and understandings under the dictates of bankruptcy law.

Davido stressed NRG's strong wish to maintain confidentiality for its negotiations with the remaining constituencies, to promote a quicker coordination of the results into a global form of restructuring. He attested in convincing fashion to the heavy burden of fielding dozens to hundreds of inquiries from individual members of a constituency, before and after formal sessions of negotiation with committees, based on actual experience during NRG's negotiations with the committees. He opined that the higher visibility and sequential pace of individual court proceedings in an "unplanned" Chapter 11 case would multiply the burden of such followup response, on a near-exponential basis.

NRG's push, then, is to be freed of the jurisdiction of this Court. Once out, it maintains, it could finish the complex restructuring process now half-way done, taking as long as that needs if the forbearance agreements hold out. It then would make a decision whether to file for Chapter 11 in its own right, and proceed accordingly.

To somewhat opposite effect, Davido acknowledged that counsel and management have already given attention to a number of formal aspects of participation in Chapter 11, including the identification of necessary "first day" motions, drafts of cash collateral agreements, and a search for financing for post-petition operations. It was not clear whether these hedges were being worked against the possibility of an order for relief in this case, a future voluntary filing, or both, but the third seems the most likely.

DISCUSSION

NRG relies on two alternative theories for its bid for dismissal.

I. 11 U.S.C. § 305(a)(1): Abstention

NRG's preferred theory is under 11 U.S.C. § 305(a)(1):

- (a) The court, after notice and a hearing, may dismiss a case under [the Bankruptcy Code], or may suspend all

In re NRG Energy, Inc., 294 B.R. 71 (2003)

proceedings in a case under [the Bankruptcy Code], at any time if-

(1) the interests of creditors and the debtor would be better served by such dismissal or suspension ...

This is a grant of authority to decline to exercise another grant of authority. The initial grant, of course, is the endowing of jurisdiction over all cases under the Bankruptcy Code and all civil proceedings arising in them, which is given by 28 U.S.C. §§ 1334(a)-(b).¹⁰ Under § 305(a), however, the bankruptcy court may decline to exercise that jurisdiction, relegating a debtor and its creditors to the governance of non-bankruptcy law. H.R. REP. No. 595, 95th Cong. 1st Sess. 325 (1977); S. REP. No. 989, 95th Cong. 2d Sess. 35 (1978), U.S. Code Cong. & Admin. News 1978, pp. 5963, 5787. See also *In re G-N Partners*, 48 B.R. 459, 461 (Bankr.D.Minn.1985) (“Congress has therefore given the Court the power to actually decline the jurisdiction that Congress has given it ...”).

In its one generally-applicable aspect,¹¹ § 305(a) identifies the grounds for abstention *80 in broad language, making the relevant measure the “interests of creditors and the debtor.” This language has been construed as vesting the bankruptcy courts with discretionary authority. E.g., *In re Spade*, 269 B.R. 225, 227 (D.Colo.2001); *In re Central Mtg. & Trust, Inc.*, 50 B.R. 1010, 1021 (S.D.Tex.1985); *In re Sherwood Ents., Inc.*, 112 B.R. 165, 167 (Bankr.S.D.Tex.1989); *In re Fitzgerald Group*, 38 B.R. 16, 17 (Bankr.S.D.N.Y.1983). To different effect, however, some courts have said it gives “an extraordinary power which therefore must be exercised with extraordinary care.” *In re G-N Partners*, 48 B.R. at 461. See also *In re Paper I Partners, L.P.*, 283 B.R. 661, 678 (Bankr.S.D.N.Y.2002); *In re RCM Global Long Term Capital Appreciation Fund, Ltd.*, 200 B.R. 514, 525 (Bankr.S.D.N.Y.1996); *In re 801 South Wells St. L.P.*, 192 B.R. 718, 726 (Bankr.N.D.Ill.1996); *In re Grigoli*, 151 B.R. 314, 319 (Bankr.E.D.N.Y.1993); *In re MELP, Ltd.*, 143 B.R. 890, 892 (Bankr.E.D.Mo.1992).

The observation in *G-N Partners* is somewhat overstated, or at least has been undercut in rationale a bit by legislative amendment.¹² Nonetheless, given the limitation on appellate review, it is clear that the issue of abstention under § 305(a) requires a thorough vetting of the relevant facts, and a careful analysis of the consequences of the alternate results.

This is best done by identifying the practical benefits to all constituencies of resolving a debtor's financial distress under the respective legal regimes, and in their affiliated forums. *In re Spade*, 269 B.R. at 227 (bankruptcy court should make very specific findings of fact to support decision on motion for abstention under § 305(a)).

As courts will, they have expounded at length in an attempt to make the bare language of § 305(a) more amenable to comprehension and application. The results, of course, have been a variety of “tests,” or aggregations of relative “factors” to consider. Ultimately, these considerations have been assembled into a seven-factor list:

1. The economy and efficiency of administration;
2. The availability of another forum, or the actual pendency of an insolvency proceeding in one;
3. The essentiality of federal jurisdiction to a just and equitable resolution;
4. The availability of alternative means for an equitable distribution of assets and value;
5. The lesser cost of a non-bankruptcy process that would serve all interests as well;
6. The possibility that commencing administration in bankruptcy would duplicate previous effort toward a workout in a non-bankruptcy setting; and
7. The purpose for which bankruptcy jurisdiction was sought by the petitioners.

*81 *In re Fax Station, Inc.*, 118 B.R. 176, 177 (Bankr.D.R.I.1990). See also *In re 801 South Wells St. L.P.*, 192 B.R. at 723; *In re Trina Assoc.*, 128 B.R. 858, 867 (Bankr.E.D.N.Y.1991).

This iteration's components reflect the “paradigm case” for abstention identified in the legislative history:

The court may dismiss or suspend under [§ 305(a)], for example, if an arrangement is being worked out of court, there is no prejudice to the rights of creditors in that arrangement, and an involuntary case has been commenced by a few recalcitrant creditors to provide a basis for future threats to extract full payment. The less expensive out-of-court workout may better serve the interests in the case ...

In re NRG Energy, Inc., 294 B.R. 71 (2003)

H.R. REP. No. 595, 95th Cong. 1st Sess. 325; S. REP. No. 989, 95th Cong. 2d Sess. 35, U.S. Code Cong. & Admin. News 1978, pp. 5963, 6281, 5787, 5822; *In re Artists' Outlet, Inc.*, 25 B.R. 231, 234 (Bankr.D.Mass.1982); *In re Wine and Spirits Specialties of Kansas City, Inc.*, 142 B.R. 345, 347 (Bankr.W.D.Mo.1992); *In re Sherwood Ents.*, 112 B.R. 165, 167–168 (Bankr.S.D.Tex.1989); *In re Lufttek, Inc.*, 6 B.R. 539, 548 (Bankr.E.D.N.Y.1980). Substantial support by creditors for abstention and a non-bankruptcy process is an important factor in the analysis. *In re Iowa Trust*, 135 B.R. 615, 623 (Bankr.N.D.Iowa 1992); *In re M. Egan Co., Inc.*, 24 B.R. 189, 191 (Bankr.W.D.N.Y.1982). Ultimately, though, in passing on abstention under § 305,

a bankruptcy court is not bound by a prescriptive template; it may consider any factors it deems relevant to the determination of whether it is in the best interests of the parties to the suit [*sic*] to seek dismissal.

In re Spade, 269 B.R. at 228. See also *In re Iowa Coal Mining Co.*, 242 B.R. 661, 671 (Bankr.S.D.Iowa 1999).

The unspoken thought here is that the “interests of creditors and the debtor” coincide with the values that underlie the Bankruptcy Code's legal regime. Those values include a playing field level among creditors similarly-situated under non-bankruptcy law, in which no single one gets an undue advantage over others; an orderly administration of the value inherent in current assets or future revenues, and the preservation of as much of that value as possible during that administration; and the assurance of a responsible distribution to creditors, prioritized and rateably in accordance with the expectancies each constituency properly had before the debtor's financial distress began. *E.g.*, *In re Taylor Agency, Inc.*, 281 B.R. 354, 361 (Bankr.S.D.Ala.2001); *In re Wine and Spirits Specialties of Kansas City, Inc.*, 142 B.R. at 347 (creditors' deference to debtor's self-conducted liquidation and confidence in debtor's good faith in completing distribution of proceeds supported abstention); *In re Fitzgerald Group*, 38 B.R. at 18 (completion of winding-up of partnership under state law would result in prioritized and rateable distribution, hence abstention merited). These values are consistent with the structure of most consensual “global” workouts. *In re Colonial Ford, Inc.*, 24 B.R. 1014, 1021 (Bankr.D.Utah 1982).

One prominent factor that militates in favor of a consensual arrangement under a non-bankruptcy process is economy.

For two decades or more, the courts have recognized that the notice requirements, procedural exactitude, and public oversight that debtors-in-possession assume in exchange for the court's protection and imprimatur entail rapidly-mounting costs, and can consume more time as well. *E.g.*, *82 *In re Spade*, 269 B.R. at 228; *In re Fitzgerald Group*, 38 B.R. at 18; *In re Colonial Ford, Inc.*, 24 B.R. at 1016 (high administrative costs of Chapter 11 diminish value available for distribution to lower-priority claimants).

Over that time, private and public participants in the bankruptcy process acknowledged the tensions between these alternate vehicles, recognized the benefit of the federal forum, and then developed means for cost containment that keep the protections of the bankruptcy jurisdiction.

One, the statutory “fast track” form of reorganization for small businesses, appears to have had marginal utilization, and marginal utility. See *In re Coleman Enterprises, Inc.*, 266 B.R. 423, 430–432 (Bankr.D.Minn.2001).

Two others, the so-called “pre-packaged plan” and the “pre-negotiated plan,” have been used extensively in some jurisdictions. See *United Artists Theatre Co. v. Walton*, 315 F.3d 217, 224 n. 5 (3d Cir.2003) (defining “prenegotiated bankruptcy” and “prepackaged bankruptcy”); *In re Pioneer Fin. Corp.*, 246 B.R. 626, 630 (Bankr.D.Nev.2000) (defining “prepackaged plan” and “prenegotiated plan”); *In re Sunshine Precious Metals, Inc.*, 142 B.R. 918, 919 (Bankr.D.Idaho 1992); *In re TS Indus., Inc.*, 117 B.R. 682, 688 (Bankr.D.Utah 1990). See also, in general, Mark E. MacDonald and Daren W. Perkins, *Prepackaged Chapter 11 Plans: The Alternative to ‘Free Fall’ Bankruptcy*, 1 J. Of Bankr.L. & Pract. 31 (1991). Building on the Code's grant of leave under 11 U.S.C. § 1126(b) to solicit binding acceptances of a plan before a Chapter 11 filing, practitioners have sought and some courts have established expedited procedures for the early approval of disclosure statements, solicitation of acceptances, and confirmation of plans that are based on terms of debt restructuring negotiated pre-petition.

Coupled with a judicial willingness to entertain debtors' requests for “first-day orders” on extremely abbreviated notice and with substantial deference to debtors' substantive proposals, these developments have led to a distinctive mode of practice in the bankruptcy reorganization of large business concerns, almost a regional legal culture in itself. *E.g.*,

In re NRG Energy, Inc., 294 B.R. 71 (2003)

Sandra E. Mayerson, *Current Developments in Prepackaged Bankruptcy Plans*, 787 PLI/Comm 937 (1999) (describing procedures adopted in Southern District of New York).¹³

Clearly, the presentation of a pre-packaged plan in a bankruptcy case is the contingency against which NRG's bid for abstention must be evaluated. Davido acknowledged the possibility that NRG would go through formal reorganization in a new case under the Bankruptcy Code, after fully framing and fine-tuning a restructuring. He was quite guarded about the likelihood, but it is improbable that NRG will do anything but. NRG's debt *83 structure is probably too complex, and its creditors too great in number and variety, to expect a universal deference to any compilation of accords negotiated with single large lenders and representative committees. Too, the large prominence of bond and public debt issues in its debt structure is an especially strong indicant of the need for formal reorganization in bankruptcy. The Code addresses just this issue; confirmation of a plan binds all members of classified constituencies to the treatment of their claims, despite individual members' rejection of the plan. 11 U.S.C. § 1141(a).¹⁴ The real question is whether NRG should be required to go forward in the confirmation process now in this case, at a time not quite of its choosing, and before it has achieved a comfortable breadth of resolution and accord.

Thus far, NRG has made substantial progress toward the milestones of a plan of reorganization; it would not be starting from scratch in this case or outside. It has done so, however, under a best-of-all-possible-worlds scenario—duly protected by forbearance agreements and the automatic stay, but without the burden of the Code's regimen for accountability. If an order for relief is entered in this case, NRG will have to shoulder that burden immediately. In a case with debt and asset structures valued in the multiple billions of dollars, and with the likelihood of thousands of creditors entitled to notice, that burden will be substantial and consuming. It would continue until an equilibrium under bankruptcy-law principles is achieved, consensually or through litigation. The transactional costs—professional compensation, noticing expenses, the quarterly fee to the U.S. Trustee System Fund, among others—would be large. Many of them would be directly attributable to the presence in Chapter 11, rather than to the general effort to adjust the terms of debtor-creditor relationships.

NRG's management professes to be willing to leave its shelter under the bankruptcy jurisdiction, and to expose NRG to unrestrained creditor action, to avoid an immediate assumption of the transactional costs of a Chapter 11 case. It believes that the former presents a lesser risk. It characterizes the latter as premature, unnecessary, and excessive, if they were to be generated out of the present, half-resolved state of its relationships with creditors. The question posed by this motion, then, is whether this outcome-scenario, coupled with the prospect of a return to Chapter 11 on a voluntary basis at some future date, is more in the interests of creditors and NRG than leaving NRG in Chapter 11 here, in this case.

The merits of NRG's position are not unimpregnable, but Shaw's arguments simply do not carry enough weight to the contrary. The reasons are several.

The costs of noticing and presenting the formal motions that would be incumbent on NRG as a debtor-in-possession early in the case¹⁵ would be very substantial, when *84 there could be hundreds or thousands of parties entitled to receive them under rule and statute. The professional fees attendant to preparing documents, negotiating stipulations, attending court hearings, and giving post-hearing detail on such formal matters would also be large. Debt service on post-petition financing, or even the costs of maintaining liquidity under cash collateral agreements, would likely be higher than that imposed on a debtor outside of bankruptcy.¹⁶

Many of these formal proceedings in a bankruptcy case have corollary functions in an out-of-court workout or restructuring. The formalities of memorializing them do not include the overlay of court documents, proceedings, and hearings, though. None of these sorts of proceedings would be avoided in a “planned” Chapter 11 case. However, they could be simplified by a coordinated pre-petition effort, which would be finalized without the immediate distraction of meeting early-case requirements from the United States Trustee and without the larger-scale distraction of fending off motions and other proceedings brought by creditors on the offensive in the formal arena of the bankruptcy court. Such responsibilities all descend on a reorganizing debtor in its early days in Chapter 11, in a multitude but focused down to a pinpoint of burden. Their weight increases by multiples with the magnitude and complexity of debt and asset structures. Because the automatic stay becomes a focus

In re NRG Energy, Inc., 294 B.R. 71 (2003)

of litigation itself, it often is not an immeasurable God-send of protection, as compared to a forbearance agreement. Any bankruptcy judge with any length of experience can attest to larger cases that were marked by a “feeding frenzy” in their first weeks, with multiple creditors and constituencies jousting for advantage out of the fear that a more permanent ordering of priorities and claims will set in before they act themselves.

The paradoxical concept of “too big to fail,” then, seems to apply with a gut-level verisimilitude to a besieged debtor like this one. It gives a substantial incentive to creditors to forbear and to work things out, as long as the debtor is responsible and responsive. A hasty and unwarned injection into bankruptcy might lift the lid off, however. Shaw's protestation, fundamentally, is that NRG is engaged in forum-shopping for the inevitability of a second filing, when it could proceed in this case at the same cost or less. There is a shallow sheen of attraction to this, to be sure. However, in the end it is simply not as persuasive as NRG's presentation, against the courts' accumulated real-life experience in the economics of debtor-creditor restructuring through Chapter 11, particularly in very large cases.¹⁷

***85** Beyond these specifics of cost in dollars, there is a more intangible aspect that goes to the efficacy of the process: the complex pace and momentum of settlement negotiations that are going on simultaneously on many different fronts, all focused back in on NRG directly or indirectly. NRG's uncontroverted evidence strongly suggests that this sort of complex restructuring has become very much an art in itself, forcing participating professional persons to develop specialized expertise and a heavy focus on coordination. The intended results of such a process, of course, are to be desired; Congress made that clear. See *In re Colonial Ford, Inc.*, 24 B.R. at 1015–1018, and legislative history cited therein. The dynamics of the corollary process in a Chapter 11 case are somewhat different, however—not exclusively focused on the end-product, more consumed by the formalities of accountability, economically burdened by additional transactional costs, and marked by the strong likelihood of a greater cost of financing.

In this case, a restructuring process began before the filing of the involuntary petition, but it obviously achieved its speed afterwards. NRG and its professional persons have

had the benefit of that best-of-all-possible-worlds position, in being able to pursue a multi-leveled restructuring as if NRG were not in bankruptcy. However, there is the specter that much of a partly-completed process could be derailed at least temporarily, were NRG formally put into Chapter 11 by the entry of an order for relief. In such instance, significant further delay is possible and substantially greater expense is probable.

Evidence, experience, and the whole surrounding ethos make this scenario much more likely than the one that Shaw's counsel suggests, that all participants would go forward without a blink. There is just too much in the record to indicate that progress in negotiations would be set back by days-to-weeks, were NRG locked into bankruptcy in this case. There is much more to establish that the transactional costs would be markedly greater than those for the completion of an out-of-court process, even were its results segued into a second Chapter 11 case. Shaw's bland but conclusory assertion that NRG can continue its negotiations while in Chapter 11, but in an open and supervised process, is not evidence. More to the point, its insinuation—that such is the only defensible procedure—is belied by accumulated experience, surrounding circumstances, and common sense.

To sum it up: there is a significant risk that forcing the maintenance of the bankruptcy jurisdiction over negotiations well-started under different assumptions and rules would unduly distort the process, reduce creditors' ultimate realizations, and prejudice the results. This debtor was injected into involuntary bankruptcy by a small group of creditors whose claims were a very small component of a huge debt structure. They believed that their interests were not being recognized or heeded in negotiations that were well underway; they used a threat—the Archimedes' lever of involuntary bankruptcy—to command NRG's attention. They got what they wanted, on a compromised basis,¹⁸ but in the meantime they put NRG into the arena of bankruptcy before it believed it was best-put to use it.

***86** In the end, NRG's argument and proof on the primacy of timing are convincing enough. At this time, abstaining from exercising the bankruptcy jurisdiction over NRG and its creditors is more in the general interest than the alternative, which would be relegating NRG to litigate a contested involuntary petition and then proceed

In re NRG Energy, Inc., 294 B.R. 71 (2003)

into formal reorganization if appropriate. Considerations of cost, efficiency, latitude in action, and likelihood of better outcome all support this conclusion. It is reinforced by a congressional preference for negotiated resolution of systemic financial distress, whether that resolution is ultimately effectuated under non-bankruptcy law or through a subsequent bankruptcy filing.

This could end the discussion, but for the other aspect of Shaw's argument noted earlier:

NRG clearly is contemplating a pre-packaged bankruptcy filing and is using its motion to abstain as a stepping stone to a future filing in a different forum.

...

This Court must be wary of NRG's motives in seeking this Court's abstention ... Granting NRG's motion under Section 305 may be viewed as a tacit endorsement of NRG's arguments including (1) that NRG continues to operate its business and is generally paying its debts as they become due, (2) that NRG can decide when and where to file a reorganization, and (3) that Minnesota is not an appropriate forum for such a filing.

Shaw pitches this argument against the backdrop of the "Chapter 11 venue issue," a phenomenon that has received much comment in legal literature high and low. This, of course, is the incidence of Chapter 11 filings by debtors with very large debt and asset structures, or with publicly-traded equity, in a very small number of federal judicial venues. Most prominent among those venues are the District of Delaware where numerous large and/or publicly-held business entities are incorporated, and the Southern District of New York, where, for reasons of management, finance, or operation many prominent American corporations have a presence of some sort. Once filed in these venues, such debtors often use the "prepack" procedures to get through the case quickly. *See* articles cited *supra* at p. 82, n. 13.¹⁹

NRG may be positioning itself for a filing under Chapter 11 in one of these districts, right now; if its management has elided the issue to some degree in this case, not a soul has been fooled. Ultimately, however, the prospect is beside the point. The argument made here, by Shaw, is simply not one that a court can recognize in the context of a motion for abstention. If abstention is appropriate on the merits

recognized by Congress, the result cannot be unseated by the prospect of a voluntary refile for the very same relief in another forum. That has to be so even if the successor forum turns out to be one *87 to which a debtor is less "connected" in the maintenance of physical assets; the degree of local investment; the extent of creditor, management, or employee presence locally; or any way other than the attenuated link of situs of incorporation.

The reason is that 28 U.S.C. § 1408 gives a reorganizing debtor an initial choice of forum. Congress elected to make "domicile" a basis for choosing venue in a particular district. With the growth of the "Delaware phenomenon," the propriety of this policy choice has been increasingly debated, but Congress has not effected a change of its original policy. The possibility of a transfer under 28 U.S.C. § 1412 is a check on the debtor's power to elect venue. The check, however, is exercised post-petition, on motion, and on all of the facts put at that time before the court of the initial filing. A court is ill-suited to forecast the factors that would go into either "justice" or "convenience" for such a motion, whether for a date in the near future or far. The record for doing so for this debtor at this time is completely lacking.²⁰

The same considerations mandate the denial of Shaw's alternate request, that this Court "condition" a dismissal of this case on a mandate to NRG to file a future Chapter 11 petition in this Court. Issues of ripeness and enforceability aside, the request simply does not recognize the governing law, as just summarized.

NRG, therefore, has made its case, that the relinquishment of bankruptcy jurisdiction over it and its creditors is appropriate, at this time. Its motion for abstention will be granted.

II. 11 U.S.C. § 303(j)(2): Dismissal

In the alternative, NRG requested dismissal of this case pursuant to 11 U.S.C. § 303(j)(2):

(j) Only after notice to all creditors and a hearing may the court dismiss a petition filed under [the Bankruptcy Code]—

...

In re NRG Energy, Inc., 294 B.R. 71 (2003)

(2) on consent of all petitioners and the debtor ...

NRG maintained that this relief was merited for an eminently simple reason: as part of its settlement with the Original Petitioning Creditors, those parties agreed not to oppose a dismissal of this case.

The matter was not as simple as that, however, due to Shaw's later-filed joinder in the involuntary petition. Shaw argued that its refusal to now consent defeated NRG's case on this ground, at least insofar as an unconditioned dismissal was concerned.²¹ In response, NRG argued that *88 Shaw lacked standing as a petitioning creditor.²² As NRG would have it, Shaw thus does not count as a "petitioner" for any purpose under § 303, and specifically does not factor into the issue of a unanimity of petitioner consent under § 303(j). In rejoinder, Shaw argues that Congress's unadorned use of the word "petitioner" in § 303(j)(2) signifies an intent to include all who, *de facto*, sought relief against a debtor on an involuntary basis, whether they had standing to do so or not.

This all presents a set of pretty issues.²³ It is not necessary to get snarled in their complexities, however, because the result under § 305(a) affords a disposition at the more fundamental level of jurisdiction. Call it mootness, or call it judicial restraint, but a ruling on this issue is not necessary, and will not be made.²⁴

DISPOSITION

IT IS THEREFORE ORDERED:

1. Pursuant to 11 U.S.C. § 305(a), this Court abstains from exercising jurisdiction over any aspect of this case, which is hereby dismissed.
2. NRG's alternate motion for dismissal under 11 U.S.C. § 303(j)(2) is denied, as moot.

All Citations

294 B.R. 71

Footnotes

- 1 Several times during this period, NRG and the Original Petitioning Creditors requested a deferral of a final hearing on these matters. The Court used the status conferences as a way to enforce the mandate of Fed. R. Bankr.P. 1013(a), that "[t]he court ... determine the issues of a contested petition at the earliest practicable time ..."
- 2 During the pendency of the negotiations, NRG did not pursue its motion to require the Original Petitioning Creditors to post a bond. On April 10, it did not argue the request or present evidence on it—clearly, because it had made peace with the respondents to the motion.
- 3 Over the three-and-one-half-month pendency of the motion, several other parties had filed formal objections or had stated their intention to do so, most saliently Connecticut Light & Power Company. By the time of the evidentiary hearing, Connecticut Light & Power Company had withdrawn its objection, and none of the others had come forward formally.
- 4 During the final status conference, NRG's bankruptcy counsel identified Scott J. Davido, NRG's senior vice-president, general counsel, and corporate secretary, as its only contemplated witness for its motion. Davido was, indeed, the only witness who gave testimony. The following findings of fact are based on his in court statements and the exhibits received.
- 5 In its Form 10-K for the fiscal year ending December 30, 2002, filed with the United States Securities and Exchange Commission, NRG admitted that its "financial condition ha[d] deteriorated significantly in the recent past," that it did not expect that it would "have sufficient funds to make required principal and interest payments on its corporate debt," and that it hence would remain in default to its bond-holders and major lenders.
- 6 It is not clear from the record whether the Debtor has any derivative or indirect liability on any of this debt.

In re NRG Energy, Inc., 294 B.R. 71 (2003)

- 7 Davido identified three main committees, all dealing directly with NRG on its largest financial issues: a “Global Bank Steering Committee,” the members of which were institutional lenders and which accounted for approximately \$2,000,000,000 of NRG's debt structure; a “Finco Group,” composed of lenders for NRG-owned and subsidiaries' individual projects; and a “Note-holders' Committee,” the members of which were holders of debt securities. NRG also promoted the organization of creditors for individual subsidiaries' projects, “to various degrees.”
- 8 Davido observed that many of the agreements governing its relationships with its creditors gave individual constituents the right to recover attorney fees and other such expenses from NRG, in the event of default.
- 9 The record is not clear whether the Debtor would seek the protection of Chapter 11 for any or all of its subsidiaries, as part of an overall strategy for implementation. In direct examination, Davido never spoke to that issue with specificity. No one inquired on cross-examination.
- 10 The statutory grant is to the district court. The judicial authority under this jurisdiction can be delegated to the bankruptcy judges of a district, by reference under 28 U.S.C. § 157(a). In Minnesota, the reference has been made by operation of Loc. R. Bankr.P. (D.Minn.) 1070–1.
- 11 11 U.S.C. § 305(a)(2) authorizes abstention from exercising jurisdiction over a case ancillary to a foreign bankruptcy or insolvency proceeding—a rather rare bird on most courts' dockets.
- 12 As expressly noted in *G–N Partners*, 48 B.R. at 461, the strength of its observation sprang in large part from the circumstance that the original language of 11 U.S.C. § 305(c) completely insulated an abstention decision from appellate review. Bankruptcy Reform Act of 1978, Pub.L. No. 95–598, § 101, 92 Stat. 2561 (effective Oct. 1, 1979). That language was amended in 1990 by the Judicial Improvements Act of 1990, however. Pub.L. No. 101–650, § 309, 101 Stat. 5113 (effective Dec. 1, 1990) (decision under § 305(a) is not reviewable by appeal to court of appeals or by Supreme Court of the United States).
- 13 The whole phenomenon has not been without critics. Some of them have mustered empirical analysis to bolster their argument that the process is no more effective in the long term than the Code's standard structure for reorganization. In these commentators' view, the Delaware/New York complex of practices may exit large companies from bankruptcy with insufficient attention to the deep roots of their insolvency, leading to the need to file for Chapter 11 again. *E.g.*, Lynn M. LoPucki and Sara D. Kalin, *The Failure of Public Company Bankruptcies in Delaware and New York: Empirical Evidence of a 'Race to the Bottom'*, 54 Vand. L.Rev.. 231 (2001); Lynn M. LoPucki and Sara D. Doherty, *Why are Delaware and New York Bankruptcy Reorganizations Failing?*, 55 Vand. L.Rev.. 1933 (2002). For another view based on the same data, see Robert K. Rasmussen and Randall S. Thomas, *Whither the Race? A Comment on the Effects of the Delawarization of Corporate Reorganizations*, 54 Vand. L.Rev.. 283 (2001).
- 14 The relevant text of this statute is:
- (a) ... the provisions of a confirmed plan bind the debtor, any entity issuing securities under the plan, any equity acquiring property under the plan, and any creditor, equity security holder, or general partner in the debtor, whether or not the claim or interest of such creditor, equity security holder, or general partner is impaired under the plan and whether or not such creditor, equity security holder, or general partner has accepted the plan.
- 15 The varieties of such motions number several dozens. The usual ones are requests for authority to use cash collateral and to afford adequate protection, for the resolution of issues over honoring outstanding checks and payroll payments, for authority to obtain post-petition financing, for leave to pay ordinary-course pre-petition claims of “critical vendors,” and the like. One would assume that NRG would not have to make peace with a utility provider under 11 U.S.C. § 366, but one never knows.
- 16 Davido's uncontroverted controversy is to this effect. So is the experience in many reorganizations.

In re NRG Energy, Inc., 294 B.R. 71 (2003)

- 17 This passage of time is why Shaw's heavy reliance on several summary pronouncements in *G–N Partners* is unfortunate. That decision truly came from a different place, long, long ago, and far, far away. In the first instance, the movant in *G–N Partners* was a single creditor, not a debtor, and one that seemed to have no theory for the motion that matched to the considerations specified by the statute. 48 B.R. at 461. The movant ignored the “paradigm case” for abstention identified in the legislative history—probably because there was no factual basis for it—and never articulated a reason why a return to the governance of state law would further a *global* resolution of the debtor's problems. *Id.* It is no wonder, then, that the *G–N Partners* court phrased a rationale in language as restrictive of the scope of § 305(a). Times have changed, and this case is hugely different; the lamp of experience prompts a slightly more accepting notion of the statute's applicability.
- 18 Davido testified that the negotiations with the Original Petitioning Creditors had been hard-fought, until all parties agreed to the payment of claims reduced from the amounts the petitioners had demanded previously.
- 19 The motivation for these venue choices is a matter of debate. Some commentators attribute the choices to a perceived judicial deference to reorganizing debtors, particularly to the interests of their management, and a willingness to alter notice and procedural requirements at their request. See discussion in Theodore Eisenberg and Lynn M. LoPucki, *Shopping for Judges: An Empirical Analysis of Venue Choice in Large Chapter 11 Reorganizations*, 84 Cornell L.Rev. 967, 1001–1003 (1999). The justification publicly espoused is the judicial expertise in the often complex and very specialized issues of these cases that these districts' judiciaries develop. David A. Sheel, Jr., *Bankruptcy Judges and Bankruptcy Venue: Some Thoughts on Delaware*, 1 Del. L.Rev. 1 (1998); David A. Sheel, Jr., *Lockups and Delaware Venue in Corporate Law and Bankruptcy*, 68 U. Cin. L.Rev. 1243 (2000). There may be some truth in both.
- 20 Another point deserves a mention: seriously entertaining the argument could put the assigned judge into an odd sort of conflict, intangible but nonetheless cognizable. It is a verity that very large Chapter 11 cases are attractive to most bankruptcy judges, for reasons that match their own motivations in taking appointment to judicial office. They involve interesting issues of law, and give novel insights into the workings of fundamental components of the American economy. They usually feature high-quality lawyering; sometimes that breeds excess complexity, but more often it makes the job of judging easier and more enjoyable. And they offer media attention, an opportunity to educate the public, another forum to display the work-product of hard judicial effort. Such heady attractions, however, go to the judicial ego, and not necessarily to justice. A pitch like Shaw's is framed as an emotional accusation of gamesmanship, but it offers precious little substance. More critically, it presents an opportunity to subordinate a result that is consistent with the law, to a judge's sense of self-importance and personal territoriality. The temptation should be eschewed, and so it is.
- 21 In its final written argument, Shaw complicated the issue by stating that it would *not* object to dismissal under § 303(j) as long as it were conditioned on a mandate to re-file in the District of Minnesota. For the reasons noted in the discussion under § 305(a), such a result would be inappropriate. The mere suggestion also calls into question the strength of Shaw's commitment to a consistent application of the law—as opposed to a specific outcome acceptable to it.
- 22 Consistent with its position throughout this case, NRG maintained that it had a bona fide dispute with Shaw over its liability on account of Shaw's claim against Pike Energy. It denies Shaw's theories of liability via alter ego and piercing of the corporate veil, and it maintains that its liability as guarantor lapsed under the guaranty's express terms.
- 23 The analysis would be further complicated by the fact that, after the close of the record on this motion, other creditors—FirstEnergy Ventures Corp., The Toledo Edison Company, The Cleveland Electric Illuminating Company, Fortistar Capital, Inc., and Fortistar Methane, LLC—filed joinders in the involuntary petition. On its face, this appears to have been a tawdry gambit to further derail NRG's motion under § 303(j)(2). What is worse, some of the creditors that did it had maintained a fairly constant but low-level presence through local counsel throughout the case. The joinders could have been made much earlier. The good faith and responsibility of the late-fired shot are quite suspect.
- 24 This obviates the need to get into the issue of whether NRG's settlement with the Original Petitioning Creditors was made in good faith, a consideration considered relevant to the analysis under § 303(j)(2) in some of the cases. *In re*

In re NRG Energy, Inc., 294 B.R. 71 (2003)

Warren, 181 B.R. 136, 138 (Bankr.N.D.Ala.1995); *In re Rajneesh Neo-Sannyas Internat'l Commune*, 59 B.R. 49, 51 (Bankr.D.Or.1986).

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47 F.4th 193

United States Court of Appeals, Third Circuit.

IN RE: ESSAR STEEL MINNESOTA,
LLC; ESML Holdings, Inc., Debtors
Mesabi Metallics Company, LLC, F/K/
A Essar Steel Minnesota, LLC; Chippewa
Capital Partners, LLC, Appellants

v.

B. Riley FBR, Inc., F/K/A [B. Riley & Co., LLC](#)

No. 20-3002

|

Argued September 29, 2021

|

(Opinion filed: August 25, 2022)

Synopsis

Background: Chapter 11 debtor brought adversary proceeding for interpretation and enforcement of discharge injunction bankruptcy court had issued in prior plan confirmation order. The United States Bankruptcy Court for the District of Delaware dismissed the proceeding. Debtor appealed. The United States District Court for the District of Delaware, [Leonard P. Stark, J.](#), 2019 WL 2356979, granted stay pending appeal, and certified direct appeal, 2020 WL 3574743. Debtor appealed.

The Court of Appeals, [Ambro](#), Circuit Judge, held that bankruptcy court had subject matter jurisdiction to determine whether financial advisor's contingency fee that was related to debt financing transactions was discharged and redress possible contempt of its plan and confirmation order.

Reversed and remanded.

Procedural Posture(s): On Appeal; Motion to Enforce Discharge Injunction.

*194 Appeal from the United States Bankruptcy Court for the District of Delaware (District Court Nos. 1-16-bk-11626; 18-ap-50833; 1-19-cv-00397)

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Before: [AMBRO](#), [KRAUSE](#), and [BIBAS](#), Circuit Judges

OPINION OF THE COURT

[AMBRO](#), Circuit Judge

The scope of a bankruptcy court's jurisdiction narrows after the confirmation of a debtor's restructuring plan. Parties thus often dispute whether bankruptcy jurisdiction extends to their post-confirmation proceedings. *195 We review such an issue here, where the Delaware Bankruptcy Court dismissed for lack of jurisdiction an adversary proceeding asking it to interpret and enforce a discharge injunction issued in its prior restructuring plan and confirmation order. For the reasons below, we hold that the Bankruptcy Court had jurisdiction over the adversary proceeding, and so reverse its decision and remand for further proceedings.

I. BACKGROUND

A. The Essar Steel/ESML Bankruptcy

ESML Holdings Inc. and Essar Steel Minnesota LLC (together with their debtor-affiliates, "ESML") filed for Chapter 11 bankruptcy in the District of Delaware in July 2016. *In re ESML Holdings Inc.*, No. 16-11626, ECF No. 1 (Bankr. D. Del. July 8, 2016). Nearly a year later, the Bankruptcy Court confirmed ESML's bankruptcy plan of reorganization. Chippewa Capital Partners, LLC ("Chippewa"), as the plan's sponsor, funded ESML's exit from

bankruptcy. Of relevance here, the plan and confirmation order (1) discharged all claims against ESML arising before the plan's effective date and (2) enjoined actions against ESML and Chippewa by holders of those claims. The Court retained jurisdiction over “any matter (a) arising under the Bankruptcy Code, (b) arising in or related to the Chapter 11 [c]ases or the [p]lan, or (c) that relates to” various other matters stemming from the plan or its confirmation order. J.A. at 103–05; *see also* J.A. at 204. The plan became effective on December 22, 2017, at which time ESML emerged from bankruptcy as Mesabi Metallica Company LLC (“Reorganized Mesabi”).

B. The Engagement Agreement with B. Riley

During the bankruptcy case, Chippewa sought to acquire ESML. Its affiliate, ERP Iron Ore (“ERPI”), agreed to engage B. Riley & Co., LLC (now known as B. Riley FBR, Inc.) as its exclusive financial advisor to assist the “Company” (defined as ERPI and its affiliates) with the acquisition; B. Riley would receive a “Restructuring Transaction Fee” if ERPI successfully acquired ESML. The parties later amended the agreement to stipulate, among other things, that B. Riley would “provide additional financial advisory services to the Company” in connection with a financing transaction for which B. Riley would receive a success fee of 3–5% on consummation of certain debt financing transactions.¹ J.A. at 342–43.

On December 21, 2017—a day *before* the plan's effective date—B. Riley, ERPI, and Chippewa entered a second amendment (as so amended, the “Engagement Agreement”). Most relevant here, that amendment purported to bind ERPI, Chippewa, *and* the post-effective date Reorganized Mesabi.²

C. The Fee Dispute and Ensuing Litigation

After a debt financing transaction closed in June 2018, B. Riley sought payment from Chippewa and Reorganized Mesabi (for ease of reference, they are jointly *196 referred to hereafter as simply “Mesabi”) of more than \$16 million as a success fee under the Engagement Agreement. When Mesabi refused to pay, B. Riley brought two actions to collect: (1) a lawsuit in the United States District Court for the District of Minnesota, *see B. Riley FBR, Inc. v. Chippewa Cap. Partners LLC*, No. 18-cv-2575 (D. Minn.); and (2) an arbitration filed with the Financial Industry Regulatory Authority (“FINRA”).³

In response, Mesabi filed in the Bankruptcy Court an adversary complaint for civil contempt, declaratory judgment, and breach of the plan, maintaining the fee had been discharged by the plan and its confirmation order, and B. Riley's actions to collect violated that order. B. Riley moved to dismiss the adversary proceeding, contending, among other things, that its claim was not a pre-effective date claim enjoined by the plan and confirmation order. Mesabi opposed dismissal and asserted that (1) Clarke lacked authority to bind Reorganized Mesabi before the effective date, and (2) even if he had authority, any claim B. Riley may have under the Engagement Agreement arose when the second amendment was entered on December 21, 2017, and so was discharged a day later on the plan's effective date.

The Bankruptcy Court took the matter under advisement and held oral argument, during which subject matter jurisdiction was raised. In a bench ruling the next day, the Court ruled it lacking, thus dismissing the adversary proceeding.

Mesabi appealed to the District Court and requested, with the support of B. Riley, the appeal be certified directly to our Court. The District Court, without ruling on the merits, did so on the following issues:

- (1) whether the Bankruptcy Court erred in concluding it lacked subject matter jurisdiction to interpret and implement the Discharge Injunction it issued by prior Confirmation Order and related Plan, and (2) whether the Bankruptcy Court erred in concluding it lacked subject matter jurisdiction to redress contempt of its prior Confirmation Order.

J.A. at 28. We agreed to hear the appeal.

II. JURISDICTION AND STANDARD OF REVIEW

The Bankruptcy Court's jurisdiction is at issue and is discussed in detail below. The District Court had jurisdiction under 28 U.S.C. § 158(a) to hear bankruptcy appeals “from final judgments, orders, and decrees,” and discretionary jurisdiction over appeals “from other interlocutory orders and decrees.” *Id.* § 158(a)(1), (3). We have jurisdiction under 28 U.S.C. § 158(d)(2), as the District Court certified the Bankruptcy Court's order for direct appeal, and we authorized that appeal.

We review a bankruptcy court's dismissal for lack of subject matter jurisdiction anew, or *de novo*. *In re W.R. Grace & Co.*, 591 F.3d 164, 170 n.7 (3d Cir. 2009).

III. ANALYSIS

The parties suggest different approaches for determining whether the Bankruptcy Court had jurisdiction over the adversary proceeding. B. Riley urges us to follow the lead of that Court and *197 apply the “close nexus” test from *In re Resorts International, Inc.*, 372 F.3d 154, 166–68 (3d Cir. 2004). Under that test, as the term sounds, if a post-confirmation proceeding lacks a close connection to the implementation of a plan of reorganization or the underlying bankruptcy case, the bankruptcy court lacks jurisdiction. *Id.* Mesabi counters that the action was a core proceeding over which bankruptcy courts unequivocally have jurisdiction and to which the close nexus test did not apply. It also contends the Bankruptcy Court's ruling conflicted with the Supreme Court's declaration that a bankruptcy court “plainly ha[s] jurisdiction to interpret and enforce its own prior orders.” *Travelers Indem. Co. v. Bailey*, 557 U.S. 137, 151, 129 S.Ct. 2195, 174 L.Ed.2d 99 (2009).

A. The Contours of Statutory Bankruptcy Jurisdiction

Before delving into the substance of the parties' arguments, we ground our discussion in the broader context of bankruptcy jurisdiction. The aim of the Bankruptcy Code, 11 U.S.C. § 101 *et seq.*, is to sort out, as much as possible, a debtor's financial affairs in one place. *See* Douglas G. Baird, *The Elements of Bankruptcy* 24 (7th ed. 2022). That place is a bankruptcy court.

Getting there requires a pass-through, however. Only district courts are directly assigned the authority to rule in bankruptcy matters. Under 28 U.S.C. § 1334(a)–(b), “district courts shall have original and exclusive jurisdiction of all cases under title 11 [in the Bankruptcy Code],” and “original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11.” Think of a “case” as the entirety of the process a bankruptcy petition triggers, and a “proceeding” is one of the discrete activities within that process that may include, among other things, contested matters and certain litigated matters (the latter called “adversary proceedings,” *see* Fed. R. Bankr. P. 7001). *See generally* 1 Collier on Bankruptcy ¶ 3.01[2] (16th ed. 2022). Fleshed out, district courts have jurisdiction over

four types of title 11 matters (the first of which is not relevant here): “(1) cases under title 11, (2) proceeding[s] arising under title 11, (3) proceedings arising in a case under title 11, and (4) proceedings related to a case under title 11.” *Resorts*, 372 F.3d at 162 (internal quotation marks omitted). As one court recently explained:

A case⁴ ‘arises under’ [the Bankruptcy Code] when the cause of action is based on a right or remedy expressly provided by the Bankruptcy Code. Proceedings ‘arising in’ a case under [the Bankruptcy Code] include matters that, though not explicitly mentioned in the Code, would not exist outside of bankruptcy. Related matters are generally causes of action under state law that are imported into the bankruptcy because of their impact on the size of the debtor's estate, and hence the distribution to the debtor's creditors.

In re Weiland Auto. Indus., 612 B.R. 824, 854 (Bankr. D. Del. 2020) (internal quotation marks omitted) (footnote added).

So where do bankruptcy courts come in? They are adjuncts of district courts who, under 28 U.S.C. § 157(a), may “refer[]” Title 11 cases to bankruptcy judges in their districts. By institutional custom and practice, that is what routinely occurs. Section 157 also sets out the types of proceedings bankruptcy courts may hear. Under that section, they may “hear *198 and determine ... core proceedings,” 28 U.S.C. § 157(b)(1) (emphasis added), but in non-core proceedings may only hear and make proposed findings of fact and conclusions of law unless all parties consent, *id.* § 157(c)(1)–(2). These categories overlap with § 1334's four avenues to bankruptcy jurisdiction discussed above. Core proceedings are “[c]ases under title 11, proceedings arising under title 11, and proceedings arising in a case under title 11,” while non-core proceedings are “‘related to’ a case under title 11.” *In re Combustion Eng'g, Inc.*, 391 F.3d 190, 225 (3d Cir. 2004). Because the words “arising under,” “arising in,” and “related to” are so general and indeterminate, courts seek to sift meaning from context. And there we go next.

B. The Applicability of the Close Nexus Test

The proceeding here (asking the Bankruptcy Court to interpret and implement the discharge injunction it issued in the plan and confirmation order) is a post-confirmation adversary proceeding. While “the scope of bankruptcy court jurisdiction diminishes with plan confirmation, [that] jurisdiction does not disappear entirely.” *Resorts*, 372 F.3d at 165. To determine whether a bankruptcy court has jurisdiction over a proceeding, courts must consider whether it falls into

one of these core or non-core categories. B. Riley begins with “related to” jurisdiction and argues that the Bankruptcy Court lacked jurisdiction because Mesabi failed to show a close nexus to the underlying bankruptcy. *See id.* at 166–67. We disagree, as we conclude that test does not apply to Mesabi’s claims.

The close nexus test derives from *Resorts*, where our Court addressed the scope of a bankruptcy court’s jurisdiction over a post-confirmation adversary proceeding. *Id.* at 159, 161. It involved a malpractice action brought by a litigation trust set up under the debtors’ confirmed bankruptcy plan against an accounting firm that had provided the trust with tax advice and accounting services. *Id.* at 158–59. We focused our analysis on whether the Bankruptcy Court had “related to” jurisdiction over the malpractice dispute. *Id.* at 171. In so doing, we declined to decide whether the malpractice action was a core proceeding, because “ ‘related to’ jurisdiction is the broadest of the potential paths to bankruptcy jurisdiction.” *Id.* at 163.

The key question in *Resorts* thus became whether there existed “a close nexus to the bankruptcy plan or proceeding sufficient to uphold bankruptcy court jurisdiction over the matter.” *Id.* at 166–67. When that happens, such “as when a matter affects the interpretation, implementation, consummation, execution, or administration of a confirmed plan or incorporated litigation trust agreement, retention of post-confirmation bankruptcy court jurisdiction is normally appropriate.” *Id.* at 168–69. But the malpractice action in *Resorts* lacked a close connection “to the bankruptcy plan or proceeding and affect[ed] only matters collateral to the bankruptcy process,” as “resolution of the[] malpractice claims [would] not affect the estate” and would “have only incidental effect on the reorganized debtor.” *Id.* at 169. We thus held the Bankruptcy Court lacked “related to” subject matter jurisdiction. *Id.* at 170–71.

B. Riley contends *Resorts*’ close nexus test governs here and disposes of this case. Yet that analytical tool does not extend to core proceedings. *In re Seven Fields Dev. Corp.*, 505 F.3d 237, 260 (3d Cir. 2007). A non-exhaustive list of the categories of core proceedings is set out in § 157(b)(2), and includes “determinations as to the dischargeability of particular debts,” “objections *199 to discharges,” and “confirmations of plans.” 28 U.S.C. § 157(b)(2)(I), (J), (L).

This matter falls within those categories of core proceedings, as Mesabi asked the Bankruptcy Court to interpret the

discharge injunction order in its own plan and confirmation order to determine whether B. Riley’s fee was discharged in the bankruptcy.⁵ Indeed, bankruptcy courts routinely recognize similar requests as core. *See, e.g., Weiland Auto. Indus.*, 612 B.R. at 831, 855 (post-confirmation request to interpret and enforce discharge injunction in plan and confirmation order is a core proceeding under § 157(b)(2)(I)–(J)); *In re G-I Holdings, Inc.*, 580 B.R. 388, 424 (Bankr. D.N.J. 2018) (“Enforcing the discharge injunction is within this Court’s core jurisdiction because it is enforcing this Court’s confirmation order based on rights provided in the Code” (internal quotation marks omitted)); *In re Christ Hosp.*, 502 B.R. 158, 179–80 (Bankr. D.N.J. 2013) (motion to enforce confirmation order is core under § 157(b)(2)(L) & (N) because “[e]nforcement motions relating to such orders are ... squarely within this court’s jurisdiction to hear and determine”); *In re Texaco Inc.*, 182 B.R. 937, 944 (Bankr. S.D.N.Y. 1995) (“There can be no question that a proceeding such as this, to enforce and construe a confirmation order issued by this Court in this case, constitutes a proceeding arising in or related to a case under title 11 ... [, and so] is a core proceeding under section 157(b)(2).” (internal quotation marks omitted)).

Moreover, executing the second amendment a day before the plan’s effective date may hint that Chippewa and ERPI tried to circumvent the bankruptcy process to bind Reorganized Mesabi to a contract containing a major contingency fee before the entity came into existence and could independently review and consent—something that, viewed in this light, we would consider a core bankruptcy proceeding. Our conclusion is further supported by *In re Allegheny Health Education & Research Foundation*, where we determined that an adversary proceeding requesting a bankruptcy court interpret and enforce its own sale orders “was a core proceeding because it required the court to interpret and give effect to its previous sale orders.” 383 F.3d 169, 174–76 (3d Cir. 2004); *cf. In re Somerset Reg’l Water Res., LLC*, 949 F.3d 837, 844 (3d Cir. 2020) (dispute asking bankruptcy court to interpret and enforce its own loan order “falls within the bankruptcy court’s statutory jurisdiction over core proceedings”).

B. Riley nonetheless contends “post-confirmation plan and confirmation order disputes can be ‘related to’ matters that trigger application of the close nexus standard ... [if they are] not per se ‘core’ matters falling under the bankruptcy court’s jurisdiction.”⁶ Appellee Br. at 15–16 *200 (citing *In re Shenango Group, Inc.*, 501 F.3d 338, 342–44 (3d Cir. 2007)). In *Shenango*, we held that a post-confirmation

motion to reopen a bankruptcy case to compel the reorganized debtor to comply with the bankruptcy plan and fully fund benefit increases for certain pensioner-creditors fit “related to” jurisdiction. 501 F.3d at 343–44. We never addressed whether these proceedings could also qualify as core. Doing so was unnecessary, as “ ‘related to’ jurisdiction is the broadest of the potential paths to bankruptcy jurisdiction, so we need[ed] only [to] determine whether [the] matter [was] at least ‘related to’ the bankruptcy” to ascertain our authority to decide. *Resorts*, 372 F.3d at 163. Because it was related, we had jurisdiction and needed go no further. Thus *Shenango* only shows post-confirmation proceedings *can* be “related to” matters; it does not go so far as to say they cannot be core.⁷ See also *Seven Fields*, 505 F.3d at 260 n.21 (“Our decision in *Shenango Group* does not affect this case[,] as here the issue is not whether the suit is ‘related to’ the bankruptcy, but, instead, whether it is ‘arising in’ the bankruptcy.”).

The Bankruptcy Court here also had subject matter jurisdiction to redress a possible contempt of its plan and confirmation order. As our sister circuits have explained, “[c]ivil contempt proceedings arising out of core matters are themselves core matters.” *In re Ocean Warrior, Inc.*, 835 F.3d 1310, 1318 (11th Cir. 2016) (alteration in original) (quoting *In re Skinner*, 917 F.2d 444, 448 (10th Cir. 1990)); see also *In re White-Robinson*, 777 F.3d 792, 795–96 (5th Cir. 2015) (per curiam) (observing that a contempt order fell “within one of the statutorily-enumerated examples of core proceedings because it was a ‘matter concerning the administration of the estate’ ” (alterations adopted) (quoting 28 U.S.C. § 157(b) (2))).

Because the contempt proceeding here arose out of the previously entered plan and confirmation order—which, as we have explained, themselves implicated explicitly enumerated core proceedings under § 157(b)(2)—it was also a core proceeding over which the Bankruptcy Court had jurisdiction.

C. The *Travelers* Principle

In addition, the Bankruptcy Court's conclusion that it lacked subject matter jurisdiction over the adversary proceeding conflicted with *Travelers*, where the Supreme Court recognized that bankruptcy courts have jurisdiction to interpret and enforce their prior orders. That decision arose out of the bankruptcy proceedings of Johns-Manville Corporation, a major supplier and manufacturer of asbestos products. *Travelers*, 557 U.S. at 140, 129 S.Ct. 2195. After

becoming mired in lawsuits for injuries caused by asbestos, it filed for bankruptcy under Chapter 11.

Travelers, as Johns-Manville's primary insurer, had a stake in the outcome of the bankruptcy proceedings. *Id.* In 1986, the Bankruptcy Court issued an insurance settlement order that created a creditor trust to compensate future injured claimants. *Id.* at 141, 129 S.Ct. 2195. That order provided that *Travelers* and other insurers would fund the trust in exchange for an injunction against future actions by injured *201 claimants. *Id.* at 141–42, 129 S.Ct. 2195. The settlement order was later incorporated by reference in the Bankruptcy Court's order confirming the reorganization plan. *Id.* at 142, 129 S.Ct. 2195.

More than a decade later, *Travelers*, facing new asbestos-related claims, asked the Bankruptcy Court to enjoin those lawsuits under the 1986 orders. *Id.* at 142–43, 129 S.Ct. 2195. The Court issued a clarifying order that the prior orders barred the new actions. *Id.* at 143–45, 129 S.Ct. 2195. On appeal, the Second Circuit reversed, holding that the new claims fell outside the scope of the 1986 orders, so the Bankruptcy Court lacked jurisdiction to enjoin the new actions and enter the clarifying order. *Id.* at 146–47, 129 S.Ct. 2195.

Travelers appealed to the Supreme Court. It reversed and upheld the clarifying order because the Bankruptcy Court properly interpreted its 1986 orders. *Id.* at 148–51, 129 S.Ct. 2195. Whether that Court had jurisdiction to issue the clarifying order was “easy,” as it “plainly had jurisdiction to interpret and enforce its own prior orders.” *Id.* at 151, 129 S.Ct. 2195.

We apply that same principle here. Like *Travelers*, Mesabi asked the Bankruptcy Court to enforce the discharge and injunction provisions of its plan and confirmation order after the debtor emerged from bankruptcy. Moreover, where a reorganized debtor seeks to invoke the jurisdiction of the Bankruptcy Court to enjoin third-party lawsuits is arguably *closer* to the underlying bankruptcy than the *Travelers* proceeding, which merely involved a third party's request to enjoin third-party lawsuits.

B. Riley tries to distinguish *Travelers*, arguing it is out of step with our Circuit's “fact-based approach to post-confirmation jurisdiction,” and that applying it here “threatens unending jurisdiction.” Appellee Br. at 24–25 (quoting *Resorts*, 372 F.3d at 160). We are not persuaded. As we explained, the cases are factually similar in key respects, so we see no reason why

the *Travelers* principle should not apply here. Just because the facts do not compel B. Riley's desired result does not mean we have deviated from our precedent. Also not persuasive is its specter of “unending jurisdiction.” Bankruptcy courts are quite capable of recognizing and distinguishing the key facts here from other cases. Moreover, a court has wide latitude under 28 U.S.C. § 1334(c)(1) to “permissively abstain from any proceeding over which it has jurisdiction.”⁸ *Bricker v. Martin*, 348 B.R. 28, 34 (W.D. Pa. 2006). Accordingly, we conclude the Bankruptcy Court “plainly had jurisdiction to interpret and enforce” the discharge and injunction provisions of its plan and confirmation order. See *Somerset Reg'l Water Res.*, 949 F.3d at 845 (internal quotation marks omitted) (recognizing bankruptcy court “plainly had jurisdiction to interpret and *202 enforce” previously issued loan order under *Travelers*).

* * *

In an adversary proceeding, Mesabi asked the Bankruptcy Court to determine whether a fee it purportedly owed B. Riley was discharged under the prior-issued plan and confirmation order, and, if so, to enforce that order against B. Riley. Applying the close nexus test, the Court dismissed the proceeding for lack of subject matter jurisdiction. But as the action was a core proceeding under the Bankruptcy Code, the close nexus test is not in play. Further, dismissal here deviated from the principle the Supreme Court articulated in *Travelers* that a bankruptcy court “plainly ha[s] jurisdiction to interpret and enforce its own prior orders.” 557 U.S. at 151, 129 S.Ct. 2195. As jurisdiction exists for this action, we reverse and remand to the Bankruptcy Court for further proceedings.

All Citations

47 F.4th 193, Bankr. L. Rep. P 83,802

Footnotes

- 1 The initial agreement and first amendment were signed on behalf of ERPI by Thomas Clarke, as CEO of Chippewa and CEO and controlling owner of ERPI.
- 2 Clarke signed the second amendment on behalf of ERPI and Chippewa. A week before the parties entered that amendment, ESML had disclosed that Clarke would become a board member of Reorganized Mesabi, which had yet to come into existence. Following the effective date, he became CEO of that entity.
- 3 The Minnesota action was dismissed with prejudice, and the FINRA arbitration has been stayed pending the outcome of this case. In addition to these actions against Mesabi, B. Riley sued Clarke personally, alleging fraud in connection with the negotiation, execution, and performance of the Engagement Agreement. See *B. Riley FBR, Inc. v. Clarke*, No. 18-cv-2318 (D. Minn.). That case settled following the Minnesota District Court's denial of Clarke's motion to dismiss.
- 4 “[C]ase” here is used colloquially to refer to a matter of litigation (thus a proceeding) and not a bankruptcy case as intended in the next sentence.
- 5 B. Riley contests this framing, contending Mesabi “merely asked [the Bankruptcy Court] to enforce the discharge provision, not to interpret it.” Appellee Br. at 20. Not so. The nature of this adversary proceeding required the Court to determine the interplay between the Engagement Agreement on the one hand, and the plan and confirmation order on the other—a task that necessarily requires interpretation of those documents.
- 6 In a similar vein, B. Riley also cites *In re Wilshire Courtyard*, where the Ninth Circuit applied the close nexus test to hold that “related to” jurisdiction extended to a motion to reopen a bankruptcy case to enforce a discharge order. 729 F.3d 1279, 1287–93 (9th Cir. 2013). Before applying that test, the Court rejected the reorganized debtor's argument that there was “arising under” (or core) jurisdiction. *Id.* at 1285. Resolution of the underlying dispute implicated § 346 of the Bankruptcy Code, but, the Court noted, that section did “not provide the substantive rule of decision.” *Id.* (citing 11 U.S.C. § 346). *Wilshire Courtyard* does not apply because it concerned a different Code provision than the one implicated here. And to the extent that case conflicts with our ruling, we are, in any event, not bound by it.
- 7 We likewise note that we do not hold that post-confirmation plan and confirmation order disputes are *per se* core proceedings that confer bankruptcy jurisdiction. Rather, whether a proceeding is core should be decided on a case-by-case basis, and, for the reasons stated above, the facts here make this case a core proceeding.

- 8 B. Riley also argues that, even if the Bankruptcy Court did have jurisdiction over the adversary proceeding, we may still affirm its ruling on the ground that the Court had discretion to abstain from hearing the matter. We disagree. While [28 U.S.C. § 1334\(c\)\(1\)](#) allows bankruptcy courts to abstain from hearing any proceeding “arising under [the Bankruptcy Code] or arising in or related to a case under [the Bankruptcy Code],” if it is “in the interest of justice, or in the interest of comity with State courts or respect for State law,” [28 U.S.C. § 1334\(c\)\(1\)](#), permissive abstention decisions are the exclusive domain of the bankruptcy courts and are not reviewable by our Court. See [Seven Fields](#), 505 F.3d at 251; see also [28 U.S.C. § 1334\(d\)](#). We thus cannot affirm the ruling of the Bankruptcy Court on this ground. We note, of course, that it may consider abstaining on remand if it is so inclined.

676 B.R. 356

United States District Court, S.D. Texas, Houston Division.

IN RE: [The CONTAINER STORE GROUP, INC.](#), et al., Debtors.

Kevin M. Epstein, United States Trustee for Region 7, Appellant,

v.

[The Container Store Group Inc.](#), et al., Appellees.

BANKRUPTCY CASE NO. 24-90627

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CIVIL ACTION NO. H-25-618

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Filed February 12, 2026

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Signed March 6, 2026

Synopsis

Background: Chapter 11 debtors, a specialty retailer and affiliated companies, sought confirmation of prepackaged reorganization plan that included third-party releases obtained through opt-out procedures, permanent injunction enforcing releases, and gatekeeping provision requiring court approval before filing certain claims. The United States Trustee (UST) and the United States Securities and Exchange Commission (SEC) objected. The United States Bankruptcy Court for the Southern District of Texas, Alfredo R. Pérez, J., overruled objections and confirmed plan, and, after UST filed notice of appeal, denied UST's motion for stay pending appeal, [2025 WL 4226766](#).

Holdings: The District Court, [Lee H. Rosenthal](#), Senior Judge, held that:

the appeal was not equitably moot;

federal law, not state contract law, governs whether claimants have “consented” to third-party releases in a reorganization plan;

the failure to “opt out” may constitute consent to a third-party release under the appropriate circumstances;

in the present case, the nondebtor releases were consensual and, thus, permissible, except with respect to two classes of creditors that received no distribution;

plan's permanent injunction, as a limited enforcement tool to support a third-party release authorized elsewhere in the Bankruptcy Code, was permissible under section of the Code authorizing courts to issue “necessary or appropriate” orders, except with respect to two classes of creditors that received no distribution; and

even if limited only to debtors and parties who consented to third-party release, plan's broad gatekeeping provision still exceeded the Bankruptcy Court's equitable authority to enter consent decrees, and so would have to be narrowed further.

Affirmed in part, reversed in part, and remanded in part.

Procedural Posture(s): On Appeal; Motion to Confirm Plan; Objection to Confirmation of Plan; Motion for Stay.

Attorneys and Law Firms

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MEMORANDUM AND OPINION

[Lee H. Rosenthal](#), Senior United States District Judge

***365** This bankruptcy appeal involves Chapter 11 relief sought by the Container Store and affiliated companies. The U.S. Trustee appealed the Bankruptcy Court's confirmation order, challenging three parts of the reorganization plan: the third-party releases; the permanent injunction enforcing those releases; and the gatekeeping provision. (Docket Entry No. 2). The Debtors have moved to dismiss on the grounds that the Trustee lacks standing and that the appeal is equitably moot. (Docket Entry No. 12). The Debtors also argue that the appeal fails on the merits. (Docket Entry No. 13).

Based on the motions, the briefs, the record, and the applicable law, the court largely affirms the judgment of the Bankruptcy Court. The court affirms the third-party release provision and permanent injunction except as applied to Class 5 and Class 8 claimants. The court narrows rather than strikes the gatekeeping provision and remands to the Bankruptcy Court to determine the proper scope of that provision. The court denies the Debtors' motion to dismiss the appeal based on standing and equitable mootness, (Docket Entry No. 12), and denies the Trustee's motion to stay, (Docket Entry No. 17).

I. Background

The Container Store's Chapter 11 bankruptcy was a complex response to the significant financial difficulties the Container Store faced in the aftermath of COVID. (Bankr. Docket Entry No. 6 ¶ 39). On December 21, 2024, the Container Store succeeded in reaching a Transaction Support ***366** Agreement with lenders on a restructuring and reorganization plan that provided much-needed new capital. (*Id.* ¶¶ 8, 52). The next day, the Container Store and its affiliates filed for Chapter 11 bankruptcy, submitting a prepackaged Plan. (Bankr. Docket Entry Nos. 1, 19).¹

The Plan called for multiple creditor classes, only one of which was entitled to vote on the proposed terms. (Bankr. Docket Entry No. 181 at 100). Those not voting included three creditor classes—other secured claims, prepetition asset-based lending claims, and general unsecured claims—that would receive a full recovery and were deemed to accept the Plan under § 1126(f), (Classes 1, 2, and 4); two classes of creditors—the subordinated claims and the existing equity interests—that would not receive any recovery and were deemed to reject the Plan under § 1126(g), (Classes 5 and 8); and two classes of creditors whose claims were held by the Debtors and their affiliates that were deemed to either accept or reject the plan under §§ 1126(f) and (g), (Classes 6 and 7). (*Id.* at 100–03). The only class of creditors that could vote was Class 3, an “impaired” class consisting of all prepetition term loan creditors.² (*Id.* at 101).

Article IX.C of the Plan included a third-party release.³ (*Id.* at 133–34). The Plan defined “Releasing Parties” to include creditors who do not “opt out of” the releases in the Plan or do not timely object to the third-party releases. (*Id.* at 91). The Plan defined “Released Party” to include, among other things, both Debtors and nondebtor releasing parties. (*Id.*). The definitions of “Releasing Parties” and “Released Party”

both included “Related Parties,” such as the Store's current and former members, directors, managers, and officers. (*Id.* at 90–91). The third-party release provided that “each Releasing Party” has “released, and absolved each Released Party from any and all Claims and Causes of Action, whether known or unknown,” that are “based on or relating to, or in any manner arising from, in whole or in part,” 10 categories of claims.⁴ (*Id.* at 133–34). The third-party release excluded claims of fraud, gross negligence, or willful misconduct that arise out of, or are related to, any act or omission of a Released Party. (*Id.* at 134). It also excluded claims against a Released Party “arising from any obligations owed to the Releasing Party that are wholly unrelated to the Debtors or the Reorganized Debtors.” (*Id.*).

To implement the third-party release, the Debtors proposed that the Bankruptcy ***367** Court enter a permanent injunction enjoining parties from asserting released claims. The injunction was contained in Article IX.E of the Plan. (*Id.* at 135). In addition to the permanent injunction, Article IX.E also provided that “No Person or Entity” may sue “the Debtors, the Reorganized Debtors, the Exculpated Parties, or the Released Parties” for a claim or cause of action “that relates to or is reasonably likely to relate to any act or omission with, related to, or arising out of” a released claim, without the Bankruptcy Court first determining that the claim was “colorable” and “specifically authorizing” the claim to be brought. (*Id.* at 135–36). The parties refer to this as the “gatekeeping provision.”⁵ (Docket Entry No. 2 at 20; Docket Entry No. 13 at 24).

After a hearing, the Bankruptcy Court entered an order approving notice and solicitation procedures. (Bankr. Docket Entry No. 81). The Debtors sent the creditors a “Combined Notice,” which included the date of the confirmation hearing, objection procedures, and instructions to access the disclosure statement detailing the Plan. (*Id.* at 11–17). The release, injunction, and exculpation provisions were included as “Appendix A” to the Combined Notice. (*Id.* at 18–23). The Debtors also sent Class 3 voters a solicitation package that included the disclosure statement, the proposed plan, and a ballot. The ballot explained that “Holders [who] do not opt out of the Third-Party Release will be deemed to have granted such releases.” (*Id.* at 27). The ballot provided a separate section on the third-party release with a checkbox to allow the voter to opt out of the release and explained that “in the event you opt out of the Third-Party Release, you will not be granted a release from the Releasing Parties under the Plan.” (*Id.* at 29–34).

The Debtors also distributed notice and opt-out materials to creditors who were not entitled to vote. (*Id.* at 41–63). As in the Combined Notice and materials distributed to Class 3 voters, the release, injunction, and exculpation provisions in the Plan were included as an appendix. (*Id.* at 45–50). The opt-out form contained in the non-voting materials stated in bold font that if the non-voter failed to opt out by following the instructions in the notice, they would “automatically” be deemed to consent to the third-party release. (*Id.* at 52). Even though holders of claims and interests in Classes 5 and 8 received no distribution and could not vote, they received an opt-out form “solely for the purposes of affirmatively opting out of the Third-Party Release.” (Bankr. Docket Entry No. 181 at 104).

The Trustee objected on the ground that the opt-out procedure for the third-party releases made the releases nonconsensual and therefore barred by the Supreme Court's decision in *Harrington v. Purdue Pharma L.P.*, 603 U.S. 204, 144 S.Ct. 2071, 219 L.Ed.2d 721 (2024). (Bankr. Docket Entry No. 150). The U.S. Securities and Exchange Commission (SEC) objected on the same basis, but only as to Classes 5 and 8. (Docket Entry No. 152). Both the Trustee and the SEC argued that state contract law applied to determine what constitutes “consent” to opt-out. (Bankr. Docket Entry No. 150 at 7; Bankr. Docket Entry No. 152 at 6). The Trustee also argued that the injunction and gatekeeping provisions were not authorized by the Bankruptcy Code and violated Fifth Circuit precedent. (*Id.* at 31–33).

On January 24, 2025, the Bankruptcy Court held a confirmation hearing and confirmed the Plan. (Bankr. Docket Entry *368 Nos. 181, 201). The Bankruptcy Court overruled the objections to the third-party releases, concluding that they were a “necessary and integral” part of the Plan and were “fair, equitable and reasonable.” (Bankr. Docket Entry No. 181 at 14). The Bankruptcy Court concluded that the releases were “designed to provide finality for the Released Parties with respect to such parties’ respective obligations under the Plan,” were “consistent with established practice in this jurisdiction and others,” and that the Debtors’ key stakeholders were “unwilling to support the Plan without the Third-Party Release.” (*Id.* at 14–15). The Bankruptcy Court also concluded that the creditors were given adequate notice of the opt-out process and pointed out that the releases were “provided in exchange for significant consideration.” (*Id.*). The Bankruptcy Court stated that the third-party release and injunction provisions were “important to the overall

objectives of the Plan” by finally resolving certain claims and were “consistent with Sections 105, 1123, and 1129” of the Code. (*Id.* at 16).

The Bankruptcy Court also overruled the objections based on *Purdue*, noting that it was “not writing on a blank slate.” (Bankr. Docket Entry No. 201 at 41). The Bankruptcy Court explained that for a long time, the Fifth Circuit had not allowed nonconsensual third-party releases—the issue at the heart of *Purdue*—but *had* allowed third-party releases that were deemed consensual “by the use of an opt-out mechanism that allows for notice to the parties, actual notice to the parties, and then allows them the opportunity to opt out.” (*Id.*). The Bankruptcy Court added that “the Supreme Court was clear in *Purdue* ... when they said nothing that we have said should be construed to call into question consensual third-party releases offered in connection with bankruptcy [re]organizations.” (*Id.* at 42). The Bankruptcy Court concluded that “the evidence [was] uncontroverted” that “service was effective” and that “giving the opportunity ... to opt out is consistent with having consensual third-party releases.” (*Id.*).

On January 28, 2025, the Plan became effective and was quickly substantially consummated. (Bankr. Docket Entry No. 200; Bankr. Docket Entry No. 280 at 3). On February 3, 2025, the Trustee appealed and filed an emergency motion to stay the confirmation order pending appeal. (Bankr. Docket Entry Nos. 209, 210). The Bankruptcy Court denied emergency treatment of the motion and later denied the stay, finding that, among other things, the Trustee had failed to show a likelihood of success on the merits. (Bankr. Docket Entry Nos. 213, 280).

II. The Legal Standard

A federal district court has jurisdiction to hear appeals from a bankruptcy court's final orders. 28 U.S.C. § 158(a). “A confirmation order is an appealable final order” within this court's jurisdiction. *In re Highland Cap. Mgmt., L.P. (Highland I)*, 48 F.4th 419, 429 (5th Cir. 2022). “The district court reviews the bankruptcy court's findings of fact for clear error and conclusions of law *de novo*.” *In re CJ Holding Co.*, 597 B.R. 597, 604 (S.D. Tex. 2019).

III. The Motion to Dismiss

A. The United States Trustee's Standing

The Debtors first argue that this appeal must be dismissed because the Trustee lacks standing. (Docket Entry No. 12

at 14). Under 11 U.S.C. § 307, the Trustee “may raise and may appear and be heard on any issue in any case or proceeding under [Chapter 11]” except for filing a plan under § 1121(c). The Trustee *369 undoubtedly has statutory authority to appear in bankruptcy court proceedings. The text of § 307—“in any case or proceeding”—indicates that Congress also intended to confer appellate standing on the Trustee. Unlike in a bankruptcy court, however, the Trustee must also have constitutional standing to appear in this court. See *Spokeo, Inc. v. Robins*, 578 U.S. 330, 339, 136 S.Ct. 1540, 194 L.Ed.2d 635 (2016) (“Congress cannot erase Article III’s standing requirements by statutorily granting the right to sue to a plaintiff who would not otherwise have standing.” (quoting *Raines v. Byrd*, 521 U.S. 811, 820 n.3, 117 S.Ct. 2312, 138 L.Ed.2d 849 (1997))).

Congress established the position of Trustee to “protect[] the public interest and ensur[e] that bankruptcy cases are conducted according to law.” *In re Revco D.S., Inc.*, 898 F.2d 498, 500 (6th Cir. 1990) (quoting H.R. Rep. No. 595, 95th Cong. 109, 2d Sess. 404, reprinted in 1978 U.S. Code Cong. & Admin. News 6070); see also Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549. The Supreme Court has recognized that, at least in some circumstances, the government has Article III standing based on purely public interests. See, e.g., *SEC v. U.S. Realty & Improvement Co.*, 310 U.S. 434, 459–60, 60 S.Ct. 1044, 84 L.Ed. 1293 (1940); see also *In re Debs*, 158 U.S. 564, 584, 15 S.Ct. 900, 39 L.Ed. 1092 (1895) (the government’s obligation to “promote the interest of all and to prevent the wrongdoing of one, resulting in injury to the general welfare, is often of itself sufficient to give it a standing in court”). In *U.S. Realty*, the Supreme Court permitted the SEC to intervene and appeal in a bankruptcy proceeding. 310 U.S. at 458–60, 60 S.Ct. 1044. The Court rejected the argument that the SEC must have “a direct personal or pecuniary interest in the subject of the litigation” to intervene. *Id.* at 459, 60 S.Ct. 1044. Rather, it was “plain that the [SEC] ha[d] a sufficient interest in the maintenance of its statutory authority and the performance of its public duties to entitle it through intervention to prevent reorganizations, which should rightly be subjected to its scrutiny from proceeding without it.” *Id.* at 460, 60 S.Ct. 1044.

The Debtors argue that the government’s “public interest” does not confer Article III standing on the Trustee. (Docket Entry No. 24 at 4–5). Their position contradicts case law from the First, Second, Third, Fourth, Sixth, and Ninth Circuits holding that the Trustee has standing to appeal a bankruptcy

order even without a pecuniary interest. See *In re Zarnel*, 619 F.3d 156, 162 (2d Cir. 2010) (“[T]he U.S. Trustee’s responsibility to represent and protect the public interest affords it a substantial interest in, and therefore standing to proceed with, this appeal.”); *United Artists Theatre Co. v. Walton*, 315 F.3d 217, 225 (3d Cir. 2003) (the Trustee has standing under § 307 and as an “officer[] of the Department of Justice who protect[s] the public interest by aiding bankruptcy judges in monitoring certain aspects of bankruptcy proceedings”); *In re Donovan Corp.*, 215 F.3d 929, 930 (9th Cir. 2000); *In re Clark*, 927 F.2d 793, 795–96 (4th Cir. 1991); *In re Plaza de Diego Shopping Ctr., Inc.*, 911 F.2d 820, 824 (1st Cir. 1990); *In re Revco, D.S., Inc.*, 898 F.2d at 499–500 (the Trustee had standing based on his interest in “protecting the public interest and ensuring that bankruptcy cases are conducted according to law” (quoting reference omitted)).

In *In re Community Home Financial Services, Inc.*, the Fifth Circuit favorably relied on much of this precedent, including *In re Clark*, *In re Plaza de Diego Shopping Ctr., Inc.*, and *In re Revco*. See 990 F.3d 422, 426–27 (5th Cir. 2021). The Debtors argue that *370 *In re Community Home Finance Services* is inapposite because it discussed “appellate standing of bankruptcy trustees representing the bankruptcy estate, not U.S. Trustees.” (Docket Entry No. 24 at 7 n.2). Although the case did not involve the Trustee, the Fifth Circuit cited cases involving the Trustee and other bankruptcy trustees interchangeably. Particularly relevant is the statement, quoting *In re Clark*, that “[t]rustee standing does not arise from the trustee’s pecuniary interest, but rather from the trustee’s ‘official duty to enforce the bankruptcy law in the public interest.’ ” *In re Cmty. Home Fin. Servs., Inc.*, 990 F.3d at 427 (quoting *In re Clark*, 927 F.2d at 796). *In re Community Home Finance Services* strongly supports the conclusion that the Trustee has Article III standing to appeal.

The Debtors argue that the recent Fifth Circuit decision in *In re Highland Capital Management, L.P.*, 74 F.4th 361 (5th Cir. 2023), supports their position that the Trustee lacks standing. (Docket Entry No. 12 at 20). But that case did not involve the Trustee and instead considered a private party’s standing under § 1109(b), which states that “[a] party in interest ... may raise and may appear and be heard on any issue in a case under [Chapter 11].” 74 F.4th at 370 (quoting 11 U.S.C. § 1109(b)). The Fifth Circuit held that § 1109(b) did not confer appellate standing on parties who were not “person[s] aggrieved” by the outcome of the bankruptcy proceeding. *Id.* at 370–71. Because § 1109(b) uses the same language as §

307, the Debtors argue that the same reasoning requires this court to conclude the Trustee lacks appellate standing.

There are several issues with that argument. First, three relevant statutory provisions use the phrase “may raise and may appear and be heard on any issue” in a Chapter 11 case. See 11 U.S.C. §§ 307, 1109(a), 1109(b). Only one of those provisions prohibits the relevant party—in that case, the SEC—from “appeal[ing] from any judgment, order, or decree entered in the case.” *Id.* § 1109(a). It cannot be accurate that the phrase “may raise and may appear and be heard on any issue” never confers appellate standing; otherwise, the portion of § 1109(a) that prohibits the SEC from appealing would be surplusage.⁶ Second, it is unclear how “persons aggrieved” is different from persons “directly and adversely affected pecuniarily” by a bankruptcy order. See *In re Combustion Eng'g, Inc.*, 391 F.3d 190, 214 (3d Cir. 2004) (explaining the history of the “persons aggrieved” test). As detailed above, multiple circuits, including the Fifth Circuit, have rejected the pecuniary-interest test as the foundation for Trustee standing. See, e.g., *In re Cmty. Home Fin. Servs., Inc.*, 990 F.3d at 427 (recognizing “the inadequacy of a pecuniary-interest test for trustee standing”). Rather, the Trustee’s “official duty to enforce the bankruptcy law in the public interest” confers appellate standing. See *id.* (quoting *In re Clark*, 927 F.2d at 796).

The Plan includes third-party releases obtained through an opt-out procedure, a permanent injunction enforcing the releases, and a “gatekeeping provision” that requires the Bankruptcy Court to screen certain future claims. The Trustee argues that those provisions are unlawful. Cf. *Purdue*, 603 U.S. at 227, 144 S.Ct. 2071 (“[T]he *371 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.”).⁷ Unlike the patent infringement analogy offered by the Debtors, (Docket Entry No. 24 at 4–5), the Trustee represents a significant and concrete public interest in this case by advocating for those who have not formally appeared in the proceedings. That interest gives the Trustee standing, regardless of the merits of the appeal.

B. Equitable Mootness

The Debtors also ask the court to dismiss this appeal as equitably moot. (Docket Entry No. 12 at 21). “Unlike an Article III inquiry which examines whether a live controversy exists, an equitable mootness analysis recognizes that a

point exists beyond which a court cannot order fundamental changes in reorganization actions.” *In re Idearc, Inc.*, 662 F.3d 315, 318 (5th Cir. 2011). The Fifth Circuit is “more hesitant to invoke equitable mootness than many circuits, treating it as a ‘scalpel rather than an axe.’ ” *In re Sneed Shipbuilding, Inc.*, 916 F.3d 405, 409 (5th Cir. 2019) (quoting *In re Pac. Lumber Co.*, 584 F.3d 229, 240 (5th Cir. 2009)). “This court examines three factors when assessing equitable mootness: (i) whether a stay has been obtained, (ii) whether the plan has been ‘substantially consummated,’ and (iii) whether the relief requested would affect either the rights of parties not before the court or the success of the plan.” *In re Idearc, Inc.*, 662 F.3d at 318–19 (quoting *In re Scopac*, 624 F.3d 274, 281 (5th Cir. 2010)). The Fifth Circuit applies equitable mootness “claim-by-claim, instead of appeal-by-appeal.” *Highland I*, 48 F.4th at 429.

“Unlike Article III mootness, equitable mootness is prudential, not jurisdictional.” *In re Blast Energy Servs., Inc.*, 593 F.3d 418, 424 (5th Cir. 2010). The Fifth Circuit is reluctant to apply equitable mootness and will often hold issues justiciable “notwithstanding the tug of equitable mootness.” *In re Pac. Lumber Co.*, 584 F.3d at 243. The Fifth Circuit places heavy emphasis on a court’s ability to excise aspects of a plan. “Only when the relief that a party requests will likely unravel the plan does it become impracticable and inappropriate for a court to grant such relief; in such a case, the court abstains from reviewing the appeal.” *In re Blast Energy Servs.*, 593 F.3d at 424. “‘To that end, a court may ‘fashion whatever relief is practicable’ instead of declining to review simply because full relief is not available.’ ” *Id.* (quoting *In re Pac. Lumber Co.*, 584 F.3d at 241). “In exercising its discretionary power to dismiss an appeal on mootness grounds, a court cannot avoid its obligation to scrutinize each individual claim, testing the feasibility of granting relief against its potential impact on the reorganization scheme as a whole.” *In re Pac. Lumber Co.*, 584 F.3d at 241 (quoting *In re AOV Indus. Inc.*, 792 F.2d 1140, 1148 (D.C. Cir. 1986)).

The Debtors argue that all three equitable mootness factors are met, although *372 they do not distinguish among the parts of the Plan on appeal and seemingly consider the third-party release, injunction, and gatekeeping provision together. (See generally Docket Entry No. 12). The Debtors first assert that the Trustee did not obtain a stay and did not even try to obtain a stay until after all the transactions in the Plan had been consummated. (*Id.* at 22–23). Next, they emphasize that the Plan has been “substantially consummated.” (*Id.* at 23). Finally, they argue that granting the Trustee’s requested relief

would affect parties not before the court and undermine the success of the Plan because it would open numerous parties to the unexpected risk of liability, impose new financial liability on the Container Store, and disturb Plan finality. (*Id.* at 25–26). The Debtors also point out that the Bankruptcy Court found that the third-party releases were “a necessary and integral aspect of the Plan.” (*Id.* at 26 (quoting Bankr. Docket Entry No. 181 at 14)). In response, the Trustee notes that when the Bankruptcy Court denied the stay, it agreed that equitable mootness should not apply because that doctrine is “narrowly interpreted.” (Docket Entry No. 19 at 21 (quoting Bankr. Docket Entry No. 280 at 17)). The Trustee further argues that the court can excise the challenged provisions without undermining the success of the Plan. (*Id.* at 21).

The court declines to apply equitable mootness to any of the three provisions at issue. Notably, in *Highland I*, the Fifth Circuit reviewed whether equitable mootness applied to challenges to the permissibility of the exculpation, injunction, and gatekeeper provisions (the “protection provisions”) in a reorganization plan. The Fifth Circuit first commented that while there was no stay and the plan had been substantially consummated, those considerations alone did not “trigger equitable mootness.” 48 F.4th at 430. The Fifth Circuit then found that equitable mootness did not apply because “equity strongly supports appellate review of issues consequential to the integrity and transparency of the Chapter 11 process.” *Id.* at 431 (quoting *In re Hilal*, 534 F.3d 498, 500 (5th Cir. 2008)). The court asserted that “the goal of finality sought in equitable mootness does not outweigh a court’s duty to protect the integrity of the process.” *Id.* (quoting *In re Pac. Lumber Co.*, 584 F.3d at 252). It concluded that “[a]s in *Pacific Lumber*, the legality of a reorganization plan’s non-consensual non-debtor release is consequential to the Chapter 11 process and so should not escape appellate review in the name of equity.” *Id.* at 431–32. Equitable mootness “d[id] not bar” the court’s review of the protection provisions. *Id.* at 432.

In this case, similarly, there was no stay, the Plan has been substantially consummated, and the Bankruptcy Court found that the third-party release (enforced by the injunction and gatekeeping provision) was “necessary” to provide “finality.” (Bankr. Docket Entry No. 181 at 14). The Bankruptcy Court noted that the Debtors’ key stakeholders were unwilling to support the Plan without the release. (*Id.* at 15). Although the Debtors lean heavily on the Bankruptcy Court’s findings as to finality in their discussion of the third factor, (Docket Entry No. 12 at 25–26), *Highland I* and *In re Pacific Lumber Co.* are explicit that the goal of finality is

insufficient to outweigh issues related to procedural integrity, and that the permissibility of releases is precisely the kind of issue that “should not escape appellate review in the name of equity.” *Highland I*, 48 F.4th at 431–32; see also *In re Pac. Lumber Co.*, 584 F.3d at 251–52.

The Debtors also suggest that there might be some financial liability on the Container Store if the releases were struck *373 because the Store has indemnified some of the third parties subject to the release. (Docket Entry No. 12 at 26). Those vague assertions are insufficient to justify the application of equitable mootness here. The Fifth Circuit routinely allows appeals to proceed to the merits when the ramifications of reversal are significantly clearer, and greater, than those the Debtors present. See *In re Tex. Grand Prairie Hotel Realty, L.L.C.*, 710 F.3d 324, 328 (5th Cir. 2013) (noting that the Fifth Circuit has “permitted appeals to go forward even where granting full relief ‘could have imposed a very significant liability on the estate, to the great detriment of both the success of the reorganization and third parties’ ” (quoting *In re Scopac*, 624 F.3d at 282)).

In summary, there is little justification for applying equitable mootness to this appeal, which: (1) challenges only certain excisable provisions, rather than the entire Plan; and (2) raises important questions of due process and fairness in the bankruptcy context. Cf. *In re Ultra Petrol. Corp.*, No. 21-20049, 2022 WL 989389, at *5 (5th Cir. 2022) (affirming the district court’s application of equitable mootness where the plaintiff was requesting “reversal of the entire confirmation order” and not just the opt-out process and releases). That the Plan might not have moved forward without these provisions does not insulate them from review.

IV. The Merits

A. The Third-Party Releases

The Trustee’s appeal primarily challenges the Plan’s third-party release provision.⁸ Consent to the third-party release was secured on an opt-out basis. The issue is whether the notification and opportunity to opt out of the third-party releases made the releases consensual, and therefore binding, on the Releasing Parties.

The Debtors argue that this court has long held that consent to a release may be obtained by providing affected parties with clear notice of the release and an opportunity to opt out. (Docket Entry No. 13). The Bankruptcy Court found that the affected parties received adequate notice and opportunity to

opt out. (Bankr. Docket Entry No. 201 at 41–43). The Trustee challenges the sufficiency of the notice procedures in passing but primarily takes the broad position that opting out can *never* provide consent under state law, making the releases ineffective under *Purdue*. In short, as it has done in several other cases both in this district and around the country, “[t]he Trustee wants to use the *Purdue* holding as an opportunity to advance its long-held position that consensual third-party releases in a plan should require an opt-in feature, rather than an opt-out.” *In re Robertshaw US Holding Corp.*, 662 B.R. 300, 322 (Bankr. S.D. Tex. 2024).

Purdue confirmed what the Fifth Circuit had long held: that a bankruptcy court may not confirm a plan that provided nonconsensual nondebtor releases. 603 U.S. at 227, 144 S.Ct. 2071 (holding “only that the bankruptcy code does not authorize a release and injunction that, as part of a plan reorganization, effectively seeks to discharge claims against a nondebtor without the consent of affected claimants”). That was already the law in the Fifth *374 Circuit. See *In re Pac. Lumber Co.*, 584 F.3d at 251–53. And the Court made clear that “[a]s important” as the questions it decided that day were the “ones [it] d[id] not.” *Purdue*, 603 U.S. at 226, 144 S.Ct. 2071. The Court emphasized that “[n]othing in what [it] ha[s] said should be construed to call into question *consensual* third-party releases offered in connection with a bankruptcy reorganization plan.” *Id.* The Court also clarified that it did not “have occasion ... to express a view on what qualifies as a consensual release.” *Id.* Although *Purdue*’s analysis of the Bankruptcy Code created questions explored further below, it did not call into question this court’s long-established view that procedurally proper opt-out provisions can create consent to third-party releases.

The alleged twist in this case—and the argument that the Trustee has made in other courts since *Purdue*—is the assertion that opt-outs are nonconsensual under *state* law and are therefore barred by *Purdue*. The Trustee presents this as an *Erie* question, arguing that “the question of whether there is consent to a third-party release is governed by the same substantive contract law that would apply if there had been no bankruptcy.” (Docket Entry No. 18 at 10). The Trustee is correct that, under *Erie*, “[e]xcept in matters governed by the Federal Constitution or by acts of Congress, the law to be applied in any case is the law of the state.” *Erie R. Co. v. Tompkins*, 304 U.S. 64, 78, 58 S.Ct. 817, 82 L.Ed. 1188 (1938). But in this case, which arises under federal bankruptcy law, there may be federal statutes or “federal interest[s]” that “require[]” an application of federal law

where state law might otherwise govern. *Butner v. United States*, 440 U.S. 48, 55, 99 S.Ct. 914, 59 L.Ed.2d 136 (1979). In such situations, “it is for the federal courts to fashion the governing rule of law according to their own standards.” *Clearfield Tr. Co. v. United States*, 318 U.S. 363, 367, 63 S.Ct. 573, 87 L.Ed. 838 (1943); see, e.g., *Textile Workers Union of Am. v. Lincoln Mills of Ala.*, 353 U.S. 448, 457, 77 S.Ct. 912, 1 L.Ed.2d 972 (1957); see also Henry J. Friendly, *In Praise of Erie—And of the New Federal Common Law*, 39 N.Y.U. L. Rev. 383, 422 (1964) (“The complementary concepts—that federal courts must follow state decisions on matters of substantive law appropriately cognizable by the states whereas state courts must follow federal decisions on subjects within national legislative power where Congress has so directed—seem so beautifully simple, and so simply beautiful”).

The Trustee raises two questions that the court must address at the outset: (1) does state or federal law determine whether the claimants consented to the third-party releases; and (2) what does consent require under the applicable law?

1. Federal Law Applies

The Trustee argues that “state law” applies (although it does not clearly identify in its opening brief which state’s law applies)⁹ because third-party releases are “separate agreements between non-debtors” and “[t]here is no Bankruptcy Code provision that preempts this otherwise applicable state contract law.” (Docket Entry No. 2 at 31). The Debtors argue that “federal law” governs the issue, pointing in general terms to the Bankruptcy Code, this court’s precedent, and analogous class action procedures. (Docket Entry No. 13). In a hearing, the Debtors clarified their position that the consensual *375 releases were specifically authorized by 11 U.S.C. § 1123(b)(6), authorization that *Purdue* did not change. (Docket Entry No. 30 at 21). The Debtors also analogize an agreed reorganization plan to a consent decree. (Docket Entry No. 13 at 62–63).

The court concludes that there are two separate and independent bases of federal authority that require the application of federal law, rather than state contract law, to the question of whether claimants have “consented” to third-party releases contained in a bankruptcy reorganization plan. The first is the Bankruptcy Code via § 1123(b)(6) and § 105(a), which grant statutory authority to bankruptcy courts over the provisions they may include in a reorganization

plan. The second, and broader, basis for applying federal law is the inherent authority of federal courts to enter consent decrees in cases arising in equity within their subject-matter jurisdiction. Under either basis, federal law is the answer to the threshold question of what law provides the bankruptcy court with authority to enter consensual third-party releases. Unique federal interests compel the application of a federal, not state, rule of decision.

i. The Bankruptcy Code

Chapter 11 of the Bankruptcy Code “grants the bankruptcy courts residual authority to approve reorganization plans including ‘any ... appropriate provision not inconsistent with the applicable provisions of this title.’ ” *United States v. Energy Res. Co.*, 495 U.S. 545, 549, 110 S.Ct. 2139, 109 L.Ed.2d 580 (1990) (quoting 11 U.S.C. § 1123(b)(6)). The Code also provides that bankruptcy courts “may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions” of Chapter 11. 11 U.S.C. § 105(a). The Supreme Court has twice addressed claims that a reorganization plan exceeded the limits of a bankruptcy court’s statutory authority under § 1123(b)(6): *Energy Resources* and *Purdue*.

In *Energy Resources*, the bankruptcy court included in the reorganization plan a provision that ordered the Internal Revenue Service to apply the debtor’s tax payments to trust-fund tax liability before other kinds of tax liability. *Energy Res. Co.*, 495 U.S. at 547, 110 S.Ct. 2139. If the debtor failed to pay the trust fund taxes, the government could “collect an equivalent sum directly from the officers or employees of the employer who are responsible for collecting the tax.” *Id.* The IRS, the debtor, and the nondebtor officers all understood that the nondebtor officers would face “personal liability” if the employer was undercapitalized. *In re Energy Res. Co.*, 59 B.R. 702, 704 (Bankr. D. Mass. 1986). The nondebtor officers contributed funds to the bankruptcy plan to “forestall” that outcome. *Id.* The upshot was that the bankruptcy court extinguished in part claims the IRS had against the nondebtors who insured the debtor’s tax liabilities.

The IRS objected on the basis that the Code did not allow the bankruptcy court to limit its statutory “assurance that its taxes will be paid even if the reorganization fails” by directing the accounts it must credit. *Energy Res. Co.*, 495 U.S. at 550, 110 S.Ct. 2139. The Supreme Court rejected the IRS’s argument. The Court explained that the order was

“necessary for a reorganization’s success,” which meant the IRS could “in all likelihood ... collect the tax debt owed,” and was “otherwise wholly consistent with a bankruptcy court’s authority under the Bankruptcy Code.” *Id.* at 549–51, 110 S.Ct. 2139. Nothing “require[d]” the Court “to hold that the orders” were “improvident.” *Id.* at 551, 110 S.Ct. 2139. As a result, even though Code did not explicitly authorize bankruptcy courts to approve reorganization plans *376 containing that kind of tax-allocation provision, the order was nonetheless “appropriate” under §§ 1123(b)(6) and 105(a). *Id.* at 549, 110 S.Ct. 2139.

In *Purdue*, the bankruptcy court confirmed a reorganization plan that included “an order extinguishing vast numbers of existing and potential claims” against the Sacklers, nondebtor officers of the debtor corporation, “without securing the consent of those affected.” 603 U.S. at 209, 144 S.Ct. 2071. The Supreme Court held that the nonconsensual third-party releases were inappropriate. The Court explained that § 1123(b)(6) is a “catchall” confined by the other provisions of § 1123(b), “all of which concern *the debtor*—its rights and responsibilities, and its relationship with its creditors.” *Id.* at 217–18, 144 S.Ct. 2071. The Court noted that a nonconsensual release would be “inconsistent” with many “related provisions” in the Code. *Id.* at 221, 144 S.Ct. 2071. Yet the Court did not “call into question *consensual* third-party releases offered in connection with a bankruptcy reorganization plan,” “express a view on what qualifies as a consensual release,” or “pass upon a plan that provides for the full satisfaction of claims against a third-party nondebtor.” *Id.* at 226, 144 S.Ct. 2071. Nor did the Court explicitly limit § 1123(b)(6) to only the creditor-debtor relationship. At the same time the Court emphasized that § 1123(b)’s focus on the creditor-debtor relationship limited § 1123(b)(6)’s scope, it noted that “[d]oubtless, paragraph (6) operates to confer *additional* authorities on a bankruptcy court.” *Id.* at 218, 144 S.Ct. 2071 (emphasis added) (citing *Energy Res. Co.*, 495 U.S. at 549, 110 S.Ct. 2139).

The cases establish two principles. First, under *Energy Resources*, “[a] bankruptcy court may confirm a plan that modifies a relationship between a creditor and a nondebtor third-party.” *In re CJ Holding*, 597 B.R. at 607 (citing *Energy Res. Co.*, 495 U.S. at 549, 110 S.Ct. 2139). Second, under *Purdue*, a bankruptcy court may not confirm a plan that nonconsensually discharges a nondebtor. *Purdue*, 603 U.S. at 227, 144 S.Ct. 2071. The question is the scope of a bankruptcy court’s authority between *Energy Resources* and *Purdue* to include other kinds of nondebtor releases under § 1123(b)

(6). Under a maximalist reading of *Purdue*, § 1123(b)(6) is limited to the creditor-debtor relationship; under a fairer reading of *Purdue* and *Energy Resources*, *Purdue* merely prevents a bankruptcy court from relying on § 1123(b)(6) to enter nonconsensual third-party releases and says nothing about a bankruptcy court's authority under this provision to approve other kinds of releases, such as consensual or full-satisfaction releases.

Energy Resources is unclear as to precisely why the bankruptcy court was allowed to limit the IRS's recovery from the nondebtor officers even though the IRS did not expressly consent. One reading is that the IRS impliedly consented because the bankruptcy court found that the provision was necessary to a successful reorganization, under which “the IRS, in all likelihood, will collect the tax debt owed.” *Id.* at 549, 110 S.Ct. 2139. Adopting this approach, *Energy Resources* stands for the principle that § 1123(b)(6) provisions in a bankruptcy plan based on implied consent are appropriate when, for example, they “provide[] for the full satisfaction of claims against a third-party nondebtor.” *Purdue*, 603 U.S. at 226, 144 S.Ct. 2071; cf. 11 U.S.C. § 1126(f).

Another reading of *Energy Resources* is that even if the bankruptcy court's order functionally limited the IRS's opportunity to recover against a nondebtor, the order formally altered only the “creditor-debtor relationship[],” *Energy Res. Co.*, 495 U.S. at 549, 110 S.Ct. 2139, affecting only how *377 the IRS accounted for the debtor's tax liabilities. This reading is seemingly inconsistent with Fifth Circuit case law preventing a bankruptcy court from adopting a provision that “effectively discharges a nondebtor.” *In re Zale Corp.*, 62 F.3d 746, 760 (5th Cir. 1995); see also *In re Vitek, Inc.*, 51 F.3d 530, 536 n.27 (5th Cir. 1995) (“[N]on-debtor property ... should not ordinarily be shielded by the powers of the bankruptcy court.”). The Code recognizes contingent, unmaturing, or future property rights, see 11 U.S.C. § 101(5)(A); the IRS held such a right against the nondebtor officers, see *Energy Res. Co.*, 495 U.S. at 547, 110 S.Ct. 2139; and the bankruptcy court's order effectively discharged it, see *Purdue*, 603 U.S. at 265–66, 144 S.Ct. 2071 (Kavanaugh, J., dissenting).

The better reading of *Energy Resources*—in line with the fairer reading of *Purdue*—is that nondebtor releases are appropriate under § 1123(b)(6) when, for example, the plan will “in all likelihood,” 495 U.S. at 549, 110 S.Ct. 2139, “provide[] for the full satisfaction of claims against [the] third-party nondebtor,” *Purdue*, 603 U.S. at 226, 144 S.Ct. 2071. Fifth Circuit precedent, which has long held that the

Code does not permit nonconsensual nondebtor releases, follows this reading of *Energy Resources*. For example, the Fifth Circuit recognizes that “permanent injunctions of third-party claims against non-debtors have been allowed ... when the injunction ‘channel[s] those claims to allow recovery from separate assets and thereby avoid[s] discharging the nondebtor.’ ” *In re Highland Cap. Mgmt. (Highland II)*, 132 F.4th 353, 359 n.5 (5th Cir. 2025) (quoting *In re Zale Corp.*, 62 F.3d at 760); see also *In re Pac. Lumber Co.*, 584 F.3d at 252 (explaining that “non-debtor releases are most appropriate as a method to channel mass claims toward a specific pool of assets”). So long as a plan does not nonconsensually discharge—that is, immunize from liability—a nondebtor, it is consistent with *Purdue*. Cf. *In re Pac. Lumber Co.*, 584 F.3d at 252 (contrasting these remedies with “non-consensual nondebtor releases and permanent injunctions”); *Highland II*, 132 F.4th at 359 & n.5 (same).¹⁰ *Energy Resources* and *Purdue* do not prohibit a bankruptcy court from relying on § 1123(b)(6) to create *consensual* or *full-satisfaction* releases.¹¹

The viability of consensual nondebtor releases under § 1123(b)(6) finds further support in § 1123(a)(4). This subsection requires the reorganization plan to “provide the same treatment for each claim or interest of a particular class, unless the holder of a particular claim or interest agrees to a less favorable treatment of such particular claim or interest.” 11 U.S.C. § 1123(a)(4). Parties who agree to a settlement under this provision are considered unimpaired. See *378 *In re Hanish, LLC*, 570 B.R. 4, 20 (Bankr. D.N.H. 2017) (“[A]n agreement to less favorable treatment under 11 U.S.C. § 1123(a)(4) does not create an impairment, it removes one.”). Through § 1123(a)(4), the Code “contemplates the possibility of a creditor consenting to specific treatment that is less than the creditor's full legal and equitable rights, with such agreed upon treatment not constituting impairment.” *In re Spirit Airlines, Inc.*, 668 B.R. 689, 702 (Bankr. S.D.N.Y. 2025). Just as a claimant who receives “full satisfaction of claims against a third-party nondebtor,” *Purdue*, 603 U.S. at 226, 144 S.Ct. 2071; e.g., *Energy Res. Co.*, 495 U.S. at 549, 110 S.Ct. 2139, is unimpaired and deemed to accept a plan, cf. 11 U.S.C. § 1126(f);¹² so too may a party who is impaired by a nondebtor release agree to accept a plan, cf. *id.* § 1123(a)(4).

In sum, a bankruptcy court's power to grant consensual third-party releases is based in its authority to include in reorganization plans “appropriate” provisions that are not “inconsistent” with the Code, 11 U.S.C. § 1123(b)(6), and to issue any “order ... that is necessary or appropriate to carry out” such provisions, *id.* § 105(a). There is no

Code inconsistency in modifying the relationship between claimants and nondebtors when claimants consent or their claims are fully satisfied. See *In re CJ Holding Co.*, 597 B.R. at 607–08; *Energy Res. Co.*, 495 U.S. at 549–551, 110 S.Ct. 2139; *In re Spirit Airlines*, 668 B.R. at 700–03; cf. *Purdue*, 603 U.S. at 226, 144 S.Ct. 2071.

Because a bankruptcy court's authority to enter consensual releases follows from the Code's text and structure, it raises questions of federal law: what is “appropriate”; what is “necessary”; and what it means to “agree.” The inquiry begins with ordinary meaning and statutory definitions. *Ransom v. FIA Card Servs., N.A.*, 562 U.S. 61, 69, 131 S.Ct. 716, 178 L.Ed.2d 603 (2011). “[I]n the absence of congressional definition[,] this is a matter to be determined by decisions of” the federal courts “after due consideration of the structure and purpose of the Bankruptcy Act as a whole, as well as the particular provisions of the Act brought in question.” *Katchen v. Landy*, 382 U.S. 323, 328, 86 S.Ct. 467, 15 L.Ed.2d 391 (1966); see also *In re Spirit Airlines*, 668 B.R. at 702. “[W]hat constitutes consent, including opt-out features and deemed consent for not opting out, has long been settled in this [d]istrict.” *In re Robertshaw US Holding Corp.*, 662 B.R. at 323; see also *In re Pipeline Health Sys., LLC*, No. 22-90291, 2025 WL 686080, at *4 (Bankr. S.D. Tex. Mar. 3, 2025) (concluding that “[o]pt-out procedures are a proper means to obtain consent to third-party releases in a chapter 11 plan”).

ii. Consent Decree

There is a separate basis for concluding that a bankruptcy court's authority to enter consensual third-party releases derives from federal law: a federal court's inherent power to enter consent decrees resolving claims within their jurisdiction. See *Trump v. CASA, Inc.*, 606 U.S. 831, 841, 145 S.Ct. 2540, 222 L.Ed.2d 930 (2025) (“The Judiciary Act of 1789 endowed federal courts with jurisdiction over ‘all suits ... in equity.’ (quoting § 11, 1 Stat. 78)”; see, e.g., *Pac. R.R. v. Ketchum*, 101 U.S. 289, 297, 25 L.Ed. 932 (1879)). The Debtors make *379 this analogy in their response brief. (Docket Entry No. 13 at 62–63). *Purdue* alluded to this power in rejecting the argument that the Sacklers sought anything like a “traditional release.” See 603 U.S. at 223, 144 S.Ct. 2071 (citing *Loc. No. 93, Int'l Ass'n of Firefighters, AFL-CIO C.L.C. v. City of Cleveland*, 478 U.S. 501, 529, 106 S.Ct. 3063, 92 L.Ed.2d 405 (1986)). And the Fifth Circuit has explained that a “bankruptcy plan ... represents a kind of

consent decree.” *In re Tex. Com. Energy*, 607 F.3d 153, 158 (5th Cir. 2010) (citing *In re Stratford of Tex., Inc.*, 635 F.2d 365, 368 (5th Cir. 1981)).

Consent decrees “rest on different legal grounds than the nonconsensual release” at issue in *Purdue*. 603 U.S. at 226, 144 S.Ct. 2071. A consent decree is a “ ‘hybrid creature[]’ that is ‘part contract and part judicial decree.’ ” *ODonnell v. Harris County*, Civ. Action No. H-16-1414, 2019 WL 4224040, at *13 (S.D. Tex. Sep. 5, 2019) (quoting *Smith v. Sch. Bd. of Concordia Par.*, 906 F.3d 327, 334 (5th Cir. 2018)). “[I]n addition to the law which forms the basis of the claim, the parties’ consent animates the legal force of a consent decree.” *Firefighters*, 478 U.S. at 525, 106 S.Ct. 3063. As a result, “[t]he entry of a consent decree is more than a matter of agreement among litigants. It is a ‘judicial act.’ ” *League of United Latin Am. Citizens, Council No. 4434 v. Clements*, 999 F.2d 831, 845 (5th Cir. 1993) (en banc) (quoting *United States v. Swift & Co.*, 286 U.S. 106, 115, 52 S.Ct. 460, 76 L.Ed. 999 (1932)).

Because of the unique combination of these two characteristics, “a consent decree can sweep more broadly than can other forms of court-ordered relief.” *Smith*, 906 F.3d at 335. “[A] federal court is not necessarily barred from entering a consent decree merely because the decree provides broader relief than the court could have awarded after trial.” *Firefighters*, 478 U.S. at 525, 106 S.Ct. 3063; see *In re Agent Orange Prod. Liab. Litig.*, 818 F.2d 179, 185 (2d Cir. 1987) (“[A] district court may provide broader relief in an action that is resolved before trial than the court could have awarded after trial.” (alterations and quotation omitted)); *ODonnell v. Harris County*, 808 F.Supp.3d 738, 756–57 (S.D. Tex. Oct. 30, 2025) (explaining that consent decrees may award “more than what a court would have ordered absent the settlement” (quoting *Rufo v. Inmates of Suffolk Cnty. Jail*, 502 U.S. 367, 389, 112 S.Ct. 748, 116 L.Ed.2d 867 (1992))). The relief must, however, “spring from, and serve to resolve, a dispute within the court's subject-matter jurisdiction; must come within the general scope of the case made by the pleadings; and must further the objectives of the law upon which the complaint was based.” *Smith*, 906 F.3d at 335 (quoting *Frew ex rel. Frew v. Hawkins*, 540 U.S. 431, 437, 124 S.Ct. 899, 157 L.Ed.2d 855 (2004)); see *Clements*, 999 F.2d at 846 (“A consent decree must arise from the pleaded case and further the objectives of the law upon which the complaint is based.”).

Under these principles, federal courts may enter judgments, including releases of claims between claimants and nondebtors, in conjunction with a reorganization plan that involves the claimants, debtors, and nondebtors. Consent decrees are within the subject-matter jurisdiction of the bankruptcy courts because they arise out of a petition filed under the Code and resolve claims that either “aris[e] under title 11, or aris[e] in or related to [a] case[] under title 11,” 28 U.S.C. § 1334; see *Celotex Corp. v. Edwards*, 514 U.S. 300, 307 n.5, 115 S.Ct. 1493, 131 L.Ed.2d 403 (1995) (explaining that Congress granted courts jurisdiction over “suits between third parties which have an effect on the bankruptcy estate”).¹³ The releases are within the general scope of the petition for relief under Chapter 11 because they are related to the case and “necessary to the success of a reorganization plan.” *Energy Res. Co.*, 495 U.S. at 549, 110 S.Ct. 2139; (*Contra* Docket Entry No. 18 at 23 (arguing that the released claims are not pending before the Bankruptcy Court)). And the releases further the Code’s purpose of ensuring the success of a viable business and equity among creditor parties. See, e.g., 11 U.S.C. §§ 1129(a)(7), (b)(1). Here, the Bankruptcy Court made specific findings that the nondebtor releases were a “necessary and integral” part of the Plan and were “fair, equitable and reasonable.” (Bankr. Docket Entry No. 181 at 14).

Although federal courts have the power to enter consent decrees enforcing relief broader than that allowed by federal law, the decree cannot extend beyond the terms of the consent that allowed the court to enter it. “[P]arties who choose to resolve litigation through settlement may not dispose of the claims of a third party” and “may not impose duties or obligations on a third party, without that party’s agreement.” *Firefighters*, 478 U.S. at 529, 106 S.Ct. 3063. “A court’s approval of a consent decree between some of the parties therefore cannot dispose of the valid claims of nonconsenting” parties. *Id.* This limit raises the question of whether a state or federal rule controls if a party “consented” to a reorganization plan confirmed by a bankruptcy court under its authority to enter consent decrees. See *Lincoln Mills*, 353 U.S. at 457, 77 S.Ct. 912 (“[S]tate law, if compatible with the purpose of [federal law], may be resorted to in order to find the rule that will best effectuate the federal policy.”).

The federal rule of decision applies in this case. Whether federal or state rules govern the settlement of claim turns on the nature of the claim: federal claims are settled under federal law, and state claims are settled under state law. *In re Deepwater Horizon*, 786 F.3d 344, 354 & n.14 (5th Cir.

2015); see *Borne v. A & P Boat Rentals No. 4, Inc.*, 780 F.2d 1254, 1256 (5th Cir. 1986) (collecting cases).¹⁴ *381 This rule is consistent with the one governing whether parties are bound by federal judgments. “The preclusive effect of a federal-court judgment is determined by federal common law.” *Taylor v. Sturgell*, 553 U.S. 880, 891, 128 S.Ct. 2161, 171 L.Ed.2d 155 (2008) (citing *Semtek Int’l Inc. v. Lockheed Martin Corp.*, 531 U.S. 497, 507–08, 121 S.Ct. 1021, 149 L.Ed.2d 32 (2001)). But the rule of decision adopted by federal common law depends on the nature of the judgment. When federal “substantive law is at issue,” there is a “need for a uniform federal rule,” *Semtek*, 531 U.S. at 508–09, 121 S.Ct. 1021, that is “determine[d] and declare[d]” by the Supreme Court, *Taylor*, 553 U.S. at 891, 128 S.Ct. 2161. When a federal court sits in diversity, federal courts “adopt[], as the federally prescribed rule of decision, the law that would be applied by state courts in the State in which the federal diversity court sits.” *Semtek*, 531 U.S. at 508, 121 S.Ct. 1021. But even then, because the rule of decision is ultimately a federal question, “federal reference to state law will not obtain ... in situations in which the state law is incompatible with federal interests.” *Id.* at 509, 121 S.Ct. 1021.

The consensual releases here are part of a reorganization plan issued by a bankruptcy court. See Anthony Casey & Joshua Macey, *Purdue Pharma and the New Bankruptcy Exceptionalism*, 2024 Sup. Ct. Rev. 365, 394–95 (concluding that because the question of consent “is all tied up in the Chapter 11 plan confirmation process, the authority for such releases would lie in a provision of bankruptcy law, as opposed to state contract law”); cf. *Wellness Int’l Network, Ltd. v. Sharif*, 575 U.S. 665, 683–85, 135 S.Ct. 1932, 191 L.Ed.2d 911 (2015) (relying on a federal standard for implied consent to a bankruptcy-court judgment). This resolution is distinguishable from private settlements made between parties during a bankruptcy case that are not made part of the final judgment. See, e.g., *In re Omni Video, Inc.*, 60 F.3d 230, 232 (5th Cir. 1995) (holding that state law governed a settlement between two parties in a bankruptcy adversary proceeding that was not incorporated into a final judgment); see also *Kokkonen v. Guardian Life Ins. Co. of Am.*, 511 U.S. 375, 380–82, 114 S.Ct. 1673, 128 L.Ed.2d 391 (1994) (distinguishing between private settlement contracts and agreed judgments entered by federal courts); *Lynch, Inc. v. SamataMason Inc.*, 279 F.3d 487, 489 (7th Cir. 2002) (“A settlement agreement, unless it is embodied in a consent decree ..., is enforced just like any other contract.”). Instead, the Fifth Circuit has applied federal law’s “general rules” of contract to a “bankruptcy plan” because it “represents a

kind of consent decree.” *In re Tex. Com. Energy*, 607 F.3d at 158. The federal common law directs the application of a federal, not state, rule of decision on the question of whether a claimant consented to a consent decree.

A state rule of decision defining consent for third-party releases in a *382 reorganization plan would also materially undermine federal interests. There is a “strong federal interest,” *In re Omni Video, Inc.*, 60 F.3d at 232, in applying a “uniform federal rule,” *Semtek*, 531 U.S. at 508, 121 S.Ct. 1021, to judgments that terminate cases arising under Congress’s “uniform Laws on the subject of Bankruptcies,” U.S. Const. art. 1, § 8, cl. 4. A federal rule defining consent to a bankruptcy judgment can be appropriately tied to the “structure and purpose of the Bankruptcy Act as a whole.” *Katchen*, 382 U.S. at 328, 86 S.Ct. 467. Applying federal law ensures the consistency of the administration of the bankruptcy laws throughout the United States. If state contract law applies, what would prevent a state from passing a bespoke law defining consent to a reorganization plan as including the most expansive opt-out imaginable, beholden to none of the principles established by precedent and practice?¹⁵ Federal courts have been no strangers in recent years to unique state laws related to reorganization. *See, e.g., In re LTL Mgmt., LLC*, 64 F.4th 84, 95–96, 110–11 (3d Cir. 2023) (dismissing, as filed in bad faith, a bankruptcy petition based on the Texas Two-Step, a corporate divisional merger authorized by Texas law).¹⁶ There is a “strong federal interest” in determining whether claimants have consented to a reorganization plan that is based on the Code and on its equitable authority to approve a consent decree. *In re Omni Video, Inc.*, 60 F.3d at 232.

2. Opt-Out Consent

A bankruptcy court’s authority to enter consensual third-party releases is a matter of federal law. And, as discussed, “what constitutes consent, including opt-out features and deemed consent for not opting out, has long been settled in this [d]istrict.” *In re Robertshaw US Holding Corp.*, 662 B.R. at 323. But as courts have recognized over the past several years, bankruptcy courts may not infer consent to a reorganization plan merely because notice and an opportunity to opt out has been provided. Although “[h]undreds of Chapter 11 cases have been confirmed in this [d]istrict” with third-party releases made consensual through opt-outs, *id.*, bankruptcy courts do not simply rubber-stamp such releases. Courts have refined the principles that guide a bankruptcy court’s factual

determination of whether claimants have consented to third-party releases.

The key precedent for finding that a claimant consented to be bound a judgment by failing to opt out is *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 105 S.Ct. 2965, 86 L.Ed.2d 628 (1985). In *Shutts*, the Court rejected the idea that a plaintiff needed to affirmatively “opt in” to be bound by a class-action judgment. The *383 “essential question” was “how stringent the requirement for a showing of consent will be” to infer an agreement to be bound by the court’s judgment. *Id.* at 812, 105 S.Ct. 2965. The Court concluded that the procedure followed in that case, in which a descriptive notice was sent via first-class mail to each class member with an explanation of the right to “opt out,” was sufficient to infer consent. *Id.* at 801, 811–14, 105 S.Ct. 2965. The Court found the inference of consent appropriate under the circumstances because an absent plaintiff could “sit back and allow the litigation to run its course, content in knowing that there are safeguards provided for his protection.” *Id.* at 810, 105 S.Ct. 2965. The economics of consent further supported the opt-out. Requiring a more demanding showing would be self-defeating: an absent “plaintiff’s claim may be so small, or the plaintiff so unfamiliar with the law, that he would not file suit individually, nor would he affirmatively request inclusion in the class.” *Id.* at 813, 105 S.Ct. 2965. At the same time, if the “plaintiff’s claim is sufficiently large or important that he wishes to litigate it on his own, he will likely have retained an attorney or have thought about filing suit, and should be fully capable of exercising his right to ‘opt out.’” *Id.*

Shutts’s logic applies “with full force” in bankruptcy proceedings. Jonathan L. Goldberg, Note, “*Otherwise Consistent*”: A Due Process Framework for Mass-Tort Bankruptcies, 98 N.Y.U. L. Rev. 1696, 1727, 1720–1737, 1737 n.278 (2023). The bankruptcy system provides a host of loyalty features that ensure adequate representation among the claimants. The largest unsecured creditors form a committee to represent major constituencies, and, subject to court approval, those creditors retain counsel to monitor the debtor. 11 U.S.C. §§ 1102, 1103; *see also* Troy A. McKenzie, *Toward a Bankruptcy Model for Nonclass Aggregate Litigation*, 87 N.Y.U. L. Rev. 960, 1020 (2012). The committee acts as a fiduciary to those claimants, with the obligation to put the creditors’ interests “ahead of their own for the benefit of all.” *In re Roman Cath. Diocese of Syracuse, N.Y.*, 667 B.R. 628, 634 (Bankr. N.D.N.Y. 2024). In addition, the Trustee acts as a powerful watchdog protecting the creditors’ interests. *See* McKenzie, *Toward Bankruptcy*,

87 N.Y.U. L. Rev. at 1010. No reorganization plan can be confirmed without the bankruptcy court's approval, which ensures that claimants are treated fairly and that the nondebtor releases are necessary. See *In re Bestwall LLC*, 606 B.R. 243, 251 (Bankr. W.D.N.C. 2019) (concluding that claimants received due process based in part on the “approval of the plan of reorganization by both this Court and the District Court”), *aff'd*, 71 F.4th 168 (4th Cir. 2023).

Added to these loyalty protections are structural voice features that ensure the reorganization plan benefits the claimants. By centralizing the creditors, debtors, and interested parties into a single forum, bankruptcy allows all the interested parties to negotiate the best, equitable resolution to an otherwise imminent business failure. See Goldberg, “*Otherwise Consistent*”, at 1735. Claimants often have their own lawyers that advocate on their behalf as part of crafting this resolution. See, e.g., *In re Roman Cath. Diocese*, 667 B.R. at 635. The Code's voting structure also provides the opportunity for parties to reject the plan if it does not sufficiently benefit their interests. See *In re Combustion Eng'g*, 391 F.3d at 245 (asking whether the vote represents the “indicia of support by affected creditors” (quoting *In re Windsor on the River Assocs., Ltd.*, 7 F.3d 127, 131 (8th Cir. 1993))); *In re Bestwall LLC*, 606 B.R. at 251 (similar). The Fifth Circuit carefully guards the vote to ensure *384 that it accurately reflects whether the creditors think the plan is in their best interests. See *In re Greystone III Joint Venture*, 995 F.2d 1274, 1279 (5th Cir. 1991) (“[T]hou shalt not classify similar claims differently in order to gerrymander an affirmative vote on a reorganization plan.”).

The Code structures its proceedings to ensure that those most interested can participate “to safeguard the interests of all.” *Mullane v. Cent. Hanover Bank & Tr. Co.*, 339 U.S. 306, 319, 70 S.Ct. 652, 94 L.Ed. 865 (1950). The Code ensures that a claimant can “sit back and allow the litigation to run its course, content in knowing that there are safeguards provided for his protection.” *Shutts*, 472 U.S. at 810, 105 S.Ct. 2965. For this reason, bankruptcy courts may find that claimants “consent” to nondebtor releases in appropriate circumstances. *Id.* at 812, 105 S.Ct. 2965. Bankruptcy courts evaluate consent to nondebtor releases “based on the unique facts and circumstances of the case at issue including the clarity of the language used, the history of the case, and the incentive for the affected creditors to engage in the bankruptcy case.” *In re Spirit Airlines*, 668 B.R. at 714. Courts have considered many factors in determining whether the procedures around the opt-outs were sufficient to find consent, including:

- Whether the notice provided to the claimants was clear and prominent, *In re Avianca Holdings S.A.*, 632 B.R. 124, 137 (Bankr. S.D.N.Y. 2021);
- Whether the opt-out mechanism is easy to use, such as through an online portal, including whether there are multiple ways to opt out, *In re LATAM Airlines Grp. S.A.*, No. 20-11254, 2022 WL 2206829, at *47 (Bankr. S.D.N.Y. June 18, 2022), *aff'd*, 55 F.4th 377 (2d Cir. 2022); cf. *In re Washington Mut., Inc.*, 442 B.R. 314, 345, 352–53 (Bankr. D. Del. 2011) (noting that the releases were modified just before confirmation);
- Whether the opt-out mechanism was separate from the vote for or against the plan, *In re Spirit Airlines*, 668 B.R. at 709 n.22, 713; cf. *In re SunEdison, Inc.*, 576 B.R. 453, 461 (Bankr. S.D.N.Y. 2017);
- Whether the opt-out and nondebtor releases have been consistently discussed, presented, and debated over the history of the case, *In re Spirit Airlines*, 668 B.R. at 705 (collecting cases);
- Whether the case has been subject to publicity and is well-known to the claimant population, *In re Mallinckrodt PLC*, 639 B.R. 837, 880 (Bankr. D. Del. 2022); *In re Spirit Airlines*, 668 B.R. at 709–10;
- Whether the opt-out mechanism was used by claimants, *In re Spirit Airlines*, 668 B.R. at 708–09; see also *Shutts*, 472 U.S. at 813, 105 S.Ct. 2965;¹⁷
- Whether there has been consistent and independent involvement of the creditor population in the bankruptcy proceedings, *In re Mallinckrodt*, 639 B.R. at 880–81; *In re Roman Cath. Diocese*, 667 B.R. at 635;
- Whether there is a substantial amount of affirmative support for the plan, *385 *In re Spirit Airlines*, 668 B.R. at 708; *In re Mallinckrodt*, 639 B.R. at 881; *In re Bestwall LLC*, 606 B.R. at 251;
- Whether there are economic disincentives to follow the bankruptcy case or opt out, see *In re Spirit Airlines*, 668 B.R. at 704–05 (collecting cases); cf. *In re Chassis Holdings, Inc.*, 533 B.R. 64, 80–81 (Bankr. S.D.N.Y. 2015); cf. also *Amchem Prods., Inc. v. Windsor*, 521 U.S. 591, 628, 117 S.Ct. 2231, 138 L.Ed.2d 689 (1997);
- Whether the payout to the claimants is fair, reasonable, and adequate, *In re Spirit Airlines*, 668 B.R. at 710; *In re*

Roman Cath. Diocese, 667 B.R. at 635; cf. *In re Chassis Holdings, Inc.*, 533 B.R. at 80, including whether it is necessary to the reorganization plan and to avert financial ruin, *In re Spirit Airlines*, 668 B.R. at 695–96, 712; cf. *In re Smallhold, Inc.*, 665 B.R. 704, 709 (Bankr. D. Del. 2024) (theorizing about a “college education fund” unrelated to the purpose of the bankruptcy); cf. also *Reynolds v. Beneficial Nat. Bank*, 288 F.3d 277, 286 (7th Cir. 2002); *Staton v. Boeing Co.*, 327 F.3d 938, 961 (9th Cir. 2003);

- Whether, if enough claimants opt out of the third-party releases, the plan will fail, see Goldberg, “*Otherwise Consistent*”, at 1737 n.278 (explaining that debtors and released nondebtors “must not only win enough votes to confirm a plan but also disincentivize enough opt-outs to make the reorganization economical”); see, e.g., *In re Spirit Airlines*, 668 B.R. at 706 & n.16 (citing *In re Roman Cath. Diocese*, 667 B.R. at 635–36);
- Whether there are unique circumstances that might bear on whether the claimants are consenting to the release through silence, see, e.g., *In re Roman Cath. Diocese*, 667 B.R. at 635 (discussing evidence attributing nonresponsiveness to the emotional difficulties raised by the nature of the claims against the estate).

In sum, “third-party releases through the use of opt-outs [can] be consensual—and permissible—under bankruptcy law after careful consideration of the circumstances within each case.” *In re Azul S.A.*, 676 B.R. 277, 290 (Bankr. S.D.N.Y. Jan. 6, 2026); accord *In re CJ Holding Co.*, 597 B.R. at 610. Courts can generally infer consent because a claimant knows that the reorganization, and the releases necessary to procure it, is in his or her best financial interests.

A rule that permits opt-outs on a case-by-case basis also complies with the “general rules” of contract law. *In re Tex. Com. Energy*, 607 F.3d at 158.¹⁸ The Restatement (Second) of Contracts provides that “silence and inaction operate as an acceptance” when “the offeror has stated or given the offeree reason to understand that assent may be manifested by silence or inaction, and the offeree in remaining silent and inactive intends to accept the offer.” Restatement (Second) of Contracts § 69(1)(b) (Am. L. Inst. 1981); see 2 Williston on Contracts § 6:70 (4th ed. Supp. 2025) (“[I]f the offeror has authorized silence as a means of indicating assent, and the offeree, by remaining silent, intends to manifest assent, every requirement for the formation of a contract seems satisfied.”).

*386 The Restatement offers the following illustrations:

(2) A offers by mail to sell to B a horse already in B's possession for \$250, saying: “I am so sure that you will accept that you need not trouble to write me. Your silence alone will operate as acceptance.” B makes no reply, but he does not intend to accept. There is no contract.

(4) The facts being otherwise as stated in Illustration 2, B makes no reply and remains inactive with the intention of thereby expressing his acceptance. There is a contract.

Restatement (Second) of Contracts cmt. c, illus. 2, 4. These illustrations show that the offeree's intent drives the analysis. *Shutts* puts that principle into practice, asking whether the totality of the circumstances—including the efficacy of the notice, the economic incentives, and the structural protections for the absent party—are sufficient to find that the party consented to be bound by the outcome. See 472 U.S. at 808–13, 105 S.Ct. 2965.

Texas contract law—which the Trustee's reply brief argues is applicable here—applies these principles as well. “[T]he parties’ relationship or the surrounding circumstances justify the expectation of a reply; under proper circumstances the parties may be justified in assuming inaction or silence indicates approval.” *Com. Bank of Tex., N.A. v. Luce*, 92 S.W.3d 636, 639 (Tex. App.—Beaumont 2002, no pet.) (citing Williston on Contracts § 6:49–54); see also *Taita Chem. Co. v. Westlake Styrene Corp.*, 246 F.3d 377, 386 (5th Cir. 2001) (Louisiana law). “Silence, plus forbearance, may, in some cases, constitute an acceptance.” *Union Carbide Corp. v. Jones*, No. 01-14-00574-CV, 2016 WL 1237825, at *6 (Tex. App.—Houston [1st Dist.] Mar. 29, 2016, no pet. h.) (mem. op.). “Whether silence is acceptance ... is a question of fact.” *Supply Pro, Inc. v. Ecosorb Int'l, Inc.*, No. 01-15-00621-CV, 2016 WL 4543136, at *5 (Tex. App.—Houston [1st Dist.] Aug. 30, 2016, pet. denied); see *Parker Drilling Co. v. Romfor Supply Co.*, 316 S.W.3d 68, 73 (Tex. App.—Houston [14th Dist.] 2010, pet. denied) (“The existence of an implied contract involves inferences drawn from circumstantial evidence and is therefore a question of fact.”). As a result, courts will send such cases to the jury for a determination that a contract exists. See, e.g., *Luce*, 92 S.W.3d at 639; *Union Carbide*, 2016 WL 1237825, at *6. Just as a jury can infer consent from silence in appropriate cases, so too may bankruptcy courts, even under state contract law. See *In re Spirit Airlines*, 668 B.R. at 717–21.

To be sure, as the Trustee argues, the general rule is that silence does not constitute acceptance. But the Trustee cites cases that illustrate the rule that proves the exception.

Imperial Industrial concerned “[t]acit acquiescence between relative strangers” who had been involved in a single transaction. *Imperial Indus. Supply Co. v. Thomas*, 825 F. App’x 204, 206 (5th Cir. 2020) (per curiam). The same is true for *Norcia v. Samsung Telecommunications America, LLC*, 845 F.3d 1279 (9th Cir. 2017); see *In re Spirit Airlines*, 668 B.R. at 718 n.36 (distinguishing *Norcia*), which is also a decision with which other courts have disagreed, see *Hill v. Gateway 2000, Inc.*, 105 F.3d 1147, 1150 (7th Cir. 1997). By contrast, creditors are creditors because they have a pre-existing financial relationship that continued through the filing of the bankruptcy petition. See 11 U.S.C. § 101(10). Although not every creditor is closely related to the debtor, it is unfair to equate them to total strangers or disinterested parties. See *In re Yentis*, 125 B.R. 158, 163 n.6 (N.D. Tex. 1991) (“The Bankruptcy Code contemplates *387 that concerned creditors will take an active role in protecting their claims.”).

“Bankruptcies, in this regard, give rise to unique moral and ethical concerns because each creditor’s action may affect the rights of every party in interest.” *In re Teligent, Inc.*, 282 B.R. 765, 772 (Bankr. S.D.N.Y. 2002). “The fundamental purpose of reorganization is to prevent the debtor from going into liquidation, with an attendant loss of jobs and possible misuse of economic resources.” *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 528, 104 S.Ct. 1188, 79 L.Ed.2d 482 (1984). “In bankruptcy, everyone’s fate—the debtors, its employees and its creditors—is often intertwined and dependent on the success of a plan.” *In re Teligent, Inc.*, 282 B.R. at 772. Although it may be unreasonable to impose on creditors an unequivocal duty to speak up—such that opt-outs under any condition are acceptable—it is often “reasonable” to assume that the creditor “should notify [the bankruptcy parties] if he does not intend to accept,” *Restatement (Second) of Contracts* § 69(1)(c), because everyone else is relying on him, see, e.g., *In re Ruti-Sweetwater, Inc.*, 836 F.2d 1263, 1266–68 (10th Cir. 1988) (concluding that a creditor accepted an impairment by failing to object after receiving notice of the impairment under the plan); *In re Szostek*, 886 F.2d 1405, 1413 (3d Cir. 1989) (similar); *Shaw v. Aurgroup Fin. Credit Union*, 552 F.3d 447, 457 (6th Cir. 2009) (similar); *In re Adelphia Commc’ns Corp.*, 368 B.R. 140, 224 (Bankr. S.D.N.Y. 2007) (similar); *In re Cypresswood Land Partners, I*, 409 B.R. 396, 430 (Bankr. S.D. Tex. 2009) (similar); *In re Trib. Co.*, 464 B.R. 126, 183–84 (Bankr. D. Del. 2011) (similar), *aff’d*, 972 F.3d 228 (3d Cir. 2020). When reorganizations plans are achieved through hard-fought negotiation by the interested parties, including those similarly situated to the silent creditor; inure to the

creditor’s benefit; give creditors proper notice; and require substantial consent to the third-party releases for the plan’s success, it is reasonable to infer an intent to accept the plan from a creditor’s silence.

The Trustee argues in part that the opt-out theory is not viable after *Purdue* because it depends on the premise that the claimant “defaulted” and could be bound under the Bankruptcy Court’s pre-*Purdue* power to enter nonconsensual releases. (Docket Entry No. 2 at 44). The Trustee relies heavily on *In re Smallhold*, an opinion from the Bankruptcy Court for the District of Delaware, for this assertion. But this argument, and *In re Smallhold*’s default theory, are unpersuasive, for two reasons. First, *Shutts* bars this argument.¹⁹ The question in *Shutts* was whether the Kansas court had personal jurisdiction over the absent plaintiffs. *Shutts*, 472 U.S. at 806, 105 S.Ct. 2965. The Court held that the Kansas court had jurisdiction over the plaintiffs because they had consented to jurisdiction by declining to opt out. See *id.* at 812–14, 105 S.Ct. 2965. If the failure to opt out did not equate to consent to jurisdiction, then even the plaintiffs’ status as a party to the litigation under the class-action procedure would not have bound *388 them to the Kansas court’s judgment. See *Juris v. Inamed Corp.*, 685 F.3d 1294, 1330 (11th Cir. 2012); see also *Ins. Corp. of Ireland v. Compagnie des Bauxites de Guinee*, 456 U.S. 694, 706, 102 S.Ct. 2099, 72 L.Ed.2d 492 (1982) (explaining that parties may ignore judicial proceedings and contest personal jurisdiction collaterally). Under *Shutts*, courts can infer consent in appropriate circumstances from the failure to opt out after proper notice. Second, “the Fifth Circuit has never permitted the grant of nonconsensual third-party releases in bankruptcy cases, but courts in that Circuit have routinely allowed consensual releases using an opt-out mechanism before *Purdue*.” *In re Spirit Airlines*, 668 B.R. at 715. Because *Purdue* did not overturn this Circuit’s longstanding practice of using opt outs, “the *Smallhold* court’s default theory cannot be reconciled with the approach of the Fifth Circuit on this issue.” *Id.*

The Trustee’s remaining argument that reliance on *Shutts* and class-action jurisprudence contravenes the Supreme Court’s warning about “de facto” class actions is unpersuasive, for three reasons. First, each of the cases in which the Supreme Court has cautioned parties about creating a “de facto” class action occurred in the context of traditional civil litigation. See, e.g., *Richards v. Jefferson County*, 517 U.S. 793, 802, 116 S.Ct. 1761, 135 L.Ed.2d 76 (1996); *Taylor*, 553 U.S. at 901, 128 S.Ct. 2161; *Smith v. Bayer Corp.*, 564 U.S. 299, 315, 131

S.Ct. 2368, 180 L.Ed.2d 341 (2011); *United States v. Sanchez-Gomez*, 584 U.S. 381, 389, 138 S.Ct. 1532, 200 L.Ed.2d 792 (2018). Outside of Rule 23, there are no protections or procedures for absent litigants from which a court can infer consent to a judgment. By contrast, and as discussed, bankruptcy provides a host of analogous, if not stronger, structural protections that permit an inference of consent. Second, some class actions are distinguishable because they can bind parties without notice and an opportunity to exit, even if monetary claims are at stake. See *Ortiz v. Fibreboard Corp.*, 527 U.S. 815, 846–48, 119 S.Ct. 2295, 144 L.Ed.2d 715 (1999); *Taylor*, 553 U.S. at 900–01, 128 S.Ct. 2161; *Wal-Mart Stores, Inc. v. Dukes*, 564 U.S. 338, 364, 131 S.Ct. 2541, 180 L.Ed.2d 374 (2011). Procedural rigidity is necessary to ensure that even *nonconsenting* plaintiffs receive due process; as the Trustee concedes, the rule does not ensure that *all* parties consent. See *Taylor*, 553 U.S. at 893–95, 128 S.Ct. 2161 (placing consent to be bound by a judgment and class actions in separate doctrinal categories). The concern is not warranted here, because the Code requires procedures to obtain and make findings of consent to opt out. Third, the bankruptcy courts are making largely individualized (or group-based) determinations of consent for claimants. If a finding of consent is inappropriate for a group or even an individual claimant, then they are not bound by the releases.

For these reasons, consistent with its longstanding precedent, the court holds that the failure to opt-out constitutes consent to a third-party release under the appropriate circumstances.

3. The Bankruptcy Court's Findings

The remaining question is whether the Bankruptcy Court erred in finding that the claimants consented to the nondebtor releases. The Trustee argues that the Bankruptcy Court erred as matter of law by not applying state contract law; takes a view of state law that is highly formalistic; and assumes that consent could not be found on this record as a matter of law. Only in passing does the Trustee connect specific facts from the record to the law. That is not sufficient. See *ODonnell*, 2025 WL 3033987, at *9 n.4. Unsurprisingly, the Debtor's response *389 brief does not focus on the record and the bases for the Bankruptcy Court's findings. Although this court would be justified in affirming the Bankruptcy Court's findings as practically unchallenged, the Trustee does raise one error that requires examination. See *United States v. Alvarado-Santilano*, 434 F.3d 794, 795 (5th Cir. 2005)

(explaining that appellate courts may raise clear, prejudicial error). A review of the findings below is necessary.

The Bankruptcy Court found that the nondebtor releases were consensual based on the factors that courts in the Fifth Circuit have been applying for “many years.” (Bankr. Docket Entry No. 280 at 9). The Bankruptcy Court found that the “third-party releases were integral to the Plan,” allowing unsecured creditors to become unimpaired (given in exchange for the new money needed to provide liquidity)” and allowing secured parties to receive well more than the “pennies on the dollar” that they otherwise would have received. (*Id.* at 9–11). The Bankruptcy Court found that all parties received sufficient notice of the Plan details, the deadline to object to confirmation, the voting deadline, and their ability to opt out. (*Id.* at 9–10). The Bankruptcy Court rejected the Trustee's argument that notice of how to opt out was ineffective. (*Id.* at 10). The Court instead concluded that many of the unsecured creditors did not opt out because they were being paid in full, rather than face a hopelessly insolvent company that could not reorganize. (*Id.* at 10–11). The Bankruptcy Court applied well-established law in this Circuit and made appropriate findings of consent, which would likely hold even under state law.

With a narrow exception, the Trustee's arguments do not justify reversing the Bankruptcy Court. First, the Trustee argues that those who voted for the Plan but failed to opt out did not consent. This argument has been rejected, even by courts who otherwise have rejected opt outs to nondebtor releases. The creditors “undertook an affirmative act by returning a ballot, indicating that the creditor was actively engaged in the process and affirmatively chose to not check the opt-out box,” whether or not they “voted to accept the Plan or to reject the Plan.” *In re Spirit Airlines*, 668 B.R. at 720; see also *In re Smallhold*, 665 B.R. at 723–25. There is ample basis to find that a party who voted against the Plan but did not opt out intended to grant the nondebtor release because a vote against speaks to the “Plan's treatment of the creditor's allowed claim.” *In re Smallhold*, 665 B.R. at 724 (emphasis omitted). Creditors may vote against how they are treated under the Plan without signaling that they opposed the third-party releases, which may be viewed (as found here) as essential to the Plan. A vote against the Plan may signal dissatisfaction with a creditor's individual treatment; a decision not to opt-out signals an overarching desire for a successful reorganization. The Bankruptcy Court's findings of consent for the Class 3 voters are “plausible in light of the full record.” *In re Mahadevan*, No. AP 21-03054, 676 B.R.

162, 171 (S.D. Tex. Nov. 24, 2025) (quoting *Sweet Additions Ingredient Processors, LLC v. Meelunie Am., Inc.*, 139 F.4th 1217, 1225 (11th Cir. 2025) (per curiam)).

The Trustee briefly argues that it is unfair to find that some of the claimants consented by not opting out because those who could not vote may not have read the full notice; because the notice was otherwise confusing and in multiple parts; and because some returned opt outs were not complete. (Docket Entry No. 2 at 40–41). The Trustee does not point to case law supporting an inference that the notice was materially deficient or undermining the Bankruptcy Court's finding that the *390 notice was effective. Cf. *In re Spirit Airlines*, 668 B.R. at 703–09 (discussing other cases and the notice provided). The Trustee instead uses these concerns to argue more broadly that courts should never infer consent from a failure to opt out. (See Docket Entry No. 2 at 41–43). But the Bankruptcy Court found that the releases were necessary to the successful reorganization; that the company was hopelessly insolvent; that the reorganization enabled the secured creditors to make substantial recoveries and the unsecured credits to become unimpaired; and that the creditors consented to the releases for that reason. (Bankr. Docket Entry No. 280 at 10–11). The fact of unanimous creditor support among voting parties and absence of creditor objections further support the Bankruptcy Court's findings. (See Bankr. Docket Entry No. 181 at 10). The Trustee does not meaningfully contest the Bankruptcy Court's findings based on the totality of the circumstances. See also *In re Spirit Airlines, Inc.*, 668 B.R. at 714 (concluding that consent via opt-outs was valid in part because “all affected creditors” received a “substantial recovery, and general unsecured creditors receiv[ed] 100% distributions”).

Despite the largely uncontested findings, it is clear that two groups of claimants who received notice and an opt-out opportunity did not consent to the third-party releases: the subordinated-claims holders in Class 5 and the equity holders in Class 8.²⁰ These claimants were not allowed to vote because they received nothing under the Plan and were deemed to reject it. (See Bankr. Docket Entry No. 181 at 100–03). There is no basis to find that claimants “who did not respond wanted, in addition losing their equity, to give up even more by releasing claims.” (Docket Entry No. 18 at 17). These claimants could not “sit back ... content” in knowing that the reorganization would secure them equitable recovery. See *Shutts*, 472 U.S. at 810, 105 S.Ct. 2965. The notice informed them that they would receive nothing. (Bankr. Docket Entry No. 81 at 42). They had no incentive to accept

the releases to help the reorganization. Courts consistently avoid applying releases to claimants who receive nothing under a reorganization plan. See *In re Emerge Energy Servs. LP*, No. 19-11563, 2019 WL 7634308, at *18 (Bankr. D. Del. Dec. 5, 2019) (holding that the classes of equity holders who received little or nothing from the bankruptcy did not consent to the third-party release by failing to opt out); *In re Spirit Airlines*, 668 B.R. at 704 n.14, 714 (ensuring that the “equity holders here—the only parties who receive no recovery under this Plan—are not subject to the Third-Party Releases at all”); *In re Avianca Holdings*, 632 B.R. at 133 (same). There is no basis in the record to depart from these rulings. The Bankruptcy Court's findings of consent for these claimants are inconsistent with its findings as to the other creditors who received substantial recovery. The Bankruptcy Court erred by finding that the claimants in Class 5 and Class 8 consented to the third-party releases by failing to opt out.

In sum, the third-party releases are consensual, with the exception of claimants in Class 5 and Class 8, who received no recovery *391 under the Plan and were deemed to reject it.

B. The Permanent Injunction

In addition to its objections to the third-party releases, the Trustee argues that the Bankruptcy Court erred by entering a permanent injunction barring claims between nondebtors. (Docket Entry No. 2 at 51). This provision, contained in Article IX.E, enjoins any person or entity from bringing a released claim. (Bankr. Docket Entry No. 181 at 135). The Bankruptcy Court had found that the injunction provision was within its jurisdiction under 28 U.S.C. § 1334; was necessary to preserve and enforce the releases and was narrowly tailored to achieve that purpose; was an integral part of the Plan; was in the best interest of the Debtors, their estates, and the claimants; and was, like the third-party releases, consistent with §§ 105, 1123, 1229 and other applicable Code provisions. (*Id.* at 15–16).

The Trustee challenges the permanent injunction on a variety of grounds. First, the Trustee contests the Bankruptcy Court's jurisdiction to issue the injunction under 28 U.S.C. § 1334(b), which provides a bankruptcy court with jurisdiction over proceedings “related to” a bankruptcy case. (Docket Entry No. 2 at 52). The Trustee argues that the Bankruptcy Court lacked jurisdiction to enter the injunction under this statute because the enjoined claims between thousands of nondebtors “do not ‘relate to’ Debtors’ chapter 11 case” after Plan confirmation. (*Id.*). The Trustee argues that

“[p]ost-confirmation jurisdiction is more limited.” (*Id.*). This argument is refuted by the Fifth Circuit caselaw holding that so long as a bankruptcy court has “related to” jurisdiction over certain claims at the outset of a case, it may enter a permanent injunction as to those claims.

For example, the Fifth Circuit in *Zale* rejected the argument that bankruptcy courts lacked jurisdiction to enter a permanent injunction because the third-party claims “will have no effect on the estate after confirmation of the plan.” 62 F.3d at 759. It held instead that “because jurisdiction existed” over the third-party contract claims during the bankruptcy case, “the bankruptcy court had jurisdiction over the request for injunctive relief on the contract claims.” *Id.*; see also *In re Morris*, 950 F.2d 1531, 1534 (11th Cir. 1992) (asking whether the dispute “was related to the bankruptcy case at the time of its commencement”). Similarly, *Craig’s Stores* distinguished “post-confirmation relations between the parties” from “a post-confirmation dispute over” a matter “provided for in the debtor’s reorganization plan.” *In re Craig’s Stores of Texas, Inc.*, 266 F.3d 388, 391 (5th Cir. 2001). The court recognized that, under Fifth Circuit precedent, the Bankruptcy Court has core jurisdiction over a “settlement of a creditor’s claim” that is “part of the reorganization plan itself.” *Id.* (citing *In re Case*, 937 F.2d 1014, 1017 (5th Cir. 1991)).

The Trustee’s argument rests on legal principles pertinent to claims that were not within the Bankruptcy Court’s “related to” jurisdiction before confirmation or that arise from post-confirmation conduct. The Trustee does not argue the former, and, as noted above, the Supreme Court has recognized that Congress granted courts jurisdiction over “suits between third parties which have an effect on the bankruptcy estate.” *Celotex Corp.*, 514 U.S. at 307 n.5, 115 S.Ct. 1493; see also *In re CJ Holding Co.*, 597 B.R. at 601, 610 (analyzing a permanent injunction coextensively with a third-party release and concluding that the bankruptcy court had subject-matter jurisdiction under § 1334(b) to release and enjoin the plaintiff’s sexual harassment, discrimination, *392 and retaliation claims based on alleged pre-petition conduct). Meanwhile, the Trustee’s latter argument is inapplicable because no post-confirmation conduct is at issue here. The Bankruptcy Court had jurisdiction to issue the permanent injunction.

Next, the Trustee argues that the Debtors lacked standing to seek the permanent injunction because they did not show that their potential injury was “real and immediate, not conjectural or hypothetical.” (Docket Entry No. 2 at 53 (quoting *City*

of Los Angeles v. Lyons, 461 U.S. 95, 105, 103 S.Ct. 1660, 75 L.Ed.2d 675 (1983))). But the Bankruptcy Court found that the third-party releases were “a necessary and integral aspect” of the Plan and that the injunction was the “way you enforce the third-party releases.” (Bankr. Docket Entry No. 181 at 14; Bankr. Docket Entry No. 201 at 43). The Trustee has pointed to no case law supporting its argument that the Debtors lacked standing to seek an injunction that the Bankruptcy Court concluded was critical to the success of the Plan. The Trustee cites *In re Stewart*, 647 F.3d 553 (5th Cir. 2011), but that case is inapposite. *In re Stewart* involved a bankruptcy court’s order of broad injunctive relief against Wells Fargo in a variety of other bankruptcy cases based on a single debtor’s bankruptcy case. 647 F.3d at 557. The Fifth Circuit accepted that bankruptcy courts have the “power to address certain issues collateral to the case before it,” but concluded that a wide-ranging injunction was not “shown to be sufficiently necessary” under the circumstances. *Id.* at 558. In contrast, this case involves injunctive relief explicitly tied to the third-party releases contained in the confirmation order entered by the Bankruptcy Court. This injunction merely enforces the releases, which are based on claims related to the Debtors and their affiliates.²¹ This case does not raise the questions that led to the *In re Stewart* decision.

Finally, the Trustee argues that there is “no authority in the Bankruptcy Code for the injunction barring claims between non-debtors.” (Docket Entry No. 2 at 54). It argues that the Debtors cannot rely on § 105(a) because “nothing in the Code authorizes the court to use its judicial power to bar claims between non-debtors.” (*Id.*). But, as discussed, the Bankruptcy Code provides authority for a Bankruptcy Court to enter consensual third-party releases under § 1123(b)(6). The injunction is simply an enforcement tool, meaning it was appropriate for the Bankruptcy Court to conclude that the injunction provision was necessary and authorized under § 105(a). (Bankr. Docket Entry No. 181 at 15–16 (stating that the injunction was “necessary” and “consistent with” §§ 105, 1123, and 1129)). Unlike in the Fifth Circuit cases that have rejected permanent injunctions as outside the power of § 105, the injunction here is coextensive with a consensual release authorized by § 1123(b)(6). Cf. *In re Zale Corp.*, 62 F.3d at 760 (“Accordingly, because the permanent injunction as entered improperly discharged a potential debt of ... a nondebtor, the bankruptcy court exceeded its powers under § 105”); *Highland II*, 132 F.4th at 358–59 (discussing *Zale* and *In re Pacific Lumber Co.*). The Bankruptcy Court was not using § 105(a) to “act as [a] ‘roving commission[] to do equity’ ” but instead to have the injunction serve as

a limited enforcement tool to support a ***393** third-party release authorized elsewhere by the Code. *In re Southmark Co.*, 49 F.3d 1111, 1116 (5th Cir. 1995) (quoting *In re Haber Oil Co.*, 12 F.3d 426, 443 (5th Cir. 1994)).

For similar reasons, the Trustee's argument that the Bankruptcy Court needed to explicitly run through the permanent injunction factors appears to hold no water. Courts routinely uphold permanent injunctions coextensive with proper releases contained in reorganization plans. *See, e.g., In re CJ Holding Co.*, 597 B.R. at 610 (construing the plaintiff's silence as consent to the reorganization plan and stating that the bankruptcy court did not err in approving *both* the third-party release and permanent injunction enforcing that release contained in the plan); *Highland I*, 48 F.4th at 438 (holding that the permanent injunction was "otherwise affirm[ed]" once the related nonconsensual exculpation provision was appropriately narrowed); *see also In re Zale*, 62 F.3d at 761 (explaining that an injunction may be warranted if the settlement it enforces is "unquestionably an essential element" of the reorganization plan and the injunction is a "key component" of the settlement (quoting *In re Drexel Burnham Lambert Grp., Inc.*, 960 F.2d 285, 293 (2d Cir. 1992))).

Entering the injunction was also permissible under the Bankruptcy Court's alternative authority to enter a consent decree. *See Firefighters*, 478 U.S. at 525, 106 S.Ct. 3063; *United States v. Michigan*, 131 F.4th 409, 423–24 (6th Cir. 2025) (holding that courts do not need to apply "the traditional four-part test for injunctive relief" to approve a consent decree). The Trustee argues that the parties did not consent to the injunction because there were not separate opt-out boxes for the releases and the injunction. (Docket Entry No. 2 at 46). This argument is unpersuasive; parties can consent to a release and an injunction as a package deal. In *In re CJ Holding Co.*, the court approved the third-party release *and* permanent injunction in the confirmation order based on the plaintiff's silent consent to the confirmation order alone. 597 B.R. at 608–10, 614. When, as here, an injunction merely enforces a release, there is no reason to separate consent for one from consent for the other. Assuming that a claimant would choose not to opt out of the third-party release but would want to opt out of a coextensive injunction is inconsistent; a claimant would not want to proceed on a claim on which they cannot succeed. *Cf. Carnegie v. Household Int'l, Inc.*, 376 F.3d 656, 661 (7th Cir. 2004) (Posner, J.) ("[O]nly a lunatic or a fanatic sues for \$30."). A separate checkbox for the injunction would serve no practical or logical purpose.

In sum, the court approves the permanent injunction and has found no cause to strike it from the Plan. The injunction does not apply, however, to the claimants in Classes 5 and 8.

C. The Gatekeeping Provision

Finally, the Debtor and the Trustee contest the validity and the scope of the gatekeeping provision.²² This provision states that "[n]o Person or Entity may commence or pursue a Claim or Cause of Action, as applicable, of any kind against the Debtors, the Reorganized Debtors, the Exculpated Parties, or the Released Parties, as applicable, that relates to or is reasonable likely to relate to any act or omission in ***394** connection with, related to, or arising out of a Claim or Cause of Action, as applicable, subject to Article IX hereof," without the Bankruptcy Court determining that the claim is "colorable" and "specifically authorizing" that person or entity to bring that claim. (Bankr. Docket Entry 181 at 135–36). While the permanent injunction provides an expeditious defense to a subsequent lawsuit by a claimant, the gatekeeping provision makes the defense unnecessary by requiring claimants to ask the Bankruptcy Court for leave to sue in the first place. The Trustee challenges the gatekeeping provision as, among other things, outside of the Fifth Circuit's recent authorization in the *Highland* cases. (Docket Entry No. 18 at 31).²³ The court agrees, although it narrows rather than strikes the whole provision.

"Courts have long recognized bankruptcy courts can perform a gatekeeping function." *Highland I*, 48 F.4th at 439. But bankruptcy courts "nonetheless do not have unrestricted power to protect non-debtors from liability via a pre-filing injunction." *Highland II*, 132 F.4th at 359. Historically, the "*Barton* doctrine"²⁴ allows bankruptcy courts to serve as a gatekeeper "when the action is against the trustee or other bankruptcy-court-appointed officer, for acts done in the actor's official capacity." *Villegas v. Schmidt*, 788 F.3d 156, 159 (5th Cir. 2015). The Fifth Circuit has also held that bankruptcy courts may perform a limited gatekeeping function when exercising their "significant discretionary power to manage their docket" under § 105. *In re Salubrio, L.L.C.*, No. 23-50288, 2024 WL 1795773, at *2 (5th Cir. Apr. 25, 2024) (per curiam). But beyond the few individuals identified in *Villegas*—the trustee or other bankruptcy-court-appointed officers—the Fifth Circuit has "never extended the *Barton* doctrine to give bankruptcy courts gatekeeping power over claims against non-debtors." *Highland II*, 132 F.4th at 359.

In *Highland II*, the Fifth Circuit clarified its holding in *Highland I*. The Fifth Circuit found that the “proper reading” of *Highland I* was to narrow the definition of “Protected Parties” in the gatekeeper provision of the reorganization plan to be coextensive with the definition of “Exculpated Parties” in the exculpation provision. 132 F.4th at 360. Because the original exculpation provision improperly nonconsensually released third parties, the Fifth Circuit had narrowed the class of exculpated parties down to trustee-like figures who could be nonconsensually released. The only parties protected by the gatekeeper provision in the Fifth Circuit’s final version were “(i) the Debtor; (ii) the Independent Directors [of the debtor company], for conduct within the scope of their duties; (iii) the Committee [of unsecured creditors]; and (iv) the members of the Committee in their official capacities, for conduct within the scope of their duties.” *Id.* at 358.²⁵ Due *395 to the unusual nature of the bankruptcy, these figures all seemed to fall within the Fifth Circuit’s understanding of persons and entities covered by the *Barton* doctrine; the final gatekeeper clause went no further than these pre-existing limits.²⁶

Despite *Highland II*’s narrow understanding of gatekeeping provisions, the Debtors make two arguments in favor of the expansive provision here, both based on § 105. First, relying on *In re Salubrio*, they assert that bankruptcy courts have “discretionary power” to manage their dockets under § 105, and that, like the permanent injunction, the gatekeeper provision is just “another layer of protection” for released parties. (Docket Entry No. 13 at 63–64). *In re Salubrio*, however, concerned a gatekeeping provision directed at a single identified vexatious litigant. 2024 WL 1795773, at *1. In *Highland I*, the Fifth Circuit distinguished vexatious litigant injunctions, noting—in a footnote about narrowing the injunction and gatekeeper provisions—that “[n]othing in this opinion should be construed to hinder the bankruptcy court’s power to” designate certain figures in the bankruptcy as vexatious litigants, but that “non-debtor exculpation within a reorganization plan is not a lawful means to impose vexatious litigant injunctions and sanctions.” 48 F.4th at 439 n.19. There is no basis for relying on a bankruptcy court’s authority under § 105 to issue limited gatekeeping provisions against individuals identified as vexatious to support the worldwide gatekeeping provision at issue here, which states broadly that “No Person or Entity” may commence certain claims without the Bankruptcy Court’s permission.

Second, the Debtors note that *Highland II* states that “injunctions ... may not be entered to protect non-debtors not legally entitled to release.” 132 F.4th at 358. In the Debtors’ view, the question is whether the gatekeeping provision exceeded the scope of the exculpation provision and consensual third-party release here. (Docket Entry No. 13 at 66). The Fifth Circuit made that statement in *Highland II* while examining the traditional injunction that enforced the exculpation provision, not the gatekeeper provision. In the separate section on the gatekeeper provision, the Fifth Circuit made clear that bankruptcy courts have only limited power to protect nondebtors from liability through such injunctions, and that the *Barton* doctrine has “never” been extended to allow bankruptcy courts to enforce gatekeeping provisions against nondebtors. *Highland II*, 132 F.4th at 359. The Fifth Circuit’s analysis of the gatekeeper provision was tethered to the legality of the releases at issue only to the extent that those releases had already been narrowed down to trustee-like figures covered by the *Barton* doctrine; the gatekeeper provision and the final exculpation provision were necessarily coextensive. The Fifth Circuit neither held nor implied that consensual third-party releases could allow a bankruptcy court to authorize gatekeeping provisions beyond the bounds of the *Barton* doctrine under § 105. Rather, doing so would be “patently beyond the *396 power of an Article I court under § 105.” *Id.* at 362.

Even if limited only to the Debtors and the parties who consented to the third-party release, the Plan’s broad gatekeeping provision still exceeds the Bankruptcy Court’s equitable authority to enter consent decrees. “[T]he permissible scope of a consent decree is not unlimited.” *Smith*, 906 F.3d at 335. “Consent decrees entered in federal court must be directed to protecting federal interests” and “must further the objectives of the law upon which the complaint was based.” *Frew*, 540 U.S. at 437, 124 S.Ct. 899. The *Barton* doctrine “prevents usurpation of the powers and duties which belong exclusively to the appointing bankruptcy court that would make impossible of performance the duty of that court to distribute the trust assets to creditors equitably and according to their respective priorities.” *Highland II*, 132 F.4th at 359 (cleaned up) (quoting *Barton*, 104 U.S. at 136). It protects court officers from unjustified personal liability for acts taken within the scope of their official duties. *See Carroll v. Abide*, 788 F.3d 502, 506 (5th Cir. 2015). The gatekeeping provision here extends the *Barton* doctrine beyond these limits to cover people and entities who are not officers of the Bankruptcy Court and to cover conduct that is not within the scope of their official duties. The provision does not further

the objectives of the Code and creates unnecessary conflict with First Amendment rights to access the courts. Cf. *Venable v. Keever*, 61 F. Supp. 2d 552, 559–60 (N.D. Tex. 1999) (discussing the First Amendment right to access the courts). A federal court cannot, consistent with its equitable authority, enter a gatekeeping provision beyond the limited scope of the *Barton* doctrine.

The Plan's gatekeeping provision must be limited to the scope of *Highland II*, which in turn limits the provision to the *Barton* doctrine. Because the parties did not brief this issue, the court remands it. The Bankruptcy Court must in the first instance determine who may, consistent with *Highland II* and the *Barton* doctrine, be included in the gatekeeping provision.²⁷

The court affirms in large part and reverses in limited part the judgment of the Bankruptcy Court. The court affirms the third-party release and permanent injunction except as applied to Class 5 and Class 8 claimants. The court narrows the scope of the gatekeeping provision to the limits imposed by *Highland II* and leaves it to the Bankruptcy Court to determine the provision's proper scope in the first instance. The court denies the motion to dismiss. (Docket Entry No. 12). The court denies the motion to stay. (Docket Entry No. 17). The court remands to the Bankruptcy Court for proceedings consistent with this opinion.

**AFFIRMED IN PART; REVERSED IN PART;
REMANDED IN PART.**

V. Conclusion

All Citations

676 B.R. 356

Footnotes

- 1 The Plan was later amended. (Bankr. Docket Entry No. 165).
- 2 The Plan defined “impaired” to mean “with respect to any Claim or Interest, a Claim or Interest that is ‘impaired’ within the meaning of section 1124 of the Bankruptcy Code.” (Bankr. Docket Entry No. 181 at 86). The Code generally considers claims against the debtor to be impaired if the reorganization plan alters the value of the claim. See 11 U.S.C. § 1124(1). In cases with third-party releases, creditors may still be impaired-in-fact even if their claims against the debtor are unimpaired; the third-party releases may alter the value of the creditors’ claims against the third parties. See *Harrington v. Purdue Pharma, L.P.*, 603 U.S. 204, 227, 144 S.Ct. 2071, 219 L.Ed.2d 721 (2024) (discussing releases that provide “for the full satisfaction of claims against a third-party nondebtor”).
- 3 The Debtors’ release was contained in Article IX.B. (Bankr. Docket Entry No. 181 at 132–33).
- 4 Among other things, those categories included the management, ownership, or operation of the Debtors or the nondebtor affiliates; the purchase, sale, or rescission of “any Security” of the Debtor or the nondebtor affiliates; and the “business or contractual arrangements between” any Debtor or nondebtor affiliate and any other entity. (Bankr. Docket Entry No. 181 at 133–34).
- 5 A gatekeeping provision is also a type of injunction; it is a *pre-filing* injunction. See *In re Highland Cap. Mgmt., L.P. (Highland II)*, 132 F.4th 353, 356 n.2 (5th Cir. 2025).
- 6 Another provision states that “[t]he Board, the Department of Transportation, and any State or local commission having regulatory jurisdiction over the debtor may raise and may appear and be heard on any issue in a case under this chapter, but *may not appeal* from any judgment, order, or decree entered in the case.” 11 U.S.C. § 1164 (emphasis added). When Congress wanted to allow a government entity to participate in bankruptcy proceedings but prevent it from appealing, it knew how to say so.
- 7 In *Purdue*, the Trustee challenged a Chapter 11 bankruptcy on the basis that the plan involved nonconsensual third-party releases. The parties argued standing in their briefs before the Supreme Court and at least two Justices asked about standing at the argument. But the Court resolved the case on the merits. Although not dispositive, the fact that neither the majority nor the dissent questioned the Trustee’s standing supports the Trustee’s argument that it has standing to bring this appeal. Cf. *Trump v. Hawaii*, 585 U.S. 667, 697, 138 S.Ct. 2392, 201 L.Ed.2d 775 (2018) (“Because we have

an obligation to assure ourselves of jurisdiction under Article III, we begin by addressing the question whether plaintiffs have standing to bring their constitutional challenge.”).

- 8 The Trustee argues in its reply brief that the Debtors forfeited several arguments. (See, e.g., Docket Entry No. 18 at 15, 30). Meanwhile, the Debtors argue that the Trustee also forfeited relevant arguments. (Docket Entry No. 13 at 61–62). As a matter of fairness, the court considers all arguments. In addition, the court largely affirms, which it can do on any basis. *In re Mahadevan*, No. 25-cv-901, 676 B.R. 162, 177 n.6 (S.D. Tex. Nov. 24, 2025).
- 9 In its reply brief, the Trustee more clearly asserts that Texas law controls, on the ground that “no party has argued that any other jurisdiction’s law applies.” (Docket Entry No. 18 at 13).
- 10 The channeling injunction is analogous to the common-law full-satisfaction rule for joint tortfeasors. A judgment creditor generally may not recover from more than one judgment debtor if the recovery from the first judgment debtor is “sufficient to put him in the position he would have occupied had there been no” injury giving rise to the judgment. *Aro Mfg. Co. v. Convertible Top Replacement Co.*, 377 U.S. 476, 512, 84 S.Ct. 1526, 12 L.Ed.2d 457 (1964). The Fifth Circuit’s channeling-injunction rule finds support in this concept because a fully-satisfied claimant would be barred from pursuing the nondebtor after recovering from the separate pool of assets, just as a judgment creditor would be barred from pursuing the second judgment debtor after recovering from the first. Anthony Casey & Joshua Macey, *Purdue Pharma and the New Bankruptcy Exceptionalism*, 2024 Sup. Ct. Rev. 365, 393 & n.129.
- 11 *Highland I*, which analyzed these statutory provisions in the context of a nonconsensual release, does not alter this court’s analysis. *Highland I*, 48 F.4th at 437.
- 12 A person who receives full compensation and is deemed to accept the plan under the Code is distinct from a person who receives both full compensation from the debtor and the released nondebtor. See *Purdue*, 603 U.S. at 226, 144 S.Ct. 2071 (clarifying that the Court did not address a plan that provides full satisfaction for a claimant’s claim against a nondebtor).
- 13 Before the Bankruptcy Court, the Debtors argued that the nondebtor releases were narrowly tailored and related to this bankruptcy case. (Bankr. Docket Entry No. 201 at 35–36). The Bankruptcy Court found that it had jurisdiction to include the releases as part of the reorganization plan. (*Id.* at 39). The Trustee does not argue on appeal that certain claims affected by the third-party releases are outside the Bankruptcy Court’s “related to” jurisdiction. The Trustee’s jurisdictional arguments in this appeal concern the Bankruptcy Court’s jurisdiction to enjoin suits based on claims that no longer exists after a confirmation order releases them. To the extent any claims within the releases are not “related to” the bankruptcy case or otherwise based on federal-question jurisdiction, state law would define consent to the third-party releases. But for the reasons explained in this opinion, Texas law does not require affirmative consent to releases in all bankruptcy cases.
- 14 The rule governing the interpretation of consent decrees is federal, but recent Fifth Circuit precedent is less clear. The Supreme Court has consistently applied federal rules of interpretation to consent decrees. See, e.g., *United States v. Armour & Co.*, 402 U.S. 673, 681–82, 91 S.Ct. 1752, 29 L.Ed.2d 256 (1971); *United States v. ITT Cont’l Baking Co.*, 420 U.S. 223, 235–37, 236 n.10, 95 S.Ct. 926, 43 L.Ed.2d 148 (1975). The Fifth Circuit traditionally did as well. See, e.g., *Eaton v. Courtaulds of N. Am., Inc.*, 578 F.2d 87, 90 (5th Cir. 1978); *Strouse v. J. Kinson Cook, Inc.*, 634 F.2d 883, 885 (5th Cir. 1981); *Lelsz ex rel. Lelsz v. Kavanagh*, 824 F.2d 372, 373–74 (5th Cir. 1987). But recently, the Fifth Circuit has started to interpret consent decrees based on the law of the state in which the decree is entered. See, e.g., *Chisom v. Louisiana ex rel. Landry*, 116 F.4th 309, 318 (5th Cir. 2024); cf. *Allen v. Louisiana*, 14 F.4th 366, 371 & n.7 (5th Cir. 2021) (explaining that the court “consult[s] the contract law of the relevant state”). It is unclear when the Fifth Circuit makes state law controlling, as opposed to persuasive. But to the extent recent precedent has made state law controlling, such a rule does not appear tied to any precedent that conducted a choice-of-law analysis. A review of the cases frequently cited in recent Fifth Circuit precedent interpreting consent decrees refer to “general principles of contract interpretation,” not state contract law, see, e.g., *United States v. Chromalloy Am. Corp.*, 158 F.3d 345, 349 (5th Cir. 1998), or to cases about private contracts between private parties, see, e.g., *Clardy Mfg. Co. v. Marine Midland Bus. Loans Inc.*, 88 F.3d 347, 352 (5th Cir. 1996), or to cases where the parties cited to state law to interpret the decree, *Frew v. Janek*, 780 F.3d 320, 327 n.28 (5th Cir. 2015). The sum of the precedent on how to interpret consent decrees further supports the conclusion that federal law controls the standard for consenting to them.

- 15 Such a state-law rule may go beyond the previously recognized limits of due process in the context of federal preclusion law. See *Taylor*, 553 U.S. at 891–96, 128 S.Ct. 2161. But if the state-law definition of consent truly controls whether a contract has formed between parties to a reorganization plan, then a federal court is bound to apply it absent some substantive constitutional reason not to do so. See *Erie*, 304 U.S. at 78, 58 S.Ct. 817. Yet federal courts have long been out of the constitutional business of interfering with the substance of state contract law. E.g. *Lochner v. New York*, 198 U.S. 45, 25 S.Ct. 539, 49 L.Ed. 937, (1905), abrogated by *W. Coast Hotel Co. v. Parrish*, 300 U.S. 379, 57 S.Ct. 578, 81 L.Ed. 703 (1937).
- 16 See also, e.g., Niko Gallogly, *New Texas Laws Open a Wild West for Corporate Governance*, N.Y. Times (Aug. 16, 2025), <https://www.nytimes.com/2025/08/16/business/dealbook/texas-incorporation-delaware.html> (discussing the current developments in the ongoing regulatory race to the bottom between states for corporate charters).
- 17 It is often difficult to assess this factor in isolation because opposing parties draw conflicting inferences from opt-out metrics. See Elizabeth J. Cabraser & Samuel Issacharoff, *The Participatory Class Action*, 92 N.Y.U. L. Rev. 846, 863–64 (2017) (thinking through the ambiguous messages sent by opt-out results).
- 18 Similar principles are found throughout the law. For example, under the Fourth Amendment, if “silence follows a request for consent,” then implicit consent “can be inferred from silence or failure to object to a search.” *United States v. Stagers*, 961 F.3d 745, 757 (5th Cir. 2020).
- 19 The Trustee tries to distinguish *Shutts* by arguing that the Supreme Court distinguished consent to personal jurisdiction from consent to state law. (Docket Entry No. 18 at 26). This argument misreads *Shutts*. The *Shutts* Court questioned whether the absent plaintiffs, by consenting to be bound by the judgment, also consented to be bound by Kansas law as the rule of decision, without answering the question specifically. 472 U.S. at 820, 105 S.Ct. 2965. That caution is reasonable, as no absent plaintiff should know about, and thus have reason to agree to, the application of a specific state's substantive law. The Court's caution reaffirms that the existence and scope of consent to be bound by court proceedings through a failure to opt out depends on the circumstances.
- 20 When discussing classes that were “wiped out,” the Trustee focuses exclusively on the equity holders, (see, e.g., Docket Entry No. 2 at 39), but the Plan treats Class 5 and Class 8 claimants the same. The court does not see—and the Trustee does not point to—a concrete indication in the record that Class 5 claimants are no longer relevant to this appeal. Despite the exclusive reference to “equity holders” as the “wiped out” class, for both caution and completeness, the court proceeds by treating Class 5 and Class 8 claimants alike.
- 21 The Trustee did not argue before the Bankruptcy Court, (Bankr. Docket Entry No. 150 at 31–32), and does not argue on appeal, (see generally Docket Entry Nos. 2, 18), that the injunction provision goes beyond enforcement of the third-party release barring claims against nondebtors.
- 22 The parties refer to this provision as the “gatekeeping provision” or “gatekeeping injunction.” (See, e.g., Docket Entry No. 2 at 56; Docket Entry No. 13 at 52). In the *Highland Capital* cases, the Fifth Circuit referred to a similar provision as the “gatekeeper” clause or provision. There is no difference.
- 23 The Trustee also argues that, as with the injunction, the Bankruptcy Court lacked both jurisdiction and standing to enter the gatekeeping provision. (Docket Entry No. 2 at 56). The court rejects those arguments for the same reasons it rejected those arguments as to the permanent injunction.
- 24 *Barton v. Barbour*, 104 U.S. 126, 26 L.Ed. 672 (1881).
- 25 The gatekeeper provision had previously applied to: “collectively, (i) the Debtor and its successors and assigns, direct and indirect majority-owned subsidiaries, and the Managed Funds, (ii) the Employees, (iii) Strand, (iv) the Reorganized Debtor, (v) the Independent Directors, (vi) the Committee, (vii) the members of the Committee (in their official capacities), (viii) the Claimant Trust, (ix) the Claimant Trustee, (x) the Litigation Sub-Trust, (xi) the Litigation Trustee, (xii) the members of the Claimant Trust Oversight Committee (in their official capacities), (xiii) New GP LLC, (xiv) the Professionals retained by the Debtor and the Committee in the Chapter 11 Case, (xv) the CEO/CRO; and (xvi) the Related Persons of each of the parties listed in (iv) through (xv).” *Highland II*, 132 F.4th at 356.

- 26 As explained in *Highland I*, for “nontraditional” reasons, the independent directors were appointed to act as the bankruptcy trustee for Highland Capital. 48 F.4th at 437. Meanwhile, the members of the Unsecured Creditors’ Committee were appointed by the Trustee. *Id.* at 425. Finally, the court allowed the gatekeeping provision to cover Highland Capital itself under the *Barton* doctrine because “Highland Capital, for all practical purposes, was a debtor in possession entitled to the rights of a trustee.” *Id.* at 439 n.17.
- 27 This appeal was filed in February 2024, and *Highland II* (which significantly clarified *Highland I*) was published in March 2025. The Bankruptcy Court did not have the opportunity to consider *Highland II*. In any event, the court concludes that the Bankruptcy Court’s assertion that “*Highland Capital* permits the gatekeeping function with respect to the exculpated parties, which, in this case, is only the Debtor, as well as the parties that are released,” is inconsistent with *Highland I* and *Highland II*’s narrow understanding of gatekeeping provisions, which limited them to the *Barton* doctrine. (Bankr. Docket Entry No. 201 at 43).

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677 B.R. 509

United States Bankruptcy Court, D. Delaware.

IN RE: [AIO US, INC.](#), et al., Debtors.

Case No. 24-11836 (CTG) (Jointly Administered)

|

Signed August 21, 2025

Synopsis

Background: In jointly administered cases, debtor, a United States-based holding company that was wholly owned by a Brazilian corporation, together with some of its U.S. subsidiaries, sought confirmation of Chapter 11 plan establishing a liquidating trust to resolve unliquidated personal injury claims arising from alleged exposure to debtors' talc-containing cosmetic products. United States Trustee (UST) and various insurers objected, asserting, inter alia, that plan was not proposed in good faith, improperly altered insurers' rights, and contained an impermissible "gatekeeping" provision.

Holdings: The Bankruptcy Court, [Craig T. Goldblatt, J.](#), held that:

- [1] the plan was proposed in good faith;
- [2] liquidating trustee's duty of impartiality ran to trust's beneficiaries, not to insurers;
- [3] the plan was not required to comport with subsection of the Bankruptcy Code authorizing court to issue an injunction channeling asbestos-related claims to trust created under confirmed Chapter 11 plan;
- [4] the plan's payment of up to \$850,000 in reasonable bond indenture fees was permissible; and
- [5] the plan's "gatekeeping" provision, which barred assertion of any claim that could be reasonably understood to violate plan's exculpation provision and permitted such claim to go forward only if the Court found that it was "colorable" on the merits, could not be approved over UST's objection.

Ordered accordingly.

Procedural Posture(s): Motion to Confirm Plan; Objection to Confirmation of Plan; Motion for Stay.

West Headnotes (54)

[1] **Bankruptcy** 🔑 Particular proceedings or issues

When proponent of a plan of reorganization seeks confirmation of that plan, the contested matter falls within the district court's subject-matter jurisdiction over matters "arising under" the Bankruptcy Code, which jurisdiction, in turn, has been referred to the bankruptcy court. [11 U.S.C.A. § 1129](#); [28 U.S.C.A. § 1334\(b\)](#).

[2] **Bankruptcy** 🔑 Good faith and legality

Requirement that, for proposed Chapter 11 plan to be confirmed, it must be proposed in good faith and not by any means forbidden by law means that both the means used and the ends sought in proposing a plan need to accord with the purposes of bankruptcy law. [11 U.S.C.A. § 1129\(a\)\(3\)](#).

[3] **Bankruptcy** 🔑 Good faith and legality

In determining whether a Chapter 11 plan has been proposed in good faith, courts are to consider the entire record and reach a judgment based on the totality of the circumstances. [11 U.S.C.A. § 1129\(a\)\(3\)](#).

[4] **Bankruptcy** 🔑 Good faith and legality

Statements made by counsel are not evidence, for purposes of determining whether Chapter 11 plan satisfies good faith requirement for plan confirmation. [11 U.S.C.A. § 1129\(a\)\(3\)](#).

[5] **Bankruptcy** 🔑 Good faith and legality

Chapter 11 plan that established a trust to resolve unliquidated personal injury claims arising from alleged exposure to debtors' talc-containing cosmetic products was proposed

in good faith; plan, whose trust distribution procedures were broadly intended to create a construct under which trust would settle talc claims with individual talc claimants on terms that roughly mirrored company's settlement history outside of bankruptcy, while treating debtors' insurers fairly, generally sought to achieve ends that were within contemplation of bankruptcy laws, record evidence supported debtors' assertion that they set out to "do things right," and although plan's treatment for foreign exposures to debtor's products, in rendering claims arising from exposure outside United States or United Kingdom not eligible for payment, weighed against a good-faith finding, it was insufficient to tip balance under "totality of the circumstances," given lack of objection by affected talc claimants. 11 U.S.C.A. § 1129(a)(3).

[6] **Bankruptcy** 🔑 Acceptance

If a proposed Chapter 11 plan provided materially inferior treatment to class of foreign creditors, it could be confirmed only if the disadvantaged class voted in favor of confirmation. 11 U.S.C.A. §§ 1129(b), 1513(b).

[7] **Bankruptcy** 🔑 Power and Authority

No part of the judicial role of the bankruptcy court is more important than protecting the integrity of the bankruptcy proceeding as a whole.

[8] **Bankruptcy** 🔑 Effect of Bankruptcy Relief; Injunction and Stay

Bankruptcy law intends for the bankruptcy filing of an insured to be as "neutral" as possible to the rights and obligations of the insurer.

[9] **Bankruptcy** 🔑 Insurance policies and liabilities thereon

Bankruptcy Code brings into the bankruptcy estate all of the property, including insurance

policies, that belonged to the debtor immediately before the bankruptcy filing. 11 U.S.C.A. § 541.

[10] **Bankruptcy** 🔑 Effect of state law in general

Property rights of debtor that are brought into the bankruptcy estate upon the bankruptcy filing are defined by non-bankruptcy law. 11 U.S.C.A. § 541.

[11] **Bankruptcy** 🔑 Effect of state law in general

Unless there is some bankruptcy-related reason that requires otherwise, there is no reason why property interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding.

[12] **Bankruptcy** 🔑 Effect of Bankruptcy Relief; Injunction and Stay

"Neutrality principle" of bankruptcy law, whereby bankruptcy filing of an insured is intended to be as "neutral" as possible to rights and obligations of insurer, serves an important point of bankruptcy policy, namely, uniform treatment of property interests by both state and federal courts within a state, which serves to reduce uncertainty, to discourage forum shopping, and to prevent a party from receiving a windfall merely by reason of the happenstance of bankruptcy.

[13] **Bankruptcy** 🔑 In general; nature and purpose

Chapter 11 of the Bankruptcy Code is intended to permit an otherwise viable business facing financial distress to reorganize.

1 Case that cites this headnote

[14] **Bankruptcy** 🔑 In general; nature and purpose

Chapter 11 of the Bankruptcy Code may properly be used to maximize value by permitting a

going concern sale and facilitating an appropriate resolution of estate causes of action.

[1 Case that cites this headnote](#)

[15] Bankruptcy 🔑 [Jury trial, authority and discretion to conduct](#)

Claimant who asserts a claim for wrongful death or personal injury has a right to a jury trial on allowance of that claim in bankruptcy. [U.S. Const. Amend. 7](#); [28 U.S.C.A. § 157\(b\)\(5\)](#).

[16] Bankruptcy 🔑 [Construction, execution, and performance](#)

Insurance coverage dispute between liquidating trust created by a confirmed Chapter 11 plan and a debtor's insurers should be viewed exactly the way it would be if the parties had engaged in a transaction that achieved the same economic result outside of bankruptcy.

[17] Bankruptcy 🔑 [Executory nature in general](#)

Chapter 11 debtors' insurance policies, covering a period in the past for which all premiums had been paid, were not executory contracts. [11 U.S.C.A. § 365](#).

[18] Bankruptcy 🔑 [Executory nature in general](#)

Under the Countryman definition, an “executory contract” is one under which the obligation of both the debtor and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing performance of the other. [11 U.S.C.A. § 365](#).

[19] Bankruptcy 🔑 [Executory nature in general](#)

Pursuant to the Countryman definition of “executory contract” used in the bankruptcy context, contractual rights fall into one of three categories: first, if the debtor has fully performed but the counterparty has not, the estate simply has an asset – the right to obtain

the counterparty's performance; second, if the counterparty has performed and the debtor has not, the counterparty simply holds a prepetition claim for the value of the debtor's performance; and in the third category are contracts that are materially unperformed on both sides, which are within the scope of an executory contract. [11 U.S.C.A. § 365](#).

[20] Bankruptcy 🔑 [Settlement, adjustment, or enforcement of claims](#)

Trust distribution procedures set forth in proposed Chapter 11 plan for resolution of unliquidated personal injury claims arising from alleged exposure to debtors' talc-containing cosmetic products did not improperly eliminate requirement that a claimant show causation but, instead, reflected a voluntary settlement between debtors and liquidating trust, on the one hand, and claimants, on the other, with the rights of insurers to dispute coverage being fully preserved; under the procedures, claimant with mesothelioma who could show that they had been exposed to debtors' cosmetic products would be entitled to receive a settlement offer from the trust, and the requirement that would otherwise apply in the tort system, namely, that a plaintiff show that exposure to defendant's product caused plaintiff's injury, was essentially being compromised as part of global resolution reflected in trust distribution procedures. [11 U.S.C.A. §§ 502, 1123\(a\)\(3\)](#).

[21] Bankruptcy 🔑 [Acceptance](#)

If a class of creditors accepts a Chapter 11 plan's proposed “treatment” of that class, the class's acceptance can bind an individual creditor in that class who opposes that treatment.

[1 Case that cites this headnote](#)

[22] Bankruptcy 🔑 [Determination](#)

Under the Bankruptcy Code, every individual claimant is entitled to the protections provided by the statutory process of determining the allowed

amount of that creditor's claim. 11 U.S.C.A. § 502.

[23] Bankruptcy 🔑 Claims allowable; what constitutes "claim."

Under the Bankruptcy Code, the “allowance” of a claim is distinct from “treatment” of a claim, and the class vote does not bind a dissenting creditor with respect to whether its claim is allowed. 11 U.S.C.A. § 502.

[24] Bankruptcy 🔑 Means of implementation

So long as the conditions to which a claimant is subject pursuant to the trust distribution procedures set forth in a Chapter 11 plan do not unduly burden the exercise of claimant's statutory right to the judicial process, those conditions constitute a matter within court's discretion and may appropriately be included as part of trust distribution procedure. 11 U.S.C.A. § 502; 28 U.S.C.A. §§ 157(b)(5), 1411(a).

[25] Bankruptcy 🔑 Settlement, adjustment, or enforcement of claims

To the extent that the trust distribution procedures set forth in a Chapter 11 plan provide that creditors with certain types of injuries will receive settlement offers from the trust in particular amounts, in the absence of some suggestion that the plan has been proposed in bad faith, the particular amounts need not be approved by the bankruptcy court as “fair,” “equitable,” “reasonable,” or otherwise.

[26] Bankruptcy 🔑 Claims allowable; what constitutes "claim."

Under the Bankruptcy Code, claims “allowance” is an individual right. 11 U.S.C.A. § 502.

[27] Bankruptcy 🔑 Classification of claims

In bankruptcy, personal injury claims are classified as general unsecured claims. 11 U.S.C.A. § 1122.

[28] Bankruptcy 🔑 Equality of treatment within classes

Under the Bankruptcy Code, within a class, all claims must receive equal “treatment” by a Chapter 11 plan, which is what the holder of a claim within a class receives on account of the claimant's allowed claim. 11 U.S.C.A. § 1122.

[29] Bankruptcy 🔑 Means of implementation

Nothing in a proposed Chapter 11 plan's trust distribution procedures may expand or contract the rights of debtors' insurers.

[30] Bankruptcy 🔑 Confirmation; Objections

Bankruptcy court is not entitled to pick up its own pen to mark up a proposed Chapter 11 plan so that it reads the way the court might prefer; rather, the role of the court is limited to answering the question whether the proposed plan is confirmable, and to confirming the plan if the statutory requirements are met. 11 U.S.C.A. §§ 1121, 1129(a).

[31] Bankruptcy 🔑 Confirmation; Objections

Bankruptcy court may require changes to a proposed Chapter 11 plan only where those changes are necessary to render the plan confirmable. 11 U.S.C.A. § 1129(a).

[32] Bankruptcy 🔑 Conclusiveness

Insurance 🔑 Policy provisions, in general

Even though, outside of bankruptcy, a debtor's insurer might be able to enforce a contractual anti-assignment clause when the debtor seeks to transfer its insurance policy to a third party, an insurer's anti-assignment defense is unavailable when the transfer occurs under a plan of

reorganization in a Chapter 11 case. 11 U.S.C.A. § 1123(a)(5)(B).

1 Case that cites this headnote

[33] **Bankruptcy** 🔑 Means of implementation

Insurance 🔑 Transfers of Policies

Rights of Chapter 11 debtors in their insurance policies, which covered a period in the past for which all premiums had been paid, could not be transferred, without the policies' associated terms and conditions, into trust created by debtors' plan to resolve unliquidated personal injury claims arising from alleged exposure to debtors' talc-containing cosmetic products; to the extent those terms and conditions were enforceable under non-bankruptcy law the day before the bankruptcy, they remained enforceable by insurers against the liquidating trust. 11 U.S.C.A. § 1123(a)(5)(B).

1 Case that cites this headnote

[34] **Bankruptcy** 🔑 Claims allowable; what constitutes "claim."

Bankruptcy 🔑 Settlement, adjustment, or enforcement of claims

Although claims resolved by liquidating trust established by Chapter 11 debtors' confirmed plan to resolve unliquidated personal injury claims arising from alleged exposure to debtors' talc-containing cosmetic products could be described as "allowed" claims, that allowance reflected a voluntary settlement, not the Bankruptcy Court's adjudication of liability or the "allowance" contemplated by the section of the Bankruptcy Code governing allowance of claims or interests. 11 U.S.C.A. § 502.

[35] **Res Judicata** 🔑 Manner of Asserting or Contesting Preclusion

Generally, the preclusive effect of a court's judgment is properly decided by the subsequent court, not the rendering court: a court usually does not get to dictate the preclusion consequences of its own judgment.

[36] **Res Judicata** 🔑 Manner of Asserting or Contesting Preclusion

Disputes about the preclusive effect of a decision in one case on the prosecution of another are for the judge presiding in the second case.

[37] **Bankruptcy** 🔑 Construction, execution, and performance

Trustee of a post-confirmation trust established by a Chapter 11 plan, like the trustee of any trust, owes a fiduciary duty to the beneficiaries of the trust, which includes taking appropriate steps to maximize the corpus of the trust.

[38] **Bankruptcy** 🔑 Construction, execution, and performance

Trustee of a post-confirmation trust created by a Chapter 11 plan has a duty to administer the trust in a manner that is impartial with respect to the various beneficiaries of the trust; that duty of "impartiality," however, does not extend to entities, like insurers, against which the trust may hold causes of action.

[39] **Bankruptcy** 🔑 Construction, execution, and performance

Duty of trustee of a post-confirmation trust created by a Chapter 11 plan is to do her best to maximize claimant recoveries, much like the directors of a corporate entity owe duties to maximize shareholder value.

[40] **Bankruptcy** 🔑 Means of implementation

"Sharing" provisions in proposed Chapter 11 plan of debtors, whereby non-talc unsecured creditors in one class could make election that would entitle them to receive same percentage recovery on their allowed claims as the recovery that was ultimately obtained for talc claimants, pursuant to mechanism requiring

that certain proceeds recovered by liquidating trust on account of liability insurance policies and retained causes of action be allocated to particular fund from which non-talc claimants would receive their distribution, did not render the plan unconfirmable, where the sharing mechanism was clearly set forth in debtors' disclosure statement and was agreed to by 100% of the talc claimants.

[41] Bankruptcy 🔑 Right; grant or denial; discretion

Bankruptcy rules providing that orders confirming a plan and providing for the sale of assets are automatically stayed for 14 days unless the bankruptcy court orders otherwise operate primarily as a courtesy to the district court, providing it some time to consider the merits of any motion for a stay pending appeal before a plan is consummated. *Fed. R. Bankr. P. 3020(e), 6004(h)*.

[42] Bankruptcy 🔑 Requisites of Confirmable Plan

In the jointly administered cases of 20 debtors that were separate corporate entities, each of the 20 proposed Chapter 11 plans had to meet the confirmation requirements set forth in the Bankruptcy Code, even though, as a matter of convenience, the plans were contained in a single document described colloquially as "the plan." *11 U.S.C.A. § 1121*.

[1 Case that cites this headnote](#)

[43] Bankruptcy 🔑 "Deemed" acceptance; unimpaired classes

Non-voting impaired class would be deemed to have accepted proposed Chapter 11 plan of debtor in jointly administered cases, where clearly disclosed solicitation procedures that were approved by the Bankruptcy Court, without objection and on notice to all parties in interest, provided that a non-voting class would be deemed to have accepted the plan. *11 U.S.C.A. § 1129(a)(10)*.

[1 Case that cites this headnote](#)

[44] Bankruptcy 🔑 Settlement, adjustment, or enforcement of claims

Congress enacted subsection of Bankruptcy Code authorizing court to issue an injunction channeling asbestos-related claims to trust created under confirmed Chapter 11 plan to address the due process concerns associated with discharging a claim held by someone who may have been exposed to an asbestos-containing product but had not yet suffered from any disease as of the time of the debtor's bankruptcy. *U.S. Const. Amend. 5; 11 U.S.C.A. § 524(g)*.

[45] Bankruptcy 🔑 Settlement, adjustment, or enforcement of claims

Bankruptcy 🔑 Effect as discharge

In jointly administered Chapter 11 cases, proposed plan establishing a liquidating trust to resolve unliquidated personal injury claims arising from alleged exposure to debtors' talc-containing cosmetic products was not required to comport with subsection of the Bankruptcy Code authorizing court to issue an injunction channeling asbestos-related claims to trust created under confirmed Chapter 11 plan; debtors were liquidating, not reorganizing, and so were not eligible to be discharged under the section of the Code governing the effect of confirmation, let alone to receive the "supplemental discharge" contemplated by the subsection addressing channeling injunctions. *11 U.S.C.A. §§ 524(g), 1141(d)*.

[46] Bankruptcy 🔑 Contents in general

In jointly administered Chapter 11 cases, proposed plan establishing a liquidating trust to resolve unliquidated personal injury claims arising from alleged exposure to debtors' talc-containing cosmetic products was not barred by the subsection of the Bankruptcy Code stating that a Chapter 11 plan may include any appropriate provision not inconsistent with the application of title 11; instead, giving a post-

confirmation trust the authority to resolve claims against the estate and distribute the proceeds of estate causes of action fit squarely within the “catch-all.” 11 U.S.C.A. § 1123(b)(6).

[47] Bankruptcy Contents in general

Provision contemplated by the subsection of the Bankruptcy Code stating that a Chapter 11 plan may include any appropriate provision not inconsistent with the application of title 11 must concern the debtor—its rights and responsibilities, and its relationship with its creditors. 11 U.S.C.A. § 1123(b)(6).

[48] Bankruptcy Contents in general

Under the subsection of the Bankruptcy Code stating that a Chapter 11 plan may include any appropriate provision not inconsistent with the application of title 11, a provision cannot include a radically different power to discharge the debts of a nondebtor without the consent of affected nondebtor claimants. 11 U.S.C.A. § 1123(b)(6).

[49] Bankruptcy Confirmation; Objections

United States Trustee (UST) had standing to raise objection to proposed Chapter 11 plan on the basis that plan's payment of bond trustee fees was impermissible, even if UST lacked an economic stake in the matter; Bankruptcy Code granted UST standing to be heard on any issue in a bankruptcy case. 11 U.S.C.A. §§ 307, 503(b).

[More cases on this issue](#)

[50] Bankruptcy Equality of treatment within classes

In jointly administered Chapter 11 cases, proposed plan's payment of up to \$850,000 in reasonable bond indenture fees comported with the Bankruptcy Code, even over United States Trustee's (UST) objection, the economic substance of which was that payment of the bond trustee fees provided unequal treatment to claims arising under bond indenture, as compared to other, similarly situated creditors in the class;

all affected creditors consented to the disparate treatment. 11 U.S.C.A. § 1123(a)(4).

[51] Bankruptcy Equality of treatment within classes

Statutory right to “equal treatment” across different classes is not one that may be enforced at the behest of an individual creditor or party-in-interest, so long as the class of affected creditors votes to accept the plan's treatment of their claims by the requisite majorities. 11 U.S.C.A. § 1123(a)(4).

[52] Bankruptcy Settlement, adjustment, or enforcement of claims

In jointly administered Chapter 11 cases, proposed plan's “gatekeeping” provision, which barred assertion not only of claims that were released or exculpated under the plan, but also prohibited assertion of any claim that could be reasonably understood to violate plan's exculpation provision, and only permitted such claim to go forward if the Bankruptcy Court found that the claim was “colorable” on the merits, could not be approved over United States Trustee's (UST) objection; neither the Bankruptcy Code nor the *Barton doctrine*, 104 U.S. 126, provided substantive authority for such an injunction.

[2 Cases that cite this headnote](#)

[53] Bankruptcy Leave to sue

Under the *Barton doctrine*, 104 U.S. 126, bankruptcy trustees may not be sued outside of bankruptcy court without the bankruptcy court's permission.

[54] Bankruptcy Pendent or ancillary jurisdiction

Bankruptcy court retains jurisdiction to resolve a dispute about the meaning of its order.

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MEMORANDUM OPINION

CRAIG T. GOLDBLATT, UNITED STATES
BANKRUPTCY JUDGE

*516 TABLE OF CONTENTS

Factual and Procedural Background...518

1. The Avon business...518

2. The company's talc liability...519

3. The bankruptcy case...520

4. The plan...522

5. The confirmation hearing...526

Jurisdiction...530

Analysis...531

I. The plan was proposed in good faith...531

A. The plan generally seeks to achieve ends that are within the contemplation of the bankruptcy laws...531

B. While the plan's treatment of claims for foreign exposures to the debtors' talc products is a factor that weighs against a finding of good faith, it is insufficient to tip the balance under the "totality of the circumstances."...532

II. Modest changes to the plan are required in order for the plan to respect the rights of the insurers...534

A. The insurance contracts are not executory...539

B. The trust distribution procedures reflect a voluntary settlement between the debtor/trust and the claimants...541

C. Certain of the insurers' remaining objections lack merit; others require modifications to the proposed order...545

1. Although the insurance policies are not executory, it is nevertheless the case that the rights cannot be transferred without the associated terms and conditions...545

2. Claims resolved by the trust may be described as "allowed" claims; that allowance, however, reflects a voluntary settlement, not an adjudication of liability...546

3. The plan and confirmation order should be silent about the preclusive effect of this Court's actions...548

4. The liquidating trustee need not be "neutral."...549

5. The "sharing" provisions are permissible...550

6. The Court will not waive the rules providing for a stay of the effectiveness of the confirmation order if any party represents that it intends to seek a stay pending appeal...551

*517 III. The insurers' remaining objections to confirmation are overruled...552

A. The objections based on the vote are without merit...553

B. The plan need not comport with § 524(g)...555

C. Debtor is not required to liquidate all claims before confirmation...557

IV. The plan's payment of bond indenture fees is permissible...558

V. The gatekeeping provision cannot be approved over the UST objection...561

Conclusion...564

Avon Products, Inc. and various of its affiliates filed these bankruptcy cases in 2024. The debtors were once the owners of the iconic Avon cosmetics brand. They spun off their U.S. assets, however, in a 2016 transaction. During these bankruptcy cases, they sold their foreign operations to Natura, their Brazilian parent company. The debtors and Natura also resolved, after extensive litigation with the Committee,

various estate claims that the debtors held against Natura. Accordingly, the debtor entities now hold only the proceeds of those sales, insurance assets, and other causes of action. The question now before this Court is whether the plan of reorganization that the debtors have proposed can be confirmed.

These bankruptcy cases were precipitated by personal injury claims asserted against the debtors by plaintiffs who allege that their diseases were caused by exposure to the debtors' talc-containing cosmetic products. The debtors proposed a plan in February of this year and this Court approved a disclosure statement in May. The U.S. Trustee and various insurers objected to confirmation of the plan. This Court conducted a confirmation hearing in July.

As described in further detail below, the Court concludes that certain provisions of the plan and confirmation order must be revised in order to permit the plan to be confirmed. Subject to those revisions, however, the plan is confirmable. *First*, the Court concludes that the plan has been proposed in good faith. The evidence suggests that the debtors undertook a process designed to treat constituencies fairly and to maximize value for the benefit of creditors, as the Bankruptcy Code contemplates. There are imperfections in the plan. For example, the provision that bars recovery from claimants whose exposure to the debtors' products did not occur in the United States or the United Kingdom looks to this Court like an improper effort by certain plaintiffs' lawyers to protect their turf. Even so, however, the totality of the evidence supports a finding that the plan has been proposed in good faith.

Second, the Court largely overrules the objections asserted by insurers that relate directly to the treatment of their insurance policies, though certain of those objections require modifications to the terms of the plan. Broadly speaking, as far as the insurers are concerned, the trust distribution procedures established in the plan should be viewed as a voluntary settlement, between the talc claimants and the debtor/trust, of talc claims. A financially distressed company can, outside of bankruptcy (and without court approval) enter into a settlement under materially similar economic terms with plaintiffs who are asserting claims against it – assigning both the claims and its insurance assets to a trust – and wind down its business. That trust can then sue the company's insurers, arguing that there is insurance coverage for the settlements the trust reached with the claimants. The insurers could respond to such a lawsuit by arguing that the trust

has not complied with the various conditions to insurance coverage, and therefore ***518** the coverage is vitiated. The principal point this Court intends to make is that the respective rights of the trust (which is to be created under this plan) and the company's insurers should be essentially the same as they would be had this occurred out of bankruptcy. (There is an exception for the insurers' rights to challenge the assignment of the policies to the trust, which are preempted by [§ 1123\(a\)\(5\)\(B\) of the Bankruptcy Code](#)). To be sure, this may set up a high stakes and complex dispute to be resolved in insurance coverage litigation. But that is what it is. So long as small adjustments to the plan and confirmation order are made to comport with the principle that the bankruptcy neither expands nor contracts the rights of the parties, the insurer objections to the trust distribution procedures do not provide a reason why the plan cannot be confirmed.

Third, the insurers raise a handful of objections that are not directly related to their insurance policies. While the insurers' standing to assert these objections (particularly in view of the fact that they do not claim to be creditors here) is uncertain, the Court ultimately concludes that these objections fail on the merits. One of the 20 debtors in this case has only a single creditor that has asserted a claim, and that creditor did not vote on the plan. While there is a division of authority on the question, many courts hold, as the insurers here argue, that in such circumstances the class has not accepted the plan. Here, however, the solicitation order clearly provides that such a class will be deemed to have accepted the plan. Whether or not the inclusion of such language is appropriate, here it was entered on notice to all parties in interest and without objection. That order will therefore control. The Court also rejects the insurers' argument that the plan must comply with [§ 524\(g\) of the Bankruptcy Code](#) and their contention that the Bankruptcy Code prohibits assigning the task of resolving unliquidated claims to a post-confirmation liquidating trust.

Fourth, the U.S. Trustee argues that the payment of indenture trustee fees under the plan is an improper end run around [§ 503\(b\) of the Bankruptcy Code](#), which authorizes the payment of such fees only on a showing that the indenture trustee made a "substantial contribution" to the case. The Court concludes that on the facts present here, the payment of the fees is fundamentally a question of whether the plan discriminates among similarly situated creditors. Under the Bankruptcy Code, however, unfair discrimination is an objection that can be raised only by a class of creditors that rejects the plan's treatment of their claims. Because here the payment of these fees was appropriately disclosed, and all of the creditors who

might be viewed as “victims” of the discrimination voted to support the plan, this form of disparate treatment is not a basis to deny confirmation of the plan.

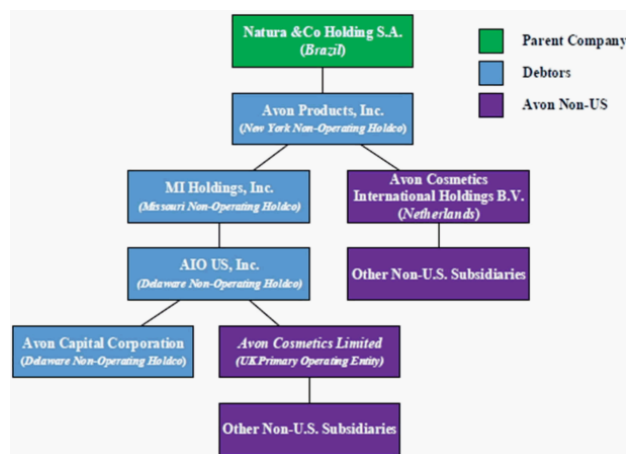
Finally, the plan contains a “gatekeeper” provision that bars the assertion of any claim that could be reasonably understood to violate the plan’s exculpation provision. And any claim that falls within that sweep may go forward only if this Court finds that the claim is “colorable” on the merits. The Bankruptcy Code provides no authority for such an order. The gatekeeping provision must be removed.

Factual and Procedural Background

1. The Avon business

Avon, founded in 1886, is a leading global beauty, fashion, and home related products company.¹ The corporate entities that filed these bankruptcy cases, however, *519 have not operated or sold products in the United States since 2016, when they spun off their U.S.-based assets.² The debtors now before this Court are Avon’s U.S. holding companies., which as of the time of the filing owned non-debtor foreign Avon subsidiaries and the majority of Avon’s intellectual property assets.³

All of the debtors’ revenue was derived from foreign operations.⁴ The debtors are wholly owned by Natura, a Brazilian corporation.⁵ After acquiring the debtors in 2019, Natura provided substantial funding to them.⁶ As of the petition date, the debtors owed Natura \$1.271 billion, a substantial portion of which was secured by the debtors’ assets.⁷ The chart below, created by the debtors, provides a high-level summary of the company’s ownership structure:⁸



2. The company's talc liability

Beginning in 2010, various plaintiffs began to assert personal injury claims against the debtors on account of alleged exposure to Avon’s talc-containing products.⁹ Claimants alleged that Avon’s talc-containing cosmetic products were contaminated with asbestos and caused *mesothelioma* *520 or other diseases.¹⁰ By 2020, debtors faced a rapid influx of talc-related lawsuits.¹¹ This increase in filings against Avon coincided with the bankruptcy filing of LTL, a Johnson & Johnson subsidiary, and the imposition of a stay against the assertion of talc-related claims against Johnson & Johnson.¹²

The debtors have incurred roughly \$225 million in defense and settlement costs since 2010.¹³ As of the petition date, the debtors had obtained dismissal of 197 talc claims and settled 350 talc claims. The median value of these settlements was \$99,500.¹⁴ Between 2020 and 2024 alone, the debtors obtained dismissal of 119 talc claims and settled 310 claims.¹⁵ They paid roughly \$123.5 million in settlement costs, settling 35 talc claims for less than \$10,000; 268 talc claims between \$10,000 and \$3 million; and 7 talc claims for amounts greater than \$3 million.¹⁶

The debtors took only two talc cases to trial, suffering adverse jury verdicts in both.¹⁷ The *Chapman* trial resulted in a jury verdict of \$46 million and is currently on appeal.¹⁸ The *Ramirez* trial resulted in a jury verdict of \$24.5 million.¹⁹ The debtors assert that they would have appealed that verdict as well, but the case is currently stayed as a result of this chapter 11 filing.²⁰

As of the petition date, 386 talc-related cases were pending against Avon.²¹ Also as of the petition date, debtors had

outstanding liquidated talc liabilities of approximately \$78.1 million – \$7.6 million for cases that they had settled but had not yet paid the amounts promised in the settlements and \$70.5 million on account of the two judgments entered against them.²²

3. The bankruptcy case

Debtor API, a U.S. based holding company, and certain of its U.S. subsidiaries filed these chapter 11 cases in August 2024.²³ In October 2024, 16 additional U.S. subsidiaries filed chapter 11 cases in this Court.²⁴ The debtors' cases are being jointly administered.²⁵ Natura, which is the debtors' parent company and their prepetition secured lender, agreed to provide the debtors a \$43 million DIP loan to finance these bankruptcy cases.²⁶

The debtors had also negotiated, before the bankruptcy filing, a proposed settlement with Natura, under which Natura would provide cash and other consideration to the bankruptcy estate in exchange *521 for a release of estate causes of action.²⁷ Specifically, Natura would pay the debtors \$30 million in cash, exclude certain assets including insurance receivables and preference claims from its proposed asset purchase, assume all liabilities related to API's pension plan, waive roughly \$530 million in secured debt, and grant a release of the debtors and their estates from certain claims that would otherwise reduce creditor recoveries.²⁸ The debtors asserted that this proposed settlement preserved the going concern value of the business, provided numerous benefits to the estates, and resulted in meaningful recoveries for unsecured creditors.²⁹ In addition, Natura agreed to serve as a stalking horse bidder to acquire substantially all of the debtors' assets.³⁰

The Committee vigorously opposed this settlement and sale.³¹ While the debtors sought a sale hearing in late October, the Court gave the Committee an additional month to take discovery, setting the hearing on the sale and proposed settlement for late November. The parties engaged in extensive litigation over the course of the following months, which included substantial discovery and the Committee filing a motion to dismiss the case.³²

While the parties were engaged in active discovery, the debtors also ran a 13-week marketing process for the sale of substantially all of the debtors' assets. They received no

additional qualifying bids and cancelled the auction.³³ The Committee, the debtors, and Natura ultimately settled on the eve of trial and proposed a global settlement that resolved both the estate claims against Natura as well as the objections to the sale.

At the December 5, 2024 hearing, the parties explained the terms of the global settlement, which included that (1) Natura would provide the debtors \$34 million of unencumbered cash, (2) Natura would exclude the following assets from the sale: the debtors' cash as of the closing date, liquidation insurance receivables (approximately \$4.8 million), rabbi trust assets (approximately \$25.5 million), preference claims and commercial tort claims, (3) Natura would assume certain pension assets and liabilities, (4) Natura would assume the attorneys' fees incurred in connection with API's prosecution of the appeal from the *Chapman* verdict and Natura may assume prosecution of the appeal, (5) Natura would waive all unsecured claims, intercompany claims, and all secured claims (except to the extent necessary to satisfy Natura's credit bid), (6) Natura would fund, in full and in cash, all outstanding DIP commitments prior to the sale closing date, and (7) all of the debtors' rights under talc insurance policies would be transferred into a trust, created by the plan, for the benefit of creditors.³⁴ Natura and the debtors also agreed to release each other from any and all claims, current, unknown, or future.³⁵

Following a hearing during which the terms of orders approving the sale and *522 settlement were discussed (which is discussed further in Part V of this Memorandum Opinion), the Court entered orders approving both the settlement and the sale of substantially all of the debtors' assets to Natura.³⁶

4. The plan

After approval of the sale and settlement, the parties undertook negotiations toward a plan. On February 28, 2025 the debtors filed an initial chapter 11 plan of liquidation and a proposed disclosure statement.³⁷

The debtors' primary assets are preference and commercial tort causes of action, rights to coverage under insurance policies, and an anticipated \$31 million in cash as of the effective date.³⁸ The plan proposes that, on the effective date, all of the debtors' assets will vest in a liquidation trust created by the plan.³⁹ Melanie L. Cyganowski will be appointed as

liquidating trustee to administer, resolve, liquidate, and pay all claims against the debtors.⁴⁰ The trust is a mechanism for resolving only those claims presented during the life of the trust, not future arising claims.⁴¹ The trust will be dissolved at the earlier of five years after its creation or when all trust assets have been depleted.⁴²

Classification and treatment of creditors under the plan

The plan establishes eight creditor classes: priority claims (class 1); secured claims (class 2); general unsecured claims (class 3); talc claims (class 4); subordinated claims (class 5); intercompany claims (class 6); intercompany interests (class 7); and parent interests (class 8).⁴³

Classes 1, 2, and 7 are unimpaired and deemed to accept – the debtors anticipate that class 1 and 2 claimants' rights under the plan will be unaltered and that their claims will be paid in full; class 7 intercompany interests will receive no distribution under the plan and will be reinstated solely to maintain the debtors' corporate structure and to facilitate the debtors' dissolution.⁴⁴

Classes 5 and 8 are impaired and deemed to reject – class 5 claims are subordinated claims and they will be deemed expunged, released, and extinguished as of the effective date; class 8 interests are parent (API) interests that will be cancelled and new parent interest *523 will be issued to the liquidation trust.⁴⁵ Class 6 intercompany claims will all be either reinstated or cancelled and released at the option of the debtors or the liquidating debtors.⁴⁶ Regardless, no distributions will be made out on account of intercompany claims.⁴⁷ Intercompany claim holders are not entitled to vote on the plan, and their claims can either be treated as unimpaired, and deemed to accept, or impaired, and deemed to reject.⁴⁸

Class 3 and 4 creditors are the only impaired classes eligible to vote to accept or reject the plan.⁴⁹ Class 3 includes all general unsecured claims against the debtors such as the unsecured 2043 note claims, trade claims, and former employee-related claims.⁵⁰ The debtors have upwards of \$49 million in outstanding liability on account of class 3 claims.⁵¹ The bond trustee's fees and expenses relating to the 2043 notes are excluded from the class 3 claim pool and instead are proposed to be paid pursuant to an agreement between

the debtors and the bond trustee as a condition precedent to confirmation of the plan.⁵²

The plan provides that class 3 creditors can either (1) recover their *pro rata* share of waterfall distributions from a general unsecured claims recovery fund (which will be funded with up to \$14 million in cash) or (2) they can elect to receive treatment identical to class 4 talc claimants in accordance with trust distribution procedures, and recover their *pro rata* share of cash proceeds from insurance rights and retained causes of action.⁵³ The net result of this mechanism is that claimants who make the class 3 election will recover the same percentage of the liquidated value of their claims as class 4 talc claimants do. While this election might (or might not) result in greater recoveries, the payout amount and timing are uncertain.⁵⁴

The holders of talc claims against any or all of the debtors are assigned to class 4.⁵⁵ The plan provides that talc claims that were unliquidated as of the petition date will be resolved and liquidated in accordance with trust distribution procedures.⁵⁶ Talc claims that were liquidated pre-petition, whether by settlement or pursuant to a jury verdict, will be paid as soon as practicable from the trust.⁵⁷

All other talc claims will be paid out on a first-in, first-out basis.⁵⁸ The trust will only pay talc claims if the talc exposure, from use of debtors' talc-cosmetic products, occurred in the United States or the United Kingdom.⁵⁹ Claimants' recoveries are dependent *524 on the proceeds from insurance coverage and those from other estate causes of action. The debtors emphasized that nothing in the trust distribution procedures determines whether the insurers are obligated to pay under their policies on account of the talc claims.⁶⁰

Mesothelioma talc claimants can elect to have their claims reviewed through either the expedited review or an individual review process.⁶¹ If a **mesothelioma** talc claimant selects the expedited review process and provides satisfactory evidence of a **mesothelioma** diagnosis and regular exposure to the debtors' cosmetic talc products for at least three years, then the claimant will be offered the scheduled value (\$10,000) of the claim.⁶² A claimant must submit evidence of the name of the products to which the claimant was exposed, how often the claimant used the product, the time frame in which the claimant was exposed, the duration of use, and information

regarding where and when the debtors' talc product(s) were purchased.⁶³ The trust distribution procedures also establish strict medical diagnosis criteria – the trust “must have reasonable confidence that the medical evidence provided in support of the talc claim is credible and consistent with recognized medical standards.”⁶⁴

If the [mesothelioma](#) talc claimant selects the individual review process, the claimant will be required to satisfy the exposure and medical diagnosis criteria described above and must also submit additional evidence to aid the liquidating trustee's specific liquidated value determination.⁶⁵ This includes information about whether the claimant used other non-debtor talc products and if the claimant had exposure to asbestos or asbestos products other than what was alleged to be present in the debtors' cosmetic talc products.⁶⁶ The liquidating trustee will consider the historical liquidated values of other similarly situated [mesothelioma](#) talc claims against the debtors in the tort system and the historical value of such claims paid out by the debtors.⁶⁷ A [mesothelioma](#) talc claimant's allowed claim under the individual review process will be capped at \$3 million.⁶⁸ Subject only to the application of this cap, however, the principal requirement of the trust distribution procedures is to generate allowed claim amounts that mirror the debtors' prepetition experience in resolving talc claims.

All other disease talc claimants will automatically proceed through the individual review process.⁶⁹ If the liquidating trustee determines that the claimant has provided satisfactory evidence of a disease diagnosis and has also established that he or she has had no exposure to asbestos or non-debtor talc products, then the claimant may receive an allowed claim of up to \$6,000.⁷⁰

Claimants are not required to accept the liquidated value assigned to their claims through these processes. The trust distribution procedures provide that claimants may arbitrate any disputes arising from the liquidating trustee's determination of ***525** claim allowance or the value of their talc claims.⁷¹ The plan does not contemplate, however, any access to a judicial process to determine the allowed amount of a talc claim. A claimant's sole recourse is to arbitration, and the task of the arbitrator will be to determine whether the trust applied the trust distribution procedures correctly.

Distribution structure

The plan provides that on the effective date, the liquidating trust will first pay in full all professional fees (including those fees and expenses of the bond trustee for the 2043 notes), administrative expense claims, secured claims, and priority claims. Remaining cash on-hand would be allocated to the operating expense reserve for the benefit of the liquidating trustee, and then to the general unsecured claims recovery fund.⁷² Once all other outstanding claims and the liquidating trustee's operating expenses have been paid, post-effective date cash (insurance proceeds and any recoveries from other causes of action) will be allocated for the benefit of class 4 talc claimants and class 3 special election claimants.⁷³

Voting and solicitation procedures

Classes 3 and 4 are the only impaired classes whose members are eligible to vote to accept or reject the plan.⁷⁴ The proposed voting and solicitation procedures order temporarily allowed all class 3 and 4 claims for purposes of voting on the plan.⁷⁵ Each class 4 talc claimant was accorded one vote on the plan against debtor API only.⁷⁶ And for voting purposes only, all [mesothelioma](#) talc claims were valued at \$10,000 (reflecting the scheduled expedited review value of such claims in the trust distribution procedures) while all other talc disease claims were valued at \$20.⁷⁷

Debtors also noted that they were aware of only one potential claim that may be against a debtor other than API – the EPA (represented by the Department of Justice, acting on behalf of the United States), which has a claim against debtor MIH.⁷⁸ This, coupled with the fact that none of the other debtors, other than API, hold any assets, led the debtors to propose that the MIH claimant receive the same treatment as creditors of API under the plan.⁷⁹ The debtors explained as much in a footnote to the disclosure statement.⁸⁰

The plan provides that any class that, as of the commencement of the confirmation hearing, does not have at least one holder of an allowed claim in an amount greater than zero for voting purposes shall be considered “vacant” and deemed eliminated from the plan for voting purposes.⁸¹

Other relevant provisions

The plan contains standard debtor-releases, an exculpation provision, an injunction, and a “gatekeeping” provision.⁸² The gatekeeping provision provides that parties may not pursue any claims that may relate to, or are reasonably likely to relate to, claims released or exculpated in the *526 plan, without first requesting a determination from the bankruptcy court that such claim was not subject to a plan injunction and is a “colorable” claim on the merits.⁸³

Disclosure statement and proposed voting and solicitation procedures hearing

Various insurers objected to the disclosure statement and proposed voting and solicitation procedures.⁸⁴ The debtors resolved most of those objections and filed an amended plan, disclosure statement, and proposed solicitation procedures order reflecting the terms of those resolutions.⁸⁵ London Market Insurers, however, maintained objections to the temporary allowance of talc claims and to the confirmation timeline.⁸⁶ The debtors argued that London Market Insurers lacked standing to object to the proposed voting procedures for talc claimants.⁸⁷

The Court held a hearing on the debtors’ motion for approval of the disclosure statement and solicitation and voting procedures on May 19, 2025. The Court approved the disclosure statement and solicitation and voting procedures subject to certain changes to the ballots to which the debtors had agreed.⁸⁸ The Court also issued an opinion that held that the London Market Insurers were parties in interest who were entitled to be heard with respect to both objections. The Court, however, overruled the objections on the merits, finding the procedures and confirmation timeline to be appropriate.⁸⁹

5. The confirmation hearing

After the May 19, 2025 hearing, certain insurers filed various motions to adjourn the confirmation hearing. They sought extensions for discovery and filed a motion to dismiss the bankruptcy case.⁹⁰ The insurers notified debtors of their intent to conduct a 30(b)(6) deposition and also proposed to introduce expert testimony at confirmation to establish that exposure to talc does not cause [mesothelioma](#). The debtors moved *in limine* to exclude any expert testimony on this topic.⁹¹ They argued that it was not relevant to confirmation because such testimony goes to the merits of the talc claims, and the plan does not prejudice the insurers’

authority to contest, for coverage purposes, the merits or value of the talc claims.⁹² The debtors also moved to quash all 30(b)(6) topics pertaining to the merits of the underlying talc claims, including historical data trends and prepetition talc verdicts and settlement histories (although the debtors had produced, in discovery, documents that contained such information).⁹³ The Court, during a status conference, denied the debtors’ motion to quash certain topics from the 30(b)(6) deposition but granted the *in limine* motion regarding the proposed expert testimony after the debtors and the Committee represented that the intent of the plan was to leave in place all of the insurers’ rights with respect to the merits of the underlying talc claims.

*527 The U.S. Trustee and the insurers objected to confirmation of the plan.⁹⁴ The U.S. Trustee objected to the plan injunction and gatekeeping provision and argued that the plan provision for payment of the bond trustee’s fees and expenses circumvents the requirements of § 503(b) and results in disparate treatment of creditors, rendering the plan unconfirmable.⁹⁵ Insurers objected on various grounds, arguing that the plan was not proposed in good faith, the plan did not obtain the necessary votes, the plan improperly seeks to alter insurers’ rights by “allowing” talc claims and binding insurers to the trust’s claim valuations, and asserting that their insurance policies are executory contracts such that the plan cannot assign rights under the insurance policies without also transferring the debtors’ obligations.⁹⁶ The debtors amended the plan in response to those objections. The second modified plan was filed on July 17, 2025.⁹⁷

The Court held the confirmation hearing on July 21 and 23, 2025. Philip Gund, the debtors’ chief restructuring officer and treasurer, testified on behalf of the debtors and was subject to cross examination. All other testimony came in by declaration.⁹⁸ All opposing parties had the opportunity to present their arguments. The debtors responded to the filed objections and those raised during the hearing.

Philip Gund testified to the debtors’ intent with respect to the plan and trust distribution procedures, the negotiations underlying the plan, how the trust distribution procedures are intended to mirror the tort system for talc claims, and the debtors’ history in the tort system regarding talc-related claims.⁹⁹ Gund testified that the debtors’ decision to file for bankruptcy was prompted by an increase in talc filings against the estate, \$1.3 billion in funded debt with little cash on-hand,

growing defense costs, and concerns that recent adverse jury verdicts would affect the debtors’ historical ability to reach smaller settlements.¹⁰⁰ He testified that the trust distribution procedures and the plan were intended to maximize the value of the estate while creating a “fair and equitable process for the resolution of unsecured creditor claims [and] talc claims.”¹⁰¹

Gund testified that the debtors maintained a spreadsheet of all talc claims against the debtors, 386 of which were outstanding as of the petition date.¹⁰² Gund had asked the debtors to create a summary of 429 claims between 2020-2024 that had been resolved, excluding verdicts.¹⁰³ That summary showed the following:¹⁰⁴

***528**

Category	Number of resolutions	Percent of resolutions by count	Percent of settlements by count	Total resolution value
Settlement amount greater than \$3 million	7	1.6%	2.3%	\$48,450,000
Settlement amount between \$10,000 and \$3 million	268	62.5%	86.5%	\$74,944,000
Settlement amount less than \$10,000	35	8.2%	11.3%	\$79,000
Dismissed	119	27.7%	N/A	\$0
Total	429	100%		\$123,473,000

Gund testified that the trust distribution procedures are intended to mimic the tort system in process and resolution.¹⁰⁵ The trust distribution procedures establish medical criteria consistent with those used in the tort system for the liquidating trustee to consider when evaluating claims and also provide historical settlement values with which the liquidating trustee is charged with aligning.¹⁰⁶

Mesothelioma talc claimants can have their claims reviewed under the expedited review or individual review process. Debtors’ counsel suggested that, in light of the company’s tort history, most mesothelioma claimants will likely elect individual review because the scheduled value for expedited review claims is so low.¹⁰⁷ And while the statements of counsel are not evidence, the evidence that is in the record of the proposed result of the expedited review process and the company’s settlement history (in light of ordinary common sense) seems to support that assertion.

The expedited review process assigns mesothelioma talc claimants with valid claims a \$10,000 value – which is the lower bound of the category in which the debtors

place the majority of settlements (268) they had reached.¹⁰⁸ Mesothelioma talc claimants who elect the individualized review process will be able to recover up to, but no greater than, \$3 million. This value reflects the higher bound of the category in which the debtors place the majority of settlements they had reached.¹⁰⁹ The \$3 million cap was negotiated with the Committee and reflected the debtors’ view that such a cap would result in significant savings in the claims resolution process.¹¹⁰

All other talc-disease claims will be individually reviewed by the liquidating trustee and are subject to a \$6,000 cap.¹¹¹ Debtors’ counsel explained that the drastic difference between the scheduled value assigned *529 to other talc-disease claims (such as ovarian cancer claims) and mesothelioma claims reflects the difference in the strength of the evidence of causation.¹¹² Gund testified that the Committee had proposed to include in the trust distribution procedures the average value of mesothelioma claims, but the debtors rejected this proposition because they were concerned that “the average value would either become a target or a minimum and would, ultimately, inflate claims.”¹¹³

Gund testified that the debtors do not concede that their products contain asbestos.¹¹⁴ In fact, the debtors maintained throughout, and adhere to the position, that their products were safe.¹¹⁵ But despite the fact that outside of bankruptcy the debtors could respond to talc claims by arguing, for example, that exposure to the debtors' talc products does not cause *mesothelioma*, under the expedited review process *mesothelioma* claimants need only establish proof of diagnosis and exposure to an Avon talc product for three years to receive a settlement offer.¹¹⁶ While in the individual review process, the liquidating trustee may consider evidence regarding whether the products at issue contained asbestos, for purposes of the expedited review process the debtors were effectively compromising their defense that exposure to talc does not cause *mesothelioma*.¹¹⁷ The debtors contend that in light of the increase in claims they faced in recent years, the trust distribution procedures provide a streamlined and more efficient process for claims resolution. Coupled with the \$3 million cap, the debtors contend that these procedures greatly reduce the total cost of managing their talc liability.¹¹⁸

Gund testified that the debtors intended both for the plan to protect the estate's right to recover on available insurance assets, and (relatedly) to protect the insurers' rights. He testified that the debtors were unwilling to agree to a plan or trust distribution procedures that inflated values for talc claims.¹¹⁹ He explained that the debtors insisted on provisions expressly stating that the trust distribution procedures do not affect the insurers' rights and also added in audit provisions to protect against fraudulent or improper claims.¹²⁰ And though not in evidence, debtors' counsel also explained that the debtors would not agree to a plan provision that would grant the liquidating trustee broad authority to amend the trust distribution procedures' scheduled values and criteria without court approval.¹²¹

Stephenie Kjontvedt's declaration regarding the tabulation of votes was also admitted into evidence.¹²² Sixty-one general unsecured class 3 claimants (90.71% of the voting creditors in the class) holding \$8,143,287.51 in claims (96.93% in amount) voted to accept the plan.¹²³ Seven class 3 claimants (10.29% of the voting creditors in the class) holding \$258,000.00 (3.07% in amount) in claims voted to reject the ***530** plan.¹²⁴ Debtors' counsel also submitted a proffer of testimony with respect to the voting status of the fourteen non-bondholder creditors in class 3 – all fourteen

non-bondholder creditors, totaling \$4,054,287.15 in claims, voted to accept the plan, none voted to reject it.¹²⁵ Just over 90 percent of class 3 claimants elected to forgo their *pro rata* share of distributions from the general unsecured claims recovery fund in favor of receiving treatment identical to class 4 creditors and sharing in the pool of insurance and cause of action recovery proceeds.¹²⁶ All of the class 4 (talc) claimants (100%) who submitted ballots voted to accept the plan.¹²⁷ No class 4 claimant voted to reject the plan.¹²⁸

The debtors only received ballots for class 3 against debtor API and no other debtor.¹²⁹ Debtors had entered into a stipulation with the EPA, a creditor of debtor MIH, whereby the EPA agreed to have its claim against MIH be treated as a non-electing class 3 claim against debtor API.¹³⁰ The EPA did not, however, vote on the plan.¹³¹ Class 4 votes were only solicited for debtor API in accordance with the plan and the solicitation procedures order.¹³²

During closing arguments, the debtors described certain changes to the plan that they agreed to make in response to the objections asserted during the hearing. The debtors agreed to remove certain conflicting provisions or phrases that might be understood to affect the insurers' rights.¹³³ They also agreed to remove the debtors and liquidating debtors entirely from the protection of the section 10.4 plan injunction, and agreed to revise the plan injunction to ensure that insurers' rights are not impaired by the plan injunction.¹³⁴ At the close of argument, the Court directed the debtors to file a redline on the docket showing those plan changes, which filing has been docketed at D.I. 1362.¹³⁵ The insurers were invited to file a further redline showing those changes that they believed needed to be made for the plan to be confirmable (subject to the reservation of their rights to contend that no plan would be confirmable). Two such redlines were filed at D.I. 1386 and 1388.

Jurisdiction

[1] When a proponent of a plan of reorganization seeks confirmation of that plan, the contested matter arises under § 1129 of the Bankruptcy Code and thus falls within the district court's subject-matter jurisdiction over matters "arising under" the Bankruptcy Code provided in 28 U.S.C. § 1334(b). That jurisdiction has been referred to this Court

under 28 U.S.C. § 157(a) and the district court's February 29, 2012 standing order of reference. Plan confirmation is a core matter under 28 U.S.C. § 157(b)(2)(L).

*531 Analysis

The debtors' confirmation brief walks through the elements that a plan proponent is required to establish to confirm a plan of reorganization, including satisfaction of the various elements of § 1129(a) of the Bankruptcy Code, and identifies the record evidence that, they contend, demonstrates the satisfaction of each of those elements.¹³⁶ Much of what the debtors say there is not contested.

This Memorandum Opinion will not contain specific findings and conclusions addressing each element necessary to show that the plan is confirmable. As is customary, the Court is prepared to enter a confirmation order that makes the necessary and appropriate findings, which will need to be revised by the parties to reflect the conclusions set forth herein. This Memorandum Opinion is addressed only to the objections to confirmation that were raised by one or more party in interest.¹³⁷

Four parties in interest asserted objections to plan confirmation – three groups of insurers and the U.S. Trustee.¹³⁸ These objections fall into five categories that the Court will address in the following order:

- *First*, the insurers argue that the plan was not proposed in good faith;
- *second*, insurers challenge certain findings and particular plan provisions on the ground that they would give the trust an improper “leg up” in subsequent insurance coverage litigation;
- *third*, the insurers assert a number of other confirmation objections that do not, on their face, relate to the treatment of their rights under their insurance policies;
- *fourth*, the U.S. Trustee argues that the plan's proposed reimbursement of the fees of the bond indenture trustee is impermissible; and
- *finally*, the U.S. Trustee contends that the “gatekeeper” provision in the proposed plan injunction is improper.¹³⁹

I. The plan was proposed in good faith.

A. The plan generally seeks to achieve ends that are within the contemplation of the bankruptcy laws.

[2] [3] Section 1129(a)(3) of the Bankruptcy Code provides that a plan of reorganization must be “proposed in good faith and not by any means forbidden by law.”¹⁴⁰ Courts have read this language to mean that both the means used and the ends sought in proposing a plan need to accord *532 with the purposes of bankruptcy law.¹⁴¹ In making this assessment, courts are to consider the entire record and reach a judgment based on the “totality of the circumstances.”¹⁴²

[4] Statements made by counsel, of course, are not evidence. But counsel for the debtors explained that the debtors took time to study what had occurred in other mass tort bankruptcy cases. “We understand the issues that have been raised by courts, by insurers, by other creditors, other objecting parties. And we worked very hard to minimize those issues here ... [by seeking] to do things right.”¹⁴³

The evidence at the confirmation hearing is broadly consistent with that representation. There is no question that the bankruptcy was filed in good faith. As described above, the bankruptcy was precipitated by the press of talc claims against the debtors, including two large adverse judgments.¹⁴⁴ During the bankruptcy case, the debtors reached an arm's length settlement (after extensive litigation) with the Committee that provided for the settlement of various estate causes of action against Natura arising out of pre-petition transactions and a process for the marketing and sale of the companies' assets (principally the shares of non-debtor foreign subsidiaries), which culminated in a sale of those assets to Natura.¹⁴⁵

[5] The evidence also demonstrates that the plan was proposed in good faith. Gund testified that the plan's trust distribution procedures were broadly intended to create a construct under which the trust would settle talc claims with individual talc claimants on terms that roughly mirrored the company's settlement history outside of bankruptcy.¹⁴⁶ He explained that as a fiduciary, the debtors believed they were obligated to seek to preserve whatever insurance was available for the benefit of the talc claimants (who made up a substantial fraction of the companies' creditor body).¹⁴⁷ At the same time, however, he testified that the debtors sought to do this in a way that treated the companies' insurers

fairly and preserved coverage defenses that the insurers would otherwise have.¹⁴⁸

B. While the plan's treatment of claims for foreign exposures to the debtors' talc products is a factor that weighs against a finding of good faith, it is insufficient to tip the balance under the "totality of the circumstances."

The insurers contend that under the plan's trust distribution procedures, foreign *533 claims are not eligible for payment.¹⁴⁹ The insurers cast this objection as one under § 1129(a)(1), presumably because they contend that the provision is inconsistent with § 502(b), which provides that claims allowance should turn on whether the creditor holds a valid "right to payment" against the debtor under applicable non-bankruptcy law.¹⁵⁰ For reasons this Court will describe in Part II.B, the settlement mechanism set up through the trust distribution procedures does not and need not (in light of the unanimous consent of the talc claimants) precisely reflect parties' legal rights outside of bankruptcy. The Court is therefore not persuaded that the inclusion of this provision, without any objection from an affected talc claimant, raises a question about improperly altering the rules of claims allowance.

[6] It does, however, bear on the question of good faith. As an initial matter, the debtors are correct in pointing out that § 6.7 of the trust distribution procedures is focused on location where the claimant alleges to have been exposed to the debtor's product, not on the claimant's nationality.¹⁵¹ That provision states that "[n]otwithstanding anything to the contrary herein, the Trust shall only pay Talc Claims if there is an allegation of Debtor Talc Exposure in the United States or the United Kingdom."¹⁵² Claimants exposed in the United States or in the United Kingdom are thus eligible to receive payment from the trust while claimants who allege that they were exposed to the debtors' products elsewhere are not. The debtors assert that this provision is simply based on the history of the kinds of claims that were asserted and settled before the bankruptcy filing.

But if the only concern were with the potential allowance of otherwise invalid foreign claims, it would be sufficient for the trust distribution procedures to focus on whether the claim was valid, without regard to where the alleged exposure occurred. And while it may well be true that claimants asserting exposure to the debtors' products from outside the

United States or the United Kingdom have not sued the company before, the past is not always a perfect predictor of the future. So there surely is no basis to say that a claimant exposed in some other country might not be able to present a claim to the trust demonstrating that the claimant has a valid "right to payment" from the debtor under non-bankruptcy law, which is generally what is required to recover as a creditor in bankruptcy.

In addition to being unnecessary to serve any legitimate bankruptcy purpose, improper reasons why such a provision *534 might be included in a trust distribution procedure come readily to mind. If, for example, the typical clients of those plaintiffs' lawyers representing committee members are individuals who have been exposed to the debtors' products in the United States or the United Kingdom, those lawyers might well draft a provision like this one to ensure that their "turf" not be invaded by others. Particularly in view of the fact that trust distribution procedures tend to make it easier and less expensive to assert claims against a trust than it was for plaintiffs to file suit against the debtors in the tort system (a feature of bankruptcy trusts discussed in Part II, below), this is certainly an approach that a committee member's attorney concerned with protecting one's own market share might take.

To be clear, the record contains no evidence that demonstrates that this is the reason for the provision, and the Court makes no such finding. But the motive and opportunity for a committee to seek to include such a provision, and the failure of the parties to suggest a legitimate reason for the provision that is at all persuasive, might well allow one to connect the dots.

[7] The Third Circuit has, in other mass tort bankruptcy cases, emphasized the important role of the bankruptcy court in protecting the "integrity of the bankruptcy court proceeding as a whole."¹⁵³ No part of the judicial role is more important than that. Even so, the record before this Court contains a substantial body of evidence demonstrating the debtors' good faith in proposing the plan. The debtors explained that they set out to "do things right" – and that statement that is backed up by a great deal of record evidence. It is also significant that not a single talc claimant with exposure to the debtors' products outside the United States or the United Kingdom has objected to the plan on this basis.

For those reasons, the Court will find that the debtors have established that this plan was proposed in good faith and not by any means forbidden by law. The requirements of

§ 1129(a)(3) are therefore satisfied. The Court emphasizes, however, that the inclusion of a provision like this is not a good look. In the absence of prior authority addressed to the question, the Court does not believe that its inclusion overcomes the substantial body of other evidence demonstrating the debtors' good faith. But now that this marker has been placed, however, the Court would not expect in future cases to confirm a plan containing a provision like this one in the absence of a more persuasive justification for its inclusion.

II. Modest changes to the plan are required in order for the plan to respect the rights of the insurers.

[8] [9] [10] [11] The insurers also assert a number of objections to confirmation that relate directly or indirectly to the plan's treatment of their insurance policies. As a conceptual matter, it is now settled that bankruptcy law intends for the bankruptcy filing of the insured to be as "neutral" as possible to the rights and obligations of the insurer. The Third Circuit's recent *Boy Scouts* opinion makes this point clearly.¹⁵⁴ Section 541 of the Bankruptcy Code brings into the bankruptcy estate all of the property, including insurance policies, that belonged to the debtor immediately before the filing.¹⁵⁵ Those property rights, however, *535 are defined by non-bankruptcy law.¹⁵⁶ And unless there is some bankruptcy-related reason that requires otherwise, the Supreme Court explained in *Butner*, "there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding."¹⁵⁷

[12] This neutrality principle serves an important point of bankruptcy policy. "Uniform treatment of property interests by both state and federal courts within a State serves to reduce uncertainty, to discourage forum shopping, and to prevent a party from receiving a windfall merely by reason of the happenstance of bankruptcy."¹⁵⁸ The forum shopping point is an especially important one here.

[13] [14] Chapter 11 is intended to permit an otherwise viable business facing financial distress to reorganize.¹⁵⁹ It may also properly be used, such as in cases like this one, to maximize value by permitting a going concern sale and facilitating an appropriate resolution of estate causes of action. But the powerful tools of bankruptcy are famously subject to misuse.¹⁶⁰ If the estate's interest in property were greater in bankruptcy than outside of bankruptcy, a debtor

might file for bankruptcy for reasons that have nothing to do with chapter 11's purpose of facilitating the reorganization of a distressed business. Rather, cases might be filed by debtors that seek a tactical advantage over another party.

That would be inconsistent with bankruptcy policy, which provides that a "debtor's property does not shrink by happenstance of bankruptcy, but it does not expand, either."¹⁶¹ As the Third Circuit's discussion in *Boy Scouts* reveals, the principle of *Butner* seeks to guard against the risk that parties might "forum shop" into bankruptcy for tactical purposes.

A series of Third Circuit decisions, including *Combustion Engineering* and *Boy Scouts*, have sought to give effect to the *Butner* principle in the context of a mass tort bankruptcy filing by a debtor that holds insurance coverage under a standard liability policy.¹⁶² The challenge, as the circumstances of this case demonstrate, is that basic principles of insurance and bankruptcy law clash in a way that makes the goal of "neutrality" – while it sounds laudable and is easy enough to articulate – a very difficult one to achieve in practice.

The nub of the problem is that the basic insurance bargain presumes that the insured's liability will be determined in the tort system. When an insured receives a claim, the insured may tender that claim to *536 the insurer. If the insurer accepts that the claim is covered by the policy (or is prepared to defend under a "reservation of rights"), the insurer steps in and defends the claim. And the insured is subject to a contractual obligation to cooperate in defending the claim. Collusion between the claimant and the insured will typically void the coverage.

The practice in mass-tort bankruptcy cases is difficult to square with this insurance model. To begin, a debtor with mass tort liability, like any debtor in a bankruptcy case, requires the creditors' support for its plan of reorganization to emerge from bankruptcy. And what looks to a bankruptcy lawyer like good faith negotiations between a debtor and its creditors over a plan of reorganization, including the treatment of claims held by mass tort claimants, may well look to an insurance lawyer like collusion between the insured and the claimants.

[15] That practice is complicated further by the way in which post-confirmation bankruptcy trusts operate. As a statutory matter, a claimant who asserts a claim for wrongful death or personal injury has a right to a jury trial on allowance

of that claim in bankruptcy.¹⁶³ But as a practical matter, claimants in mass tort bankruptcy cases very rarely exercise this jury-trial right. Rather, the task of liquidating the (often) thousands of unliquidated personal injury claims is left to a post-confirmation trust. While many details differ across cases, the usual practice is for the trust to make a settlement offer to a claimant based on information that the claimant provides. A claimant may decline the offer and seek a more individualized assessment from the trust. In many cases, a claimant may not resort to a jury trial until various steps in the process (often including mediation) are exhausted. These procedures are typically set forth in “trust distribution procedures.” In many cases (though not in this case), these procedures will include matrices that set out presumptive claim values based on the type of disease and its severity. These trust distribution procedures are commonly approved by the bankruptcy court as part of the plan of reorganization.

As sensible as all of this may be from the perspective of creating a mechanism for liquidating thousands of tort claims so that tort victims may recover their *pro rata* share of the estate assets, this mechanism of liquidating claims is very different from the process contemplated by the debtor's insurance policies. At the end of the day, the trust – which will succeed to the debtor's rights under its insurance policies – will likely seek insurance coverage for claims that have been “allowed” under these trust distribution procedures. To be sure, the insurers will be free to argue that the trust's failure to tender claims and cooperate with the insurers in their defense operates to vitiate the insurance coverage. But in the event of litigation between the trust and the insurers, the trust will likely trumpet (to a state court judge who may be unfamiliar with the bankruptcy process) that these procedures have all been approved by a bankruptcy court who found the plan, among other things, to be “fair and equitable.” Against that backdrop, *537 there is a sense in which declaring the plan to be “neutral” with respect to insurance issues is about as effective as a court order declaring a bell to have been unrung.

Except that perhaps there is still a way to square this circle. The basic transaction involved in the creation of a post-confirmation liquidating trust is simply the creation of a trust under state law and a transaction under which the debtor's assets are transferred to the trust. As part of the transaction, the trust becomes liable for making *pro rata* distributions to creditors on account of claims that had run against the debtor. The trust distribution procedures are simply an agreement as among the claimants and the debtor/trust regarding the process by which claims will be liquidated and paid.

While this commonly occurs in a bankruptcy case, there is no reason why it *cannot* occur outside of bankruptcy. Indeed, a state law assignment for the benefit of creditors similarly involves impressing on the debtor's assets a trust, over which the assignee serves as trustee. State corporate law may provide other similar mechanisms by which a corporate entity can wind down its affairs in such a manner. To the extent there is a way to make the bankruptcy “neutral” with respect to insurance, the closest way this Court believes it can do so is to make clear that, as between the trust and the insurers, subject to one exception discussed below in Part II.C.1, the parties’ rights vis-à-vis one another should be no different than they would be had such a transaction taken place under state law outside of bankruptcy. That is (again, subject to the one exception), this Court's order confirming the plan should not put a thumb on the scale one way or the other. The parties’ rights are essentially the same as they would be had such a transaction occurred outside of bankruptcy.

[16] Indeed, courts applying state law have confronted insurance coverage disputes that have involved insureds reaching “voluntary settlements” with an underlying claimant without having tendered the claim to the insurer or cooperating in the defense of the claim. This Court does not purport to opine on any such dispute. Unless and until the trust in fact seek insurance coverage for one or more claims, any such pronouncement would be premature and inappropriate. But it bears note that courts considering such matters have reached varying conclusions in varying circumstances. In some cases, courts have found that the failure to follow the procedures contemplated by the insurance policies renders insurance coverage unavailable.¹⁶⁴ In others, courts have found that the actions of the insured did not prejudice the insurer, and therefore that coverage remained available.¹⁶⁵ Perhaps, if the trust *538 could show that its procedures for resolving claims was the same as the process to which the insurers had consented before the bankruptcy, a coverage court would similarly find that the process adopted here did not prejudice the insurers. This Court, however, is making no finding one way or the other on this issue. To the extent there is a takeaway for the benefit of a court that may subsequently be hearing an insurance coverage dispute between the trust and the insurers in this case, it is that (again, subject to the exception about assignment, discussed below in Part II.C.1) the question before that court should be viewed exactly the way it would be if the parties had engaged in a transaction that achieved the same economic result outside of bankruptcy.

To be clear, the Court appreciates that even if insurers have every ability to assert insurance coverage defenses in precisely the way they would have in the event that a similar transaction had occurred outside of bankruptcy, they may still feel aggrieved by the process. *First*, the creation of a trust with relatively simple and inexpensive mechanisms for asserting and liquidating claims may encourage claimants who would not have chosen to sue (due to the cost, burden, and delay associated with the tort system) to assert claims against the trust.¹⁶⁶ In this sense, it is certainly possible that (by virtue of claims coming out of the woodwork) the insurers may end up paying more than they otherwise would have.¹⁶⁷ The insurers contend that this is inconsistent with the principle of neutrality reflected in *Butner* and the cases described above.¹⁶⁸ *Second*, having the trust resolve hundreds or thousands of claims, and then present all of these claims for coverage, creates something of an “all or nothing” problem for an insurer. In the typical case in which there is a dispute about whether a particular claim falls within an insurance policy’s coverage, an insurer can typically make a decision about whether to provide coverage or litigate a coverage dispute with its insured in which the stakes are limited to the claim that is presented. Having the insured (which is now the trust) aggregate these claims and present them *en masse* may well affect the negotiating leverage between the parties in a way that the insurer had not contemplated in issuing the policies, and that the insurer may contend places it at a disadvantage.

The answer to both of these objections, however, is the same one set out above. The debtors could have created a similar trust outside of bankruptcy that could have, in the same way, encouraged the assertion of claims that would not have been filed in the tort system, and aggregated many claims that would all be presented at once. Had the debtors done so and the insurers argued that the policies did not cover these “voluntary settlements,” a court with jurisdiction over the insurance coverage case would resolve that dispute by applying state law and the terms of the insurance policies. So too, here. While the Court will address the *539 parties’ specific insurance-related objections in the balance of this Part II, the overarching objective is to achieve the form of “neutrality” described above.

A. The insurance contracts are not executory.

[17] Hartford contends that its insurance policies are executory contracts.¹⁶⁹ If that is true, they could only be assumed and assigned to the trust if the debtors were able to

provide “adequate assurance” that the trust would be able to meet the debtors’ obligations under the policies.¹⁷⁰ Courts have uniformly rejected the contention that an insurance policy covering a period in the past, for which all premiums have been paid, is an executory contract within the meaning of § 365. Judge Kearsse’s decision in an appeal arising out of the *Ames Department Stores* bankruptcy case is an example. “Courts considering insurance policies in which the policy periods have expired and the initial premiums have been paid routinely find that they are not executory contracts despite continuing obligations on the part of the insured.”¹⁷¹ Literally every other case this Court has been able to identify has reached the same result.¹⁷² In view of the consistency of this authority, this Court will follow the unbroken line of precedent and reach the same conclusion.

[18] In fairness to Hartford, however, a colorable case can be made that this line of authority is less than fully satisfactory. But even if one were to play out this line of argument to its logical conclusion, it would make no difference to the outcome here. To back up to first principles, the term “executory contract” is not defined in the Bankruptcy Code. The Third Circuit, however, has followed the generally prevailing view and adopted the Countryman definition of the term.¹⁷³ Under that definition, an executory contract is one “under which the obligation of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute *540 a material breach excusing performance of the other.”¹⁷⁴

[19] On this understanding, contractual rights will fall into one of three categories. *First*, if the debtor has fully performed but the counterparty has not, the estate simply has an asset – the right to obtain the counterparty’s performance. *Second*, if the counterparty has performed and the debtor has not, the counterparty simply holds a prepetition claim for the value of the debtor’s performance. The *third* category, contracts that are materially unperformed on both sides, are within the scope of the Countryman definition of an executory contract.¹⁷⁵ And what is meant by “materially unperformed,” in the bankruptcy context, is that one party’s failure to perform will excuse the other party’s performance.¹⁷⁶

If one takes a careful look at the cases involving liability insurance policies covering past periods for which all premiums have been paid, courts find these policies to be non-executory for one of two reasons. *First*, some cases, such as the bankruptcy court’s decision in *Federal-Mogul*,

find the contracts to be non-executory because the insured's remaining obligations, such as the duty to cooperate with the insurer in connection with the defense of claims, are purely “ministerial,” or “immaterial” in the Countryman sense. Hartford seeks to distinguish that line of cases, arguing that its policy is governed by New York law, and that under New York law the insured's failure to cooperate will void the coverage (that is, it will excuse the insurer's obligation to perform under the contract).

The question of whether the trust will comply with its obligations under the contract – and whether, if it does not, that failure operates to void the coverage – is the *merits* question in an insurance coverage matter that is not yet ripe and is not for this Court to decide. As described above, cases involving “voluntary settlements” by insureds depend on the particular facts and circumstances of each case and may well vary based on the governing state law. So at least in this Court's view, declaring the policies to be non-executory on the ground that the insured's obligations are all purely “ministerial” sweeps too broadly. That may or may not turn out to be right, based on the particular facts and circumstances that have not yet transpired. It does not seem, however, to be a wholly satisfactory basis on which to conclude that policies are non-executory.

The second rationale that some of the cases provide for finding the obligations to be non-executory is that the insurer does not have an unconditional *right* to obtain the insured's performance of its contractual obligations. Instead, the insured has a choice whether it wants to obtain insurance coverage, or not. If the insured does not want insurance coverage, it has no obligation to tender claims, cooperate in the defense, or anything else. Understood this way, the insured's obligations can be understood not as executory obligations, but simply as conditions to coverage. And as the Third Circuit explained in *Weinstein*, there “is a distinction between failure of a condition and a breach of a duty. If the remaining obligations in the contract are mere conditions, not duties, then the contract cannot be executory for purposes of § 365.”¹⁷⁷ The Court in *Sudbury* found a liability insurance policy to be non-executory on this basis. While the insured's failure *541 to meet the conditions of coverage might well operate to vitiate coverage, that was true only with respect to particular claims. The insured's “failure to cooperate as to any one claim would not meet the Countryman definition since it would not excuse the Insurer's performance in respect of other claims.”¹⁷⁸

In *Sudbury*, the question whether the contracts were executory mattered only because the insurer sought administrative claim status for retroactive premiums that might become due under the policies.¹⁷⁹ That question is not presented here. Rather, Hartford is presumably contending that if the policy is executory, the failure to provide adequate assurance means that the contract must be rejected and therefore (perhaps) that Hartford no longer needs to perform its contractual obligations.

That outcome cannot be correct. Regardless of the pigeonhole in which one wants to put this problem, the central principle here derives from *Butner*. The bankruptcy filing should neither expand nor contract either party's rights. The insured still has all of the contractual obligations provided for under the contract. And if the insured can live up to those obligations (or if its failure to do so is excused under applicable non-bankruptcy law), then the insurer is likewise required to meet its obligations. Perhaps one can reach that conclusion (as *Sudbury* does) by describing the insured's obligations as “conditions to coverage” rather than “executory obligations.” It is also conceivable that one could reach the same result by treating the contract as an executory one but finding that the insurer's ability to assert coverage defenses in the future provides it with appropriate adequate assurance of the trust's future performance. As noted above, in light of the uniformity of the caselaw finding the policies to be non-executory, this Court will follow that course. It bears note, however, that even if one were to view the contract as executory, the ultimate outcome here would be the same – the trust would get the policies subject to the same terms and conditions under which the debtors had them. In no event, however, should either party obtain a windfall by virtue of the happenstance of the bankruptcy filing.

B. The trust distribution procedures reflect a voluntary settlement between the debtors/trust and the claimants.

[20] The objecting insurers also raise a host of challenges to the trust distribution procedures themselves, arguing (among other things) that the procedures improperly eliminate the requirement that a claimant show causation. Under the trust distribution procedures, a claimant with *mesothelioma* who can show that the claimant had been exposed to the debtors' cosmetic products will be entitled to receive a settlement offer from the trust. The requirement that would otherwise apply *542 in the tort system, that the plaintiff show that exposure to the defendant's product caused the plaintiff's injury, is

essentially being compromised as part of the global resolution reflected in the trust distribution procedures.

To engage this objection (and others that relate to the operation of the trust distribution procedures), one needs to step back and unpack what trust distribution procedures are, and how they fit into the processes contemplated by the Bankruptcy Code. To start with the statutory provisions, the Code contemplates two separate things: (1) the mechanism for liquidating an unliquidated claim (which the Code describes, in § 502, as claims “allowance”), and (2) the recovery that creditors in each particular class will receive on account of their allowed claim (which is described, in § 1123(a)(3), as the “treatment” provided to claims in a particular class).

The trust distribution procedures in this case, as is common in mass tort bankruptcy cases, address both the mechanism for “allowing” the unliquidated claims (the settlement process contemplated by the trust distribution procedures) and the “treatment” that allowed talc claims will receive (each claimant will receive a ratable share of insurance recoveries and the recoveries on other causes of action assigned to the trust). In this Court's view, the process of fixing the amount of the otherwise unliquidated claims is best understood as “allowance,” while the distribution of the proceeds of any insurance recoveries (including the sharing with other creditors that make the election) is “treatment.”¹⁸⁰

The debtors take a different view of this, describing all of the work done by the trust distribution procedures as a form of “treatment.”¹⁸¹ Debtors cite to the bankruptcy court opinion in *Boy Scouts* as support for that proposition. It is true that a passage in that opinion could perhaps be read, in isolation, to support that view.¹⁸² A more careful review of the *Boy Scouts* opinion, however, reveals that the *Boy Scouts* court was sensitive to the Bankruptcy Code's distinction between “allowance” and “treatment.”

[21] [22] The distinction is an important one. If a class of creditors accepts a plan's proposed “treatment” of that class, the class's acceptance can bind an individual creditor in that class who opposes that treatment. But every individual claimant is entitled to the protections provided by the statutory process of determining the allowed amount of that creditor's claim.¹⁸³ *543 Because claims allowance is not a matter on which the vote of a majority can bind a minority, the Court does not believe it correct to describe the mechanism of

resolving unliquidated claims as part of a plan's “treatment” of a class of creditors.

[23] [24] The court in *Boy Scouts* reached that same conclusion. “The allowance of a claim is distinct from treatment of a claim and the class vote does not bind a dissenting creditor with respect to whether its claim is allowed.”¹⁸⁴ The Court accordingly does not believe it correct to say that everything contained in a trust distribution procedure can fairly be described as a form of “treatment,” and the Court does not read the opinion in *Boy Scouts* to so hold. In *Boy Scouts*, individual claimants had ultimate recourse to the tort system to liquidate their claims, as § 502 of the Bankruptcy Code and §§ 157(b)(5) and 1411(a) of title 28 require. To be sure, the trust distribution procedures in *Boy Scouts* required claimants to jump through various hoops (such as engaging in mediation efforts) before doing so, but that is no different from a court's inherent authority, in a civil case, to direct parties to mediation. So long as those conditions do not unduly burden the exercise of a claimant's statutory right to the judicial process, that is a matter within a court's discretion and may appropriately be included as part of a trust distribution procedure. Whether that exercise is called “treatment” or something else is of little moment. In this Court's view, it probably is not, since the Court views the issue of “allowance” to be logically antecedent to “treatment.” Nothing in this case, however, requires the Court to resolve that question. The only point that matters for current purposes is that because not *everything* in the trust distribution procedures is properly described as “treatment,” the class's acceptance of the trust distribution procedures does not insulate the procedures from all judicial scrutiny.

[25] That gives rise to another question that the *Boy Scouts* opinion engaged: “what standard” a court should apply in assessing a trust distribution procedure.¹⁸⁵ The *Boy Scouts* court's answer to that question may be more implicit than express. This Court reads the case to be saying, in effect, that so long as individual creditors' rights to access the claims allowance process are appropriately preserved, and the class of creditors affected by the procedures votes to accept the proposed “treatment,” the Court otherwise need not say more about the trust distribution procedures beyond making those findings the Bankruptcy Code itself requires. Otherwise put, to the extent that the trust distribution procedures provide that creditors with certain types of injuries will receive settlement offers from the trust in particular amounts, in the absence of some suggestion that the plan has been proposed in bad faith,

the particular amounts need not be approved by the court as “fair,” “equitable,” “reasonable,” or otherwise.

Here, various insurers raise a host of objections to the trust distribution procedures, arguing that the settlement offers that the trust will make to claimants under those procedures are too high, and that the procedures improperly dispense with the requirement that a claimant establish causation in order to obtain an allowed claim.¹⁸⁶ The insurers are correct that the trust distribution procedures provide that a claimant suffering with [mesothelioma](#) will receive a settlement offer from the *544 trust so long as the claimant demonstrates exposure to the debtors’ product.¹⁸⁷ The claimant is not required, as a plaintiff would be in the tort system, to show that the exposure to the product is causally related to the claimant’s disease.

But the insurers’ challenge to this process misapprehends what the Court is doing in “approving” the trust distribution procedures. In this Court’s view, this distribution procedure is no more than an agreement that binds the claimants and the trust with respect to the mechanism for determining each claimant’s respective share of the trust’s assets. That is all. Nothing in this process ought to affect, let alone to determine, the insurers’ obligations under their policies. This is the reason the Court granted the debtors’ motion *in limine* and excluded the insurer’s expert who sought to testify that exposure to talc does not cause [mesothelioma](#). While it is true that under the trust distribution procedures, the trust will make settlement offers to talc claimants diagnosed with [mesothelioma](#) without requiring proof of a causal relationship, nothing in this Court’s approval of the trust distribution procedures is intended to suggest that such a claimant holds a valid “right to payment” that would be compensable outside of bankruptcy. As described above, the parties would be able to reach an identical agreement outside of bankruptcy without court approval. And as between the trust and the insurers, the fact that the Court is approving the trust distribution procedures is not intended in any way to alter the parties’ rights. The insurers’ rights to dispute coverage are fully preserved. To the extent an argument is made to a court hearing an insurance coverage dispute that this Court’s confirmation order reflects an adjudication by this Court about the “fairness” or “reasonableness” of the procedures, this Memorandum Opinion is intended to provide a clear and blunt answer: it doesn’t.

[26] [27] [28] [29] In sum, then, this Court views the principles that govern approval of trust distribution procedures to be as follows:

- (1) Claims “allowance” is an individual right. Every claimant is entitled to access to the tort system with respect to the allowance of their own claim. Here, the plan gives every claimant the right to an arbitration in which the arbitrator would apply the trust distribution procedures, not access to the tort system. Had any claimant objected to the plan on this basis, the Court would not be able to deprive that claimant of access to the tort system. Accordingly, a single objection from a claimant who alleged exposure to the debtors’ products outside the United States or the United Kingdom would be sufficient to derail this plan. No such objection, however, was received. Because the claimants have unanimously supported the plan and no claimant has raised any objection, this procedure is acceptable.
- (2) All of the process under which unliquidated claims may be liquidated through a consensual process is just that – a voluntary and consensual process between the claimants and the trust. The Court does not believe it has any meaningful role in “approving” or in superintending that process. So long as the process does not unduly burden a claimant’s right to access to the tort system (which the claimants here have waived, *see* point (1), above), the various steps that the parties will *545 take under the trust distribution procedures are no different from any other out-of-court settlement mechanism.
- (3) [Section 1122 of the Bankruptcy Code](#) imposes certain limits on how claims may be classified. Personal injury claims are all general unsecured claims. In some cases, however, trust distribution procedures create separate classes of different types of personal injury claimants and provide different treatment to those classes. This case, however, does not require the Court to address any question of “classification” as all talc claims are classified together.
- (4) Within a class, all claims must receive equal “treatment,” which is what the holder of a claim within a class receives on account of the claimant’s allowed claim. Here, there is no dispute that this requirement is met.
- (5) As described above, nothing in this process may expand or contract the rights of the insurers. Accordingly, any proposed “finding” that would tilt the playing field in a subsequent coverage dispute one way or the other should be deleted.

C. Certain of the insurers' remaining objections lack merit; others require modifications to the proposed plan and confirmation order.

[30] [31] While the analysis above resolves most of the objections to the trust distribution procedures, the insurers advance a number of other objections related to the treatment of their insurance policies, some of which do require modifications to the terms of the plan and/or the confirmation order. To that end, the Court notes that it does not believe it is entitled to pick up its own pen to mark up the plan so that it reads the way the Court might prefer. [Section 1121 of the Bankruptcy Code](#) identifies who may file a plan, and the bankruptcy judge is not among the listed parties. Rather, the role of the Court is set out in [§ 1129\(a\)](#), which provides that the court “shall” confirm a plan if the statutory requirements are met. Accordingly, this Court views its role as being limited to answering the question whether the plan the debtors have proposed is confirmable. The Court may require changes to the plan only where those changes are *necessary* to render the plan confirmable.

1. Although the insurance policies are not executory, it is nevertheless the case that the debtors' rights cannot be transferred without the associated terms and conditions.

[32] The Court addressed the insurers' arguments that their policies are executory contracts subject to [§ 365](#) in Part II.A, above. The policies are not executory. That said, even without the ability to rely on [§ 365\(f\)](#), the insurers may not enforce the anti-assignment provisions of their insurance agreements. This is the exception referenced above in the introductory paragraphs to this Part II. [Section 1123\(a\)\(5\)\(B\) of the Bankruptcy Code](#) provides that a plan shall “provide adequate means for the plan's implementation, such as ... transfer of all or any part of the property of the estate to one or more entities.” In *Federal-Mogul*, the Third Circuit held that this provision preempts state law to the extent that state law would otherwise prevent a debtor-in-possession from transferring an insurance policy to a post-bankruptcy trust.¹⁸⁸

***546** This is an exception to the principle described above under which the filing of the bankruptcy case neither expands nor contracts the rights of the parties to an insurance contract. Outside of bankruptcy, an insurer might (or might not) be able to enforce a contractual anti-assignment clause when an insured seeks to transfer an insurance policy to a third party such as a trust. (In certain circumstances, state law

might not permit the enforcement of this kind of provision, such as where the transfer did not change the risk borne by the insurer.)¹⁸⁹ Under *Federal-Mogul*, however, that defense is unavailable when the transfer occurs under a plan of reorganization in a chapter 11 bankruptcy case.

[33] The insurers do not take issue with that statement of the law. Their principal argument, however, is that any assignment of the insurance “rights” must bring with it the “obligations” under the insurance policies. As described above in the discussion whether the insurance policies are executory contracts, that is not quite right. When an executory contract is assumed and assigned, the assignee must of course take the rights subject to the obligations. But Part II.A explains that the insurance policies here, fully paid and expired, are not executory. Strictly speaking, the insured debtors have no remaining “obligations” under the contracts. If the trust chooses not to seek insurance coverage under one or more of the policies, the trust (as successor to the debtor) will have no obligation at all under that policy. Rather, the policies contain certain terms and conditions. Nothing in the transfer alters those terms and conditions. To the extent those terms and conditions were enforceable under non-bankruptcy law the day before the bankruptcy, they remain enforceable by the insurers against the trust. To the extent any of the plan language may be read to suggest that the insurance “rights” may be transferred without the corresponding terms and conditions, the plan and confirmation order must be revised to reflect the fact that the “rights” remain subject to those terms and conditions.

2. Claims resolved by the trust may be described as “allowed” claims; that allowance, however, reflects a voluntary settlement, not an adjudication of liability.

The insurers object to the language in the plan that describes claims resolved by the trust in accordance with the trust distribution procedures as “allowed” claims. The insurers would instead use the terminology “resolved.”

This dispute has quite a bit of history. A typical liability policy provides that the insurer becomes liable for the amount that the insured is “legally obligated to pay,” or words to similar effect. Courts have struggled with how this language intersects with the bankruptcy process. In *UNR Industries*, the Seventh Circuit suggested that the confirmation of a plan of reorganization amounted to a “judgment or settlement” of the debtor's total estimated (present and future) asbestos liability,

and concluded that its insurers were liable, by virtue of the order confirming the plan, for that amount.¹⁹⁰ In this Court's view, that statement reflects a misapprehension of federal bankruptcy law, confounding the *547 confirmation process with the claims allowance process.

At the other extreme, certain insurers read the decision of a California appellate court in *Fuller-Austin* to hold that insurers were obligated to indemnify the post-bankruptcy trust only the cents-on-the-dollar payment that the trust actually paid to claimants, not the full amount of the allowed claims owed by the debtor to the claimants.¹⁹¹ It is less than clear to this Court that the certain insurers' description of the *Fuller-Austin* holding is correct. That, however, is of little moment for current purposes. This Court's concern is with ensuring that the plan and confirmation order properly describe what is happening by virtue of *this Court's* orders. The effect of those decisions on some subsequent insurance coverage case is for a later court to decide.

[34] As a matter of federal bankruptcy law, nothing in the Court's confirmation order is adjudicating or resolving *any* individual talc claim, let alone the debtors' aggregate present and future talc liability. To be sure, the Bankruptcy Code envisions that it is the role of the bankruptcy court to "allow" or "disallow" creditors' claims. In this case however (as in many mass tort cases), the plan does something different from what is strictly contemplated by the Bankruptcy Code. Rather than have the bankruptcy court (or a district court following a jury trial) adjudicate claims disputes, the liquidating trust expects to settle the vast majority of those claims with the claimants. To the extent those efforts are unsuccessful, the trust distribution procedures provide that the claimant and the trust will have the claim liquidated through an arbitration. At bottom, however, the plan contemplates that the claims will be settled rather than litigated.

As far as the vocabulary goes, the Court does not think that there is anything wrong with describing the result of this settlement process as the "allowance" of a claim. So the Court will overrule the insurers' objection that would require the term "allowed" to be replaced with "resolved." But it is true that this "allowance" process differs from the kind of allowance contemplated by § 502 of the Bankruptcy Code in that no court is making any adjudication of liability. Rather, the claims are being "allowed" in the settled amounts because the claimants and the trust all agreed to this settlement mechanism. In approving it, this Court is saying no more than that these "allowed" amounts shall be binding on the trust and

the claimants with respect to each claimant's relative share of the trust's assets. The consequence of that "allowance" on the insurers' obligations under their policies is not a matter that is properly before this Court, and the Court will not speculate as to how a court that may later be tasked with resolving such a dispute might do so.

Separately, however, the Court believes it appropriate (in response to the insurers' argument about how their liability should be limited to paying the cents on the dollar that the trust actually distributes to creditors) to address any potential confusion over *whose* liability is being resolved through the trust distribution procedures. As a formal matter, when a bankruptcy court resolves a claims allowance dispute under § 502 of the Bankruptcy Code, the question that is being adjudicated (at least in the first instance) is the liability of the prepetition debtor.¹⁹²

*548 The Bankruptcy Code contemplates that, in a chapter 11 case, the plan will provide for the payment of allowed claims.¹⁹³ As a practical matter, even outside of the context of mass tort cases, most chapter 11 debtors now confirm plans before all the asserted claims are fully reconciled. Accordingly, the work of resolving claims allowance disputes and making distributions to creditors on account of their claims commonly falls to a post-confirmation trust. (Certain insurers' objection to the creation of such a trust in this case is addressed below in Part III.B.) The point, for current purposes, is that the liability that is determined in a claims allowance dispute is the liability of the debtor, not the trust. And to the extent the "treatment" a class of creditors will receive under a plan is a *pro rata* distribution out of a certain pool of assets, the plan imposes on the trust the legal obligation to make those distributions to creditors.

The same is true under the trust distribution procedures in this case. The liability that is being settled is the liability of the prepetition debtors. And the trust's obligation to pay is limited to paying creditors their *pro rata* share of the proceeds of any insurance recoveries. In this sense, it might be implicit in *Federal-Mogul* that the "transfer" of the insurance policies to the trust is not literally a "transfer" of the "policies" such that the trust replaces the debtors as the insured. Rather, to capture the intent of *Federal-Mogul* of ensuring that the trust has the same rights that the debtors had to recover on the debtors' policies for the benefit of creditors, it may be more accurate to say that the trust succeeds to the debtors' rights to enforce the policies – which policies still insure the debtors' liability. For this reason, while this Court does not purport to

resolve any question of insurance coverage, the Court does believe it appropriate to clarify that it does not see how *this Court's* order would mean that the insurers' obligations would be limited to the cents on the dollar payment the trust is obligated to pay claimants. The principle that the bankruptcy filing should not operate as a windfall must apply equally in both directions.

3. The plan and confirmation order should be silent about the preclusive effect of this Court's actions.

The debtors and the insurers have each suggested their own language for § 5.4 of the plan regarding the preclusive effect of the confirmation order in a subsequent insurance coverage dispute. As this Court sees it, however, the more appropriate course is for the plan and confirmation order to be silent about the preclusive effect of the Court's order. In this Memorandum Opinion, the Court is undertaking to describe as clearly and carefully as it can the matters that it is deciding, and those that remain undecided. It ought to be clear enough, for example, that by granting the debtor's motion *in limine* and declining to consider evidence purporting to show that exposure to talc products is not causally related to incidence of [mesothelioma](#), that this Court has not "actually decided" any issue of causation, let alone that any such finding would be necessary to this Court's judgment in confirming the plan.

[35] [36] It is generally settled law, however, that the preclusive effect of a *549 court's judgment is properly decided by the subsequent court, not the rendering court. "A court usually does not get to dictate the preclusion consequences of its own judgment."¹⁹⁴ "Disputes about the effect of a decision in one case on the prosecution of another are for the judge presiding in the second case. In the law of preclusion the second court normally determines the effects of the first judge's order."¹⁹⁵ This Court believes that the best practice is to follow that admonition. Accordingly, the plan and confirmation order ought to be silent about the preclusive effect of this Court's confirmation order. This Court would certainly entertain a subsequent motion or other appropriate proceeding to enforce the plan, confirmation order, or the injunctions entered thereunder.¹⁹⁶ But unless and until a dispute arises about the effect of this Court's ruling that is properly brought before this Court to decide, the effect of this Court's judgment in some subsequent proceeding will be left to the court hearing that proceeding.

4. The liquidating trustee need not be "neutral."

[37] [38] Certain objecting insurers take issue with the appointment of Melanie Cyganowski, a former bankruptcy judge, as the liquidating trustee, claiming that as a result of her previous engagements on behalf of talc claimants, she will not be impartial.¹⁹⁷ This argument reflects a misapprehension of the role of the liquidating trustee. The trustee of a post-confirmation trust, like the trustee of any trust, owes a fiduciary duty to the beneficiaries of the trust, which includes taking appropriate steps to maximize the corpus of the trust.¹⁹⁸ A trustee has a duty to "administer the trust in a manner that is impartial with respect to the various beneficiaries of the trust."¹⁹⁹ But that duty of "impartiality" does not extend to entities, like the insurers, against which the trust may hold causes of action. To the contrary, the job of the trustee is to recover as much as the trustee can for the trust's beneficiaries.

In fairness to the insurers, the task of resolving claims disputes is, before confirmation (and in most cases, even after confirmation) the role of the bankruptcy judge. The plan here operates differently. With the consent of every claimant, the task of seeking to settle claims disputes has been assigned to the liquidating trustee, subject to the right to arbitrate if settlement efforts are unsuccessful. Regardless, to the extent insurers contend that their insurance policies do not obligate them to pay the claims as resolved by the liquidating trustee, their rights to make that argument in any court of competent jurisdiction are fully preserved.

[39] The key point for current purposes, however, is that while the liquidating *550 trustee is duty bound to be fair and impartial in the trust's dealings with the beneficiaries, these duties do not extend to entities against which the trust holds causes of action, like the insurers.²⁰⁰ Perhaps the claimants are hoping, through the appointment of a former bankruptcy judge as the trustee, that a state court handling a coverage dispute might believe that the trust's litigation positions should be given some deference on the ground that the trust is some sort of adjunct of this Court. If so, that effort ought to prove unsuccessful. With respect to efforts to obtain insurance coverage, the trust is situated no differently from any other litigant. The trustee's duty is to do her best to maximize claimant recoveries, much like the directors of a corporate entity owe duties to maximize shareholder value. The trust should be treated like any other litigant and is

entitled to no special deference. For that reason, the insurers' objection to the appointment of Cyganowski as liquidating trustee (whose qualifications are not otherwise disputed) is overruled.

5. The "sharing" provisions are permissible.

[40] As described above, the plan contains a mechanism whereby non-talc unsecured creditors (in class 3) may make an election that would entitle them to receive the same percentage recovery on their allowed claims as the recovery that is ultimately obtained for the (class 4) talc claimants. The mechanic of this election requires that certain proceeds recovered by the liquidating trust on account of the insurance policies and retained causes of action be allocated to the "Special Electing GUC Recovery Fund," from which these claimants will receive their distribution.²⁰¹

During closing argument, the insurers objected to this diversion of the proceeds of their insurance policies.²⁰² The debtors offer two responses to this concern. *First*, they suggest that under *Moore v. Bay*, the liquidating trust is free to distribute any assets that the estate recovers to all creditors.²⁰³ This Court did the best it could to grapple with the *Moore v. Bay* opinion in its recent decision in *ONH*.²⁰⁴ Whatever one thinks of *Moore v. Bay*, it is limited to the proceeds of avoidance actions. That much is clear from the fact that the decision is now codified in § 550(a) of the Bankruptcy Code. The rights under the debtors' insurance policies, however, come into the bankruptcy estate under § 541.²⁰⁵ So *Moore v. Bay* has no application here.

Moreover, third-party insurance policies are different from policies that cover damage to the debtor's own assets, in that outside of bankruptcy there are circumstances (typically, after a claimant obtains a judgment against the insured) in which claimants have direct rights to recover *551 against an insurer whose policy responds to *that claimant's* claim.²⁰⁶ In *Travelers*, the Supreme Court described this type of action as a "true 'direct action' suit," – one in which the claimant is exercising rights under state law, as a form of a traditional creditors' remedy, similar to the right to levy any asset to satisfy a judgment. Here, a claimant who holds a judgment is entitled to satisfy that judgment by seeking to recover on the insurance assets directly from the insurer. This non-bankruptcy law interest in the debtor's insurance assets may well be sufficient to give that claimant an interest in specific

and traceable proceeds that is loosely analogous to a secured creditor's interest in its collateral (though the Court need not decide the issue here).²⁰⁷ The Court is therefore not persuaded that the proceeds of liability insurance policies are wholly unencumbered estate assets that should be distributed ratably to general creditors in accordance with their statutory priority.²⁰⁸

The debtors' *second* argument is more persuasive. They argue that this sharing mechanic was clearly set forth in the disclosure statement and was agreed to by 100 percent of the talc claimants. Even accepting that the proceeds of insurance are an asset in which the talc claimants have an interest, there is nothing in the Bankruptcy Code that prohibits them from consenting to the sharing with other unsecured creditors in the manner provided for in the plan.²⁰⁹ And the limits on "gifting" established by the absolute priority rule and the Third Circuit's decision in *Armstrong* have no application in the absence of an objecting class of creditors, which is absent here.²¹⁰ The Court accordingly rejects the argument that the sharing of insurance proceeds with the electing general unsecured creditors renders the plan unconfirmable.

6. The Court will not waive the rules providing for a stay of the effectiveness of the confirmation order if any party represents that it intends to seek a stay pending appeal.

[41] Bankruptcy Rules 3020(e) and 6004(h) provide that orders confirming a plan and providing for the sale of assets are automatically stayed for 14 days unless the court orders otherwise. The debtors have asked this Court to waive that stay.

Those rules operate primarily as a courtesy to the district court. In the event that a party seeks a stay pending appeal of this Court's confirmation order, these rules are intended to provide the district court (assuming a motion for a stay pending appeal is filed promptly) some time to consider the merits of the motion for a stay pending appeal before a plan is consummated. For *552 that reason, this Court would only be prepared waive that period if no party in interest intended to seek a stay pending appeal.

Accordingly, if any party represents to the Court that it intends to seek a stay pending appeal, this Court will not shorten the 14-day period contemplated by the rules for the district to decide whether to grant a stay pending appeal (or,

if necessary, an administrative stay while it considers the request for a stay pending appeal). In the absence of a party making such a representation, however, the Court would be prepared to waive the operation of these rules as the debtors have requested.

The Court notes that the confirmation order also contains language addressing whether and when an appeal from the Court's order would be equitably moot. The doctrine of equitable mootness, however, is purely an appellate doctrine. This Court does not believe it appropriate for the bankruptcy court to address that issue one way or the other.

* * *

The Court hopes and believes that the discussion in Part II.C of this Memorandum Opinion will provide the parties with meaningful guidance on the various language issues reflected in the redlines of the plan, trust distribution procedures, and confirmation order.²¹¹ The parties are directed to meet and confer, with the benefit of this guidance, to see if they might be able to work through language that comports with this Court's rulings. To the extent that a dispute remains that requires this Court's resolution, the parties should reach out to chambers, and the Court will promptly schedule a status conference (by Zoom) to resolve any such dispute.

III. The insurers' remaining objections to confirmation are overruled.

The insurers also raise a handful of confirmation objections that are not about insurance issues. If these objections were meritorious, the question whether the Court should deny confirmation based on these objections would be complex. On the one hand, *Truck Insurance* held that insurers are parties in interest with standing to object to confirmation.²¹² And *Lexmark* dismisses "prudential standing" which had otherwise been the "standing" bar to a plaintiff suing to enforce the rights of third parties.²¹³ *Lexmark* holds that what had been described as prudential standing should properly be understood as a merits point – a statutory cause of action does not extend to permitting a plaintiff to sue on account of an injury to a third party.

So how does the *Truck Insurance* principle apply, in light of *Lexmark*, when an objector is raising a confirmation issue that is not about *that* party's rights? On the one hand, a case can be made that the statutory protection does not extend to that party (meaning, in effect, that the objector is not a "party-in-

interest" for that purpose). The Third Circuit's opinion in *PWS* (which predated both *Truck Insurance* and *Lexmark*) could be read to support that view, though that opinion is careful to note that it is addressing only the "narrower" "person aggrieved" standard *553 that governs bankruptcy appeals, not the statutory term "party in interest."²¹⁴ On the other, one could also conclude that because the proponent of a plan bears the burden of demonstrating the elements required for confirmation, a party with standing to object to confirmation (which the insurers have) can simply insist that the proponent meet its burden. As interesting as that question may be, the Court need not resolve it here, as the various objections the insurers seek to assert all fail on the merits.

A. The objections based on the vote are without merit.

[42] The plan before the Court is filed on behalf of 20 separate corporate entities, each of which filed its own bankruptcy case in this Court, which cases are being jointly administered.²¹⁵ *Tribune* holds that such a plan needs to meet the requirements for confirmation for each of the individual debtors.²¹⁶ This Court agrees. Section 1121 provides that the "debtor may file a plan ... at any time in a voluntary case," and goes on to explain the circumstances in which another party in interest may file a plan.²¹⁷ After all, during the exclusive period, only *the debtor*, not a corporate parent or affiliate, may file a plan for that corporate entity. So it must follow as a matter of logic from the command of § 1121 that the 20 debtors in this bankruptcy case filed 20 plans. As a matter of convenience, those plans are contained in a single document that may be described colloquially as "the plan." As a statutory matter, however, they can only be understood as 20 plans, each of which must meet the requirements for confirmation.²¹⁸

Here, the voting declaration (which was admitted into evidence) states that the only votes cast were with respect to API.²¹⁹ On this basis, certain insurers argue that the plans for the other 19 debtors fail to meet the requirements of *554 § 1129(a)(10).²²⁰ The debtors correctly respond, however, that 18 of those 19 debtors have no impaired classes of creditors.²²¹ Because § 1129(a)(10) applies only "[i]f a class of claims is impaired under the plan," the subsection is inapplicable to the 18 debtors that do not have any impaired class.²²²

[43] That leaves only one debtor, MIH, which has a voting class – one that contains a single creditor, the United States, which elected not to vote on the plan.²²³ Debtors rely on the Tenth Circuit's decision in *In re Ruti-Sweetwater* that holds that a creditor's failure to vote “constituted an acceptance of the Plan.”²²⁴ As *Collier* explains, that case “has been followed by some courts and rejected by others. The latter cases appear to reason that the failure or inability of a creditor to vote on a plan is not the equivalent of acceptance of the plan.”²²⁵ The bankruptcy court in *Vita*, for example, joined what it described as a “clear majority of courts” in holding that “an impaired class that fails to vote to reject a Chapter 11 plan is not deemed to have accepted the plan.”²²⁶

The courts in both *Adelphia* and *Tribune*, however, concluded that where the rule that a non-voting class is deemed to have accepted is “explicit and well-advertised” to creditors, the court may enforce that rule.²²⁷ While this Court might state the point slightly differently, the Court generally agrees with the basic analysis of those decisions. In this Court's view, the critical point is not that the principle was announced by the debtor and “well advertised” to the creditors. Rather, the point is that the rule was approved by the court itself after notice to the creditors. After all, if the *Vita* decision is correct and a class without votes is not an accepting class, then it is hard to see what authority the debtor would have simply to announce a different rule – even if it says so explicitly and clearly. The Court is more persuaded, however, by the fact that here this rule was not announced unilaterally by the debtor but was instead included in the solicitation procedures that were approved by the Court, without objection, on notice to all parties in interest.

Paragraph 44 of the Solicitation Order that this Court entered in May provides that “[a]ny Class that contains Claims entitled to vote but for which no valid votes are returned shall be deemed to have accepted the Proposed Plan.”²²⁸ This provision was clearly disclosed in the debtors’ solicitation motion.²²⁹ And while various of the insurers asserted objections to the debtors’ proposed solicitation procedures, none of those objections raised any question about this provision.²³⁰ That amounts to consent. As this Court explained elsewhere,

The reason debtors file motions for courts to approve their solicitation procedures *555 is so that, before the estate incurs the expense of distributing the disclosure statement and plan ballot to creditors, all parties in interest have

a chance to weigh in on the propriety of the proposed procedures, and the Court can resolve any dispute about them. Once a court has considered the motion and decided that the procedures are appropriate, that decision should not generally be subject to a subsequent challenge.²³¹

That is the case here, and provides sufficient reason to overrule, on the merits, the insurers’ objection to the voting.

B. The plan need not comport with § 524(g).

The insurers argue that the plan improperly creates an asbestos trust addressing future claims without complying with § 524(g).²³² For this reason, the insurers contend, the plan fails to comport with the Bankruptcy Code and thus cannot be confirmed on account of § 1129(a)(1).²³³

[44] Congress enacted § 524(g) of the Bankruptcy Code to address the due process concerns associated with discharging a claim held by someone who may have been exposed to an asbestos-containing product but had not yet suffered from any disease as of the time of the debtor's bankruptcy. That section provides that future-arising claims may be “channeled” to a trust, but only upon the satisfaction of strict requirements designed to ensure that the plan treat the future-arising claimants fairly, despite their practical inability to participate in the bankruptcy case.²³⁴ This provision was necessitated by the fact that if those who will become sick in the future do not hold “claims” that are subject to being discharged in the bankruptcy case, those claimants would be able to assert those claims against the reorganized debtor. In that event, the reorganization of a distressed company with asbestos liability would be effectively impossible. That result was viewed as worse for all involved.

[45] That concern is absent here. These debtors are liquidating rather than reorganizing. As a result, they are not eligible to be discharged under § 1141(d) of the Bankruptcy Code, let alone to receive the “supplemental discharge” contemplated by § 524(g). While the insurers and the Office of the U.S. Trustee raised concerns that the plan's injunction, as drafted, effectively operated as a discharge in disguise, the Court understands that the parties have consensually resolved those objections.²³⁵

The insurers’ remaining point is that this plan effectively *will* deal with future-arising claims because the trust distribution procedures provide a broad definition of talc claims. As a

result, the insurers contend that a claimant who is diagnosed with [mesothelioma](#) after the petition date but while the trust is still in existence is likely to receive a settlement offer from the trust.²³⁶ The insurers argue that this is only permissible in a [§ 524\(g\)](#) case. But that is incorrect.

***556** Because this case does *not* involve a [§ 524\(g\)](#) trust, the trust created by this plan ought to deal with “claims” in essentially the same way that a chapter 7 trustee would. As unfair as it may seem to a future-arising claimant, a chapter 7 trustee would distribute the debtor's assets to those creditors who presented “claims” while the trustee still had assets to distribute. Those who presented claims after the bankruptcy estate was fully administered would be unable to recover out of the estate's assets.

But what about a claimant that appeared after the bar date, but while the chapter 7 trustee still had assets to distribute, because the claimant did not develop a disease until after the bar date had passed? There is little doubt that the recent diagnosis of an asbestos-related disease would satisfy the “excusable neglect” standard.²³⁷ So the failure to file a proof of claim by the bar date would not preclude that creditor from recovering.

And what about the insurers’ argument that such a creditor does not hold a “claim” under [§ 101\(5\) of the Bankruptcy Code](#) that would entitle that claimant to recover out of the bankruptcy estate? The answer to that objection is provided by the Third Circuit's decision in *Grossman's*, which suggests that such a creditor does indeed hold a “claim” in bankruptcy.

The question in *Grossman's* arose in the context of determining whether a creditor's claim had been discharged. But the statutory term “claim” has the same meaning in the context of the discharge as it does in deciding who may receive a distribution. In *In re Grossman's*, the *en banc* Third Circuit held that the scope of the term “claim” in [§ 101\(5\) of the Bankruptcy Code](#) is fact specific. “In determining whether an asbestos claim has been discharged, the court may wish to consider, *inter alia*, the circumstances of the initial exposure to asbestos, whether and/or when the claimants were aware of their vulnerability to asbestos, whether the notice of the claims bar date came to their attention, whether the claimants were known or unknown creditors, whether the claimants had a colorable claim at the time of the bar date, and other circumstances specific to the parties.”²³⁸

Similar to those courts that have adopted the “prepetition relationship” test, the point is that if the claimant would have had absolutely no reason to know to file a proof of claim in the debtor's bankruptcy case – such as the passenger who would in the future fly on an airplane that contained a defective engine manufactured by the debtor – then concerns about due process counsel strongly against reading [§ 101\(5\) of the Bankruptcy Code](#) to provide that such a claim has been discharged.²³⁹

***557** Avon's cosmetic products, however, are quite unlike the aircraft engine. Those who used the products would likely have had the kind of “prepetition relationship” with Avon that would lead their “claims” to fall within [§ 101\(5\)](#) in those jurisdictions that have adopted the prepetition relationship test. And their claims would likewise appear to satisfy the Third Circuit's definition of “claims” adopted in *Grossman's*. To be sure, a rule under which a creditor's claim is discharged in a bankruptcy case that occurs before the claimant is diagnosed with a disease may be viewed as a harsh one. But because Avon's customers knew that they had used Avon's products, the application of the *Grossman's* test would suggest that even those claimants might well hold “claims” under [§ 101\(5\)](#) that would be entitled to payment in (and, if the debtor were entitled to a discharge, be discharged by) the Avon bankruptcy case. Nothing in the insurers’ objection provides reason to believe that the definition of “claim” adopted under the plan would provide for the recognition of a “claim” that would fall outside the Bankruptcy Code's definition under applicable law.

C. The debtors are not required to liquidate all claims before confirmation.

Certain insurers also asserted, during closing argument (though the point does not appear to have been advanced in their confirmation objections) that the plan improperly establishes a post-confirmation trust to address claims and distribute the proceeds of insurance to creditors. They argue that [§ 1123\(b\)\(3\)](#) contemplates the possibility that a post-bankruptcy entity (such as a post-confirmation trust) might be charged with the task of the “settlement or adjustment of any claim or interest belonging to the estate.”²⁴⁰ But there is no statutory authority, they argue, for a post-confirmation trust to play a role in resolving claims *against* the estate.

Perhaps a case can be made that the Bankruptcy Code, as originally enacted in 1978, contemplated that the claims allowance process would be complete before plan

confirmation. Even if that is correct, the 1994 enactment of § 524(g) certainly provided for claims to be “channeled,” after confirmation, to a post-confirmation trust, that would undertake to ensure that present and future-arising claims would receive substantially similar treatment.

More fundamentally, however, as the chapter 11 process has grown increasingly expensive, it has become commonplace for post-petition entities, such as a post-confirmation liquidating trust, to take on responsibilities that the Bankruptcy Code assigned to the “trustee,” but that cannot as a practical matter be completed before confirmation. It is now unexceptional for a bankruptcy court to confirm a chapter 11 plan that leaves the liquidation of estate assets (not just the causes of action contemplated by § 1123(b)(3)(B)), and the resolution of claims against the estate, to a post-confirmation trust.²⁴¹ To be sure, *558 there are circumstances in which, when a post-confirmation trust is addressing matters that the Code envisioned being performed by the trustee (including a debtor-in-possession) before a plan was confirmed, some confusion may arise over whether the operative legal rules are those provided by the Bankruptcy Code or by the confirmed plan.

[46] [47] [48] Whatever imperfections may exist in the modern practice, this Court does not believe that these innovations are precluded by the Bankruptcy Code. Section 1123(b)(6) provides, of course, that a plan may “include any appropriate provision not inconsistent with the application of this title.”²⁴² The Supreme Court in *Purdue Pharma* explained the limits of the kind of provision that this may include. Such a provision must “concern the debtor—its rights and responsibilities, and its relationship with its creditors.”²⁴³ Accordingly, it cannot include a “radically different power to discharge the debts of a nondebtor without the consent of affected nondebtor claimants.”²⁴⁴ But giving a post-confirmation trust the authority to resolve claims against the estate and distribute the proceeds of estate causes of action is nothing like the third-party release invalidated in *Purdue Pharma*. This type of provision fits squarely within the catch-all of § 1123(b)(6).²⁴⁵ This objection is therefore overruled.

IV. The plan's payment of bond trustee fees is permissible.

Section 12.16 of the plan provides for the payment of reasonable fees and expenses for the indenture trustee for the Unsecured 2043 Notes, up to a cap “as previously agreed to in writing between the Debtors and the Bond Trustee.”²⁴⁶ In

a brief submitted by the bond trustee and in testimony that the debtors elicited at the confirmation hearing, the parties disclosed that this agreed cap was \$850,000.²⁴⁷

The U.S. Trustee objects to the payment of this amount, arguing that providing for the payment of these fees in the plan is, in effect, an end run around the demanding standard for a substantial contribution claim under § 503(b) of the Bankruptcy Code.²⁴⁸

[49] The Court disagrees with that argument on the merits. The Court notes, however, that to the extent the bond trustee or the debtors are contending that the U.S. Trustee lacks standing to raise this objection because it lacks an economic stake in the matter, the Court rejects that argument. Congress devised a system under which the U.S. Trustee would play an independent role in ensuring compliance with the Bankruptcy Code. To that end, § 307 of the Bankruptcy Code grants the U.S. Trustee standing to be heard on any issue in a bankruptcy case.²⁴⁹ As explained *559 below, the Court concludes that on the merits, the U.S. Trustee's argument is unsuccessful. But that the issues are being raised by a party that lacks an economic stake in the resolution should be understood as a feature, not a bug.

[50] As this Court sees the issue, the applicable analysis may well be different outside the plan context than it is when the payment is contemplated under a plan. The issue arises from the fact that in a typical bond indenture, there is not a direct contractual relationship between the borrower and the underlying noteholder. Rather, the borrower's relationship is with the indenture trustee, which typically handles the enforcement of rights under the indenture, and in turn has contractual obligations to the noteholders. Accordingly, the indenture trustee's right to recover legal fees (which is typically provided for under the indenture) is a general unsecured claim, no different in character from the rights of the underlying noteholders (in an unsecured bond issuance). At times, the bond trustee may well pay a constructive role in forging consensus among the noteholders and facilitating the reorganization. The issue that arises is the legal standard to apply when the trustee seeks to receive compensation out of the estate for the fees it has incurred.

The answer to that question is easy when the debtor opposes paying those fees. The standard is “substantial contribution,” as set out in § 503(b) of the Bankruptcy Code. Section 503(b) expressly contemplates that reasonable fees may be paid when the indenture trustee makes a “substantial contribution”

to the case. That standard, however, is a demanding one. It does not permit granting the trustee an allowed administrative claim (even if the fees are reasonable) to pay costs that the trustee would in any event bear to protect the interests of the bondholders.²⁵⁰

Where the debtor agrees that the bankruptcy estate should pay the fees, either under a plan or by separate motion, the analysis becomes slightly more complex, as the thoughtful decisions in *Adelphia* and *Mallinckrodt* demonstrate.²⁵¹ In both of those cases, the courts allowed for the payment of reasonable fees. As this Court understands those opinions, the courts essentially treated the request as (and this is this Court's own take on these opinions – the decisions do not say this in so many words) a consensual resolution of a § 503(b) request, to which the U.S. Trustee was objecting. In both cases, the courts took a careful look at the question of the contributions made by the indenture trustee and the reasonableness of the fees. The courts credited the debtor's judgment that the fees warranted administrative claim status. Neither court, however, treated the debtor's judgment as the beginning and end of the analysis. Both carefully examined the merits of the request and reached the independent judgment that the indenture trustee's contribution was indeed a substantial one.

That analysis is certainly a sensible one in the contexts in which those cases arose, which is different from the context of the current dispute. In *Adelphia*, the issue arose on a motion filed after confirmation.²⁵² In *Mallinckrodt*, the payment was to be made under a plan, but certain classes of creditors had voted to (or were *560 deemed to) reject the plan.²⁵³ In this regard, the issue in *Adelphia* and *Mallinckrodt* is similar to the one raised before this Court in *Yellow*, when the debtors sought to settle prepetition claims that certain creditors had asserted, while other parties in interest had pending objections to allowance of those claims.²⁵⁴ Without definitively resolving the standard that the court would apply to review the proposed settlements, this Court concluded that, at the very least, it was required to pay due respect to the objecting party's statutory right to object to the claims as a party in interest. There, that meant that the proposed settlements would be measured by a standard that was more rigorous than the most deferential form of business judgment standard that might otherwise apply to a motion under Rule 9019.²⁵⁵ In reviewing the *Adelphia* and *Mallinckrodt* decisions, where the U.S. Trustee (as a party-in-interest) had objected to the payment of the fees, those courts appear to be engaging in a similar analysis.

It is certainly possible that the fees in this case could be approved by application of that same standard, as the record here does demonstrate that the bond trustee played an important role in facilitating a consensual resolution of potential disputes between commercial creditors and the talc claimants.²⁵⁶ The Court concludes, however, that in view of the language and structure of the Bankruptcy Code, the circumstances of this case make it somewhat easier than the cases presented in *Mallinckrodt* or *Adelphia*.

[51] The reason for that is that the Bankruptcy Code's prohibition on discriminatory treatment of similarly situated creditors, as the Third Circuit explained in *Tribune*, is a statutory protection for a class of creditors that rejects the plan's treatment of their claims.²⁵⁷ The right to “equal treatment” across different classes is not one that may be enforced at the behest of an individual creditor or party-in-interest, so long as the *class* of affected creditors votes to accept the plan's treatment of their claims by the requisite majorities.

Here, the economic substance of the payment of the bond trustee's fees in 100-cent dollars is that the bond trustee was receiving a greater percentage payment on its unsecured claims than were the trade creditors who were placed in class 3 along with the indenture trustee. While the bond trustee is the only party with a direct contractual relationship with the debtor, it is not uncommon for (and the plan here allowed) individual bondholders to be permitted individually to vote the debt that they hold. As a formal legal matter, however, the claim arising out of the bond issuance (including the bond trustee's claim to fees) is a general unsecured claim entitled to the same treatment as other general unsecured creditors. Here, by providing the bondholders the same treatment afforded to other class 3 holders (on account of their claims for principal and interest under the bonds) – but paying the bond trustee's claim for fees in full – one might say that the plan provides the obligations under the bond indenture (viewed in the aggregate) with different and better *561 treatment than that provided to other class 3 creditors.

The Bankruptcy Code, however, requires that all claims within a class receive the same treatment – a requirement that an individual creditor within that class may enforce.²⁵⁸ But the payment of the bond trustee's fees was appropriately disclosed in the disclosure statement and no party in interest took issue with the bondholders being placed in the same class as the other commercial creditors. In addition, during

the confirmation hearing, the debtors proffered (without objection) the testimony of the balloting agent that all 14 of the non-bondholder claimants in class 3 voted to accept the plan.²⁵⁹ Accordingly, because the economic substance of the objection is that the payment of the bond trustee fees provides unequal treatment to the claims arising under the bond indenture, and because all affected creditors have consented to this disparate treatment – a result the Bankruptcy Code expressly contemplates in its classification and voting scheme – the Court concludes that the payment of up to \$850,000 in reasonable fees to the bond trustee comports with the Bankruptcy Code.

V. The gatekeeping provision cannot be approved over the U.S. Trustee's objection.

[52] The final issue to address is the U.S. Trustee's objection to the so-called gatekeeping provision contained in the plan. The parties have resolved the dispute raised by the U.S. Trustee over the scope of the releases and exculpations provided for in the plan. The breadth of the injunction against the assertion of claims that may be covered by those releases and exculpations, however, remains disputed.

The provision in question is § 10.8 of the plan. It provides that:

No Person may commence or pursue a Cause of Action of any kind against the Debtors, the Liquidating Debtors, the Exculpated Parties, or the Released Parties that could reasonably be characterized as a Cause of Action that will be or is extinguished, exculpated, or released by the Plan or otherwise will be or is subject to the Plan without the Bankruptcy Court first determining, after notice and a hearing, that such Cause of Action (a) represents a colorable claim against a Debtor, Liquidating Debtor, Exculpated Party, or Released Party and (b) has not been extinguished, exculpated, or released by the Plan or otherwise will be or is subject to the Plan.²⁶⁰

This type of “gatekeeping” provision – one that enjoins not only the assertion of claims that are released or exculpated under the plan, but also prohibits the assertion of claims that live in the same neighborhood as claims that are released or exculpated under the plan (here, a claim that “could reasonably be characterized” as a released or exculpated claim) – has been the subject of some recent controversy.

[53] The Fifth Circuit recently clarified its position on the issue in its decision in *Highland Capital*.²⁶¹ Relying on

the *562 *Barton* doctrine, under which bankruptcy trustees may not be sued outside of bankruptcy court without the bankruptcy court's permission, that court had previously found that bankruptcy courts may enter gatekeeping orders in limited circumstances.²⁶² *Highland Capital* asserts that Fifth Circuit precedent had never authorized the use of a “gatekeeping” provision that extends beyond “the trustee or other bankruptcy-court-appointed officers[s] for acts done in the actor's official capacity.”²⁶³ The court in *Highland Capital* accordingly concluded that the gatekeeping order entered by the bankruptcy court in that case must be narrowed so that it extended only to estate fiduciaries, and covered only acts taken in their fiduciary capacity.²⁶⁴

Even as narrowed, however, this Court does not believe there is a basis for imposing a “gatekeeping” role. To be sure, it is settled law that estate fiduciaries may be exculpated from the assertion of claims that arise out of their exercise of their fiduciary duties.²⁶⁵ And it is customary and unobjectionable to back that exculpation by an injunction against the assertion of an exculpated claim. The Court does not understand the authority, however, for extending the injunction *past* the scope of the exculpation and other appropriate releases of estate claims themselves, to apply to claims that “could reasonably be characterized” as such a claim. More puzzling still, the “gatekeeping” injunction arrogates to this Court not only the authority to determine whether such a claim falls within the plan's injunction but also requires a finding by this Court that the underlying claim (over which the Court may or may not have subject-matter jurisdiction) is a “colorable” claim on the merits.

Notwithstanding *Highland Capital* and the related Fifth Circuit authority (or the transcripts from oral rulings of bankruptcy courts in other jurisdictions), this Court does not believe that either the Bankruptcy Code or the *Barton* doctrine provides any substantive authority for the bankruptcy court to do anything like this. The parties have not identified any Third Circuit authority for such an injunction, and this Court is aware of none. The court put the point clearly in *Gulf Coast Health Care*. As here, the debtors there “had requested that [the court] retain sole and exclusive authority to determine whether a claim or cause of action against a released party arises from or is related to a debtor-released claim or a third-party released claim and, in doing so, authorize such party to bring the claim against the relevant release[d] party.”²⁶⁶ The court rejected that request. “I will sustain the U.S. Trustee's objection on this point. I see no reason to retain exclusive

jurisdiction for a determination that has been requested of me. The ... plan says what it says, and other courts should be entitled to exercise their authority to interpret it.”²⁶⁷

This Court accordingly asked counsel for the debtors, during closing argument, *563 whether any judge on this Court had ever granted an injunction with the kind of “gatekeeping” provision sought here. Counsel’s response to that question was a polite and appropriate way of saying “yes, Your Honor, it was you, dummy.”²⁶⁸ And in fairness, there is some merit to counsel’s point.

In connection with the debtors’ settlement with Natura, the debtors sought an order that included a gatekeeping provision. The issue there was that the settlement resolved estate causes of action. And the concern was over how to handle the possibility that Natura might face a claim for successor liability, as to which it can certainly be argued that such a claim actually belonged to the bankruptcy estate and was resolved in the settlement. In response to the U.S. Trustee’s objection to the proposed gatekeeper provision, this Court expressed reservations that are broadly in line with the views set forth above. “The notion that if there’s a real argument that something is an estate cause of action I retain jurisdiction to decide that question doesn’t offend me. The notion, however, that no one gets to bring a claim that’s actually an individual claim before coming to me and saying pretty please I’m not really sure I have authority to do.”²⁶⁹

Despite expressing those concerns, the Court went on to add that while “I am a stay-in-your-lane kind of judge and don’t think I ought to be enjoining things that could properly be brought in another court, I am not concerned with the proposition that I could enter an order that says ‘to the extent there is a good faith dispute about whether an action is subject to the release contained herein such actions ought to be brought before me.’”²⁷⁰ Consistent with those comments, the parties went on to submit, and this Court entered, an order stating that “no Person or Entity may commence or pursue a Cause of Action of any kind against the Debtors or Natura Releasees, as applicable, that could reasonably be characterized as a Cause of Action subject to Section 4 of the Settlement Agreement or the releases provided in this Order without the Court first determining, after notice and a hearing, that such Cause of Action is not released by Section 4 of the Settlement Agreement.”²⁷¹

With the benefit of hindsight, the Court has three reactions to the discussion at the December 2024 hearing and the language of the subsequent order. *First*, it notes that the order that the Court entered then is meaningfully narrower than what is proposed now. The settlement order limited the scope of the “gatekeeping” provision to deciding whether an asserted claim was barred by the settlement. The proposed confirmation order takes an aggressive step beyond that and would require the Court to make a finding that the underlying claim was “colorable” on the merits before it may proceed.

Second, the Court’s decision in that circumstance was undoubtedly motivated by the substantial ambiguity raised by the vexing question of determining what type of claim is an “estate” claim that is resolved when the debtor grants a release, as opposed to those claims that are held and may be asserted against third *564 parties by individual creditors. This Court wrestled with that issue (in light of the Third Circuit’s decision in *Emoral*) in its decisions in *TPC* and *First Guaranty Mortgage*.²⁷² This Court’s decision to retain jurisdiction over such disputes in the settlement order in this case may well be explained by the Court’s concern about imposing on another court the burden of having to make sense of the sometimes ambiguous effect of this Court’s settlement order.

[54] *Finally*, however, notwithstanding the prior point, the Court now believes that the approach taken by the court in *Gulf Coast Health Care* is the better one. To be sure, this Court retains jurisdiction to resolve a dispute about the meaning of its order.²⁷³ And if a dispute were to arise in the future about whether a claim asserted in another court were actually enjoined by virtue of this Court’s confirmation order, this Court would undoubtedly be willing to address the matter through a declaratory judgment action, rather than requiring another court to guess as to the meaning of this Court’s order. That said, and despite the Court having done so in the settlement order in this case, the Court now believes that the better view is that it ought not assert *exclusive* jurisdiction over that issue. As the court said in *Gulf Coast Health Care*, to the extent another court were otherwise inclined to resolve a dispute over the meaning of this Court’s order, the Court does not believe that it can or should enter an injunction that would preclude that.

The settlement order, of course, is now a final and non-appealable order. It says what it says, and the Court stands prepared to enforce it. With the benefit of hindsight, however, this Court does not believe that the entry of such a gatekeeping

provision is authorized by law. In order for the Court to confirm the plan, this provision will need to be modified.

Conclusion

For the foregoing reasons, the Court concludes that various revisions to the plan and/or confirmation order need to be made before the Court may enter them. Subject to those

revisions, however (none of which the Court views as a material change requiring re-solicitation), the Court finds that the plan may be confirmed. The parties are thus directed (as described above, at the end of Part II) to meet and confer with respect to a revised form of plan and confirmation order.

All Citations

677 B.R. 509

Footnotes

- 1 D.I. 12 ¶ 23 (first-day declaration). The Court relies on the first-day declaration only as to background matters. In connection with the elements of plan confirmation, the Court relies only on documents and testimony that were admitted into evidence during the confirmation hearing.
- 2 *Id.* ¶ 29.
- 3 *Id.*
- 4 *Id.* ¶ 38.
- 5 *Id.* ¶ 39.
- 6 *Id.* ¶ 41.
- 7 D.I. 12 ¶ 48.
- 8 *Id.* ¶ 33. Note that this chart depicts the entities that filed at the time these cases were initiated. Sixteen additional entities later filed separate bankruptcy petitions. These cases are now jointly administered.
- 9 July 21, 2025 Hr'g Tr. at 39.
- 10 D.I. 12 ¶ 78.
- 11 July 21, 2025 Hr'g Tr. at 40.
- 12 *Id.* at 110.
- 13 D.I. 12 ¶ 80.
- 14 D.I. 1402 ¶ 18.
- 15 Debtors' Ex. 85.
- 16 *Id.*
- 17 July 21, 2025 Hr'g Tr. at 176; D.I. 1402 ¶ 19; D.I. 12 at 32.
- 18 July 21, 2025 Hr'g Tr. at 176; D.I. 1402 ¶ 19; D.I. 12 at 33.
- 19 *Id.*
- 20 *Id.*
- 21 D.I. 12 ¶ 79.

- 22 D.I. 1402 ¶ 19.
- 23 D.I. 1. Avon Products, Inc. is referred to as “API.”
- 24 D.I. 297.
- 25 D.I. 389 at 7.
- 26 D.I. 10; D.I. 64; D.I. 56 (interim DIP order); D.I. 318 (final DIP order).
- 27 D.I. 65.
- 28 D.I. 65 at 3-4.
- 29 *Id.* at 4-5.
- 30 D.I. 64.
- 31 D.I. 163, 398, 476. The Official Committee of Unsecured Creditors is referred to as the “Committee.”
- 32 See D.I. 370, 497, 500, 501.
- 33 D.I. 415.
- 34 D.I. 577-1 at 20-22 of 41; D.I. 581 (order approving the settlement).
- 35 D.I. 577-1 at 22-25 of 41.
- 36 D.I. 581, 582.
- 37 D.I. 812, 813. The plan was amended several times prior to the disclosure statement hearing, and again prior to the confirmation hearing. This Court will cite to the second amended plan, D.I. 1319, when referring to the plan that is before this Court for confirmation. For present purposes, however, the material terms, including the distribution structure, classification and treatment of creditors, voting procedures, and other provisions material to plan confirmation have not changed materially since the earlier version of the plan filed at D.I. 965.
- 38 D.I. 1028, § 1.1. The disclosure statement was amended several times prior to the disclosure statement hearing. Except when addressing an objection to a specific prior version of the disclosure statement, this Court will cite to relevant provisions in the approved disclosure statement, D.I. 1028, which have remained materially unchanged since the version filed at D.I. 966.
- 39 D.I. 1319, § 5.4.
- 40 *Id.*, § 5.3.
- 41 D.I. 1319-1, § 3.2.
- 42 D.I. 1319, § 5.4.
- 43 *Id.*, § 3.3.
- 44 *Id.*, §§ 4.1, 4.2, 4.7.
- 45 *Id.*, §§ 4.5, 4.8.
- 46 *Id.*, § 4.6.
- 47 *Id.*

- 48 D.I. 1319, § 4.6
- 49 *Id.*, § 3.6.
- 50 D.I. 1028, § 1.2.
- 51 *Id.*
- 52 D.I. 1319, §§ 12.16, 9.1.
- 53 *Id.*, § 4.3; D.I. 1028, §§ 1, 1.5; D.I. 1319-1, § 3.2.
- 54 *Id.* Greater recoveries from the class 3 election depend on the liquidated claim value assigned to talc claims (the denominator) and insurance recovery and the proceeds of recoveries on estate causes of action (the numerator).
- 55 D.I. 1319, § 4.4.
- 56 *Id.*
- 57 D.I. 1319-1, § 4.2.
- 58 *Id.*, § 3.1.
- 59 *Id.*, § 6.7.
- 60 *Id.*, § 2.3.
- 61 *Id.*
- 62 *Id.*, §§ 4.3(b), 4.4(b).
- 63 D.I. 1319-1, § 4.3(b).
- 64 *Id.*, § 4.4.
- 65 *Id.*, § 4.3(c)(1).
- 66 *Id.*
- 67 *Id.*
- 68 *Id.*
- 69 D.I. 1028, § 1.6; D.I. 1319-1, § 4.3.
- 70 D.I. 1028, § 1.6; D.I. 1319-1, § 4.3(c)(2).
- 71 D.I. 1028, § 1.6; D.I. 1319-1, § 4.5.
- 72 D.I. 1319, § 5.10.
- 73 *Id.*, § 5.11.
- 74 *Id.*, § 3.6.
- 75 D.I. 1028, § 2.2(d).
- 76 *Id.*, § 2.5.

- 77 *Id.*, § 2.2(d)(iii).
- 78 D.I. 1028, n.13. Debtor MI Holdings, Inc. is referred to as “MIH.”
- 79 *Id.*
- 80 *Id.*
- 81 D.I. 1319, § 3.4.
- 82 *Id.*, §§ 10.4(i), 10.6, 10.7, 10.8.
- 83 D.I. 1319, § 10.8.
- 84 D.I. 1020, 1021, 1022. The insurers objected to various provisions in a prior iteration of the disclosure statement, D.I. 965.
- 85 D.I. 1027, 1028, 1029, 1030.
- 86 D.I. 1021.
- 87 D.I. 1031.
- 88 D.I. 1047.
- 89 D.I. 1125.
- 90 D.I. 1137, 1155, 1250, 1268, 1269, 1301, 1302.
- 91 D.I. 1246.
- 92 *Id.* at 8-9.
- 93 *Id.* at 5-7.
- 94 D.I. 1232, 1233, 1235, 1238. The parties objected to a prior iteration of the plan, D.I. 1050.
- 95 D.I. 1232 at 1-2.
- 96 D.I. 1233, 1235, 1238.
- 97 D.I. 1319.
- 98 The Court also admitted, during the confirmation hearing, certain exhibits as well as designated deposition testimony. To the extent the Court relies on designated deposition testimony to which a party objected, the Court overrules the objection.
- 99 July 21, 2025 Hr’g Tr. at 38.
- 100 *Id.* at 40-42, 64.
- 101 *Id.* at 71.
- 102 *Id.* at 40, 53-54.
- 103 *Id.* at 59.
- 104 *Id.* at 59-60; Debtors’ Ex. 85.
- 105 July 21, 2025 Hr’g Tr. at 62, 84-85;

- 106 *Id.* at 114; D.I. 1319-1, § 4.3(c)(1).
- 107 July 21, 2025 Hr'g Tr. at 180-181.
- 108 See Debtors' Ex. 85; Gund Dep. at 241-242.
- 109 See Debtors' Ex. 85; July 21, 2025 Hr'g Tr. at 67-69. This "bracketing" of claims as falling within a range of \$10,000 to \$3 million of course accepts the categories that the debtors chose to assign to these claims, which is (necessarily) somewhat arbitrary.
- 110 July 21, 2025 Hr'g Tr. at 67-69.
- 111 D.I. 1319-1, § 4.3(c)(2); July 21, 2025 Hr'g Tr. at 176-177.
- 112 July 21, 2025 Hr'g Tr. at 176.
- 113 *Id.* at 132, 138-139.
- 114 *Id.* at 112-113.
- 115 *Id.* at 113.
- 116 *Id.* at 114-115.
- 117 *Id.* at 171-173.
- 118 July 21, 2025 Hr'g Tr. at 84.
- 119 *Id.* at 74, 82-83.
- 120 *Id.* at 83.
- 121 *Id.* at 182-183.
- 122 D.I. 1221.
- 123 *Id.* at 4.
- 124 *Id.*
- 125 July 21, 2025 Hr'g Tr. at 120-121; D.I. 1316, n.6.
- 126 D.I. 1221-3.
- 127 D.I. 1221 at 5.
- 128 *Id.*
- 129 *Id.*
- 130 D.I. 1296.
- 131 July 21, 2025 Hr'g Tr. at 213; July 23, 2025 Hr'g Tr. at 16.
- 132 D.I. 1221 at 5.
- 133 July 23, 2025 Hr'g Tr. at 7.

- 134 *Id.* at 22-23.
- 135 The U.S. trustee objected to certain modifications to the plan injunction in § 10.4 of the plan. After conferring with the U.S. trustee, the debtors filed additional plan revisions at D.I. 1385 which resolve the U.S. trustee's objection to the § 10.4 plan injunction.
- 136 See D.I. 1320.
- 137 Certain of the objections asserted by the parties have been mooted by changes to the plan and/or confirmation order that the debtors agreed to make in light of the evidence presented at the confirmation hearing. See July 23, 2025 Hr'g Tr. at 7, 22-23. This Memorandum will not address those issues.
- 138 The U.S. Trustee objection is docketed at D.I. 1232. A broad group of insurers filed a joint objection to confirmation, docketed at D.I. 1233. During the confirmation hearing, these objections were argued by counsel for two of the groups of insurers that filed these objections. The Court will generally describe those arguments as those of the "Certain Insurers." An objection filed by Hartford-related insurers (referred to, collectively, as "Hartford") was docketed at D.I. 1235. A group of Travelers'-related insurers joined in portions of the other insurer objections. D.I. 1238.
- 139 The U.S. Trustee's objection also originally objected to confirmation on the ground that the plan injunction was overbroad. D.I. 1232 at 9-10. The parties negotiated a consensual resolution to that objection. See July 21, 2025 Hr'g Tr. at 20, 250.
- 140 11 U.S.C. § 1129(a)(3).
- 141 See *In re Combustion Engineering*, 391 F.3d 190, 247 (3d Cir. 2004) ("for purposes of determining good faith under section 1129(a)(3) the important point of inquiry is the plan itself and whether such a plan will fairly achieve a result consistent with the objectives and purposes of the Bankruptcy Code.") (cleaned up); *In re American Capital Equip.*, 688 F.3d 145, 157 (3d Cir. 2012) (same); *In re Boy Scouts of America*, 642 B.R. 504, 645 (Bankr. D. Del. 2022) (same).
- 142 *In re W.R. Grace & Co.*, 475 B.R. 34, 87 (Bankr. D. Del. 2012).
- 143 July 21, 2025 Hr'g Tr. at 145.
- 144 *Id.* at 42 (Gund testimony that debtors filed for bankruptcy because they "had approximately \$3 million in cash ... approximately \$1.3 billion in funded debt ... increasing amounts of talc claims, recent verdicts, upcoming interest payments to the bondholders as a result of that, and [they weren't] able to operate.").
- 145 D.I. 581, 582.
- 146 July 21, 2025 Hr'g Tr. at 62, 68-69, 84-85.
- 147 *Id.* at 82-84.
- 148 July 21, 2025 Hr'g Tr. at 74, 82-84.
- 149 D.I. 1233 at 45-46.
- 150 See 11 U.S.C. § 101(5).
- 151 A highly regarded former bankruptcy judge published a law review article suggesting that it may be appropriate to classify foreign creditors separately. See Barbara J. Houser, *Classification and Treatment of Foreign Claims in U.S. Bankruptcy Proceedings*, 36 Tex. Int'l L. J. 475, 494 (2001). While that issue is not before this Court, the Court appreciates that the factors identified in Judge Houser's article may provide a basis for separate classification. But even so, if a plan provided materially inferior treatment to that class of foreign creditors, it could be confirmed only if the disadvantaged class voted in favor of confirmation. See 11 U.S.C. § 1129(b); *In re Tribune Co.*, 972 F.3d 228, 232 (3d Cir. 2020). It also bears note that Judge Houser's 2001 law review article pre-dates the 2005 adoption of Chapter 15 of the Bankruptcy Code.

Section 1513(b) of the Bankruptcy Code now “specifies that foreign creditors ... must receive at least the same treatment as general unsecured creditors without priority.” 8 *Collier on Bankruptcy* ¶ 1513.02 (16th ed. 2025).

152 D.I. 1319-1 § 6.7.

153 *In re Congoleum Corp.*, 426 F.3d 675, 685 (3d Cir. 2005).

154 *In re Boy Scouts of America*, 137 F.4th 126, 164 (3d Cir. 2025).

155 11 U.S.C. § 541(a).

156 *Butner v. United States*, 440 U.S. 48, 55, 99 S.Ct. 914, 59 L.Ed.2d 136 (1979).

157 *Id.*

158 *Id.* (citation and internal quotation omitted).

159 *In re LTL Mgmt., LLC*, 64 F.4th 84, 101 (3d Cir. 2023).

160 *In re SGL Carbon Corp.*, 200 F.3d 154, 161 (3d Cir. 1999).

161 *Mission Product Holdings, Inc. v. Tempnology, LLC*, 587 U.S. 370, 381, 139 S.Ct. 1652, 203 L.Ed.2d 876 (2019) (internal quotation and citation omitted) (noting that the seminal decision in *Board of Trade of Chicago v. Johnson*, 264 U.S. 1, 15, 44 S.Ct. 232, 68 L.Ed. 533 (1924) “establish[es] this principle”).

162 *Combustion Engineering*, 391 F.3d at 218 (noting how the objective was to “not impair [the insurers’] rights or increase their burdens under the subject insurance policies”); *Boy Scouts*, 137 F.4th at 165 (relying on this discussion in *Combustion Engineering* for the proposition that “a plan cannot be confirmed when it incorporates provisions that impermissibly impair [a contractual] counterparts’ rights”).

163 See 28 U.S.C. § 157(b)(5) (“The district court shall order that personal injury tort and wrongful death claims shall be tried in the district court in which the bankruptcy case is pending, or in the district court in the district in which the claim arose, as determined by the district court in which the bankruptcy case is pending.”); *id.* § 1411(a) (“Except as provided in subsection (b) of this section, this chapter and title 11 do not affect any right to trial by jury that an individual has under applicable nonbankruptcy law with regard to a personal injury or wrongful death tort claim.”).

164 See, e.g., *Matter of State Farm Mut. Auto. Ins. Co. (Perez)*, 94 A.D.3d 1314, 1315, 942 N.Y.S.2d 688 (2012) (“Where an insurance policy expressly requires the insurer’s prior consent to any settlement by the insured with a tortfeasor, failure of the insured to obtain such prior consent from the insurer constitutes a breach of a condition of the insurance contract and disqualifies the insured from availing himself of the pertinent benefits of the policy.”) (internal citations and quotations omitted). See also *Appleman on Insurance Law & Practice* § 137.10[A][1] (“Policies commonly provide that the insured may not make any payment or assume any obligation in settling or compromising a claim, except at the insured’s own cost, without the insurer’s consent. If the insured effects a settlement with the injured person without the previous consent of the insurer as required by the policy, the insurer is thereby released, unless otherwise excused, as, for example, when the insurer withdraws or refuses to defend.”)

165 *Ideal Mut. Ins. Co. v. Myers*, 789 F.2d 1196 (5th Cir. 1986) (holding that an insurer is not discharged from liability when settlement is reasonable and does not prejudice insurer).

166 American Bankruptcy Institute, *A Practitioner’s Guide to Liquidation and Litigation Trusts*, Chapter 6.B. – Benefits of a Liquidation Trust (2016).

167 See *Boy Scouts*, 642 B.R. at 556 (relying on the testimony of Charles Bates to explain why tens of thousands “Proofs of Claim were filed in the case as opposed to the prepetition average of fifty per year”).

- 168 See Leanard P. Goldberger, *Last Man Standing: Insurers' Participation in Plan Confirmation Process*, Am. Bankr. Inst. J. at 30-31 (Nov. 2008).
- 169 D.I. 1235 at 13-21.
- 170 See 11 U.S.C. § 365(f)(2)(B).
- 171 *In re Ames Department Stores*, No. 93-4014, 1995 WL 311764, at *3 (S.D.N.Y. May 18, 1995).
- 172 See, e.g., *In re Federal-Mogul Global, Inc.*, 385 B.R. 560, 576 (Bankr. D. Del. 2008) ("because the premiums are paid, the policy coverage periods have expired, and the remaining obligations of the insureds are ministerial, the Asbestos Insurance Policies are non-executory contracts and therefore, do not fall under § 365 of the Bankruptcy Code."); *In re Grace Indus.*, 341 B.R. 399 (Bankr. E.D.N.Y. 2006) ("Where, as in this case, an insured debtor has paid the initial premium in full, and the policy period has expired, the insurance policy is not an executory contract, despite continuing obligations on the part of the insured."); *In re Vanderveer Estates Holding, LLC*, 328 B.R. 18 (Bankr. E.D.N.Y. 2005) (same); *In re Sudbury Inc.*, 153 B.R. 776 (Bankr. N.D. Ohio 1993) (same). See also Douglas N. Candeub, *When a Non-Executory Insurance Policy Is Assumed: A Case Study*, Am. Bankr. Inst. J. at 40 (March 2015) ("Bankruptcy courts consistently hold that an insurance policy for which the policy period expired prior to the insured's bankruptcy – and for which the initial premium was paid--is *not* an "executory contract" under § 365 of the Bankruptcy Code.") (emphasis in original); 3 *Collier on Bankruptcy* ¶ 365.02 (16th ed. 2025) ("An insurance policy under which the insured's bankruptcy would not relieve the insurer of its obligation, despite unpaid premiums, is not an executory contract, because the debtor's nonperformance of its premium obligations is not a breach that would excuse the insurer of its obligation to perform.").
- 173 *Sharon Steel Corp. v. Nat'l Fuel Gas Dist. Corp.*, 872 F.2d 36, 39 (3d Cir. 1989) (quoting Vern Countryman, *Executory Contracts in Bankruptcy, Part 1*, 57 Minn. L. Rev. 439, 460 (1973)).
- 174 *Id.*
- 175 3 *Collier on Bankruptcy* ¶ 365.02[2][a].
- 176 *Id.* ¶ 365.02[2][b].
- 177 *In re Weinstein Company Holdings*, 997 F.3d 497, 509 (3d Cir. 2021) (cleaned up).
- 178 See *Sudbury*, 153 B.R. at 779.
- 179 In many cases, the question whether a contract is executory is important to the question whether pre-petition defaults must be cured to obtain the counterparty's performance. See *Weinstein*, 997 F.3d at 501 ("In practice, an executory contract can be 'assumed' and then 'assigned' to a buyer under § 365 of the Bankruptcy Code provided all existing defaults are cured. A non-executory contract, on the other hand, can be sold under § 363 to a buyer, who must satisfy post-closing obligations but need not worry about pre-closing breaches or defaults, which typically remain unsecured claims against the debtor's estate. Thus, whether a contract is classified as executory or non-executory has significant implications for its treatment in a bankruptcy sale."). That concern is absent here.
- 180 See *Bankruptcy and Insurance Law Manual, Chapter 9: Defining "Claim": Bankruptcy Code vs. Insurance Policy* (4th ed. 2020).
- 181 July 21, 2025 Hr'g Tr. at 155.
- 182 *Boy Scouts*, 642 B.R. at 623. ("Trust distribution procedures, such as the TDP here, establish the method by which claims channeled to a trust will be resolved. While these procedures invariably differ somewhat in each case, the procedures encompass the means by which claims will be submitted, processed, liquidated and paid.... This is treatment.").
- 183 See e.g., *In re Filex, Inc.*, 116 B.R. 37, 40 (Bankr. S.D.N.Y. 1990) (noting a plan was "patently unconfirmable under Chapter 11 of the Bankruptcy Code because it provide[d] that all objections or disputes as to claims w[ould] be resolved by an arbitrator in accordance with the rules of the American Arbitration Association rather than by th[e] court in accordance

with 11 U.S.C. § 502.”); *In re Butcher*, 459 B.R. 115, 130 (Bankr. D. Colo. 2011) (finding chapter 13 plan unconfirmable where it sought to “cut off” the Bankruptcy Code’s claims allowance process and noting that the court was “unaware of arguments in the chapter 11 context that plan confirmation should cut off the orderly claim allowance process set out in the Bankruptcy Code and the Rules”).

184 *Boy Scouts*, 642 B.R. at 672.

185 *Id.* at 623.

186 D.I. 1233 at 20-21.

187 D.I. 1319-1, §§ 4.3(b), 4.4(b).

188 *In re Federal-Mogul Global Inc.*, 684 F.3d 355, 366 (3d Cir. 2012).

189 See, e.g., *Travelers Cas. & Sur. Co. v. U.S. Filter Corp.*, 895 N.E.2d 1172, 1178 (Ind. 2008); *SR Int’l Bus. Ins. Co. v. World Trade Center Props., LLC*, 375 F. Supp. 2d 238, 248-249 (S.D.N.Y. 2005).

190 *In re UNR Indus. v. Continental Cas. Co.*, 942 F.2d 1101 (7th Cir. 1991).

191 D.I. 1233 at 29 & n. 55 (citing *Fuller-Austin Insulation Co. v. Highlands Ins. Co.*, 135 Cal.App.4th 958, 38 Cal. Rptr.3d 716, 732 (2006)).

192 See 11 U.S.C. § 101(10) (defining a “creditor” as an entity “that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor”); *id.* § 101(5) (defining “claim” as a “right to payment”); *id.* § 502(b) (explaining that when there is an objection to a “claim,” the court shall “determine the amount of such claim ... as of the date of the petition, and shall allow such claim in such amount”).

193 11 U.S.C. § 1123(a)(3) (“a plan shall ... specify the treatment of any class of claims or interests that is impaired under the plan”).

194 *Smith v. Bayer Corp.*, 564 U.S. 299, 307, 131 S.Ct. 2368, 180 L.Ed.2d 341 (2011) (quoting Wright, Miller & Cooper, 18 *Fed. Prac. & Proc.* § 4405 (2d ed. 2002)) (internal quotations omitted).

195 *Pettibone Corp. v. Easley*, 935 F.2d 120, 123-124 (7th Cir. 1991).

196 *Travelers Indemnity Co. v. Bailey*, 557 U.S. 137, 151, 129 S.Ct. 2195, 174 L.Ed.2d 99 (2009) (“[T]he Bankruptcy Court plainly had jurisdiction to interpret and enforce its own prior orders. What is more, when the Bankruptcy Court issued the 1986 Orders it explicitly retained jurisdiction to enforce its injunctions.”) (internal citation omitted).

197 July 21, 2025 Hr’g Tr. at 291.

198 See *Restatement of the Law – Trusts (Third)* § 77 (“The trustee has a duty to administer the trust as a prudent person would, in light of the purposes, terms, and other circumstances of the trust.”).

199 *Id.* § 77.

200 The Court is aware that the bankruptcy court reached a somewhat different conclusion in *In re Diocese of Camden, New Jersey*, 653 B.R. 309, 356-357 (Bankr. D. N.J. 2023). While the Court agrees with the statement in *Diocese of Camden* that a bankruptcy court should not confirm a plan that “is so biased as to strip the Insurers of rights necessary to ensure the Plan is equitable,” *id.* at 356, it respectfully disagrees with the suggestion that the trustee of a post-confirmation trust has a duty of impartiality that runs to entities other than the beneficiaries of the trust.

201 D.I. 1319 § 4.3; D.I. 1028, §§ 1, 1.5; D.I. 1319-1, § 3.2.

202 July 21, 2025 Hr’g Tr. at 280.

- 203 July 23, 2025 Hr'g Tr. at 17. See *Moore v. Bay*, 284 U.S. 4, 52 S.Ct. 3, 76 L.Ed. 133 (1931).
- 204 *In re ONH AFC CS Investors, LLC*, 671 B.R. 680 (Bankr. D. Del. 2025).
- 205 Susan N. K. Gummow, *Bankruptcy and Insurance Law Manual*, at 87 (3d ed. 2016).
- 206 *Id.* at 89.
- 207 *Travelers*, 557 U.S. at 143 n.2, 129 S.Ct. 2195. See also *In re Caribbean Petrol. Corp.*, 580 Fed. App'x 82, 86 (3d Cir. 2014) (addressing, but rejecting in light of plan language at issue, argument that direct action statute “removes [insurance] proceeds from the bankruptcy estate, places them into a separate fund, and renders them unavailable for distribution to other general unsecured creditors under the Plan until the interests of Tort Claim holders have been satisfied”).
- 208 Taken to its logical conclusion, the implications of this position would be that those tort claimants whose claims are covered by insurance would be entitled to those proceeds, to the exclusion of claimants whose claims are not covered. As is common in mass tort bankruptcy cases, however, the plan here provides (without objection from any party in interest) for the ratable sharing of all insurance proceeds among the talc claimants. D.I. 1319-1, §§ 2.3, 3.2.
- 209 See generally *In re ICL Holding Co., Inc.*, 802 F.3d 547, 555-556 (3d Cir. 2015).
- 210 See *Armstrong World Indus.*, 432 F.3d 507, 513 (3d Cir. 2005).
- 211 D.I. 1362, 1386, 1388.
- 212 *Truck Ins. Exch. v. Kaiser Gypsum Co.*, 602 U.S. 268, 144 S.Ct. 1414, 219 L.Ed.2d 41 (2024). This Court previously held that the rationale of *Truck Insurance* meant that the insurers had standing to object to confirmation but left open the question whether there were limits to the range of issues that might properly be raised. See D.I. 1125 at 18-21.
- 213 *Lexmark Intern. v. Static Control Components, Inc.*, 572 U.S. 118, 128, 134 S.Ct. 1377, 188 L.Ed.2d 392 (2014).
- 214 *In re PWS Holding Corp.*, 228 F.3d 224, 249 (3d Cir. 2000) (“The chance that the other creditors would have acted differently is simply too speculative to be a basis for third party standing here.”). See also *Kane v. Johns-Manville Corp.*, 843 F.2d 636, 643 (2d Cir. 1988) (“Third-party standing is of special concern in the bankruptcy context where, as here, one constituency before the court seeks to disturb a plan of reorganization based on the rights of third parties who apparently favor the plan.”); *In re James Wilson Assoc.*, 965 F.2d 160, 169 (7th Cir. 1992) (Section 1109(b) was not “intended to waive other limitations on standing, such as that the claimant be within the class of intended beneficiaries of the statute that he is relying on for his claim, although a literal reading of section 1109(b) would support such an interpretation. We think all the section means is that anyone who has a legally protected interest that could be affected by a bankruptcy proceeding is entitled to assert that interest with respect to any issue to which it pertains.”).
- 215 D.I. 389 at 7.
- 216 *In re Tribune Co.*, 464 B.R. 126, 183 (Bankr. D. Del. 2011) (subsequent history, which does not bear on the discussion at issue, omitted). See also *In re JER/Jameson Mezz Borrower II LLC*, 461 B.R. 293, 302 (Bankr. D. Del. 2011).
- 217 11 U.S.C. § 1121.
- 218 The Ninth Circuit reached the opposite conclusion in *In re Transwest Resort Props.*, 881 F.3d 724, 729-730 (9th Cir. 2018). Its reasoning is that the language of § 1129(a)(10) requires that an impaired accepting class have accepted “the plan,” and thus concludes that “plain language” of the statute requires acceptance on a “per plan” not “per debtor” basis. The problem with that analysis is that it simply assumes the conclusion that the single document is one plan rather than multiple plans. The opinion never seeks to square that reading with the words of § 1121.
- 219 Debtors' Ex. 25 at 5.
- 220 D.I. 1233 at 61-67.

- 221 D.I. 1320 (relying on § 3.4 of the plan, which eliminates classes for which no creditor asserts a claim).
- 222 11 U.S.C. § 1129(a)(10).
- 223 D.I. 1296; July 23, 2025 Hr'g Tr. at 16.
- 224 836 F.2d 1263, 1266 (10th Cir. 1988).
- 225 7 *Collier on Bankruptcy* ¶ 1126.04 (16th ed. 2025) (footnotes omitted).
- 226 *In re Vita Corp.*, 358 B.R. 749 (Bkrtcy.C.D. Ill. 2007).
- 227 See *Tribune*, 464 B.R. at 183-84; *In re Adelphia Commc'ns Corp.*, 368 B.R. 140, 260 (Bankr. S.D.N.Y. 2007).
- 228 D.I. 1047 ¶ 44.
- 229 D.I. 814 at 44.
- 230 D.I. 1020, 1021, 1022.
- 231 See generally *In re Smallhold*, 665 B.R. 704, 715 (Bankr. D. Del. 2024).
- 232 D.I. 1233 at 58-60.
- 233 See 11 U.S.C. § 1129(a)(1) (plan must comply "with the applicable provisions of this title.").
- 234 See generally *Combustion Engineering*, 391 F.3d at 234 & n. 45.
- 235 See D.I. 1232 at 9-10; D.I. 1233 at 6-9; July 21, 2025 Hr'g Tr. at 20-23, 250.
- 236 D.I. 1233 at 58-60.
- 237 See *Pioneer Inv. Servs. Co. v. Brunswick Assocs., L.P.*, 507 U.S. 380, 395, 113 S.Ct. 1489, 123 L.Ed.2d 74 (1993) (describing "intervening circumstances beyond the party's control" as satisfying the excusable neglect standard). The Court recognizes that because § 726(a)(3) provides for the payment of a "proof of claim which is tardily filed" in chapter 7 cases, although at a lower priority than timely filed claims, the "excusable neglect" standard may operate differently in the chapter 7 context.
- 238 *In re Grossman's*, 607 F.3d 114, 127 (3d Cir. 2010) (*en banc*).
- 239 See generally *Epstein v. Official Committee of Unsecured Creditors of Estate of Piper Aircraft Corp.*, 58 F.3d 1573, 1578 (11th Cir. 1995) ("There is no preconfirmation exposure to a specific identifiable defective product or any other preconfirmation relationship between Piper and the broadly defined class of Future Claimants. As there is no preconfirmation connection established between Piper and the Future Claimants, the Future Claimants do not hold a § 101(5) claim arising out of Piper's prepetition design, manufacture, sale, and distribution of allegedly defective aircraft.").
- 240 See July 21, 2025 Hr'g Tr. at 350-351 (citing 11 U.S.C. § 1123(b)(3)(B)).
- 241 Counsel for the certain insurers was, perhaps to his credit (and perhaps not), wholly undaunted by the fact that the implication of his argument would fundamentally disrupt modern chapter 11 practice:

[THE COURT]: [T]here is, now, a lot of water over the dam, and the notion that we confirm a plan when the major transactions have been completed, and the mop-up work, including the mop-up work with respect to unliquidated claims is handled on a trust on a post-petition basis is now ... what happens in 98 percent of the cases.

So, is your argument that that's all wrong, and I need to decree that that shall never happen again?

[COUNSEL]: Yes.

Id. at 352.

242 11 U.S.C. § 1123(b)(6).

243 *Harrington v. Purdue Pharma L.P.*, 603 U.S. 204, 218, 144 S.Ct. 2071, 219 L.Ed.2d 721 (2024) (emphasis in original).

244 *Id.* (internal citation omitted).

245 But see *Diocese of Camden, New Jersey*, 653 B.R. at 336 (“section 1123(b)(3) applies only to actions ‘belonging’ to the estate, and not to actions ‘against’ the estate”).

246 D.I. 1048 § 12.16.

247 D.I. 1316 at 3; July 21, 2025 Hr’g Tr. at 86.

248 D.I. 1232 at 10-14.

249 11 U.S.C. § 307 (“The United States trustee may raise and may appear and be heard on any issue in any case or proceeding under this title but may not file a plan pursuant to section 1121(c) of this title.”).

250 See *Lebron v. Mechem Financial Inc.*, 27 F.3d 937, 943-944 (3d Cir. 1994).

251 See *In re Adelphia Commc’ns Corp.*, 441 B.R. 6, 12-19 (Bankr. S.D.N.Y. 2010); *In re Mallinckrodt*, 639 B.R. 837, 906-907 (Bankr. D. Del. 2022).

252 *Adelphia*, 441 B.R. at 8-9.

253 *Mallinckrodt*, 639 B.R. at 896.

254 *In re Yellow Corp.*, 670 B.R. 397 (Bankr. D. Del. 2025).

255 *Id.* at 411.

256 While the statements of counsel are not evidence, counsel for the bond trustee set out during closing argument the nature of the contributions. See July 23, 2025 Hr’g Tr. at 53-55.

257 *In re Tribune*, 972 F.3d at 237-239.

258 11 U.S.C. § 1123(a)(4) (“[n]otwithstanding any otherwise applicable nonbankruptcy law, a plan shall ... provide the same treatment for each claim or interest of a particular class, unless the holder of a particular claim or interest agrees to a less favorable treatment of such particular claim or interest”).

259 July 21, 2025 Hr’g Tr. at 120-121.

260 D.I. 1319 § 10.8.

261 See *In re Highland Capital Mgmt., L.P.*, 132 F.4th 353 (5th Cir. 2025).

262 See *Villegas v. Schmidt*, 788 F.3d 156, 158-159 (5th Cir. 2015) (citing *Barton v. Barbour*, 104 U.S. 126, 26 L.Ed. 672 (1881)).

263 *Highland Capital*, 132 F.4th at 359 (internal quotation and citation omitted). In fairness, however, a case could have been made that the prior Fifth Circuit precedent on this point was less clear than the *Highland Capital* court let on.

264 *Id.* at 360.

- 265 *In re PWS Holding Corp.*, 228 F.3d at 246; *Blixseth v. Credit Suisse*, 961 F.3d 1074, 1081-1085 (9th Cir. 2020).
- 266 *In re Gulf Coast Health Care, LLC*, Bankr. D. Del. No. 21-11336 (KBO); May 4, 2022 Hr'g Tr. at 30.
- 267 *Id.*
- 268 See July 23, 2025 Hr'g Tr. at 21-22 (in response to question whether “folks were aware of any case in this jurisdiction ... in which any court has ever approved such a provision,” counsel responded “I had time to think about it. The answer is I think Your Honor approved a very similar provision in December”).
- 269 Dec. 4, 2024 Hr'g Tr. at 45 (cleaned up).
- 270 *Id.* at 51.
- 271 D.I. 581 ¶ 12.
- 272 See generally *In re Emoral, Inc.*, 740 F.3d 875 (3d Cir. 2014); *In re TPC Group Inc.*, No. 22-10493, 2023 WL 2168045 (Bankr. D. Del. Feb. 22, 2023); *In re First Guaranty Mortgage Corp.*, No. 22-10584, 2023 WL 8940688 (Bankr. D. Del. Dec. 27, 2023). This issue was also addressed more recently by a judge on this Court in *In re Alieria Companies, Inc.*, No. 21-11548 (TMH), 2025 WL 2091090 (Bankr. D. Del. July 24, 2025).
- 273 *Travelers Indemnity*, 557 U.S. at 151, 129 S.Ct. 2195.

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132 F.4th 353

United States Court of Appeals, Fifth Circuit.

In the MATTER OF HIGHLAND
CAPITAL MANAGEMENT, L.P. Debtor,
Highland Capital Management Fund Advisors,
L.P., now known as NexPoint Asset Management,
L.P.; NexPoint Advisors, L.P., Appellants,
v.
Highland Capital Management, L.P., Appellee.

No. 23-10534

I

FILED March 18, 2025

Synopsis

Background: Co-founder of Chapter 11 debtor, an investment firm that had managed billion-dollar, publicly-traded investment portfolios for nearly three decades, together with several other creditors and United States Trustee (UST), objected to confirmation of debtor's proposed reorganization plan. The United States Bankruptcy Court for the Northern District of Texas, [Stacey G. C. Jernigan](#), Chief Judge, overruled objections and subsequently granted motion of co-founder and creditors to directly appeal confirmation order to Court of Appeals. Following consolidation of direct appeals, debtor moved to dismiss appeal as equitably moot. The Court of Appeals, [48 F.4th 419](#), denied motion to dismiss, affirmed in part, reversed in part, and remanded. On remand, the United States Bankruptcy Court for the Northern District of Texas, [Stacey G. C. Jernigan, J., 2023 WL 2250145](#), granted debtor's motion to conform plan, declining to narrow the gatekeeper provision. Investment fund parties' petition for permission to appeal plan conforming order directly to appellate court was granted.

The Court of Appeals, Elrod, Chief Judge, held that definition of "Protected Parties," as used in gatekeeper clause of Chapter 11 plan prohibiting "Enjoined Parties" from taking specific actions against non-debtor "Protected Parties" via pre-filing injunction, was coextensive with definition of "exculpated parties," as used in exculpation provision.

Reversed and remanded.

Procedural Posture(s): On Appeal; Other.

***354** Appeal from the United States District Court for the Northern District of Texas, USDC No. 3:23-CV-573, [Ada Elene Brown](#), U.S. District Judge

Attorneys and Law Firms

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Before Elrod, Chief Judge, and Willett, and Duncan, Circuit Judges.

Opinion

[Jennifer Walker Elrod](#), Chief Judge:

Appellants NexPoint Asset Management, L.P. and NexPoint Advisors, L.P. appeal the bankruptcy court's approval of Appellee Highland Capital Management, L.P.'s revised Bankruptcy Confirmation Plan. Because the bankruptcy court partially failed to amend the Plan in accordance with our previous instructions, we REVERSE in part and REMAND.

I

A

Highland Capital Management, L.P., is a Dallas-based investment firm that was co-founded by James Dondero. *In re Highland Cap. Mgmt., L.P. (Highland I)*, [48 F.4th 419, 424 \(5th Cir. 2022\)](#).¹ For nearly three decades, Highland Capital has managed billion-dollar, publicly traded investment portfolios. *See id.* at 425. In 2019, however, "myriad unpaid judgments and liabilities forced Highland Capital to file for Chapter 11 bankruptcy." *Id.*

¹ We recount the facts as set out in *Highland I*.

At the time Highland Capital filed for bankruptcy, Dondero served as a director and officer. *Id.* But at the start of the bankruptcy, the unsecured creditors' committee ***355** negotiated an agreement with Dondero under which he would

step down as a director and officer to serve as an “unpaid portfolio manager.” *Id.* The unsecured creditors' committee then “selected a board of three independent directors to act as a quasi-trustee and to govern” Highland Capital. *Id.*

During the bankruptcy, Dondero proposed several reorganization plans that the unsecured creditors' committee and the independent directors opposed. *Id.* at 426. When those plans failed, Dondero “began to frustrate the proceedings by objecting to settlements, appealing orders, seeking writs of mandamus, interfering with Highland Capital's management, threatening employees, and canceling trades between Highland Capital and its clients.” *Id.* As a result, Highland Capital's independent directors insisted that Dondero resign from the company, which he did in October 2020. *Id.* In addition, the bankruptcy court held Dondero in civil contempt and sanctioned him for his behavior. *See Highland Cap. Mgmt., L.P. v. Dondero (In re Highland Cap. Mgmt., L.P.)*, Ch. 11 No. 19-34054-SGJ11, 2021 WL 2326350, at *1, 26 (Bankr. N.D. Tex. June 7, 2021).

Meanwhile, the bankruptcy proceedings moved forward, and the unsecured creditors' committee and the independent directors agreed on a proposed reorganization plan. *Highland I*, 48 F.4th at 426–27. “Anticipating Dondero's continued litigiousness,” the proposed plan included two provisions intended to shield Highland Capital and associated persons and entities from liability: the Exculpation Provision and the Injunction Provision. *Id.* at 427.

As proposed, the Plan's Exculpation Provision permanently extinguished “any claim, obligation, suit, judgment, damage, demand, debt, right, Cause of Action, remedy, loss, and liability” against a group of “Exculpated Parties” for any conduct related to:

(i) the filing and administration of the Chapter 11 Case; (ii) the negotiation and pursuit of the Disclosure Statement, the Plan, or the solicitation of votes for, or confirmation of, the Plan; (iii) the funding or consummation of the Plan (including the Plan Supplement) or any related agreements, instruments, or other documents, the solicitation of votes on the Plan, the offer, issuance, and Plan Distribution of

any securities issued or to be issued pursuant to the Plan, including the Claimant Trust Interests, whether or not such Plan Distributions occur following the Effective Date; (iv) the implementation of the Plan; and (v) any negotiations, transactions, and documentation in connection with the foregoing clauses (i)-(iv).

The provision did not extend to actions by Highland Capital's general partner or its employees that predated the appointment of the independent directors, and it did not cover claims arising from “acts or omissions that constitute bad faith, fraud, gross negligence, criminal misconduct, or willful misconduct.” *Id.* The Plan defined “Exculpated Parties” as:

collectively, (i) the Debtor and its successors and assigns, (ii) the Employees, (iii) Strand [Advisors, Inc., Highland Capital's general partner], (iv) the Independent Directors, (v) the [Unsecured Creditors'] Committee, (vi) the members of the Committee (in their official capacities), (vii) the Professionals retained by the Debtor and the Committee in the Chapter 11 Case, (viii) the CEO/CRO; and (ix) the Related Persons of each of the Parties listed in (iv) through (viii)[.]

The Plan's Injunction Provision, for its part, broadly enjoined certain persons and entities who held claims against or equity interests in Highland Capital (the “Enjoined ***356** Parties”) from “taking any actions to interfere with the implementation or consummation of the Plan.” It also specifically prohibited the Enjoined Parties from suing, enforcing orders, or asserting rights of setoff so as to recover from Highland Capital or affect Highland Capital's property. Then, in its Gatekeeper Clause, the provision implemented an injunction² prohibiting the Enjoined Parties from taking specific actions against the “Protected Parties,” stating:

[N]o Enjoined Party may commence or pursue a claim or cause of action of any kind against any Protected Party that arose or arises from or is related to the Chapter 11 Case, the negotiation of the Plan, the administration of the Plan or property to be distributed under the Plan, the wind down of the business of the Debtor or Reorganized Debtor, the administration of the Claimant Trust or the Litigation Sub-Trust, or the transactions in furtherance of the foregoing without the Bankruptcy Court (i) first determining, after notice and a hearing, that such claim or cause of action represents a colorable claim of any kind, including, but not limited to, negligence, bad faith, criminal misconduct, willful misconduct, fraud, or gross negligence against a Protected Party and (ii) specifically authorizing such Enjoined Party to bring such claim or cause of action against any such Protected Party[.]

Chapter 11 Case, (xv) the CEO/CRO; and (xvi) the Related Persons of each of the parties listed in (iv) through (xv) [.]

- 2 Contrary to Highland Capital's assertion, the Gatekeeper Clause *is* an injunction—a pre-filing injunction. *See IntegraNet Physician Res., Inc. v. Tex. Indep. Providers, LLC*, 945 F.3d 232, 237 (5th Cir. 2019) (“[T]he ... court's order prevents a party from filing future lawsuits without that judge's permission—meaning it's a pre-filing injunction.”).

Dondero and several other interested parties objected to the Plan. *Id.* at 426. Among those parties were two entities that the bankruptcy court had found to be owned or controlled by Dondero: NexPoint Asset Management, L.P. (formerly known as Highland Capital Management Fund Advisors, L.P.) and NexPoint Advisors, L.P. These two entities were Appellants in *Highland I* and are Appellants again in this appeal. The United States Trustee also objected to the Exculpation Provision, contending that these provisions constituted an impermissible nonconsensual release of non-debtors' claims against other non-debtors. *Id.*; *see also* Bankr. Ct. Doc. 1671, at 4 (Jan. 5, 2021).

The Plan defined the term “Protected Parties” as:

collectively, (i) the Debtor and its successors and assigns, direct and indirect majority-owned subsidiaries, and the Managed Funds, (ii) the Employees, (iii) Strand, (iv) the Reorganized Debtor, (v) the Independent Directors, (vi) the Committee, (vii) the members of the Committee (in their official capacities), (viii) the Claimant Trust, (ix) the Claimant Trustee, (x) the Litigation Sub-Trust, (xi) the Litigation Trustee, (xii) the members of the Claimant Trust Oversight Committee (in their official capacities), (xiii) New GP LLC, (xiv) the Professionals retained by the Debtor and the Committee in the

B

The bankruptcy court confirmed the Plan over these objections. *Highland I*, 48 F.4th at 427. On direct appeal from the bankruptcy court under 28 U.S.C. § 158(d)(2), we “reverse[d] only insofar as the plan exculpates certain non-debtors in violation of 11 U.S.C. § 524(e), str[uck] those few parties from the plan's exculpation, *357 and affirm[ed] on all remaining grounds.” *Id.* at 424.

The investment fund parties then requested panel rehearing, asking us to clarify whether our directive to strike certain persons and entities from the definition of the term “Exculpated Parties” used in the Exculpation Provision also required striking the same persons and entities from the definition of the term “Protected Parties” used in the Injunction Provision's Gatekeeper Clause. We granted panel rehearing and made one substantive change to the opinion: deleting the sentence, “The injunction and gatekeeper provisions are, on the other hand, perfectly lawful,” and

replacing it with the sentence, “We now turn to the Plan’s injunction and gatekeeper provisions.” *Id.* at 438.

Highland Capital then filed a Motion to Conform Plan, requesting that the bankruptcy court conform the Plan to our opinion in *Highland I* by, *inter alia*, narrowing the definition of the term “Exculpated Parties” to “(i) the Debtor, (ii) the Independent Directors, (iii) the Committee, and (iv) the members of the Committee (in their official capacities).” Because the motion did not propose any change to the definition of “Protected Parties” used in the Gatekeeper Clause, as Appellants believed that it should in light of *Highland I*, Appellants filed a limited objection to the motion. In the objection, Appellants contended:

[A]mending the Plan only with respect to the definition of “Exculpated Parties” does not comport with the Fifth Circuit’s holding [in *Highland I*] because the Plan must also be changed with respect to its injunction and gatekeeper provisions in order to conform to the Final Opinion. As the Funds’ Response explains, the Plan’s permanent injunction provisions exculpate all included in the defined term “Protected Party.” To conform with the Final Opinion, this definition too must change.

The bankruptcy court held a hearing on the motion and Appellants’ objection. At the conclusion of the hearing, the bankruptcy court granted Highland’s motion as presented, without modifying the definition of “Protected Parties.” The bankruptcy court then issued a written opinion in support of its ruling, which confirmed its holding that *Highland I* required “that one change be made to the Plan to conform it to the mandate of the Fifth Circuit: revise the definition of ‘Exculpated Parties’ as proposed in the Motion and no more.”

Appellants petitioned for permission to appeal the Plan Conforming Order directly to this court, and we granted the petition. On appeal, Appellants ask us to consider two issues: (1) whether the bankruptcy court erred in failing to narrow the definition of “Protected Parties” used in the Gatekeeper Clause coextensively with its narrowing of the definition of “Exculpated Parties” used in the Exculpation Provision; and

(2) whether the Gatekeeper Clause, even if so narrowed, is lawful considering bankruptcy courts’ limited jurisdiction.³

3

Appellants raised the latter issue in their opening brief. But they walked this argument back at oral argument, averring that this appeal concerns only their first issue: whether *Highland I* should be read as narrowing the Gatekeeper Clause coextensively with the Exculpation Provision. Regardless, we decline to reach the second issue under our rule of orderliness. See *Mercado v. Lynch*, 823 F.3d 276, 279 (5th Cir. 2016). If Appellants wish to relitigate this issue, which was resolved in *Highland I*, they must do so via a petition for rehearing *en banc* or a petition for certiorari.

II

We review a bankruptcy court’s legal conclusions *de novo*. *358 *Evolve Fed. Credit Union v. Barragan-Flores (In re Barragan-Flores)*, 984 F.3d 471, 473 (5th Cir. 2021) (citation omitted).

III

We conclude that the bankruptcy court failed to properly implement our instructions in *Highland I* when it declined to narrow the definition of “Protected Parties” used in the Gatekeeper Clause to include only “(i) the Debtor; (ii) the Independent Directors, for conduct within the scope of their duties; (iii) the Committee; and (iv) the members of the Committee in their official capacities, for conduct within the scope of their duties.” In failing to make this change, the bankruptcy court exceeded its power under the Bankruptcy Code by allowing the Plan to improperly protect non-debtors from liability.

A

Although bankruptcy courts have the power to “issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of” the Bankruptcy Code, 11 U.S.C. § 105(a), this power is “not unlimited” and does not permit bankruptcy courts to “act as roving commission[s] to do equity.” *In re Mirant Corp.*, 378 F.3d 511, 523 (5th Cir. 2004) (alteration in original) (citing *In re Southmark Corp.*,

49 F.3d 1111, 1116 (5th Cir. 1995)). As relevant here, we have always recognized and enforced limitations on bankruptcy courts' power to shield non-debtors from liability.

1

The Supreme Court and this court have definitively held that bankruptcy courts may not approve a confirmation plan that non-consensually releases non-debtors from liability related to a bankruptcy proceeding.⁴ They have also recognized that bankruptcy injunctions, though not in themselves releases, similarly act to shield persons and entities from liability and therefore may not be entered to protect non-debtors not legally entitled to release.

4 We note that courts and bankruptcy confirmation plans often use the terms “release,” “exculpation,” and “discharge” loosely or interchangeably. Here, the Plan uses the term “exculpation” to refer to absolution from liability for both debts and conduct in the course of the bankruptcy. In this opinion, we mostly utilize the more generally used term “release,” but we discuss and apply cases that use other terminology when their usage is appropriate in the context of the discussion.

“Although we interpret [11 U.S.C.] § 105 liberally” to allow bankruptcy courts a range of powers, any action a bankruptcy court takes “must be consistent with the rest of the Bankruptcy Code.” *In re Zale Corp.*, 62 F.3d 746, 760 (5th Cir. 1995) (internal citations omitted). Notably, any bankruptcy court action must square with the Bankruptcy Code's edict that “discharge of a debt of the debtor does not affect the liability of any other entity on ... such debt.” 11 U.S.C. § 524(e); see, e.g., *In re Coho Res., Inc.*, 345 F.3d 338, 342–43 (5th Cir. 2003); *Hall v. Nat'l Gypsum Co.*, 105 F.3d 225, 229 (5th Cir. 1997); *In re Edgeworth*, 993 F.2d 51, 53–54 (5th Cir. 1993).

In accordance with this principle, the Supreme Court held recently in *Harrington v. Purdue Pharma L.P.*, 603 U.S. 204, 144 S.Ct. 2071, 219 L.Ed.2d 721 (2024), that 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 the affected claimants.” *Id.* at 227, 144 S.Ct. 2071. Even before *Purdue Pharma*, this court had held the same: *359 that any provision that non-consensually releases non-debtors from liability for debts and/or conduct, and any injunction that

acts to shield non-debtors from such liability, must be struck from a bankruptcy confirmation plan. See, e.g., *In re Pac. Lumber Co.*, 584 F.3d 229, 252 (5th Cir. 2009) (Fifth Circuit case law “seem[s] broadly to foreclose non-consensual non-debtor releases and permanent injunctions.”); *In re Vitro S.A.B. de C.V.*, 701 F.3d 1031, 1059, 1061–62 (5th Cir. 2012); *In re Zale Corp.*, 62 F.3d at 760 (“[W]e must overturn a § 105 injunction if it effectively discharges a nondebtor.”).⁵

5 The only situation in which permanent injunctions of third-party claims against non-debtors have been allowed is when the injunction “channel[s] those claims to allow recovery from separate assets and thereby avoid[s] discharging the nondebtor.” *In re Zale Corp.*, 62 F.3d at 760; see *In re Pac. Lumber Co.*, 584 F.3d at 252. The Bankruptcy Code explicitly authorizes this in mass tort asbestos cases. See 11 U.S.C. § 524(g).

As we explained in *Pacific Lumber*, “[t]he fresh start § 524(e) provides to debtors is not intended to serve th[e additional] purpose” of releasing non-debtors. 584 F.3d at 252–53. Thus, a bankruptcy court that approves a non-consensual release and/or injunction protecting non-debtors “exceed[s] its powers under § 105.” *In re Zale Corp.*, 62 F.3d at 761.

2

Relatedly, although we have recognized that bankruptcy courts have some power to perform gatekeeping functions, they nonetheless do not have unrestricted power to protect non-debtors from liability via a pre-filing injunction.

Under the *Barton* doctrine, we have acknowledged that an individual or entity may be required to obtain leave of the bankruptcy court before filing claims in another court “against the trustee or other bankruptcy-court-appointed officer, for acts done in the actor's official capacity” in a bankruptcy proceeding, even if the bankruptcy court would not have jurisdiction to actually adjudicate those claims. *Villegas v. Schmidt*, 788 F.3d 156, 159 (5th Cir. 2015) (citation omitted); see *Carroll v. Abide*, 788 F.3d 502, 506–07 (5th Cir. 2015); accord *Barton v. Barbour*, 104 U.S. 126, 26 L.Ed. 672 (1881). The bankruptcy court may gatekeep such claims even after the bankruptcy proceeding has concluded. See *Villegas*, 788 F.3d at 157, 159.

We have articulated several rationales for allowing bankruptcy courts to perform this limited gatekeeping function. For one, it prevents “usurpation of the powers and duties which belong[] exclusively to [the appointing bankruptcy] court [that] ... would [make] impossible of performance the duty of that court to distribute the trust assets to creditors equitably and according to their respective priorities.” *Barton*, 104 U.S. at 136; see *Carroll*, 788 F.3d at 506. In addition, “because a bankruptcy trustee is considered an officer of his appointing court, the bankruptcy court ‘has a strong interest in protecting him from unjustified personal liability for acts taken within the scope of his official duties.’” *Carroll*, 788 F.3d at 506 (footnotes omitted) (quoting *In re Lehal Realty Assocs.*, 101 F.3d 272, 276 (2d Cir. 1996)).

Beyond these few abovenamed non-debtor individuals, we have never extended the *Barton* doctrine to give bankruptcy courts gatekeeping power over claims against non-debtors. See, e.g., *Villegas*, 788 F.3d at 159; *Carroll*, 788 F.3d at 505; *In re Preferred Ready-Mix, LLC*, 2024 WL 5252498, at *1 (5th Cir. Dec. 31, 2024); *In re Foster*, 2023 WL 20872, at *5 (5th Cir. Jan. 3, 2023); *360 *In re Grodsky*, 799 F. App'x 271, 273 n.2 (5th Cir. 2020); *Baron v. Vogel*, 678 F. App'x 202, 203 (5th Cir. 2017).⁶

⁶ Other circuits have extended the *Barton* doctrine to protect a wider variety of court-appointed and court-approved fiduciaries and their agents. See, e.g., *Helmer v. Pogue*, 2012 WL 5231153, at *2–12 (N.D. Ala. Oct. 22, 2012) (applying *Barton* to debtor-in-possession); *In re Silver Oak Homes, Ltd.*, 167 B.R. 389, 394–95 (Bankr. D. Md. 1994) (applying *Barton* to debtor-in-possession's president); *Gordon v. Nick*, 1998 WL 559734, at *2–3 (4th Cir. 1998) (applying *Barton* to debtor-in-possession's general partner); *Lawrence v. Goldberg*, 573 F.3d 1265, 1270 (11th Cir. 2009) (applying *Barton* to trustee's attorneys and creditors who “functioned as the equivalent of court appointed officers”); *In re Lowenbraun*, 453 F.3d 314, 321–22 (6th Cir. 2006) (applying *Barton* to trustee's attorney); *In re Ditech Holding Corp.*, 2021 WL 3716398, at *10 (Bankr. S.D.N.Y. Aug. 20, 2021) (applying *Barton* to post-confirmation plan administrator, consumer claims representative, and their respective agents). But this circuit has never approved of broadening the *Barton* doctrine to cover such individuals.

B

As it must, *Highland I* obeys these bedrock principles concerning bankruptcy courts' power to protect non-debtors. Consequently, the proper reading of *Highland I* is to require the bankruptcy court to narrow the definition of “Protected Parties” used in the Gatekeeper Clause coextensively with the definition of “Exculpated Parties” used in the Exculpation Provision, to read simply: “collectively, (i) the Debtor; (ii) the Independent Directors, for conduct within the scope of their duties; (iii) the Committee; and (iv) the members of the Committee in their official capacities, for conduct within the scope of their duties.” Both (1) the opinion's plain language and (2) the change made to the opinion on rehearing elucidate this holding.

1

The plain language of two particular sections of *Highland I* indicates that the definition of “Protected Parties” must be narrowed.

First, in Part IV(E)(2), we stated that “Appellants' primary contention—that the Plan's injunction ‘is broad’ by releasing non-debtors in violation of § 524(e)—is resolved by our striking the impermissibly exculpated parties.” *Highland I*, 48 F.4th at 438. There is only one possible reading of this plain language: that we made a change to solve the Gatekeeper Clause's broadness—namely, narrowing it to protect the same persons and entities as the narrowed Exculpation Provision lawfully protects. In this sentence, we agreed with Appellants that the Gatekeeper Clause, as written in the Plan, was too broad, but expressly stated that we were resolving this problem by narrowing the Gatekeeper Clause in coordination with our narrowing of the Exculpation Provision. Although we did not specify by name the persons and entities to be stricken from the Gatekeeper Clause's definition of “Protected Parties,” it was implied that the same persons and entities stricken from the Exculpation Provision's definition of “Exculpated Parties” were stricken also from the Gatekeeper Clause's definition of “Protected Parties.” For clarity, we state now in explicit terms that *Highland I* struck all persons and entities from the definition of “Protected Parties” except Highland Capital; the Independent Directors, for conduct within the scope of their duties; the Committee; and the members of the Committee in their official capacities, for conduct within the scope of their duties.

In the next paragraph of *Highland I*, we considered the effect of the Injunction Provision on only “the legally exculpated parties.” *Id.* at 438. The use of this phrase *361 further links our treatment of the Exculpation Provision and the Injunction Provision and its Gatekeeper Clause. As just stated above, striking certain persons and entities from the Exculpation Provision had the effect of striking those same persons and entities from the Gatekeeper Clause, such that in the remainder of *Highland I* we needed to consider the effect of the Injunction Provision on only the “legally exculpated parties” in the remainder of the opinion. Consequently, our conclusion in Part IV(E)(2) that the injunction was “not unlawfully overbroad or vague” communicated our holding that the Injunction Provision was no longer overbroad in the sense that it protected persons and entities that it could not legally protect, because we had already stricken those persons and entities from the definition of “Protected Parties.”

Second, our summary of Part IV(E) of the *Highland I* opinion indicates that we narrowed both provisions coextensively. The summary states:

[T]he Plan violates § 524(e) but only insofar as it exculpates and enjoins certain non-debtors. The exculpatory order is therefore vacated as to all parties except Highland Capital, the Committee and its members, and the Independent Directors for conduct within the scope of their duties. We otherwise affirm the inclusion of the injunction and the gatekeeper provisions in the Plan.

Id. at 439 (first emphasis added). This is a crystal-clear statement of *Highland I*'s holding that the Plan was unlawful in that it both released and enjoined non-debtors that could not lawfully be protected. And the fact that *Highland I* states that we “otherwise affirm[ed] the inclusion of the injunction and gatekeeper provisions,” *id.*, shows that we made at least some alteration to the Injunction Provision and its Gatekeeper Clause. Given that no other changes to these provisions is evident from the face of *Highland I*, the only possible change was the non-debtors from the Gatekeeper Clause's definition of “Protected Parties.”

2

The changes made to *Highland I* on rehearing only strengthen this reading of the opinion.

Preliminarily, the fact that the *Highland I* panel granted rehearing at all shows that it intended to make changes to the Gatekeeper Clause. The petition for limited panel rehearing asked the panel for one thing only: to “confirm that the scope of the injunction and gatekeeper provisions in the Plan are limited in accordance with the Court's holding on the exculpation provision.” Although the panel did not explicitly state its reasoning for granting rehearing, this court generally only grants rehearing when parties “bring to [our] attention” specific issues in the original opinion. 5TH CIR. R. 40.1.2. Consequently, the *Highland I* panel would not have granted rehearing or made the change it did to the opinion for any purpose other than to address the issue raised by Appellants in their petition for panel rehearing.

Furthermore, on rehearing, the only change made to *Highland I* was to walk back the most conspicuous statement that could have been construed as saying that the Gatekeeper Clause should not be narrowed coextensively with the Exculpation Provision. At the beginning of Part IV(E)(2), the panel struck the sentence, “The injunction and gatekeeper provisions are, on the other hand, perfectly lawful,” *In re Highland Cap. Mgmt., L.P.*, 2022 WL 3571094, at *13 (5th Cir. Aug. 19, 2022) (withdrawn opinion), and replaced it with the sentence, “We now turn to the Plan's injunction and gatekeeper provisions,” *Highland I*, 48 F.4th at 438. In so *362 doing, the panel took steps to rectify any erroneous message that the Injunction Provision and its Gatekeeper Clause, as written in the Plan, were fully lawful.⁷

7

Highland Capital's argument that narrowing the Gatekeeper Clause in this way will “render it largely meaningless” does not undermine the conclusion that the definition of “Protected Parties” may not comprise more than the persons and entities to which we now clarify that it must be narrowed. It is indeed true, as Highland Capital points out, that “all the Exculpated Parties ceased to exist on the Effective Date of the Plan and have no role in any of the post-Effective Date activities,” such that limiting the Gatekeeper Clause in this way means that the clause will “not reach any

conduct undertaken after the Effective Date.” But as explained above, *see supra* Part III(A), the bankruptcy court lacks the power to shield non-debtors from liability in this way. Furthermore, this will not gut the Gatekeeper Clause completely, as Highland Capital warns, because the clause will still allow the bankruptcy court to gatekeep claims raised against the remaining persons and entities related to their conduct during the bankruptcy proceedings.

IV

The clear weight of Supreme Court and Fifth Circuit precedent dictates our holding: that a proper reading of *Highland I* requires that the definition of “Protected Parties” used in the Plan's Gatekeeper Clause be narrowed coextensively with the definition of “Exculpated Parties”

used in the Exculpation Provision. Any other reading of *Highland I* would improperly grant the bankruptcy court authority to enforce what is perhaps the broadest gatekeeper injunction ever written into a bankruptcy confirmation plan. Such authority is patently beyond the power of an Article I court under § 105.

Accordingly, we REVERSE in part and REMAND for the district court to revise the Plan's definitions of both “Exculpated Parties” and “Protected Parties” to read simply: “collectively, (i) the Debtor; (ii) the Independent Directors, for conduct within the scope of their duties; (iii) the Committee; and (iv) the members of the Committee in their official capacities, for conduct within the scope of their duties.”

All Citations

132 F.4th 353

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71 F.4th 168
United States Court of Appeals, Fourth Circuit.

IN RE: BESTWALL LLC, Debtor.
Bestwall LLC; Georgia-Pacific
LLC, Plaintiffs – Appellees,

v.

Official Committee of Asbestos
Claimants, Defendant – Appellant,
and

Sander L. Esserman, in His Capacity as
Future Claims Representative; Those
Parties Listed on Appendix A to Complaint;
John and Jane Does 1-1000, Defendants.

In re: Bestwall LLC, Debtor.
Bestwall LLC; Georgia-Pacific
LLC, Plaintiffs – Appellees,

v.

Sander L. Esserman, in His
Capacity as Future Claimants
Representative, Defendant – Appellant,
and

Official Committee of Asbestos Claimants
of Bestwall, LLC; Claimants of Brayton
Purcell, LLP; Claimants of Law Offices
of Peter G. Angelos, P.C.; Claimants of
Weitz & Luxenberg, P.C.; Claimants of
Nass Cancelliere; Claimants of Rebecca
S. Vinocur, P.A.; Claimants of the Deaton
Law Firm; Claimants of O'Brien Law Firm,
P.C.; Claimants of Bevan and Associates
LPA, Inc.; Claimants of Wilentz, Goldman &
Spitzer, P.A.; Claimants of the Ferraro Law
Firm, PA; Claimants of Shepard Law, P.C.;
Claimants of Shrader & Associates, L.L.P.;
Claimants of SWMW Law, LLC and Ernest
J. Foucha; Claimants of Waters & Kraus, LLP
Listed; Claimants of Levy Konigsberg, LLP;
Claimants of Flint Law Firm, LLC; Claimants
of Maune, Raichle, Hartley, French & Mudd,
LLC; Claimants of Cohen Placitella & Roth
P.C.; Claimants of the Lanier Law Firm, PC;
Claimants of Keller Fishback & Jackson,
LLP; Claimants of Kanan, McClain, Satterdown

Argued: December 6, 2022

Decided: June 20, 2023

Synopsis

Background: Debtor which, along with its non-debtor affiliate, had been formed prepetition through “Texas divisional merger” and which, pursuant to that restructuring, had become solely responsible for corporate predecessor’s asbestos-related liabilities, moved for preliminary injunction in aid of its proposed Chapter 11 plan to prevent third parties from pursuing asbestos-related personal-injury lawsuits against parties that were to be protected by channeling injunction in plan, including the non-debtor affiliate. The United States Bankruptcy Court for the Western District of North Carolina, [Laura T. Beyer](#), Chief Judge, [606 B.R. 243](#), granted motion. Claimant representatives comprised of Official Committee of Asbestos Claimants and individual who was Future Claimants’ Representative appealed. The District Court, [Robert J. Conrad, J.](#), [2022 WL 67469](#) and [2022 WL 68763](#), affirmed. Claimant representatives appealed.

Holdings: The Court of Appeals, [Agee](#), Circuit Judge, held that:

the Future Claimants’ Representative had appellate standing;

the Bankruptcy Court had “related to” jurisdiction to issue the preliminary injunction;

debtor, its corporate predecessor, and its non-debtor affiliate did not improperly manufacture jurisdiction in the Bankruptcy Court, and so the Bankruptcy Court was not prevented from exercising “related to” jurisdiction over debtor’s motion;

as a matter of apparent first impression for the court, when analyzing the likelihood-of-success requirement for a preliminary injunction, the “merits” that must be considered in a Chapter 11 case are the debtor’s rehabilitation and reorganization; and

under the likelihood-of-success prong of the preliminary injunction test, debtor was not required to show entitlement to permanent injunctive relief, that is, a permanent channeling injunction.

Affirmed.

[King](#), Circuit Judge, filed opinion dissenting in part.

Procedural Posture(s): On Appeal; Motion for Preliminary Injunction.

***172** Appeal from the United States District Court for the Western District of North Carolina, at Charlotte. [Robert J. Conrad, Jr.](#), District Judge. (3:20-cv-00103-RJC)

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Before [KING](#) and [AGEE](#), Circuit Judges, and [Henry E. HUDSON](#), Senior United States District Judge for the Eastern District of Virginia, sitting by designation.

Opinion

Affirmed by published opinion. Judge [Agee](#) wrote the opinion in which Judge Hudson joined. Judge [King](#) wrote an opinion dissenting in part.

[AGEE](#), Circuit Judge:

***173** The district court affirmed a bankruptcy court order that entered a preliminary injunction preventing thousands of third-party asbestos claims from proceeding against debtor Bestwall LLC's affiliates, including affiliate and non-debtor Georgia-Pacific LLC ("New GP"). The Official Committee of Asbestos Claimants ("Committee") and Sander L. Esserman, in his capacity as Future Claimants' Representative ("FCR") (collectively "Claimant Representatives"), appeal. They argue that the bankruptcy court lacked jurisdiction to enjoin non-bankruptcy proceedings against New GP and, alternatively, that the bankruptcy court erred in entering the preliminary injunction because it applied an improper standard.

As explained below, based on the specific facts of this case, we agree with the district court that the bankruptcy court had "related to" jurisdiction to issue the preliminary injunction and applied the correct standard in doing so. Accordingly, we affirm the judgment of the district court.

I.

Georgia-Pacific LLC ("Old GP"), the corporate parent and predecessor of New GP and Bestwall, merged with Bestwall Gypsum Company ("Old Bestwall"), a manufacturer of asbestos-containing products, in 1965. Old GP then sold those products until 1977. Commencing in or before 1979, Old GP has faced thousands of asbestos-related personal-injury lawsuits based on its sale of those products.

In 2017, Old GP underwent a divisional merger under Texas law.¹ See *Tex. Bus. Orgs. Code* § 1.002(55)(A); see also ***174** *In re LTL Mgmt., LLC*, 64 F.4th 84, 96 (3d Cir. 2023) (explaining that such a "merger splits a legal entity into two, divides its assets and liabilities between the two new entities, and terminates the original entity"). As a result of this restructuring, Old GP ceased to exist, and its assets and liabilities were divided between two new entities as wholly owned subsidiaries of Georgia-Pacific Holdings, LLC: Bestwall and New GP. The purpose of this restructuring was twofold:

- (a) to separate and align [Old GP's] business of managing and defending asbestos-related claims with the assets and team of individuals primarily related to or responsible for such claims; and (b) to provide additional optionality regarding potential alternatives for addressing those claims in the future, including through the commencement of

a chapter 11 reorganization proceeding to utilize [section 524\(g\) of the Bankruptcy Code](#) without subjecting the entire Old GP enterprise to chapter 11.

J.A. 591.

In accordance with this purpose, Bestwall received certain of Old GP's assets² and became solely responsible for certain of its liabilities, including all asbestos-related liabilities. As a result, Bestwall "ha[d] the same ability to fund asbestos claims that Old GP had." J.A. 595. New GP received all other assets of Old GP and became responsible for all other non-asbestos-related liabilities of Old GP.

Following the restructuring, asbestos claimants began naming New GP as a defendant in asbestos lawsuits even though Bestwall had taken on sole responsibility for asbestos claims and would process those claims in its bankruptcy proceeding (described below).

A.

As part of the restructuring of Old GP, Bestwall and New GP entered into a number of agreements between them.

First, in a plan of merger and merger support agreement, Bestwall and New GP agreed that:

Bestwall will indemnify and hold harmless New GP from and against all Losses to which New GP may become subject, insofar as such Losses (or Proceedings in respect thereof) arise out of, in any way relate to, or result from ... (a) a claim in respect of, any Bestwall Assets or Bestwall Liabilities or (b) reimbursement or other obligations of New GP under or in respect of any appeal bonds or similar litigation related surety Contracts that are or have ***175** been posted or entered into by New GP in connection with Proceedings in respect of any Bestwall Liabilities. New GP will indemnify and hold harmless Bestwall from and against all Losses to which Bestwall may become subject, insofar as such Losses (or Proceedings in respect thereof) arise out of, in any way relate to, or result from a claim in respect of, any New GP Assets or New GP Liabilities.

J.A. 581; see J.A. 555.

In addition, the two companies entered into a funding agreement, which required New GP to cover expenses that Bestwall incurred in the normal course of its business and to fund Bestwall's obligations to New GP, including Bestwall's

indemnification obligations as described above. Based on this funding agreement, “New GP’s evidently bountiful assets”—while “out of reach” via the tort system, *post* at 187—will be and have been available to claimants through the Bestwall bankruptcy estate.

Upon Bestwall filing for bankruptcy, New GP’s indemnification obligations included the costs of administering the bankruptcy and the costs of funding a § 524(g) asbestos trust.³ However, New GP was required to fund the trust only to the extent that Bestwall’s other assets were insufficient. Alternatively, if Bestwall did not file for bankruptcy, New GP was to provide any amounts necessary to satisfy Bestwall’s asbestos liabilities. Overall, Bestwall was not required to repay New GP for such funding, and New GP was to provide funding only to the extent that Bestwall’s subsidiaries’ distributions were insufficient to cover Bestwall’s costs and expenses (except as to the funding of the § 524(g) trust, as explained above). Thus, New GP’s assets are available to the Bestwall bankruptcy estate to cover approved asbestos claims.

In addition, Bestwall and New GP entered into a secondment⁴ agreement whereby New GP assigned some of its employees to Bestwall, including its in-house legal team that had managed the defense of the asbestos-related claims. Bestwall determined the amount of each seconded employee’s time that it needed each month so that the employee could work for Bestwall’s other affiliates in any remaining time. New GP was not permitted to recall any of the seconded employees from Bestwall without Bestwall’s consent.

B.

Following the restructuring, Bestwall filed a voluntary petition for chapter 11 bankruptcy in the Western District of North Carolina. The goal of the bankruptcy was to:

consummate a plan of reorganization that would ... provide for (a) the creation and funding of a trust established under section 524(g) of the Bankruptcy Code to pay valid asbestos-related claims and (b) issuance of an injunction under section 524(g) of the Bankruptcy Code that will permanently protect [Bestwall] and its affiliates from any further *176 asbestos claims arising from products manufactured and sold by, or operations or conduct of, Old Bestwall or Old GP.

J.A. 603.⁵

Bestwall also filed an adversary proceeding seeking a preliminary injunction under 11 U.S.C. § 105(a) enjoining any asbestos-related claims against New GP or, alternatively, a declaration that the automatic stay under § 362(a)⁶ applied to such claims against New GP. Bestwall asserted that its requested relief was necessary to avoid defeating the essential purpose of the bankruptcy. Without such relief from the bankruptcy court, Bestwall contended that asbestos claimants would proceed against New GP for the same claims already in the Bestwall bankruptcy proceeding, thereby rendering the bankruptcy futile.

The bankruptcy court first determined that it had “related to” subject matter jurisdiction under 28 U.S.C. § 1334(b)⁷ to enjoin the claims against New GP because allowing the claims against New GP to proceed outside of Bestwall’s bankruptcy proceeding could detrimentally affect the Bestwall bankruptcy estate for at least three reasons.⁸ *In re Bestwall LLC*, 606 B.R. 243, 249–51 (Bankr. W.D.N.C. 2019). First, the purpose of the bankruptcy would be defeated without the injunction because Bestwall would be unable to address all the claims against it in one forum. *Id.* at 249. Second, without the injunction, Bestwall’s personnel would be forced to spend time defending the claims against New GP at the expense of performing tasks necessary to Bestwall’s reorganization. *Id.* And third, Bestwall’s indemnity obligations to New GP would “make judgments against [New GP] ... tantamount to judgments against” the Bestwall bankruptcy estate. *Id.* at 250. The bankruptcy court also concluded that Bestwall met the requirements for the entry of a preliminary injunction in relevant part because it had a realistic possibility of a successful reorganization. *Id.* at 255.

C.

The Claimant Representatives appealed to the district court, which affirmed the *177 judgment of the bankruptcy court. *In re Bestwall LLC*, No. 3:20-cv-105-RJC, 2022 WL 68763, at *1 (W.D.N.C. Jan. 6, 2022).⁹ In doing so, the district court concluded that the FCR had standing to appeal the bankruptcy court’s order because the FCR represents those parties who may become claimants during the pendency of the injunction and would thereby be enjoined from pursuing their as-yet-unfiled claims against New GP. *Id.* at *4. The court reasoned that this was “a direct and adverse effect

on the future claimants['] pecuniary interests” and therefore sufficient to show standing. *Id.*

Next, the district court determined that the bankruptcy court had “related to” jurisdiction based on (1) the purpose of Bestwall's reorganization—which would be defeated absent the injunction; (2) the distraction of Bestwall's personnel if they needed to assist in defending litigation against New GP while also trying to pursue Bestwall's reorganization; and (3) the impact of the indemnification obligations between Bestwall and New GP on the Bestwall bankruptcy estate. *Id.* at *5–6.

Lastly, the district court found that the bankruptcy court did not abuse its discretion in granting the preliminary injunction. *Id.* at *7. Relevant to this appeal, when analyzing the likelihood-of-success element, the district court rejected Claimant Representatives' argument that the bankruptcy court applied the incorrect legal standard. It further reasoned that based on Bestwall's significant assets and contractual rights under the funding agreement, the bankruptcy court did not abuse its discretion in concluding that Bestwall had a reasonable likelihood of a successful reorganization. *Id.* at *8.

On appeal, the parties dispute appellate standing, subject matter jurisdiction, and the merits of the preliminary injunction. We analyze each argument in turn. We have jurisdiction under 28 U.S.C. § 158(d) and § 1291.

II.

We begin with Bestwall's threshold argument that the district court erred in finding that the FCR had appellate standing.¹⁰ The presence of appellate standing is a legal conclusion that we review de novo. *See Mort Ranta v. Gorman*, 721 F.3d 241, 250 (4th Cir. 2013) (explaining that when this Court reviews a decision by a district court operating as a bankruptcy appellate court, the Court reviews legal conclusions de novo); *see also LaTele Television, C.A. v. Telemundo Commc'ns Grp., LLC*, 9 F.4th 1349, 1357 (11th Cir. 2021) (explaining that determinations regarding appellate standing are reviewed de novo).

The test for standing to appeal a bankruptcy court's order is whether the party is a “person aggrieved” by the order, *In re Urb. Broad. Corp.*, 401 F.3d 236, 243 (4th Cir. 2005), meaning that the party is “directly and adversely affected pecuniarily,” *id.* at 244 (quoting *In re Clark*, 927 F.2d 793,

795 (4th Cir. 1991)); *see In re Imerys Talc Am., Inc.*, 38 F.4th 361, 371 (3d Cir. 2022) (explaining that “parties meet that standard only when a contested order ‘diminishes their property, increases *178 their burdens, or impairs their rights’ ” (citation omitted)).

We conclude that in this case, the district court properly found that the FCR had standing to challenge the bankruptcy court's order on appeal. As the district court reasoned, the FCR represents individuals who may become claimants during the pendency of the injunction and will be enjoined from litigating their asbestos-related claims outside of Bestwall's bankruptcy. The injunction thus “increases [the future claimants'] burdens” and “impairs their rights,” *In re Imerys Talc Am.*, 38 F.4th at 371 (citation omitted), such that they are directly and adversely affected by the bankruptcy court's entry of the preliminary injunction. *See In re Amatex Corp.*, 755 F.2d 1034, 1041 (3d Cir. 1985) (explaining that future claimants “clearly have a practical stake in the outcome of the [bankruptcy] proceedings”); *id.* at 1043 (stating that bankruptcy proceedings “will vitally affect [future claimants'] interests”).¹¹

III.

Next, we turn to the Claimant Representatives' argument that the bankruptcy court lacked jurisdiction to enjoin the asbestos litigation against New GP. They assert that (1) the bankruptcy court lacked “related to” jurisdiction to enter the preliminary injunction, and (2) Old GP attempted to improperly manufacture jurisdiction. Whether the court has subject matter jurisdiction is a legal question that we review de novo. *New Horizon of NY LLC v. Jacobs*, 231 F.3d 143, 150 (4th Cir. 2000).

A.

Under 28 U.S.C. § 1334(b), a bankruptcy court has jurisdiction over civil proceedings “arising in or related to cases under title 11.” This Court follows the broad test for “related to” jurisdiction first articulated by the Third Circuit in *Pacor, Inc. v. Higgins*, 743 F.2d 984, 994 (3d Cir. 1984), *overruled in part on other grounds by Things Remembered, Inc. v. Petrarca*, 516 U.S. 124, 116 S.Ct. 494, 133 L.Ed.2d 461 (1995). *See A.H. Robins Co. v. Piccinin*, 788 F.2d 994, 1002 n.11 (4th Cir. 1986) (adopting *Pacor* test). Under *Pacor*, a civil proceeding is “related to” a bankruptcy case if “the

outcome of that proceeding could conceivably have any effect on the estate being administered in bankruptcy.” 743 F.2d at 994 (cleaned up). In other words, if the outcome of the proceeding “could alter the debtor’s rights, liabilities, options, or freedom of action (either positively or negatively) and ... in any way impacts upon the handling and administration of the bankrupt estate,” the bankruptcy court has “related to” jurisdiction. *Id.* This “test does not require certain or likely alteration of the debtor’s rights, liabilities, options or freedom of action, nor does it require certain or likely impact upon the handling and administration of the bankruptcy estate.” *In re Celotex Corp.*, 124 F.3d 619, 626 (4th Cir. 1997). Instead, “[t]he possibility of such alteration or impact is sufficient to confer jurisdiction.” *Id.*

As the bankruptcy court correctly determined, the asbestos-related claims against Bestwall are identical to the claims against New GP pending now or likely to *179 be pending in the future in the various state courts. *See In re Bestwall*, 606 B.R. at 251 (“The liability being asserted against New GP and Bestwall would be identical and co-extensive in every respect.”). The Committee’s counsel admitted that litigating the *same claims* in thousands of state-court cases, that will also be resolved within the Bestwall bankruptcy case, could have an effect on the Bestwall bankruptcy estate.¹² *See* Oral Argument at 16:25-17:06 (acknowledging that it was “broadly ... true” that litigating the exact same claims in state courts and in bankruptcy court would affect what happens in the bankruptcy). And the possible effect on the Bestwall bankruptcy estate of litigating thousands of identical claims in state court is sufficient to confer “related to” jurisdiction. *See Piccinin*, 788 F.2d at 1004, 1007 (relying on “persuasive guidance” from a bankruptcy court decision that reasoned that an injunction could be extended to litigation against non-debtors where the covered actions were “inextricably interwoven with the debtor” (quoting *In re Johns-Manville Corp.*, 26 B.R. 405, 418 (Bankr. S.D.N.Y. 1983))); *In re Dow Corning Corp.*, 86 F.3d 482, 493 (6th Cir. 1996) (finding “related to” jurisdiction over claims pending against non-debtor defendants because the debtor and the non-debtor defendants “are closely related with regard to the pending ... litigation”).

For example, if New GP were found liable for asbestos-related claims in the state-court cases, that could reduce the claimants’ recovery on those claims in the bankruptcy proceeding, thereby reducing the amount of money that would be paid out of the bankruptcy estate and leaving more funds in the estate for other claimants. *See* Oral Argument at 2:55-4:17

(the Committee’s counsel admitting that “there’s obviously only one recovery, but ... the plaintiffs have the right to pursue multiple sources for reimbursement”); *see also In re Celotex Corp.*, 124 F.3d at 626 (indicating that “related to” jurisdiction exists if the proceeding *could* alter the debtor’s liabilities positively or negatively). Furthermore, issue preclusion, inconsistent liability, and evidentiary issues could well arise in the bankruptcy proceeding based on the results of the state-court litigation against New GP, and the resolution of those issues would inevitably affect the bankruptcy estate. *See Piccinin*, 788 F.2d at 1005, 1007 (describing as “persuasive guidance” a bankruptcy case in which the court granted an injunction against lawsuits against non-debtors in part due to collateral estoppel concerns (citing *In re Johns-Manville Corp.*, 26 B.R. 420, 435 (Bankr. S.D.N.Y. 1983))).

Therefore, we agree with the district court that the bankruptcy court properly concluded that it had “related to” jurisdiction to enjoin the claims against New GP.¹³ *180 We emphasize that this conclusion is based on the specific circumstances of this case, including the involvement of thousands of identical claims against New GP and Bestwall and the fact that the claims against New GP are, or could be, pending in many state courts around the country.¹⁴

B.

Our conclusion concerning “related to” jurisdiction does not end the jurisdictional analysis. The Claimant Representatives also assert that Old GP impermissibly sought to manufacture jurisdiction in the bankruptcy court which could prevent this Court from exercising “related to” jurisdiction. We disagree with the Claimant Representatives’ argument and the dissent’s acceptance of that argument.

Under 28 U.S.C. § 1359, federal courts do not have jurisdiction over civil actions “in which any party, by assignment or otherwise, has been improperly or collusively made or joined to invoke the jurisdiction of such court.” We have found this statute violated when a nominal party has no real stake in the outcome of a case such that the only possible reason for its involvement is to create jurisdiction. *See Lester v. McFaddon*, 415 F.2d 1101, 1106 & n.11 (4th Cir. 1969) (“It is the lack of a stake in the outcome coupled with the motive to bring into a federal court a local action normally triable only in a state court which is the common thread of the cases holding actions collusively or improperly brought.”). For example, we found § 1359 violated when a South Carolina

citizen procured the appointment of a Georgia citizen as administrator of an estate *181 seemingly to create diversity jurisdiction.¹⁵ See *id.* at 1103–04 (noting that the dispute was “superficially converted into a dispute between citizens of different states” because the appointed administrator had no stake in the litigation, likely would not play a role, and was clearly a “straw party ... appoint[ed] for the purpose of creating apparent diversity of citizenship” (internal quotation marks omitted)); see also *Kramer v. Caribbean Mills, Inc.*, 394 U.S. 823, 827–28, 89 S.Ct. 1487, 23 L.Ed.2d 9 (1969) (finding that a party improperly manufactured jurisdiction where he “total[ly] lack[ed] [a] previous connection with the matter” and “candidly admit[ted] that the assignment was in substantial part motivated by a desire ... to make diversity jurisdiction available” (internal quotation marks omitted)); *Lehigh Mining & Mfg. Co. v. Kelly*, 160 U.S. 327, 339, 16 S.Ct. 307, 40 L.Ed. 444 (1895) (affirming dismissal based on lack of jurisdiction—prior to the enactment of § 1359—where a Virginia corporation created a Pennsylvania corporation and conveyed to it land “for the express purpose” of enabling the Pennsylvania corporation to file suit in federal court against Virginia residents based on diversity jurisdiction).

Separate from § 1359, we have held that “neither the parties nor the bankruptcy court can create § 1334 jurisdiction.” *Valley Historic Ltd. P’ship v. Bank of N.Y.*, 486 F.3d 831, 837 (4th Cir. 2007); see *Orquera v. Ashcroft*, 357 F.3d 413, 416 (4th Cir. 2003) (indicating that parties cannot create subject matter jurisdiction). For example, parties cannot include a provision in a plan of reorganization purporting to confer jurisdiction on a bankruptcy court because “the Debtor cannot write its own jurisdictional ticket.” *Valley Historic*, 486 F.3d at 837 (cleaned up).

But unlike the cases referenced above, Old GP, New GP, and Bestwall did not manufacture jurisdiction via their Texas divisional merger. This is evident because without the restructuring, the asbestos claims would have remained with Old GP. And, if Old GP had filed for bankruptcy, the bankruptcy court would have had jurisdiction over those claims as it does over the same claims here. See 28 U.S.C. § 1334(b) (providing for bankruptcy court jurisdiction over civil proceedings “related to” cases under title 11); *Valley Historic*, 486 F.3d at 836 (explaining that “related to” jurisdiction is implicated if a civil action could alter the debtor’s rights and liabilities and impacts the administration of the bankruptcy estate). Thus, as Bestwall and New GP point out, “the corporate restructuring leaves the jurisdictional result the *same*.” Resp. Br. 40; see *U.S.I. Props. Corp. v.*

M.D. Constr. Co., 860 F.2d 1, 6 (1st Cir. 1988) (“[P]arties may legitimately try to obtain the jurisdiction of federal courts, as long as they lawfully qualify under some of the grounds that allow access to this forum of limited jurisdiction. On the other hand, using a strawman, or sham transactions, solely for the creation of otherwise *unobtainable jurisdiction*, is clearly forbidden both by statute and by the policies that underlie diversity jurisdiction.” (emphasis added)). This distinction differentiates the present circumstances from the cases on which Claimant Representatives rely and precludes the application of § 1359.

The dissent contends that we “miss[] the point” by “focusing on jurisdiction *182 over claims instead of parties.” *Post* at 193. But there is no way to separate the parties from the claims here and, even if there were, we would decline to do so because § 1334(b) requires us to analyze whether the *claims* involving New GP are “related to” the bankruptcy case. See 28 U.S.C. § 1334(b) (“[T]he district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11.”); see also *Sinochem Int’l Co. v. Malaysia Int’l Shipping Corp.*, 549 U.S. 422, 431, 127 S.Ct. 1184, 167 L.Ed.2d 15 (2007) (explaining that subject matter jurisdiction is “jurisdiction over the category of claim in suit” as compared to personal jurisdiction, which is jurisdiction over the parties). The statute does not instruct us to consider the parties in isolation.

A recent Third Circuit decision that involved a divisional merger followed by the bankruptcy of one of the parties does not affect the manufactured-jurisdiction analysis. In *In re LTL Management, LLC*, 64 F.4th 84 (3d Cir. 2023), that court was confronted with a restructuring similar to Old GP’s divisional merger—namely, a corporation undergoing a divisional merger pursuant to Texas law in order to isolate its asbestos-related liabilities in one subsidiary and its “productive business assets” in another subsidiary. *Id.* at 93. Following the restructuring, the asbestos-related subsidiary filed for bankruptcy, and the claimants moved to dismiss the bankruptcy petition as not filed in good faith. *Id.* The bankruptcy court denied the motion, but the Third Circuit reversed and dismissed the bankruptcy petition under 11 U.S.C. § 1112(b). *Id.* at 93, 111. The appellate court held that the debtor was not in financial distress and the bankruptcy petition therefore was not filed in good faith. *Id.* at 106, 109–10.

In this appeal, by contrast, Claimant Representatives do not make the arguments raised by the claimants in *LTL*

Management. They do not contend that Bestwall was not in financial distress when it filed for bankruptcy, nor does this appeal involve a motion to dismiss filed on that basis. Further, as the Third Circuit recognized in *LTL Management*, this Court applies a more comprehensive standard to a request for dismissal of a bankruptcy petition for lack of good faith; that is, the complaining party must show both “subjective bad faith” and the “objective futility of any possible reorganization.” *Id.* at 98 n.8 (quoting *Carolin Corp. v. Miller*, 886 F.2d 693, 694 (4th Cir. 1989)). The Claimant Representatives have made no showing to this Court of either required element.

As importantly, the court in *LTL Management* did not address the critical issue present here: whether the bankruptcy court had jurisdiction to enter a preliminary injunction. *See id.* at 99 n.11 (“The parties contest whether the Bankruptcy Court had jurisdiction to issue the order enjoining the Third-Party Claims against the Protected Parties. Dismissing LTL’s petition obviates the need to reach that question.”). *LTL Management* is simply not relevant to the resolution of the case before us.

Moreover, while Claimant Representatives assert that Old GP’s restructuring caused Bestwall and New GP to enter into the indemnification and funding agreements for the sole purpose of creating jurisdiction over the claims against New GP, this argument is a non-starter because our finding of jurisdiction is not predicated on those agreements. Rather, it is based on the thousands of identical claims pending against New GP outside of the bankruptcy proceeding and the effect of those claims on Bestwall’s bankruptcy estate, *183 which Old GP clearly could not and did not manufacture.

Finally, the dissent argues that Bestwall was obligated—but failed—to prove that the restructuring was “driven by an independent, legitimate business justification” rather than being pretextual. *Post* at 191. Assuming without deciding that such a showing is necessary, Bestwall did make that showing. The record establishes that the restructuring was driven by Old GP’s desire to pursue its non-asbestos-related business apart from asbestos-related litigation or a bankruptcy proceeding while keeping its assets available to satisfy any asbestos-related liabilities, if required. *See, e.g.*, J.A. 591 ¶ 13 (explaining that the purpose of the restructuring was “to separate and align [Old GP’s] business of managing and defending asbestos-related claims with the assets and team of individuals primarily related to or responsible for such claims”; to provide options for addressing those claims

“without subjecting the entire Old GP enterprise to chapter 11”; and “to make certain that [Bestwall] had the same ability to fund the costs of defending and resolving present and future asbestos claims as Old GP”).

To conclude our discussion of jurisdiction, the Court notes that Claimant Representatives appear to be using their jurisdictional arguments as a back-door way to challenge the propriety of the reorganization and the merits of a yet-to-be-filed chapter 11 plan. This is both premature and improper.

If the claimants are adversely affected monetarily by the ongoing bankruptcy, then the time and place to raise that concern is at plan confirmation, not by a purported jurisdictional challenge that really goes to the merits of the reorganization. At plan confirmation, claimants holding “at least two-thirds in amount and more than one-half in number of the allowed claims of such class” must accept the plan for the bankruptcy court to confirm it (with some exceptions not relevant here). 11 U.S.C. § 1126(c); *id.* § 1129(a)(7)–(8). Therefore, Bestwall must propose a plan that addresses the concerns held by a majority of the claimants. This mandatory reality of chapter 11 bankruptcy belies the dissent and Claimant Representatives’ false narrative that some subterfuge will befall the claimants.

Alternatively, rather than waiting for plan confirmation, claimants can bring individual actions for relief based on the specific facts of a particular claim. That is done in bankruptcy proceedings on a routine basis where appropriate. Notably, Claimant Representatives have failed to do so here.

These bankruptcy procedures promote the equitable, streamlined, and timely resolution of claims in one central place compared to the state tort system, which can and has caused delays in getting payment for legitimate claimants. *Compare Katchen v. Landy*, 382 U.S. 323, 328, 86 S.Ct. 467, 15 L.Ed.2d 391 (1966) (explaining that “a chief purpose of the bankruptcy laws is to secure a prompt and effectual administration and settlement of the estate of all bankrupts within a limited period” (cleaned up)), *with* Oral Argument at 33:23–33:50 (Bestwall’s counsel explaining that when Bestwall filed for bankruptcy in 2017, of the 64,000 pending asbestos-related claims, seventy-five percent had been pending for ten years or more, and fifty-five percent had been pending for fifteen years or more). In fact, while Claimant Representatives complain that the over four-year preliminary injunction proceeding has impeded the resolution of asbestos-related claims, the main interference

with the timely resolution of the claims in Bestwall's bankruptcy proceeding appears to ***184** be Claimant Representatives' challenge to the preliminary injunction, thereby prolonging the bankruptcy process and preventing the claimants from obtaining prompt relief. It is not clear why Claimant Representatives' counsel have relentlessly attempted to circumvent the bankruptcy proceeding, but we note that aspirational greater fees that could be awarded to the claimants' counsel in the state-court proceedings is not a valid reason to object to the processing of the claims in the bankruptcy proceeding.

The district court thus correctly rejected the Claimant Representatives' argument that Old GP, Bestwall, and New GP improperly manufactured jurisdiction.

IV.

Finally, we consider the merits of the preliminary injunction. The Claimant Representatives argue that even if the bankruptcy court properly exercised jurisdiction over the claims against New GP, the bankruptcy court should not have granted the preliminary injunction because it (1) engaged in the wrong legal inquiry by focusing on the likelihood of reorganization rather than on the likelihood of the court confirming a plan that included a *permanent* injunction, and (2) applied the wrong standard by focusing on the *realistic possibility* of reorganization instead of requiring a *clear showing* of a successful reorganization. Again, we disagree.

First, in order to grant a preliminary injunction, courts must evaluate, *inter alia*, whether the plaintiff is likely to succeed on the merits. *Mountain Valley Pipeline v. W. Pochontas Props.*, 918 F.3d 353, 366 (4th Cir. 2019). Normally, the “merits” in litigation are the resolution of an underlying civil dispute. But in a chapter 11 bankruptcy, the focus is not on resolving a particular dispute but rather on the debtor's rehabilitation and reorganization. *See In re White Mountain Mining Co., L.L.C.*, 403 F.3d 164, 170 (4th Cir. 2005) (explaining that the purpose of chapter 11 is the “rehabilitation of the debtor”); *Providence Hall Assocs. Ltd. P'ship v. Wells Fargo Bank, N.A.*, 816 F.3d 273, 279 (4th Cir. 2016) (same); *In re Premier Auto. Servs., Inc.*, 492 F.3d 274, 284 (4th Cir. 2007) (“The purpose of Chapter 11 reorganization is to assist financially distressed business enterprises by providing them with breathing space in which to return to a viable state.” (citation omitted)); *see also Carolin Corp.*, 886 F.2d at 702 (suggesting that

chapter 11's purpose is “to reorganize or rehabilitate an existing enterprise” (citation omitted)). Therefore, as our sister circuits have stated explicitly, the “merits” that must be considered for purposes of a preliminary injunction in a chapter 11 bankruptcy case are the debtor's rehabilitation and reorganization. *See In re Excel Innovations, Inc.*, 502 F.3d 1086, 1095 (9th Cir. 2007) (holding that an injunction under § 105(a) requires “a reasonable likelihood of a successful reorganization”); *In re Eagle-Picher Indus., Inc.*, 963 F.2d 855, 860 (6th Cir. 1992) (indicating that the likelihood-of-success factor requires a “realistic possibility of successfully reorganizing”); *see also Piccinin*, 788 F.2d at 1008 (affirming grant of preliminary injunction and focusing on whether “*any effort at reorganization of the debtor will be frustrated*, if not permanently thwarted” should the third-party litigation proceed (emphasis added)); *Willis v. Celotex Corp.*, 978 F.2d 146, 149 (4th Cir. 1992) (indicating that a § 105(a) injunction is appropriate, *inter alia*, if third-party proceedings “will have an adverse impact on the Debtor's *ability to formulate a Chapter 11 plan*” (emphasis added) (quoting *Piccinin*, 788 F.2d at 1003)). The bankruptcy court thus appropriately considered Bestwall's realistic likelihood of successfully reorganizing ***185** when granting an injunction under § 105(a).

The Claimant Representatives assert that, under the first prong of the preliminary injunction test, the district court should have determined whether Bestwall would ultimately be able to obtain permanent injunctive relief. But requiring a party to show entitlement to a permanent channeling injunction this early in the bankruptcy proceeding puts the cart before the horse; § 524(g) does not require such proof until the plan confirmation stage. *See 11 U.S.C. § 524(g) (1)(A)* (providing that “[a]fter notice and hearing, a court that enters an order confirming a plan of reorganization under chapter 11 may issue, in connection with such order, an injunction” (emphasis added)). Contrary to the express intent of Congress as shown through the Bankruptcy Code, the position of Claimant Representatives would effectively eliminate reorganization under chapter 11 as an option for many debtors. Therefore, we reject the Claimant Representatives' argument that the bankruptcy court needed to find that it would likely enter a permanent injunction in order to grant a preliminary injunction.

Further, the Claimant Representatives assert that the preliminary injunction standard requires a “clear showing” that the debtor will be able to reorganize rather than the “realistic possibility” standard applied by the bankruptcy

court. Opening Br. 50. But the cases on which the Claimant Representatives rely in support of their argument were decided outside the context of a preliminary injunction in bankruptcy and are thus inapposite. *See, e.g., Winter v. Nat. Res. Def. Council, Inc.*, 555 U.S. 7, 22, 129 S.Ct. 365, 172 L.Ed.2d 249 (2008) (holding—outside the context of a § 105(a) injunction—that a party seeking a preliminary injunction must make a clear showing that he or she is entitled to such relief). Moreover, if we required a “clear showing” of a debtor’s ability to reorganize before the plan-confirmation stage, chapter 11 proceedings would never get off the ground, as we just noted. For example, the debtor would have to provide significant evidence that it would be able to reorganize before the entry of the preliminary injunction necessary to make such a reorganization possible. *See In re Hillsborough Holdings Corp.*, 123 B.R. 1004, 1015 (Bankr. M.D. Fla. 1990) (“There is nothing in this record to indicate that these Debtors are not viable business entities incapable of achieving a successful reorganization which is fair and equitable to all. Their success is, however, dependent on a speedy, favorable determination of the issues raised by the Debtors in [their] Adversary Proceeding Thus, until those matters are resolved, it would be premature to conclude at this time that this reorganization process is doomed and that there is no legal justification for granting the injunctive relief sought.”).

For all these reasons, we affirm the district court’s decision affirming the bankruptcy court’s order granting a preliminary injunction.

V.

For the foregoing reasons, we

AFFIRM.

KING, Circuit Judge, dissenting in part:

The Supreme Court has long recognized that Congress’s “central purpose” in enacting the Bankruptcy Code was to “provide a procedure by which certain *insolvent debtors* can reorder their affairs, make peace with their creditors, and enjoy a new opportunity in life with a clear field for future effort.” *See Grogan v. Garner*, 498 U.S. 279, 286, 111 S.Ct. 654, 112 L.Ed.2d 755 (1991) (emphasis added). Put differently, *186 the nation’s bankruptcy laws “must be construed ... to give *the bankrupt* a fresh start.” *See*

Burlingham v. Crouse, 228 U.S. 459, 473, 33 S.Ct. 564, 57 L.Ed. 920 (1913) (emphasis added); *see also Williford v. Armstrong World Indus.*, 715 F.2d 124, 126 (4th Cir. 1983) (explaining that the relief afforded by Chapter 11’s automatic stay “belongs exclusively to the ‘debtor’ in bankruptcy”). Yet in recent years, major and fully solvent business corporations have managed to skirt that debtor-centric objective and obtain shelter from sweeping tort litigation without having to file for bankruptcy themselves. It is precisely that sort of manipulation of the Bankruptcy Code — and by extension the Article I bankruptcy courts — that lies at the heart of this important appeal.

Parting ways with my friends in the majority, I would reverse the judgment of the district court and remand for that court to vacate the bankruptcy court’s order enjoining asbestos-related lawsuits against New GP.¹ A non-debtor codefendant of debtor Bestwall, New GP is among the world’s largest manufacturing firms, and — by its own account — has every ability to defend against continued asbestos litigation and to satisfy all resulting liabilities. Nevertheless, Old GP, Bestwall, and New GP manufactured the jurisdiction of the bankruptcy court in these proceedings, in an unmistakable effort to gain leverage over future asbestos claims against New GP.

Through their creative use of the so-called “Texas divisional merger” and the creation of unorthodox contractual relationships between Bestwall and New GP, the three Georgia-Pacific entities ran afoul of the foundational principle that parties may not artificially construct a federal court’s jurisdiction — especially that of a federal bankruptcy court, which possesses particularly limited jurisdiction. And with that being so, the bankruptcy court below was unable to act under any “related-to” jurisdiction that it could theoretically have been vested with under 28 U.S.C. § 1334(b). Moreover, the bankruptcy court also lacked “arising-in” jurisdiction with which to enjoin the New GP asbestos litigation. For those reasons, and as more fully explained herein, I respectfully dissent from the majority’s affirmance of the district court’s ratification of the bankruptcy court’s injunction.²

I.

A.

For the most part, I take no issue with the majority's recitation of the relevant facts. I will emphasize, however, some of the more striking and understated details of Georgia-Pacific's history of asbestos litigation and the origins of these bankruptcy proceedings. Owing to its extensive use of asbestos in commercial products such as joint compound and certain industrial plasters, Georgia-Pacific has faced many hundreds of thousands of asbestos-related personal ***187** injury lawsuits since at least 1979 — the vast majority of which have been filed by individuals suffering from the scourge of [mesothelioma](#). Georgia-Pacific stands as one of the most frequently sued defendants in this Country's tide of asbestos litigation, having spent more than \$2.9 billion defending against such claims. And Georgia-Pacific has acknowledged that thousands of additional asbestos claims will be filed against it each year for decades yet to come.

Those financial strains notwithstanding, Georgia-Pacific has remained a fully solvent, multibillion-dollar business leader in the pulp and paper industry. Indeed, New GP — Georgia-Pacific's current corporate form and the inheritor of the bulk of Old GP's assets — represented to the bankruptcy court in the proceedings below that its assets are fully “sufficient to satisfy” the Old GP asbestos liabilities that have been assigned to Bestwall. *See* J.A. 596.³ Nevertheless, by reason of the bankruptcy court's injunction, New GP's evidently bountiful assets are now out of reach for any and all asbestos claimants seeking relief through our Nation's tort system, in either state or federal court.

Old GP obtained that protection of its assets by deciding to “undertake a corporate restructuring” on July 31, 2017. *See* J.A. 738. On that day, Old GP — then a Delaware corporation — reorganized under the laws of Texas and promptly made use of the Lone Star State's “divisional merger” statute to carve itself into two new entities — Bestwall and New GP.⁴ To Bestwall, Old GP assigned virtually all of its existing asbestos liabilities; Bestwall otherwise received minimal assets and no formal business operations. Meanwhile, New GP was entrusted with the lion's share of Old GP's assets, along with its non-asbestos-related liabilities. With Old GP dissolved, New GP resumed its predecessor's status as a Delaware corporation — where it has continued business operations just as Old GP did — while Bestwall was reorganized in North Carolina. Stunningly, Bestwall and New GP existed as Texas business entities for less than five hours.

Bestwall did not hire any employees, engage in any new business ventures, or do much of anything else following

its relocation to the Old North State. Instead, on November 2, 2017 — some three months after its inception — Bestwall filed for Chapter 11 bankruptcy in the Western District of North Carolina, securing safe harbor from its inherited asbestos liabilities by virtue of the bankruptcy court's automatic stay. *See* 11 U.S.C. § 362(a). And later that same day, Bestwall initiated an adversary proceeding in the bankruptcy court, by which it sought the entry of a preliminary injunction to shield none other than its sister corporation — New GP — from any current and future asbestos claims.

At the time of its 2017 corporate restructuring, Old GP was well aware that any successor entity holding its productive assets would face continued asbestos liabilities. It was for that reason that Old GP travelled to Texas in the first instance — to sever its extant liabilities, place them in bankruptcy, and in turn utilize the bankruptcy proceedings to stay future litigation against the remainder of its business operations.

***188** New GP, in other words, was designed to receive bankruptcy protection despite its non-debtor status, with no need to submit to the bankruptcy court's oversight or to suffer the burdens appurtenant to a Chapter 11 filing. And that is no conjecture — by its adversary complaint, Bestwall freely admitted to the bankruptcy court that the very purpose of Old GP's 2017 restructuring was “to provide [Bestwall] with the option to seek a resolution of the asbestos claims in [the bankruptcy court] under [section 524\(g\) of the Bankruptcy Code](#), without subjecting the entire Old GP enterprise to a chapter 11 reorganization.” *See* J.A. 399. Later in the bankruptcy proceedings, Bestwall and New GP clarified that “[Bestwall's] goal” in filing for Chapter 11 protection was, in part, to obtain “an injunction ... that will permanently protect [Bestwall] and its affiliates from any further asbestos claims” related to products manufactured and sold by Old GP. *Id.* at 603 (emphasis added).

Bestwall quickly achieved its goal. After concluding that any asbestos lawsuits pursued against New GP would be sufficiently “related to” Bestwall's bankruptcy estate to bring some “effect” to bear on the estate, the bankruptcy court entered the requested preliminary injunction, thereby shielding “the entire Old GP enterprise” from all civil liability. Today, then, asbestos claimants are left without any ability to seek relief for their afflictions from Georgia-Pacific — or its corporate affiliates — in the tort system. And of course, many of those claimants have and will continue to run out of time, their years cut short by asbestos-related disease while these bankruptcy proceedings grind on.

B.

Importantly, Georgia-Pacific is not alone in utilizing Texas's divisional merger statute to isolate its unwanted asbestos liabilities in bankruptcy without having to subject the whole of the corporate entity to Chapter 11 proceedings. Perhaps most notably, after facing a “torrent of lawsuits” alleging that its signature baby powder contained traces of asbestos, New Jersey-based Johnson & Johnson went to Texas in 2021 to restructure into two new entities — “LTL Management” and “Johnson & Johnson Consumer.” See *In re LTL Mgmt., LLC*, 64 F.4th 84, 92 (3d Cir. 2023). Just like Bestwall, LTL was assigned all of Johnson & Johnson's existing asbestos-related liabilities. And like Bestwall, LTL promptly filed for bankruptcy. Thereafter, the bankruptcy court extended the reach of the automatic stay of claims against LTL to cover various non-debtor entities, including Johnson & Johnson Consumer.

The majority rightly explains that the Third Circuit's 2023 decision in *LTL Management* concerning the propriety of LTL's bankruptcy petition is distinguishable here — the *LTL* case did not consider or discuss the bankruptcy court's jurisdiction to halt tort claims against a non-debtor. See *ante* 181–83. Ultimately, the court of appeals directed that LTL's petition be dismissed, as the company was never truly in financial distress. That is, pursuant to a funding agreement, LTL actually had the ability to cause Johnson & Johnson Consumer to pay it up to that company's full value to satisfy any asbestos-related liabilities. See 64 F.4th at 106–10. In any event, while the two bankruptcy cases have charted different paths, the Johnson & Johnson proceedings underscore the very point at issue here — a healthy corporation's placement of a liability-laden subsidiary into bankruptcy in order to avoid Chapter 11 reorganization for the balance of the healthy company is not guaranteed to result in smooth sailing.

II.

With the foregoing in mind, I would reverse the judgment below and remand *189 for the district court to vacate the bankruptcy court's order awarding injunctive relief, insofar as the bankruptcy court was not clothed with any jurisdiction permitting the entry of such an order. To the extent that the bankruptcy court was facially vested with “related-to” jurisdiction under 28 U.S.C. § 1334(b) — as that court, the

district court, and my good colleagues in the majority have all concluded — that jurisdiction was fabricated by way of Old GP's restructuring in Texas and the imposition of the various contractual obligations between Bestwall and New GP. And because civil claims brought against New GP by private individuals have their genesis outside of Bestwall's bankruptcy proceedings, the bankruptcy court could not have alternatively grounded its order enjoining those claims in “arising-in” jurisdiction under § 1334(b). Accordingly, the injunction as to the New GP asbestos litigation is without any lasting legal weight.⁵

A.

1.

As a general rule, bankruptcy courts — which by federal law are courts of limited jurisdiction — may not intervene in or otherwise halt civil litigation between non-debtors. See *In re Prescription Home Health Care, Inc.*, 316 F.3d 542, 547 (5th Cir. 2002). In certain situations, however, a bankruptcy court may assert “related-to” jurisdiction over matters outside of a particular debtor's bankruptcy proceedings, where the disposition of those matters may have some conceivable “effect” on the debtor's bankruptcy estate. See *A.H. Robins Co. v. Piccinin*, 788 F.2d 994, 1002 n.11 (4th Cir. 1986) (citing *Pacor, Inc. v. Higgins*, 743 F.2d 984, 994 (3d Cir. 1984)); see also 28 U.S.C. § 1334(b) (affording district — and bankruptcy — courts jurisdiction to hear proceedings “arising in or related to cases under title 11”). As the majority points out, the *Pacor* “effects” test for “related-to” jurisdiction followed in our Court is purposefully broad — and, to be sure, the majority identifies multiple possible ways that asbestos claims brought against New GP could “affect” Bestwall's bankruptcy estate. That matters not, however, if the entire factual basis for invoking the bankruptcy court's “related-to” jurisdiction was contrived.

Pursuant to 28 U.S.C. § 1359, a federal court will lack jurisdiction over any action “in which any party ... has been improperly or collusively made or joined to invoke the jurisdiction of such court.” Congress intended § 1359 to guard against “litigants' attempts to manipulate jurisdiction” where none would otherwise exist. See *In re Samsung Elecs. Co.*, 2 F.4th 1371, 1377 (Fed. Cir. 2021). In other words, § 1359 was “designed to prevent the litigation of claims in federal court by suitors who by sham, pretense, or other

fiction acquire a spurious status that would allow them to invoke the limited jurisdiction of the federal courts.” See *Nolan v. Boeing Co.*, 919 F.2d 1058, 1067 (5th Cir. 1990). And while § 1359’s prohibition on manufactured subject matter jurisdiction most frequently arises in the arena of diversity jurisdiction cases proceeding under 28 U.S.C. § 1332, today’s majority acknowledges that nothing in the text of § 1359 — nor in interpretive case law — specifies that it does not apply with equal force to bankruptcy proceedings carried out under the auspices of § 1334. See *ante* 181 n.15.

***190** In any event, this Court has routinely emphasized the fundamental principle that no actions of the parties can “create subject matter jurisdiction or waive its absence.” See *Orquera v. Ashcroft*, 357 F.3d 413, 416 (4th Cir. 2003). And we have specifically admonished that “neither the parties nor the bankruptcy court can create § 1334 jurisdiction” in any bankruptcy proceeding. See *Valley Historic Ltd. P’ship v. Bank of N.Y.*, 486 F.3d 831, 837 (4th Cir. 2007); accord *In re Combustion Eng’g, Inc.*, 391 F.3d 190, 228-29 (3d Cir. 2004) (recognizing that debtors may not create federal bankruptcy jurisdiction over non-debtor third parties by way of plans of reorganization, consent, or otherwise). Put simply, it is elementary that the debtor in bankruptcy “cannot write its own jurisdictional ticket” — and it logically follows that the debtor cannot make out such a “ticket” for a distinct, non-debtor entity either. See *Valley Historic*, 486 F.3d at 837.

Yet that is exactly what Old GP did here — it reformed its corporate existence precisely so that its principal successor entity, New GP, could be afforded bankruptcy relief without ever having to file for bankruptcy. Old GP carefully structured the relationship between New GP and its planned vehicle for unwanted liabilities, Bestwall, in such a way as to permit the bankruptcy court to spare New GP from the legal headache of continued asbestos litigation by way of an 11 U.S.C. § 105(a) injunction — extending, for all intents and purposes, the reach of the automatic stay of asbestos claims against debtor Bestwall to those pursued against New GP. But for Old GP’s assignment of its asbestos liabilities and its productive business assets and operations to separate successor entities — as well as its brokering of contracts between those entities to create the appearance of their corporate relations being inextricably intertwined — there would have been no “effects” for the bankruptcy court to rely on in resolving that it was vested with “related-to” jurisdiction. Again, Bestwall and New GP do not meaningfully dispute this. Both have acknowledged that Old GP’s restructuring and Bestwall’s bankruptcy were intended to secure “the issuance

of an injunction” that would insulate New GP from asbestos litigation “without subjecting the entire Old GP enterprise to a chapter 11 reorganization.” See J.A. 399, 603.

In concluding that asbestos claims lodged against New GP might “affect” Bestwall’s bankruptcy estate, the bankruptcy court looked primarily to the companies’ contractual arrangements. As the court explained, Bestwall was saddled with a series of indemnity obligations to New GP, requiring it to reimburse its sister company for, inter alia, any losses attributable to continued asbestos lawsuits. That being so, in the court’s view, New GP’s defense of any asbestos litigation would indirectly deplete the assets available to Bestwall in funding its 11 U.S.C. § 524(g) trust — making it such that potential asbestos judgments against New GP would be “tantamount to” judgments against Bestwall’s bankruptcy estate. See J.A. 741. Separately, the court determined that, in the event of New GP having to defend against new asbestos lawsuits, New GP lawyers temporarily assigned to Bestwall under the companies’ secondment agreement would likely be recalled by New GP to aid in litigation defense work. Those lawyers would thus be “distracted” from their work overseeing Bestwall’s Chapter 11 proceedings, effectively impairing the efficient administration of Bestwall’s bankruptcy estate. *Id.* at 740.

That is all well and good, but despite the Claimant Representatives challenging its jurisdiction to reach outside of the Bestwall proceedings and enjoin asbestos ***191** litigation against New GP, the bankruptcy court never addressed or resolved whether the agreements between Bestwall and New GP had simply been devised in order to manufacture the court’s ability to afford New GP relief.⁶ As the party seeking an injunction and asserting jurisdiction, Bestwall had (and maintains) the burden of proving that the bankruptcy court was *properly* — not artificially — vested with subject matter jurisdiction. See *United States v. Poole*, 531 F.3d 263, 274 (4th Cir. 2008) (“A court is to presume ... that a case lies *outside* its limited jurisdiction unless and until jurisdiction has been shown to be proper.”). That is, Bestwall was obliged to demonstrate that Old GP’s Texas divisional merger and the development of the contractual relationships between itself and New GP were driven by an independent, legitimate business justification, and that those maneuvers were not “pretextual.” See *Toste Farm Corp. v. Hadbury, Inc.*, 70 F.3d 640, 643-44 (1st Cir. 1995). Perhaps unsurprisingly, Bestwall has never offered any substantive explanation along those lines. To the contrary, Bestwall concedes that Old GP’s restructuring was specifically intended to shield

the corporation's assets without the need for a wholesale declaration of bankruptcy. Accordingly, I readily conclude that Old GP, Bestwall, and New GP together “improperly or collusively made” — from whole cloth — the bankruptcy court's jurisdiction. *See* 28 U.S.C. § 1359. And as a result, the court was without any ability to enter an injunction against the New GP asbestos litigation.

2.

Putting aside for the moment the question of jurisdictional manufacturing, the agreements between Bestwall and New GP relied on by the bankruptcy court were arguably not even sufficient to establish the court's “related-to” jurisdiction. As the Claimant Representatives explain in their briefing, Bestwall's supposed indemnity obligations to New GP are in fact wholly circular, essentially a legal fiction. Pursuant to the entities' funding agreement, Bestwall is entitled to obtain from New GP “the funding of any obligations of [Bestwall] owed to [New GP] ... including, without limitation, any indemnification or other obligations of [Bestwall].” *See* J.A. 337. In other words, to satisfy a claim for indemnity from New GP relating to its defense of asbestos claims, Bestwall would obtain the necessary cash from New GP itself. Any potential asbestos judgments against New GP would therefore not be “tantamount to” judgments against Bestwall — there is no indication that litigation against New GP would impair or otherwise “affect” the valuation of the bankruptcy estate at all. *Id.* at 741.⁷

***192** As to the “effects” of the potential “distraction” of New GP personnel who have been “seconded” to Bestwall, the secondment agreement specifies that “Provider [New GP] shall not remove any of the Seconded Employees from Recipient [Bestwall], unless mutually agreed by Recipient and Provider.” *See* J.A. 696. Bestwall would therefore have to assent to any “effects” of New GP lawyers leaving it behind to defend New GP from asbestos lawsuits — fully undercutting the supposed point in seeking from the bankruptcy court an injunction against such lawsuits.

Perhaps recognizing the hazards in relying on the agreements between Bestwall and New GP as a basis for “related-to” jurisdiction, the majority relegates its discussion of the entities' contractual relations to a footnote, resolving that any “effects” on Bestwall's bankruptcy estate brought about by the agreements are simply not necessary to conclude that the bankruptcy court's exercise of jurisdiction was sound.

See ante 179–80 n.13. And given its dismissal of the agreements' import, the majority declines to address whether the agreements might reveal the wrongful manufacture of the court's jurisdiction. *See id.* at 182–83.

Instead, the majority predicates its jurisdictional determination on the common nature of the tort claims that have been stayed as against Bestwall and those that might be filed against New GP absent an injunction, invoking collateral estoppel and the potential preclusive effect of adverse evidentiary rulings or judgments against New GP. In that sense, the majority explains, actively litigating against New GP the very same asbestos claims pursued against Bestwall prior to its bankruptcy filing could easily impact the value and administration of the bankruptcy estate. As the bankruptcy court put it, sanctioning “piecemeal attempts” to hold New GP liable for Bestwall's asbestos liabilities would defeat the bankruptcy filing's “fundamental purpose” of globally resolving those liabilities in one forum. *See* J.A. 740.

Once again, I do not necessarily disagree with the foregoing explanation for why New GP's asbestos litigation might conceivably “affect” Bestwall's bankruptcy estate. But the problem remains that such “effects” would arise *only* because Old GP ensured that they would. That is, Old GP purposefully created privity between its successor entities such that claims against one (the solvent, productive corporation) would necessarily have some impact on the other (the debtor hampered with old liabilities), thereby allowing the bankruptcy court to intervene on New GP's behalf. To the extent that the “effects” of parallel litigation might have permitted the bankruptcy ***193** court — on paper — to suspend claims against the non-debtor entity, “Old GP ... created this situation by placing most of its operations and assets outside the protection of bankruptcy.” *See* Reply Br. of Appellants 19. With that being so, the Claimant Representatives explain, “pleas that [Old GP's] legal successor [now] needs bankruptcy protection ring hollow.” *Id.*

The majority largely dodges the fact that its chosen basis for “related-to” jurisdiction was also concocted by Old GP, stating briefly and without support that “Old GP clearly could not and did not manufacture” the effects of identical claims pending against New GP outside of Bestwall's bankruptcy proceedings. *See ante* 183. And the majority's only other defense against the problem of manufactured jurisdiction is that, absent the Texas divisional merger, asbestos claims

against New GP would have remained claims against Old GP, such that if Old GP had opted to file for Chapter 11 protection, “the bankruptcy court would have had jurisdiction over those claims as it does over the same claims here.” *Id.* at 181. But that misses the point entirely, focusing on jurisdiction over claims instead of parties.

The issue at hand is instead whether the bankruptcy court could properly exercise jurisdiction over civil proceedings initiated against a non-debtor, third-party entity, which would not currently exist had Old GP not undergone its 2017 restructuring. Removing the divisional merger from the jurisdictional equation thus ignores and avoids the question that we have been called upon to resolve. Certainly, it is obvious that if Old GP had never undergone its divisional merger and had instead filed for bankruptcy itself, the bankruptcy court could have stayed any and all asbestos claims then pending against it. But we are now focused on that court's involvement with New GP. And the majority acknowledges as much, asserting on the one hand that “there is no way to separate the parties from the claims here,” but then conceding that “§ 1334(b) requires us to analyze whether the claims *involving New GP* are ‘related to’ the bankruptcy case.” See *ante* 182 (emphasis added). Hypothetical claims against Old GP — now a defunct corporation — simply have no bearing on our jurisdictional inquiry. Put succinctly, if New GP “wished to receive the protections offered by [Chapter 11], it must have filed for bankruptcy.” See *Kreiser v. Goldberg*, 478 F.3d 209, 213-14 (4th Cir. 2007).

At bottom, regardless of whether premised on the nature of the agreements between Bestwall and New GP or the impacts of parallel litigation on Bestwall's bankruptcy estate, the bankruptcy court's jurisdiction consistently flows from an orchestrated endeavor to fabricate it. But for Old GP, Bestwall, and New GP's improper efforts in that regard, the court would have lacked any ability to spare New GP from civil liability without a bankruptcy filing. Because — as the majority itself recognizes — “using a strawman, or sham transactions, solely for the creation of otherwise unobtainable jurisdiction ... is clearly forbidden,” the bankruptcy court in this situation could not legitimately claim to exercise “related-to” jurisdiction in issuing an injunction. See *ante* 181 (quoting *U.S.I. Props. Corp. v. M.D. Constr. Co.*, 860 F.2d 1, 6 (1st Cir. 1988)).

B.

Had it recognized its inability to exercise “related-to” jurisdiction under § 1334(b), the bankruptcy court could have — but opted not to — turn to § 1334(b)'s “arising-in” jurisdiction as a basis for its injunction. As our Court has recognized, proceedings “arising in” Chapter 11 are those that “would have no existence *194 outside of the bankruptcy.” See *In re A.H. Robins Co.*, 86 F.3d 364, 372 (4th Cir. 1996).

Here, the district court — after concluding that the bankruptcy court possessed “related-to” jurisdiction — passingly suggested in a footnote that the court might have also claimed “arising-in” jurisdiction, insofar as the issuance of an injunction under 11 U.S.C. § 105(a) “arises only in bankruptcy cases [and] would have no existence outside of a bankruptcy.” See J.A. 919. Bestwall and New GP have decided to run with that contention on appeal, insisting that the bankruptcy court enjoyed “arising-in” jurisdiction (in addition to “related-to” jurisdiction) because relief under § 105(a) can be pursued only in the context of a bankruptcy case. The majority, for its part, has declined to address the “arising-in” argument, being satisfied that the bankruptcy court possessed “related-to” jurisdiction.

Bestwall and New GP's characterization of “arising-in” jurisdiction, however, dramatically and improperly expands the scope of the bankruptcy courts' authority beyond the legitimate bounds that this and other courts of appeals have recognized. Their “arising-in” theory boils down to an assertion that any request for a § 105(a) injunction would confer the relevant bankruptcy court with jurisdiction over whatever proceedings the debtor seeks to intervene in, no matter how tangentially connected they might be to the bankruptcy case. But that is not the law. See *In re W.R. Grace & Co.*, 591 F.3d 164, 170 (3d Cir. 2009) (“While § 105(a) of the Bankruptcy Code allows a bankruptcy court to issue any order necessary to carry out the provisions of the Code, it does not provide an independent source of federal subject matter jurisdiction.”). Section 105(a) is not a magic wand that a debtor can wave to create bankruptcy jurisdiction — to make use of its provisions, a bankruptcy court must have some independent jurisdictional footing.

In any event, it borders on the absurd to suggest that the asbestos litigation Bestwall sought to have enjoined “arose in” its bankruptcy case. Simply stated, personal injury claims brought by private individuals against a distinct, non-debtor corporation cannot and do not “arise” within the confines of another corporate entity's bankruptcy proceedings. By necessity, such third-party litigation will have — at bare

minimum — some “existence outside of the bankruptcy,” *see A.H. Robins*, 86 F.3d at 372, and “would have existed whether or not the Debtor filed bankruptcy,” *see Valley Historic*, 486 F.3d at 836. The bankruptcy court, in other words, rightly passed over § 1334(b)’s provision of “arising-in” jurisdiction, and the court’s injunction could not alternatively be affirmed on that jurisdictional basis.

* * *

In sum, I would squarely reject Georgia-Pacific’s use of its 2017 restructuring — little more than a corporate shell game — to artificially invoke the jurisdiction of the bankruptcy court and obtain shelter from its substantial asbestos liabilities without ever having to file for bankruptcy. The bankruptcy court’s injunction was entered without any legitimate jurisdictional basis, and its effects run directly counter to the purposes of the Bankruptcy Code. In a pending Seventh Circuit case involving the efforts of a corporate subsidiary in Chapter 11 bankruptcy to spare its parent company from continued product liability litigation, a well-reasoned amicus submission explains that “the Bankruptcy Code has increasingly been manipulated by solvent, blue-chip companies faced with mass tort liability” that, “[t]hrough dubious readings of the Bankruptcy Code that Congress never intended ... have invented elaborate *195 loopholes enabling

them to pick and choose among the debt-discharging benefits of bankruptcy without having to subject themselves to its creditor-protecting burdens.” *See In re Aeero Techs., LLC*, No. 22-2606, at 3-4 (7th Cir. Feb. 1, 2023), ECF No. 89. Such is the essence of these proceedings — and the core of the reason why the district court’s judgment should be reversed, the bankruptcy court’s injunction vacated, and this matter remanded for further proceedings.

III.

Because any jurisdiction that the bankruptcy court was vested with under 28 U.S.C. § 1334(b) was improperly manufactured by the parties before it — and as the court’s award of injunctive relief contravened the spirit of the Bankruptcy Code — I would reverse the judgment of the district court and remand for that court to vacate the bankruptcy court’s injunction.

With great respect for the competing views of my friends in the majority, I dissent in substantial part.

All Citations

71 F.4th 168

Footnotes

- 1 The corporate-law validity of this restructuring is not at issue.
- 2 The assets Bestwall received included, among other things, approximately \$32 million in cash; all contracts of Old GP related to its asbestos litigation, such as settlement agreements, insurance policies, and engagement contracts; a tract of land and a related long-term lease of that land to an affiliate; and the full 100 percent equity interest in GP Industrial Plasters LLC (“PlasterCo”).

PlasterCo and its subsidiaries operate a profitable plasters business as a wholly owned subsidiary of Bestwall. They “develop[], manufacture[], sell[] and distribute[] gypsum plaster products,” including, e.g., industrial plaster, medical plaster, pottery plaster, and general purpose plaster, and utilize three facilities around the country for their business. J.A. 590. At the time Bestwall received the equity interest in PlasterCo, PlasterCo “was projected to generate approximately \$14 million in EBITDA in 2018 and approximately \$18 million in the years thereafter.” J.A. 595. Further, as of the date of the bankruptcy petition, PlasterCo and its subsidiaries were valued at approximately \$145 million. Therefore, although the dissent speculates that Bestwall has not “do[ne] much of anything” aside from filing for bankruptcy, *post* at 187, that characterization is not supported by the record. Since Bestwall’s inception, its plaster subsidiary has operated a significant business available to contribute millions to the Bestwall bankruptcy estate.

- 3 Section 524(g) provides for the creation of a trust that, pursuant to a chapter 11 plan of reorganization, “is to assume the liabilities of a debtor which at the time of entry of the order for relief has been named as a defendant in personal injury, wrongful death, or property-damage actions seeking recovery for damages allegedly caused by the presence of, or exposure to, asbestos or asbestos-containing products.” 11 U.S.C. § 524(g)(2)(B)(i)(I).

- 4 “Secondment” refers to “[a] period of time that a worker spends away from his or her usual job, usu[ally] either doing another job or studying.” *Secondment*, Black’s Law Dictionary (11th ed. 2019).
- 5 Section 524(g) provides the process by which a court that confirms a chapter 11 reorganization plan may issue a channeling injunction “to enjoin entities from taking legal action for the purpose of directly or indirectly collecting, recovering, or receiving payment or recovery with respect to any claim or demand that ... is to be paid in whole or in part by a trust.” 11 U.S.C. § 524(g)(1)(B). “[S]uch an injunction may bar any action directed against a third party who is identifiable from the terms of such injunction ... and is alleged to be directly or indirectly liable for the conduct of, claims against, or demands on the debtor[.]” *Id.* § 524(g)(4)(A)(ii).
- 6 In relevant part, this section provides that when a voluntary petition for bankruptcy is filed under chapter 11, all cases or claims against the debtor are automatically stayed. 11 U.S.C. § 362(a). The bankruptcy court and the district court did not address whether the protections of the automatic stay extended to the asbestos-related claims against New GP, so we do not address that particular argument either.
- 7 As explained below, the bankruptcy court has jurisdiction over civil proceedings “arising in or related to cases under title 11.” 28 U.S.C. § 1334(b).
- 8 The dissent claims the bankruptcy court failed to address whether Old GP, New GP, and Bestwall attempted to manufacture jurisdiction. But, in response to Claimant Representatives’ jurisdictional argument that “[t]he parties cannot confer jurisdiction ... through the artificial construct of the contractual indemnification provided to New GP” by Bestwall, J.A. 510, the bankruptcy court concluded that the indemnification obligations between Bestwall and New GP were not “contrived.” *In re Bestwall*, 606 B.R. at 250.
- 9 The appeals by the Committee and the FCR were docketed under separate docket numbers, so the district court issued two separate orders affirming the bankruptcy court. Because the two separate orders mirror each other, we cite only the order from No. 3:20-cv-00105-RJC for simplicity.
- 10 We can consider this argument although Bestwall did not file a cross-appeal because Bestwall does not seek to alter the district court’s judgment. See *Mayor of Balt. v. Azar*, 973 F.3d 258, 295 (4th Cir. 2020).
- 11 The district court also briefly addressed Fourth Circuit case law indicating that a party without a pecuniary interest in a case can have appellate standing arising from that party’s “official duty to enforce the bankruptcy law in the public interest.” *In re Bestwall*, 2022 WL 68763, at *4 (citing *In re Clark*, 927 F.2d at 796). However, the district court did not base its finding of standing on this precedent, and we need not address it in light of our conclusion above.
- 12 There could also be asbestos-related cases against New GP pending now or in the future in federal courts based on diversity jurisdiction or otherwise. The same reasoning and rule apply to any of those cases just as they do to state-court cases. We simply use “state-court cases” as a comprehensive generic phrase referring to all asbestos-related claims pending against New GP outside of the Bestwall bankruptcy proceedings.
- 13 Separately, we observe that the indemnification and secondment obligations—which provide for the transfer of funds and personnel between entities—would also likely have a cognizable effect on the Bestwall bankruptcy estate in the absence of the injunctive relief.

For example, based on the indemnification obligations, if the asbestos-related litigation against New GP continues during the pendency of Bestwall’s bankruptcy, and New GP sustains losses, the Bestwall bankruptcy estate would be required to indemnify New GP, but without any adjudication of those same claims otherwise pending before the bankruptcy court. New GP would step in to provide funds to cover the indemnification only if Bestwall’s subsidiaries’ distributions were insufficient to cover its obligations. It is difficult to see how this exchange of money with a debtor could *not* conceivably affect the bankruptcy estate. And if New GP provided funds to Bestwall to pay for Bestwall’s indemnification of New GP—as the dissent speculates is likely to happen—that would clearly alter Bestwall’s liabilities and thereby impact how the bankruptcy estate is handled. See *Pacor*, 743 F.2d at 994. (Also, while the dissent relies on an allegation in the briefing that New GP has provided Bestwall with \$150 million under the funding agreement, the parties do not point to any record

evidence supporting that statement. See *I.N.S. v. Phinpathya*, 464 U.S. 183, 188 n.6, 104 S.Ct. 584, 78 L.Ed.2d 401 (1984) (explaining that unsupported assertions in briefing are not evidence).)

Similarly, as to the secondment agreement, if litigation were permitted to continue against New GP and Bestwall assented to its employees leaving to assist New GP, as the dissent imagines will occur, those employees would likely have to spend significant time managing the defense of the claims against New GP such that the handling and administration of Bestwall's bankruptcy estate and Bestwall's rights and liabilities in bankruptcy would be affected.

And if—as the Claimant Representatives assert—Bestwall refused to so assent and retained its employees, New GP would have to find and train new employees to assist in managing its defense in the litigation, and Bestwall's estate could thereby be affected by adverse judgments against New GP that would implicate Bestwall's indemnity obligations or liability through collateral estoppel. Further, if New GP retained new employees to assist in its defense, Bestwall would have to indemnify New GP for the expenses associated with those employees, which would further deplete the bankruptcy estate. See J.A. 581 (“Bestwall will indemnify and hold harmless New GP from and against all Losses to which New GP may become subject, insofar as such Losses ... arise out of, in any way relate to, or result from a claim in respect of, any Bestwall Assets or Bestwall Liabilities[.]”); J.A. 559 (defining “Losses” to include “costs and expenses, including reasonable attorneys' fees”). Therefore, under either scenario, the operation of the secondment agreement could impact the bankruptcy estate.

- 14 Because we conclude that the bankruptcy court had “related to” jurisdiction over the claims against New GP, we need not consider whether the bankruptcy court separately possessed “arising in” jurisdiction.
- 15 Bestwall and New GP argue that § 1359 only applies in suits based on diversity jurisdiction. Although neither the statute itself nor case law interpreting it suggests such a limitation, we need not decide this issue because assuming the statute applies in the bankruptcy context, it does not apply to this case.
- 1 In keeping with the majority opinion, I refer to Georgia-Pacific as it existed prior to the company's 2017 restructuring as “Old GP,” and to the company as it currently exists as “New GP.” Meanwhile, “Bestwall” refers simply to Georgia-Pacific's corporate subsidiary that is the debtor in the Chapter 11 bankruptcy proceedings at issue here. Finally, I also adopt the majority's use of “Claimant Representatives” to refer collectively to the Official Committee of Asbestos Claimants and the Future Claimants' Representative.
- 2 I readily concur in the majority's threshold determination that appellant Sander L. Esserman, in his capacity as the Future Claimants' Representative, possesses appellate standing to challenge the bankruptcy court's award of injunctive relief. Accordingly, I am dissenting from the majority opinion in substantial part, though not in full.
- 3 Citations herein to “J.A. ___” refer to the contents of the Joint Appendix filed by the parties to this appeal.
- 4 As the majority has explained, the validity of Texas's divisional merger statute is not before us in this appeal. See *ante* 173 n.1. And our resolution of that issue is not necessary to determine whether the bankruptcy court possessed jurisdiction to enjoin the New GP asbestos litigation.
- 5 Because the bankruptcy court lacked any jurisdiction under 28 U.S.C. § 1334(b) with which to enjoin the asbestos litigation against New GP, I would not reach the question of whether the court applied the correct legal standard in granting Bestwall's request for a preliminary injunction pursuant to 11 U.S.C. § 105(a).
- 6 In response to my dissenting submission, the majority maintains that the bankruptcy court addressed the Claimant Representatives' assertion that bankruptcy jurisdiction had been fabricated. See *ante* 176 n.8. But the court's consideration of whether the indemnity obligations between Bestwall and New GP were “contrived” went only to its narrow conclusion that the entities' funding agreement “acts only as a backstop” (and it certainly does not, see *infra* note 7). See J.A. 741. At no point did the court actually evaluate the purpose of the two agreements, and there was simply no analysis of manufactured subject matter jurisdiction. See *id.* at 736-52.
- 7 Bestwall and New GP insist that the funding agreement is not “contrived” or “circular,” insofar as, by the agreement's terms, Bestwall's ability to seek funding from New GP for its indemnity obligations only kicks in “to the extent that any

cash distributions theretofore received by [Bestwall] from its Subsidiaries are insufficient to pay such ... obligations.” See J.A. 377.

True, that is how the funding agreement reads — but the agreement does not actually function as a “backstop” because it likewise requires Bestwall to utilize “cash distributions ... from its Subsidiaries” in “the normal course of its business” and to cover all “costs of administering the Bankruptcy Case.” See J.A. 377. And to date, New GP — by its own admission — has “contributed approximately \$150 million under the Funding Agreement” to cover those costs, indicating that distributions from Bestwall’s subsidiaries (of which there is apparently only one, a company called “PlasterCo” that the majority hails as a booming business concern) are not sufficient to cover its ordinary business and bankruptcy costs — let alone any additional indemnification costs. See Br. of Appellees 9. That being so, it is not conceivable on this record that Bestwall’s indemnity obligations to New GP would ever impact its bankruptcy estate, as any and all funding for those obligations will necessarily come out of New GP’s pockets.

Finally, it bears emphasizing that New GP actually concedes in its briefing that it contributed \$150 million to Bestwall under the funding agreement. See Br. of Appellees 9. That payment is thus not at all an “unsupported assertion” or “allegation” of an adversary, as the majority contends. See *ante* 179–80 n.13.

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IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEW JERSEY

IN RE: . Case No. 22-19361-MBK
BLOCKFI INC., et al., . (Jointly Administered)
Debtors. .
September 26, 2023
1:02 p.m.

TRANSCRIPT OF HEARING ON PLAN CONFIRMATION AND
FINAL DISCLOSURE STATEMENT APPROVAL AND MOTIONS HEARING
BEFORE THE HONORABLE MICHAEL B. KAPLAN
UNITED STATES BANKRUPTCY COURT CHIEF JUDGE

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Proceedings recorded by electronic sound recording, transcript
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INDEX**WITNESSES**

	<u>PAGE</u>
<u>FOR THE DEBTORS:</u>	
JAMES DALOIA	
Cross-Examination by Mr. Etkin	15
SCOTT VOGEL	
Cross-Examination by Mr. Etkin	18
Redirect Examination by Mr. Slade	29
Recross-Examination by Mr. Etkin	30
MARK RENZI	
Cross-Examination by Mr. Etkin	31

EXHIBITS

	<u>ID</u>	<u>EVD</u>
<u>FOR THE DEBTORS:</u>		
D-1 Declaration of Scott Vogel	11	12
D-2 Declaration of Mark Renzi	11	12
D-3 Declaration of Brett Witherell	12	12
D-4 Declaration of James Daloia	12	12

1 (Proceedings commenced at 1:03 p.m.)

2 THE COURT: Good afternoon, everyone. This is Judge
3 Kaplan, and we will be addressing the BlockFi matters on for
4 today including confirmation. We have a somewhat full court.
5 Nice to see. And we have parties at least watching remotely.

6 For the benefit of those who are watching remotely,
7 to the extent counsel wants to be heard, they should raise the
8 "raise hand" function. Otherwise, I'll be focusing on those in
9 court. And I won't go through the process of having
10 appearances since we have a full room. But as you begin to
11 speak, enter your appearance for your respective clients.

12 Let me turn -- I have an agenda. Let me turn to
13 debtors' counsel. just have an appearance on behalf of the
14 debtor. Good afternoon.

15 MR. PETRIE: Good afternoon, Your Honor.

16 Francis Petrie of Kirkland on behalf of the debtors.

17 THE COURT: All right.

18 MR. PETRIE: So at the outset, we'd just like to
19 thank the whole -- on behalf of the whole debtor advisory team
20 and company, we'd like to thank Your Honor and your chambers
21 staff for being so accommodating, especially during what was a
22 holiday weekend.

23 We were filing documents late into the night last
24 night and even filed some this morning.

25 THE COURT: Oh yes.

1 MR. PETRIE: I'm sure you noticed. And, as usual,
2 you have been extremely accommodating both today and throughout
3 the course of these cases.

4 I'd also like to highlight the efforts of the BlockFi
5 management team and all the employees of the company who have
6 helped advance these cases and worked through some extremely
7 novel issues at every turn to accomplish the resolution that we
8 have before the Court today. With their support, we've
9 committed to a path that will maximize recoveries for our
10 clients and return crypto to those individuals through the
11 BlockFi platform.

12 We also recognize the important role that the JPLs
13 played in representing the international constituency in these
14 cases in Bermuda that I've seen in the courtroom with us today,
15 and express deep appreciation to the Committee for working with
16 us to reach a global resolution. I'm sure Committee counsel
17 will be speaking at today's hearing and, like them, we
18 recognize that crypto bankruptcies are not easy cases.

19 With the Committee's assistance, we managed to
20 achieve a lot. We're at the finish line now and closer than
21 ever to ending these cases and getting the company out of
22 bankruptcy which will have people receiving distributions
23 sooner rather than later. So we are happy to be before Your
24 Honor today. At today's hearing, we're seeking approval of the
25 disclosure statement on a final basis. And we also are here

1 with a confirmable plan that solicitation has proven has
2 obtained widespread support by all creditors.

3 All nine voting classes submitted acceptances in
4 favor of the plan with each class accepting by over 90 percent
5 tin number and around the same amount in amount. We believe
6 these results speak for themselves.

7 As noted, we filed many documents over the past 72
8 hours, so I'll highlight the governing ones. We filed our
9 brief in support of confirmation at Docket Number 1608. The
10 most current plan that we seek approval of is at Docket Number
11 1609 and is called the third amended plan with additional
12 technical modifications. And the revised proposed confirmation
13 order is at Docket Number 1610.

14 We won't be seeking entry of that docketed
15 confirmation order. We have made some changes to that since
16 the hearing, prior to the hearing. So we'll submit one to
17 chambers if and when we receive confirmation today.

18 And as you noted, we did file an agenda at Docket
19 Number 1611 that shows the status of matters going forward. As
20 you can see on that agenda, we've resolved a number of the
21 formal objections through language in the plan and the
22 confirmation order and some by stipulation. Of note are some
23 recent developments, particularly that we filed a stipulation
24 with FTX that resolves their objection. That stipulation
25 appears at Docket Number 1605, though we're not seeking

1 approval of that stipulation today. We will ask Your Honor to
2 enter it before this plan can go effective.

3 The stipulation does a couple of things, but most
4 importantly it ensures that the FTX debtors' claim is
5 contractually subordinated to all BlockFi accountholders in
6 these cases and their affirmative defenses are waived. So
7 importantly for today, that stipulation resolves FTX's
8 objection to confirmation of the plan.

9 We also worked out agreeable language with Three
10 Arrows Capital in the confirmation order, clarifies their
11 treatment and builds in a construct surrounding the disputed
12 claims reserve and required notice. The one in the filed
13 confirmation order has since had some tweaks, but we are
14 resolved with Three Arrows Capital.

15 And also of note --

16 UNIDENTIFIED SPEAKER: For some reason, this is not
17 working. Let me try this again.

18 MR. PETRIE: Alan, I think you're not on mute.

19 THE CLERK: I muted him.

20 MR. PETRIE: Okay, thank you.

21 THE COURT: He is now.

22 (Laughter)

23 MR. PETRIE: So also of note, Your Honor, the Ankura
24 objection which was focused on last week was resolved. We
25 added language regarding their entitlement to be a distribution

1 agent to the confirmation order and their entitlement to fees
2 issue has been resolved through mutually agreeable language
3 between us, Ankura, and the Committee.

4 So the resolution of these threshold issues removes
5 yet another barrier that existed in these cases to eliminate
6 very large claims that are against the estate and they have
7 taken priority over client distributions. It adds certainty
8 that distributions can be made to clients more quickly, as
9 well.

10 It's undisputed that we meet the 1129 factors, so
11 that leaves us with four objecting parties. The U.S. Trustee
12 and the Securities and Exchange Commission both take issue with
13 the scope of the releases contained within the plan and the
14 gatekeeper provision. The securities lead action plaintiff who
15 has appeared in this Court before raises a couple of points
16 that we plan to address later of an individual creditor that
17 seeks to prevent the debtors and others parties in interest
18 from reconciling outstanding proofs of claim also have formal
19 objections pending.

20 We'll address each of these in turn, but first I'd
21 like to provide the Court with an overview of what the plan
22 does.

23 So after significant negotiation, we worked out a
24 plan structure over the course of several months that functions
25 to facilitate maximum distributions to clients. It includes

1 distributions that can be made in the form of digital assets,
2 including ones that are acceptable to the Securities and
3 Exchange Commission, and then a wind-down of the remaining
4 estate overseen by a Committee-selected plan administrator who
5 reports to an oversight board.

6 Perhaps most importantly is that the plan embodies
7 the terms of a settlement with the Committee. And Your Honor's
8 role in assisting us with achieving this result through
9 mediation sessions cannot be understated, and we thank you for
10 helping us get there.

11 The settlement did not come easy and virtually every
12 term was fought over and negotiated before it was agreed upon.
13 The final form of settlement does several things, but at the
14 heart of it in exchange for a release of claims, key members of
15 the company management team will provide the estates with not
16 only millions of dollars but also required minimal hours of
17 go-forward cooperation.

18 This cooperation preserves the option to make in-kind
19 distributions to clients which would likely not be possible in
20 the event these individuals were not cooperating with the
21 estate, and it provides for the retention of certain key
22 litigation causes of action that will move forward, including
23 against FTX and Three Arrows Capital. And if proceeds are
24 realized out of such litigation, it will significantly help
25 maximize recovery to creditors.

1 As is typical, we made certain modifications to the
2 plan leading up to the hearing. In certain classes, we
3 provided for a new option in treatment. If it's feasible, they
4 can elect as to whether or not they'd like to make a loan
5 repayment rather than be subject to setoff. And in the
6 convenience class which once contemplated distributions only in
7 cash, such claimants can elect to collect on their claim in
8 acceptable crypto instead.

9 These revisions are reflective of the ongoing work
10 and cooperation with the Committee and the wind-down trustee
11 and provides creditors with more optionality than they had at
12 the solicitation stage. So in short, the transactions
13 contemplated by the plan make it clear that confirmation is the
14 best solution for creditors. We've explored almost all
15 available options and constructs and are confident that the one
16 before the Court today is value-maximizing and the fastest way
17 to get money back to creditors.

18 So we've analyzed the remaining objections which I
19 just outlined and, in our assessment, these are almost entirely
20 legal in nature. No objection seems to raise disputes about
21 the facts at hand. But that said, we did file four
22 declarations in support of confirmation.

23 At Docket Number 1584 is the declaration of Scott
24 Vogel who is an independent director and a member of the
25 special committee of the board. His declaration describes the

1 terms of the settlement and the investigation that led to
2 assessing the claims that were at issue.

3 At Docket Number 1582, we filed a declaration of Mark
4 Renzi, the debtors' chief restructuring officer, which
5 describes the formulation of the plan and how we meet the 1129
6 factors.

7 At Docket Number 1583 is the declaration of Brett
8 Witherell of BRG. His declaration describes the formulation of
9 the liquidation analysis and how we passed the best-interests
10 test as part of the disclosure statement.

11 At Docket Number 1607 is the declaration of James
12 Daloia from Kroll which sets up the solicitation process and
13 the tabulation results of the votes.

14 All of these individuals are here in the courtroom
15 and are available to be cross-examined if needed. But we would
16 like to admit all four declarations into evidence to ensure
17 that we meet our evidentiary burden.

18 THE COURT: All right. Let me open it up to those
19 counsel present. Any objections to the Court admitting into
20 evidence the declarations of Mr. Witherell, Mr. Vogel, Mr.
21 Renzi, and Mr. Daloia in lieu of direct testimony?

22 (No audible response)

23 THE COURT: All right. Then for the record, Mr.
24 Vogel's declaration will be admitted as D-1. Mr. Renzi's
25 declaration CRO will be admitted as D-2. Me. Witherell's

1 declaration on behalf of BRG is D-3. And Mr. Daloia's from
2 Kroll, his declaration will be admitted as D-4. Thank you.

3 (Debtors' Exhibits D-1 through D-4 admitted into evidence)

4 MR. PETRIE: Thank you, Your Honor.

5 So with that, I think we can turn to addressing each
6 of the objections that are still outstanding.

7 For the record, by our count, we have four --

8 MR. ETKIN: Your Honor?

9 THE COURT: Yes.

10 MR. ETKIN: Sorry to interrupt.

11 I do have a few questions for a couple of the
12 declarants. And I think in terms of -- I'm sorry, Your Honor.
13 Michael Etkin, Lowenstein Sandler --

14 THE COURT: Thank you.

15 MR. ETKIN: -- on behalf of Cameron Wyatt, the
16 proposed lead plaintiff in the securities litigation.

17 I think in terms of appropriate order, but that's up
18 to Your Honor, if there's any cross, that should probably take
19 place before merits arguments --

20 THE COURT: Before argument.

21 MR. ETKIN: -- on the objection. So, again, I'll
22 leave that to Your Honor. But I'd just raise that.

23 THE COURT: And specifically, Mr. Etkin, you wish to
24 cross-examine which witnesses?

25 MR. ETKIN: It's not lengthy cross-examination, Your

1 Honor. Mr. Renzi, the declarant from Kroll, and --

2 MR. PETRIE: We had four declarations.

3 MR. ETKIN: Not Mr. Witherell.

4 MR. PETRIE: Scott Vogel?

5 MR. ETKIN: Mr. Vogel, yes.

6 THE COURT: Mr. Vogel, the independent director?

7 MR. ETKIN: Yes.

8 THE COURT: All right. So Mr. Vogel and Mr. Renzi?

9 MR. ETKIN: And the declarant Mr. --

10 THE COURT: Daloia?

11 MR. ETKIN: -- Daloia.

12 THE COURT: Any objections?

13 MR. SLADE: I'm not sure what the questions will be,
14 but there likely will be objection to the questions. But I
15 have no objection to the concept of cross-examination.

16 THE COURT: All right. I think it's better that we
17 get the testimony aspects and the factual predicate done first
18 before argument. D-3.

19 So do you have a preference?

20 MR. ETKIN: No particular preference, Your Honor.

21 THE COURT: Then let's start with Mr. Daloia,
22 representative of Kroll Restructuring.

23 Yeah, you'll be going there for --

24 MR. ETKIN: Okay.

25 THE COURT: We're just setting up the monitor.

1 MR. SLADE: (Indiscernible) questions, but it does
2 not seem like this witness is going to have anything relevant
3 to say about Mr. Etkin's objection.

4 MR. ETKIN: We'll wait and see.

5 THE COURT: Again, we'll wait. We won't speculate.

6 MR. DALOIA: Thank you, Your Honor. I'm just
7 filling out the appearance sheet.

8 THE COURT: It will be about two minutes.

9 (Pause)

10 THE COURT: And, Mr. Daloia, am I pronouncing it
11 correctly?

12 MR. DALOIA: Daloia. Yes, correct, Your Honor.

13 THE COURT: Okay. Would you please raise your right
14 hand?

15 JAMES DALOIA, DEBTORS' WITNESS, SWORN

16 THE COURT: All right.

17 THE CLERK: You can adjust it if you need it.

18 THE COURT: Thank you, Ms. Earl.

19 All right. Would you state your name and business
20 address for the record?

21 THE WITNESS: James Daloia. The business address is
22 55 East 52nd Street, New York, New York.

23 THE COURT: And the Court has accepted into the
24 record your declaration as Debtor's Exhibit D-4.

25 Mr. Etkin.

1 MR. ETKIN: Thank you, Your Honor.

2 CROSS-EXAMINATION

3 BY MR. ETKIN:

4 Q This will be extremely brief, Mr. Daloia.

5 A Great.

6 Q Thank you.

7 Mr. Daloia, do you know how many claimants were sent
8 ballots in connection with Class 3, all the classes in Class 3?

9 A Off the top of my head, I am not -- I wouldn't have the
10 exact figure on me. I would have to go back to the affidavit
11 of service.

12 Q Would it be in excess of 100,000, do you believe?

13 A To be honest, I would not know off the top of my head.

14 Q Okay. Your declaration has as an exhibit a lengthy list
15 of excluded ballots?

16 A Yes.

17 Q Do you know how many excluded ballots there were?

18 A The exact amount, no. That's why it's -- you know, what's
19 ever on the declaration is accurate.

20 Q With respect to the excluded ballots, did you note at all
21 how many or if any contained checkmarks on the opt-out box with
22 respect to the ballot?

23 A We do keep note of which ones do have checkmarks on the
24 opt-out, and that is included in the opt-out figures.

25 Q So that would be a manifestation of those particular

1 claimants that they were looking to opt out of the third-party
2 releases. Is that correct?

3 A That's correct.

4 Q And with respect to those excluded ballots, how are those
5 -- I understand what the votes, that the votes were not
6 counted. How were those opt-out elections dealt with?

7 A Again, as noted in my declaration, we don't talk to the
8 validity. We just count how many actually elect the opt outs.

9 Q So if the ballots were excluded, ultimately were the
10 opt-outs set forth in the ballots also excluded?

11 MR. SLADE: Your Honor, I would object. That seems
12 to call for a legal conclusion. Excluded for what?

13 THE COURT: You can ask him whether he knows.

14 Can you answer that question?

15 THE WITNESS: No, I cannot. Again, yeah, we don't
16 talk to the validity of -- of the opt-outs themselves. We just
17 note that they're made.

18 BY MR. ETKIN:

19 Q Right. My question is not the validity of the opt-out.
20 My question is whether they were counted or not counted if the
21 opt-out was contained in an excluded ballot.

22 THE COURT: Are you asking whether they were included
23 in the number of creditors who opted out?

24 MR. ETKIN: That's correct, Your Honor.

25 THE WITNESS: Yeah, they are included.

1 BY MR. ETKIN:

2 Q So of the 10,000-plus that's been reflected in the
3 debtors' brief, that includes opt-outs from excluded ballots?

4 A I believe so, yes. I'd have to double check, but some of
5 them are duplicative. If they are duplicative, we would not
6 double count opt-outs.

7 MR. ETKIN: Okay. I have no further questions, Your
8 Honor.

9 THE COURT: All right. Thank you.

10 Any redirect?

11 MR. SLADE: No, Your Honor. Thank you.

12 THE COURT: Mr. Daloia, thank you for your time.

13 THE WITNESS: Thank you.

14 (Witness excused)

15 THE COURT: And why don't we hear from Mr. Vogel.

16 Good afternoon, Mr. -- it's afternoon. Let's hope we
17 don't reach the next morning.

18 Please raise your right hand.

19 SCOTT VOGEL, DEBTORS' WITNESS, SWORN

20 THE COURT: Thank you. Please have a seat, and give
21 us your name and business address.

22 THE WITNESS: Scott Vogel. 885 Park Avenue, New
23 York, New York.

24 THE COURT: All right. Mr. Vogel, your declaration
25 has been admitted into evidence as D-1.

1 Mr. Etkin, cross-examine?

2 MR. ETKIN: Thank you, Your Honor.

3 CROSS-EXAMINATION

4 BY MR. ETKIN:

5 Q Thank you, Mr. Vogel.

6 And my questions are going to essentially relate to the
7 declaration that was admitted into evidence.

8 Do you have the declaration in front of you?

9 A I do not.

10 MR. SLADE: Mickey (phonetic), we have some copies.

11 MR. ETKIN: I think we might, as well.

12 MR. SLADE: May I approach?

13 THE COURT: Absolutely.

14 All right. You may continue.

15 MR. ETKIN: Thank you, Your Honor.

16 BY MR ETKIN:

17 Q Mr. Vogel, with respect to Paragraph 4 of your
18 declaration, you talk about the independent investigation with
19 respect to potential estate claims and causes of action against
20 the debtors' insiders. Do you see that?

21 A I do.

22 Q In the context of that investigation, did you look at any
23 claims with respect to violations of the federal securities
24 laws against any of these insiders?

25 A We looked at claims that the debtor would have against

1 these various parties.

2 Q So you didn't look at any of the claims asserted by anyone
3 else against these individuals. Is that right?

4 MR. SLADE: I would object. To the extent it's not
5 in the materials, that would be privileged information.

6 THE COURT: Overruled.

7 THE WITNESS: We looked at debtor claims. We didn't
8 look at individual -- what claims another individual would have
9 against the various parties.

10 BY MR. ETKIN:

11 Q I see. So you didn't look at the complaints in the
12 pending securities class actions at the time?

13 A We were aware of those filings, but we focused on what the
14 debtor would have -- what claims the debtor would have.

15 Q So the settlement that was ultimately reached that you
16 discuss in your declaration did not include any settlement of
17 non-debtor claims?

18 MR. SLADE: Yeah, I object, Your Honor, That calls
19 for a legal conclusion.

20 THE COURT: Sustained.

21 MR. ETKIN: Well, the witness already testified that
22 they only looked at debtor claims, Your Honor. I'm asking
23 whether the ultimate settlement was intended to include or
24 address any non-debtor claims.

25 THE COURT: Well, phrase it that way, then.

1 THE WITNESS: Can you repeat the question?

2 BY MR. ETKIN:

3 Q Sure. You just testified that you looked at claims that
4 the debtor would have in the context of your investigation.
5 And ultimately, a settlement was reached, the Committee
6 settlement which you discuss in your declaration. Is that
7 right?

8 A That's correct.

9 Q And with respect to that settlement, is that settlement
10 intended to address any non-debtor claims or claims that exist
11 other than the debtors against these same insiders?

12 A Well --

13 MR. SLADE: Your Honor, I would object. Asking him
14 the intent of the settlement is asking him to identify the
15 intent of many other people separate and apart from himself.
16 And also, it requires him to interpret the settlement agreement
17 which would be a legal conclusion.

18 MR. ETKIN: He spends a lot of time interpreting the
19 settlement agreement in his declaration, Your Honor. I'm not
20 asking for an interpretation. I'm asking whether certain
21 claims were included or not included.

22 THE COURT: Well, you can testify as to your
23 understanding, limited to your understanding.

24 THE WITNESS: So my understanding is that it was a
25 global settlement. Various parties would be providing

1 releases. Some of the release parties would provide releases
2 to the company, and the company would provide releases to them,
3 as well as to other parties that chose -- that participated in
4 the global release.

5 BY MR. ETKIN:

6 Q So in terms of that settlement, only the debtor is
7 providing releases. Is that correct?

8 MR. SLADE: Your Honor, I object. This again calls
9 for a legal conclusion.

10 THE COURT: I'll overrule. The question asks you of
11 your understanding of the settlement and whether or not there
12 are releases being offered by other parties other than the
13 debtor. Correct?

14 THE WITNESS: Yes.

15 MR. SLADE: Well, it's also vague as to which
16 settlement he's talking about.

17 THE COURT: Well, I assume we're talking about the
18 settlement referenced in his declaration.

19 MR. SLADE: But, Your Honor, his declaration
20 references two settlements. There are settlements that were
21 reached between the Special Committee and the individuals, and
22 then there's a global settlement that's embodied in the plan
23 that was also with the Creditors' Committee, so.

24 THE COURT: Well, then I'll ask you to refine --
25 thank you, Counsel. I'll ask you to refine your question.

1 BY MR. ETKIN:

2 Q It's the Committee settlement that's embodied in the plan
3 that I'm referring to, Mr. Vogel.

4 A So we were focused, we the debtor, were focused on
5 releases that the debtor was providing to various release
6 parties. As part of the global settlement, there was an
7 understanding that others -- that maybe others would be
8 participating in that as part of this global settlement.

9 Q When you talk about the global settlement, are you
10 referring to something other than the Committee settlement
11 that's described in your declaration?

12 A I'm talking about -- I would be talking about the plan.

13 Q Let me try it again. Is the global settlement something
14 different than the Committee settlement that's referenced and
15 discussed in your declaration?

16 A I'm talking about -- there are -- as Counsel just
17 suggested, there are two plans. There are two settlements, the
18 settlement that the debtors have with the various release
19 parties and then other people could choose to participate in a
20 global release of the debtors, as well.

21 Q What other people?

22 A The creditors.

23 Q But in terms of the Committee settlement, that involves
24 solely releases by the debtors to the other settlement parties,
25 the insiders that are referenced in the plan and the Committee

1 settlement. Is that right?

2 MR. SLADE: Your Honor I object. That calls for a
3 legal conclusion about what the global settlement and the plan
4 provides for. And he --

5 MR. ETKIN: Your Honor, this --

6 MR. SLADE: He knows the answer to these questions.
7 He's just trying to trick the witness.

8 MR. ETKIN: This declaration --

9 THE COURT: Then let's just --

10 MR. ETKIN: That's all he talks about.

11 THE COURT: Let him get to the heart of it.

12 Overruled.

13 To the extent you're able to answer the question.

14 Do you want to repeat it for him?

15 MR. ETKIN: I'll try.

16 BY MR. ETKIN:

17 Q With respect to the Committee settlement that you
18 referenced in your declaration --

19 A Yes.

20 Q -- involving certain named insiders of the debtor, the
21 debtor was the only party providing a release in connection
22 with that settlement. Is that right?

23 A I believe that's correct.

24 MR. ETKIN: Sorry it took so long to get there, Your
25 Honor.

1 THE COURT: That's fine.

2 BY MR. ETKIN:

3 Q In Paragraph 5 of your declaration in the bullets, the
4 next to the last bullet discusses an investigation or a topic
5 of the investigation being the debtor's procurement of
6 additional director and officer liability insurance in November
7 of 2022. Do you see that?

8 A I do.

9 Q Could you provide me with some additional context as to
10 what that investigation is all about with respect to the
11 procurement of the NO insurance?

12 MR. SLADE: Your, Honor I would object. That calls
13 for privileged information.

14 THE COURT: Sustained.

15 BY MR. ETKIN:

16 Q With respect to Paragraph 10 of your declaration, it talks
17 about needing the cooperation from several debtor employees
18 with respect to certain estate litigation. Do you see that?

19 A I do.

20 Q And it includes certain Committee settlement parties that
21 have agreed to devote a certain number of hours in the context
22 of that cooperation. Is that right?

23 A Yes.

24 Q How long do you think that cooperation is going to last
25 post-confirmation based upon what's in store for the debtor or

1 the liquidating debtor post-confirmation? Last a year, two
2 years, three years, with respect to all this litigation?

3 A It's hard to speculate.

4 Q Do you anticipate it lasting more than a year?

5 A Again, it's hard to speculate. It's going to be dependent
6 on how the plan administrator uses these various consultant
7 advisors and -- and what they're needed for.

8 Q Is the cooperation that you discussed in that paragraph
9 conditioned on their getting a full release from creditors?

10 A Yes, as part of that global release.

11 Q Would that include those creditors who chose to opt out of
12 the release?

13 MR. SLADE: Your Honor, I would object. Again, it's
14 asking the witness to interpret legally how the settlement
15 agreement works.

16 THE COURT: I agree. Sustained. Rephrase it.

17 MR. ETKIN: I'll try, Your Honor.

18 BY MR. ETKIN:

19 Q To the extent that there are creditors who opt out of the
20 release and the indication in the papers is that that's in
21 excess of 10,000, the fact that those creditors are not
22 releasing the Committee settlement parties, does that give the
23 Committee settlement parties the opportunity to back out of the
24 deal that they struck?

25 A No.

1 Q So even if there were 100,000 opt outs and they faced
2 claims from 100,000 creditors, they would still be obligated to
3 fulfill their cooperation obligations under the terms of the
4 Committee settlement?

5 A Well, I believe --

6 Q Is that right?

7 A Maybe, it depends on what those numbers look like in the
8 scheme of the voting classes. But I think only 10,000 or so,
9 as you noted, chose to opt out.

10 Q But it basically doesn't matter how many did or didn't opt
11 out. They would still be bound by the terms of the settlement.
12 Is that right?

13 MR. SLADE: I mean, Your Honor, again, you're asking
14 the witness a legal conclusion.

15 THE COURT: Sustained. Legal conclusion.

16 BY MR. ETKIN:

17 Q Mr. Vogel, with respect to Paragraph 20 of your
18 declaration, it mentions the gatekeeper, what's been called the
19 gatekeeper provision that's part of the settlement and the
20 subject of some objections that are pending. Is the Court's
21 approval of the gatekeeper provision a condition to
22 confirmation of the plan?

23 A Yes. It's part of this overall settlement package.

24 Q So in other words, if the Court doesn't approve that
25 gatekeeper provision, then the plan would blow up and it would

1 be starting from scratch? Would that be the result?

2 MR. SLADE: Your Honor, I would object. Lack of
3 foundation. I don't know how he could know that.

4 THE COURT: Sustained.

5 BY MR. ETKIN:

6 Q In the context of the Committee settlement that you
7 discuss in your declaration, is it your understanding that the
8 individual Committee settlement parties were providing
9 cooperation under the Committee settlement preserve all their
10 rights to any existing directors and officers liability
11 insurance?

12 A That's correct.

13 Q Do you know how much directors and officers liability
14 insurance coverage exists?

15 A Not offhand.

16 Q Again, with respect to the gatekeeper provision,
17 Mr. Vogel, is it your understanding that that provision would
18 apply even if a creditor opted out of the third-party release?

19 MR. SLADE: Your Honor, I object. This again calls
20 for legal conclusions interpreting the plan.

21 THE COURT: I'll overrule that.

22 THE WITNESS: Can you repeat the question?

23 BY MR. ETKIN:

24 Q I'm sorry. Would you like me to repeat the question?

25 A Yes.

1 THE COURT: Yeah. He asked you to repeat it.

2 MR. ETKIN: Sure.

3 BY MR. ETKIN:

4 Q With respect to the gatekeeper provision, is it your
5 understanding of the Committee settlement and the plan that
6 even if a creditor opted out of the third-party release, they
7 would still be subject to the gatekeeper provision --

8 A Yes.

9 Q -- under the plan?

10 So, in other words, it's not enough to just opt out?
11 There are other hurdles a creditor would have to overcome in
12 the context of the plan and the gatekeeper provision in order
13 to assert their claims against the individual?

14 A That's how it's drafted.

15 Q Mr. Vogel, with respect to Paragraph 25 of your
16 declaration, is it your understanding that the gatekeeper
17 provision is not severable for purposes of the plan?

18 A Correct.

19 Q And do you know whether the plan provides for the
20 potential for severing a provision that the Court ultimately
21 believes or determines is inappropriate?

22 A I am not sure I recall what the -- whether or not there's
23 a broader provision but certainly not in the context of this
24 gatekeeper provision.

25 MR. ETKIN: I have no further questions, Your Honor.

1 THE COURT: All right. Thank you.

2 Redirect?

3 MR. SLADE: Just briefly.

4 For the record, Michael Slade for the debtors.

5 REDIRECT EXAMINATION

6 BY MR. SLADE:

7 Q Mr. Vogel, just a few clarifying questions.

8 You testified in response to Mr. Etkin's question that the
9 gatekeeper provision and the opt-outs are parts of the global
10 settlement, right?

11 A Correct.

12 Q And the third-party releases are parts of the same
13 settlement, right?

14 A Correct.

15 Q Is that part of what everybody negotiated for and got
16 implemented in the plan?

17 A That's correct.

18 MR. SLADE: That's all. Thank you, Your Honor.

19 THE COURT: All right.

20 No further cross, Mr. Etkin?

21 MR. ETKIN: Just some further clarification, Your
22 Honor. One question

23 RECROSS-EXAMINATION

24 BY MR. ETKIN:

25 Q When Mr. Slade refers to the global settlement, is he

1 referring to a different settlement than the Committee
2 settlement that's set forth in your declaration?

3 MR. SLADE: Yeah, I object. I'm not sure how he
4 could know the answer to that question.

5 THE COURT: Well, overruled. He can give your
6 understanding.

7 THE WITNESS: There is a Committee settlement. And
8 as part of the plan of reorganization, there is a global
9 settlement.

10 MR. ETKIN: I think that answers the question, Your
11 Honor. Thank you.

12 THE COURT: Thank you.

13 Thank you for your time. You may step down.

14 (Witness excused)

15 THE COURT: That brings us to Mr. Renzi.

16 Good afternoon, Mr. Renzi.

17 MR. RENZI: Good afternoon, Your Honor.

18 THE COURT: If you would be so kind, please raise
19 your right hand.

20 MARK RENZI, DEBTORS' WITNESS, SWORN

21 THE COURT: Please have a seat. Provide us with your
22 name and business address.

23 THE WITNESS: Mark Renzi. 99 High Street, Bost,
24 Mass.

25 THE COURT: And for the record, we have Mr. Renzi's

1 declaration marked as Debtors' Exhibit D-2.

2 CROSS-EXAMINATION

3 BY MR. ETKIN:

4 Q Good afternoon, Mr. Renzi.

5 A Good afternoon.

6 Q I just have a few questions, again, focusing on your
7 declaration.

8 A Should I have a copy?

9 Q Yeah, that's probably a good idea.

10 A Thank you.

11 MR. SLADE: Your Honor, may I approach?

12 THE COURT: Yes, please.

13 THE WITNESS: Thank you.

14 THE COURT: Getting his good side.

15 Go ahead.

16 MR. ETKIN: I'm sorry, Your Honor. I'm fighting a
17 little bit of a cold.

18 THE COURT: That's quite all right.

19 BY MR. ETKIN:

20 Q Mr. Renzi, in the context of the disclosures set forth in
21 the disclosure statement, were you involved in the process of
22 providing information or input?

23 A Yes.

24 Q And in that context, was there ever any discussion of
25 providing specific information about the pending class action

1 litigation and what the claims were and what was asserted and
2 who the potential defendants were?

3 MR. SLADE: Objection, lack of foundation.

4 THE COURT: Sustained.

5 MR. ETKIN: Let me see if I can fix that.

6 BY MR. ETKIN:

7 Q Mr. Renzi, the debtor was aware of the pendency of the
8 securities class actions early on in the case?

9 A Yes.

10 Q In fact, early on in the case, an adversary proceeding was
11 commenced to enjoin the continued prosecution of the securities
12 litigation against the non-debtor defendants in that case. Is
13 that right?

14 A Yes.

15 Q So in that context, you became aware of the pendency of
16 those class action complaints in Massachusetts and New Jersey?

17 A Yes.

18 Q And getting back to my question, was there ever any
19 discussion about including a description of that litigation,
20 who the defendants were, what the claims were in the context of
21 the disclosure statement?

22 MR. SLADE: Objection, lack of foundation. How could
23 he know whether there was any discussion about that topic?

24

25 MR. ETKIN: Well, he would know if he was involved in

1 any discussion.

2 THE COURT: Well, ask that question.

3 BY MR. ETKIN:

4 Q Were you involved in any discussion regarding inclusion of
5 information with respect to the pending class action
6 litigation?

7 A I'd defer to counsel.

8 Q I'm not asking you if your counsel was involved. I'm
9 asking you if you were involved.

10 A It wasn't under my purview to discuss the -- the class
11 action lawsuits in terms of how they were presented in the
12 disclosure statement. The purview was to make sure the
13 financial information was done appropriately, and that was our
14 main focus.

15 Q With respect to Paragraph 35 of your declaration?

16 A I'm there.

17 Q Again, with respect to the individuals that are parties to
18 the Committee settlement and are getting releases from the
19 debtors, and again aside from the cooperation and what value
20 that might be, in the aggregate, they're contributing I believe
21 it's a shade over \$2 million. Is that right?

22 A Yes.

23 Q And --

24 A Just to clarify, that's the financial aspect of it. There
25 are other things that they're providing.

1 Q The cooperation, for example?

2 A Yes.

3 Q Anything other than the cooperation and the financial
4 aspect of it?

5 A I think they were helping, you know, with any wind-down of
6 the estate that's necessary, so that's important. And any
7 testimony required to maintain any value from litigation, you
8 know, for the estate, to help the estate with other legal
9 entities outside of the estate.

10 Q But only up to the amount of hours that they're
11 specifically committing for that purpose?

12 A It is written that way, yes, it is. However, I'm -- I'm
13 certain to the extent that they are -- they are people that are
14 diligent and to the extent that something else is needed, I'm
15 sure they can negotiate that to make sure they're maximizing
16 value for the estate. So they're good people.

17 Q That's your speculation as to what would happen?

18 A That is my speculation.

19 Q You heard me ask Mr. Vogel how long he anticipates that
20 cooperation and the scope of the cooperation that you just
21 testified to, how long is that going to be required, and he was
22 unable to estimate. Do you have an idea, would it be more than
23 a year? Is it anticipated to be more than a year?

24 A Sure. I've -- I've read Mr. Vogel's declaration. You
25 know, BRG as an institution is involved in a number of crypto

1 cases. They are complex, as you know, sir. I think it's more
2 than six months and hopefully it can be resolved within a year.
3 So if you want me to put, you know, parameters, that's my best
4 guess. It could take longer, though.

5 Q And going to Paragraph 37 of your declaration, you
6 specifically state, and Mr. Vogel and I had a little bit of a
7 discussion on it. You specifically state that the Committee
8 settlement and the debtor release under the Committee
9 settlement has no impact on the claims of third parties. Is
10 that right?

11 A Yes, I'd defer to Mr. Vogel on this aspect, but that's
12 right.

13 Q But this is what you essentially testified to in Paragraph
14 37. Is that right?

15 A Yes.

16 "And provides for releases of the debtors' potential
17 claims subject to the terms of the Committee settlement of
18 their directors, officers, and employees." Yes, that's what it
19 says.

20 "The debtor releases are a vital component of the plan,
21 and it is a sound exercise of the debtors' business judgment
22 and should be approved."

23 Q Thank you, Mr. Vogel. I'm sorry, Mr. Renzi.

24 In Paragraph 44 of your declaration, you talk about the
25 fact that the potential claims at issue are no secret. Do you

1 see that testimony?

2 A It's a long paragraph. Can you help me where that is?

3 Q It's lengthy and --

4 THE COURT: Begins with "This case and other cases."

5 BY MR. ETKIN:

6 Q Right at the end of the second sentence.

7 A "I have this case and other cases in the cryptocurrency
8 sector. More generally, I've received tremendous publicity,
9 and the potential claims at issue are no secret."

10 Q When you made that statement, were you in any way
11 referencing the claims set forth in the class action litigation
12 that's pending?

13 A Yes.

14 Q So it would be your position then that the creditors,
15 customers of BlockFi, were generally aware of the securities
16 litigation claims?

17 A I think it's public record, so if they chose to read it.

18 Q Moving on to Paragraph 49, in the first -- I'm sorry, in
19 the second sentence of Paragraph 49, you refer to the release
20 parties being exposed, and I'm quoting, "to numerous frivolous
21 litigation claims after the plan is confirmed."

22 What's the basis for that statement, Mr. Renzi?

23 A I've discussed with counsel that that's -- that's a
24 potential. That's the basis.

25 Q So you aren't relying on any particular evidence in terms

1 of making that statement?

2 A I was relying on excellent counsel.

3 Q But based upon your response just now, the idea of
4 numerous frivolous litigation claims is conjecture and
5 hypothetical. Is that right?

6 A Okay. I'm not a lawyer, so -- but I -- I do rely on
7 counsel when we're doing analyses and when pulling together a
8 declaration. So I -- I trust our counsel.

9 Q So the basis for that position is, and that understanding,
10 is simply discussions with counsel. Is that right?

11 A Yes.

12 MR. ETKIN: I have no further questions, Your Honor.

13 THE COURT: Thank you, Mr. Etkin.

14 Redirect?

15 MR. SLADE: No, Your Honor. Thank you.

16 THE COURT: All right. Mr. Renzi, thank you for your
17 time. You may step down.

18 THE WITNESS: Thank you, Your Honor.

19 (Witness excused)

20 THE COURT: Thank you, Mr. Etkin. I believe that
21 completes the witnesses.

22 MR. ETKIN: Yes, Your Honor.

23 THE COURT: Thank you.

24 MR. ETKIN: At least from my perspective.

25

1 THE COURT: Then we'll return to the next phase of
2 the hearing and argument.

3 MR. SLADE: Maybe just to make sure that the record
4 is closed, can we just confirm that nobody else has any
5 witnesses to offer in support of or in opposition to
6 confirmation?

7 THE COURT: Well, let's start with the debtor. The
8 debtor has no further witnesses, correct?

9 MR. SLADE: We do not, Your Honor.

10 THE COURT: Committee is not offering any independent
11 witnesses, correct?

12 MR. AULET: No, Your Honor

13 THE COURT: All right. U.S. Trustee?

14 MR. SPONDER: No, Your Honor.

15 THE COURT: Any of the objecting creditors?

16 MR. ETKIN: No, Your Honor.

17 THE COURT: Then the record is closed with the
18 declarations that have been admitted, and we'll turn to the
19 argument phase.

20 MR. PETRIE: Thank you, Your Honor.

21 So for the record, it's Francis Petrie of Kirkland on
22 behalf of the debtors.

23 By our count, we have four remaining objections right
24 now. So there's the U.S. Trustee and the SEC, Wyatt who is the
25 securities lead plaintiff who we just had do cross-examination,

1 and the individual creditor which I spoke about before. So
2 we'll begin -- a lot of these arguments are intertwined, but
3 we'll begin by addressing the arguments raised by the two
4 governmental entities which are the U.S. Trustee and the SEC.

5 So I'll start first with good news which is that
6 we've largely narrowed the issues that were raised in both the
7 SEC's objection and the U.S. Trustee's objection, both formally
8 and informally. There's changes to the amended plan that deal
9 with the definition of exculpated parties, for instance,
10 modifications to who is a releasing party under the plan
11 including excluding parties who are known not to receive notice
12 and holders who are deemed to reject.

13 All of those parties automatically are excluded from
14 the releases. They don't need to take any additional steps to
15 opt out, and they are automatically out. Nonetheless, one of
16 the issues raised by the U.S. Trustee that we weren't able to
17 resolve surrounds the scope of the debtor release which they
18 argue is overly broad.

19 First, the debtor release that is contained in the
20 plan is critical. Both we and the Committee had very
21 hard-fought months' long negotiations that led to the term and
22 the scope of the debtor release and tailored appropriately,
23 including multiple mediation sessions. In our view, it's
24 undeniable that the debtor release is in the best interest of
25 creditors. Without its inclusion, we would not have the

1 support of the people we need to effect the plan.

2 **

3 MR. PETRIE: Some of this might have not been clear
4 on cross, but there's a lot more to the Committee's settlement
5 than just the monetary contribution and cooperation. There's a
6 waiver of claims on the platform. There's subordination of
7 other claims. There's many pieces of the settlement that are
8 outlined in detail in the plan that shouldn't be glossed over.
9 It's very complex, and a cornerstone of the plan itself.

10 Either way, we set this out in our papers. But the
11 courts in this jurisdiction analyze debtor releases under the
12 Zenith factors which include an inquiry into five different
13 prongs, all of which are easily met in this case.

14 First, there's an examination as to the identity of
15 interest between the debtor and the non-debtor. The debtors
16 have indemnity obligations to the vast majority of the release
17 parties. So any asserted claims would effectively be circular.

18 Second, an inquiry into the contribution of the plan
19 by the non-debtor. The release parties here are providing a
20 lot, as I just outlined, in the form of cooperation with the
21 estate. The CEO, COO, and other insiders are also making
22 additional personal contributions.

23 But again, here, it's not just about the money being
24 contributed. It's about preserving the ability to make in-kind
25 distributions and to assist in recovering amounts in key

1 ongoing litigation. Without the debtor release and the other
2 provisions of the plan, those contributions, both monetary and
3 significant non-monetary, would not be possible.

4 Third prong looks at the necessity of the release to
5 the plan. The debtor release is essential to the success of
6 the plan. Absent this release, it's highly unlikely that the
7 release parties would have agreed to support, and highly
8 unlikely that would have been able to formulate a plan at all.

9 Fourth looks at the overwhelming acceptance of the
10 plan and release by creditors. We have that here. We have all
11 of these individuals who voted in favor across classes. We had
12 over 90 percent of voting creditors vote in favor of the plan,
13 which includes the release. And we should not second-guess
14 their judgment.

15 And fifth, there's an examination into the payment of
16 all or substantially all of the claims of creditors or interest
17 holders. The plan provides the highest amount and in-kind
18 recovery for creditors. And the cooperation by the management
19 team obtained as part of the release allows for the possibility
20 of real success on the litigation.

21 So for all classes, there will be truly significant
22 swings in recovery if they're able to prevail. So the fifth
23 factor is also met here.

24 Nobody's really saying that these are claims that the
25 company should be pursuing because it's not getting enough
26 value in exchange for the release. In fact, earlier this year,

1 each of the special committee of the BlockFi board and the
2 unsecured creditor's committee filed unredacted versions of
3 their investigation reports. And we engaged in several
4 contested hearings at which we made our respective views known
5 about the merits of the claims held by the debtors.

6 There's truly a very robust and extreme public
7 disclosure about the merits of estate claims, more than --
8 significantly more than you'd see in any other Chapter 11 case.
9 And through that public information, the creditor body became
10 educated on the value of these claims. And even armed with
11 that information, they submitted overwhelming votes in favor of
12 the plan.

13 The other piece of the Government objections deals
14 with the opt-out provision and the third-party release. In
15 this case, the third-party release is reasonable and
16 appropriate and wholly consistent with the decisions of this
17 Court, and the circuit more broadly.

18 First, and I can't emphasize this enough, the release
19 is consensual. The law is clear that parties that receive
20 sufficient notice of a plan's release provisions and had an
21 opportunity to object or to opt out of that release and failed
22 to or chose not to do so, including where such holder abstained
23 from voting all together, are agreeing to grant such a release.

24 In these cases, we engaged in a fulsome process
25 noticing surrounding the plan. And the third-party release

1 language is clearly and conspicuously all over multiple
2 documents. It's included in the combined hearing notice that
3 went to every one of the creditor matrix. It's on the ballots,
4 it's on the opt-out forms. And all of these were sent to
5 parties in connection with solicitation as well as the
6 disclosure statement and the plan.

7 The Committee also emphasized the option to opt out
8 for all creditors in the letter that it sent out as part of the
9 solicitation package which went to all of their constituency,
10 and through it's own tweets, emails, and other communications
11 which the debtors also engaged in highlighting the key parts of
12 these documents and the deadline to submitting voting and opt-
13 out results.

14 And even beyond that, the obligation to affirmatively
15 opt out is explicitly stated multiple times in the disclosure
16 statement. No party is surprised by the fact that opting out
17 is a key part of this plan. If it was known that a party did
18 not get proper notice, they either got a bounce back email or a
19 returned physical mailing, then those parties are not subject
20 to the release. But that's not who we're talking about here.

21 The other piece of the obligation is a suggestion
22 that parties who have rejected the plan did not have ample
23 opportunity to opt out. We also argue that that's untrue.
24 Parties who voted to reject the plan received the same ballot
25 as anyone else, and were given ample opportunity to evaluate

1 the opt-out form, though they still, like others, were required
2 to check a box or opt out if they did not want to be subject to
3 the release.

4 And many of these parties, over 10,000 of them, did
5 just that. The sheer number of parties that opted out is a
6 clear demonstration that the process worked as intended and was
7 clear and understood by all parties who chose to retain these
8 actions, if they exist, and participate in opting out.

9 I would also point out that this method follows the
10 reasoning that was followed in Aceto Corporation. And, Your
11 Honor, it's much like you saw in Sur La Table -- I know there's
12 argument about how to pronounce that -- when Your Honor
13 overruled similar objections at the SEC made here as they did
14 there.

15 So the overwhelming weight of authority in this
16 district suggests that the opt out mechanism such as the one
17 included in the plan constitute consensual releases. Courts
18 throughout this circuit follow similar reasons. Recent cases
19 including one in front of Your Honor two weeks ago upheld the
20 notion that a non-debtor release is consensual where holders
21 and claimants in interest are provided the opportunity to opt
22 out, even when the holders in such classes reject the plan.

23 The objecting parties also object to the third-party
24 release not including a carve out for fraud, intentional
25 misconduct, or gross negligence. The third-party release,

1 without such carve out, is clearly warranted in this case where
2 releasing any and all potential claims of fraud, willful
3 misconduct, and gross negligence are crucial to properly
4 implement the plan.

5 The debtors have hundreds of thousands of clients who
6 have a unique outrage towards certain of the release parties,
7 specifically the debtors' current officers and directors. We
8 needed to release such parties to implement the terms of the
9 settlement and the plan. And any carve out for fraud, willful
10 misconduct, and gross negligence would circumvent the third-
11 party release.

12 The objecting parties do not cite any Third Circuit
13 authority that requires a carve out in non-debtor releases.
14 Courts in this district and in the Third Circuit have
15 repeatedly approved plans that did not include such a carve
16 out.

17 And again, this is a consensual release. All
18 stakeholders needed to do to preserve such claims was to opt
19 out, meaning that under clear law in this circuit, the release
20 of claims given by stakeholders who do not opt out is
21 consensual, notwithstanding the inclusion or exclusion of this
22 carve out.

23 So, Your Honor, unless you have any questions, I'd
24 like to move on to the gatekeeper provision.

25 THE COURT: Please.

1 MR. PETRIE: Another piece of this objection is to
2 what's labeled as the gatekeeper provision. And to clear up
3 any misconception about what we're asking for here, this is an
4 administrative safeguard. To the extent any entity that has
5 opted out or otherwise not participated in the releases seeks
6 to assert a claim or cause of action against a released party,
7 that entity must first obtain an order from this Court
8 determining that they are authorized to bring such a claim.

9 And we'll be clear about something right now. It's
10 not contemplated necessarily that the gatekeeping court is
11 ruling on the underlying merits of the action. The Court is
12 making an inquiry into whether or not there's an ability to
13 bring the action or whether it has been addressed already as
14 part of the plan or confirmation order.

15 So what we're asking for here is for this Court to
16 make an initial threshold inquiry and engage in the
17 construction of the terms of the plan, and to interpret those
18 terms in conjunction with the confirmation order. Clearly,
19 this Court is the best forum to accurately construe the
20 language of it's own plan and confirmation order, especially
21 here where there's a bargain for benefit and complex history.

22 Settling parties provided financial and other
23 contributions to obtain the releases that are contained in the
24 plan. And this Court has jurisdiction to implement this
25 mechanism, notwithstanding what some of the objectors say.

1 Thu true that bankruptcy courts are of limited
2 authority, this is certainly within that authority. All we're
3 asking for the Court to do, as I stated, was to figure out
4 whether a claim is barred or not by the terms of the plan,
5 which this Court is otherwise very familiar with. This Court
6 can, unquestionably, decide that.

7 And if there is a real direct claim against the
8 released parties, then the claim will have to be later defended
9 on the merits. But what we and the settling parties
10 anticipated was that there will be many frivolous claims that
11 parties will bring here. As we stated, over 10,000 creditors
12 have opted out.

13 So in this case, there are a lot of lawsuits that
14 will likely have to be sorted through that may be asserted
15 against a wind-down debtor with limited resources. That is a
16 huge concern.

17 So I'll note that this mechanism isn't in every plan.
18 That's true. But it has been approved in various instances in
19 many courts in different circuits. It stems from the Barton
20 Doctrine which we've also seen in the Madoff and General Motors
21 cases. And the Fifth Circuit in Highland Capital engaged
22 heavily with the topic, and ultimately upheld confirmation of a
23 plan that found that this provision helped screen and prevent
24 bad faith litigation against parties, including directors and
25 officers.

1 One of the SEC's issues with this provision surrounds
2 burdens. They argue that the burden falls inappropriately upon
3 creditors to bring this cause of action or come before this
4 Court. Even if that's taken as true, those creditors accepted
5 that burden by overwhelmingly voting in favor of the plan which
6 contained a description of this mechanism. And the
7 solicitation version of the plan of DS did not amend this
8 version. That is what went out to creditors and what they
9 voted to accept.

10 But on this topic of burdens, odds are that if there
11 was an issue about the release of claims, those issues would
12 likely be in front of this Court anyway. The plaintiffs would
13 likely be brought here by defendants who would then seek this
14 Court to interpret the terms of the order and enforce the plan
15 against them.

16 So I argue that what this mechanism does then is to
17 preserve wind-down debtor resources that otherwise would be
18 wasted defending frivolous actions that are going to be
19 improperly brought.

20 And likewise, the structure benefits everybody.
21 Individual claimants may have no idea whether their claims are
22 released or enjoined by the plan. Clearing up this inquiry to
23 those individuals in front of this Court is beneficial. This
24 Court is definitely, at least in my view, more acceptable and
25 accessible than the vast majority of other jurisdiction or

1 forums, and will let them know whether their claim can be
2 properly brought.

3 And it prevents courts from around the country from
4 inconsistently misconstruing the terms of the plan and a
5 confirmation order, which is especially at issue here when
6 certain parties are making a substantial contribution to the
7 estates with the expectation of certain protections in return.

8 So in sum, the gatekeeping mechanism is a feature
9 that offers protection, consistency, and fairness to these
10 parties. It's inclusion and structure were negotiated heavily
11 with the Creditor's Committee, and was accepted by all voting
12 classes. It's common in other circuits and in other cases, and
13 has been approved by this Court. It's a key part of the
14 settlement that was negotiated with settling parties, and I'm
15 certain that the plan would probably not exist without its
16 inclusion.

17 To address -- so I think that addresses some of what
18 Mr. Wyatt's objection consisted of. But at the outset, we'd
19 just like to note that Mr. Wyatt, we do not believe, has
20 standing to make an objection. He has opted out of the third-
21 party release himself. But he seeks to object on behalf of
22 other individuals in a class that has not yet been certified.

23 In short, he's objecting to consensual releases given
24 by people he does not represent. And what underpins the
25 objection is that the third-party release is consensual and

1 appropriate. There's no due process issue here, as we
2 outlined. Individuals were provided notice and an opportunity
3 to opt out. If they didn't submit a response, they were sent
4 an email. There were tweets, there were posts on the debtors'
5 website.

6 The UCC had its own set of communications including a
7 letter that was sent to every creditor in this case. More than
8 10,000 people exercised the ability to opt out if they chose
9 to. The creditors understood that this feature existed, and
10 some of them exercised it.

11 But for those who received notice and did not opt
12 out, Mr. Wyatt appears to be substituting his judgment for
13 theirs. I can personally imagine many reasons why individuals
14 would choose not to opt out. For instance, they may want the
15 settlement parties to focus on other things like litigation or
16 returning things in kind to creditors without being served with
17 discovery or being distracted by another lawsuit.

18 Or maybe the individuals just want nothing to do with
19 what's probably a frivolous lawsuit and to move on. The
20 securities lead plaintiff, as I said, is attempting to
21 substitute its judgment for theirs. But for those who decided
22 not to opt out, they consented to this mutual release. It's
23 likely a lot of individuals do not even know that Mr. Wyatt
24 seeks to represent them or speak on their behalf, and
25 invalidate a release that they chose to be party to.

1 Currently, he does not represent them, and we do not know if he
2 ever will.

3 And from where we sit, no other party has really
4 expressed a desire similar to his. And the lead plaintiff had
5 ample opportunity in these cases to certify a class at this
6 point.

7 To address any issues on disclosure, we did include
8 information in the disclosure statement about his complaint and
9 the adversary proceeding. It's in Section 10-J and is cited in
10 our confirmation brief. We believe that these factors, in
11 total, mean that his objection should be overruled.

12 I'll now address the one additional objector. This
13 objector's issue was a potential ambiguity surrounding the
14 language of causes of action in the debtor release section
15 which we clarified through an additional edit at their request.

16 The edit is not a material modification to the plan.
17 It simply reinforces the rights that are otherwise provided for
18 under the plan. This individual raised their misunderstanding
19 to the UCC and the debtor several weeks ago.

20 They were notified through Counsel prior to the
21 voting deadline of the intention of the section. And if this
22 result was not what the individual wanted, we offered to change
23 the submitted vote. The individual instead chose to accept the
24 plan, notwithstanding the explanation, and offered to change
25 the vote to another direction.

1 The standard is that any plan modification is not
2 material unless if a creditor knew of the modification, they'd
3 be likely to reconsider their acceptance. And here telling me
4 this individual in fact did not change their vote when
5 presented with the option to do so.

6 The edit that we made was arguably not even
7 necessary. But we made that technical modification anyway to
8 clarify this perceived inconsistency in the plan. No other
9 creditors have joined in to argue they also believe that
10 claimed objections were going away. So no reasonable person
11 could read the disclosure statement and the plan and say no
12 claim will ever be objected to.

13 The disclosure statement and the solicited plan were
14 clear that the debtors and the wind-down debtors were
15 instituting a claims objection process. There are many
16 provisions providing descriptions of how we plan to object to
17 claims, including Page 2 of the DS, Article 11(a) under
18 multiple sections. Article 11(3)(4), all of these are
19 described in our papers and cited in our confirmation brief.

20 Article 7(b) of the solicited plan expressly provides
21 that after the effective date, the wind-down debtors would have
22 the sole authority to file, withdraw, or litigate to judgment
23 any objections to claims. The sections go on including the
24 second page of the DS which says in all capital letters that
25 the ability to object to claims after the confirmation or the

1 effective date of the plan, irrespective of whether the
2 disclosure statement identifies any such claims or objections
3 to claims.

4 There's no read of the plan or disclosure statement
5 that suggests a vote in favor of the plan ensures that a claim
6 will be wholly permitted in full at any point in time. And
7 regardless under the bankruptcy code, Section 502(a) preserves
8 the ability for any party to object to a claim, even if the
9 debtor somehow did not have this right.

10 So in light of all that, Your Honor, even if we
11 confirm the plan, that does not hinder this ability's
12 individual -- it does not hinder this individual's ability to
13 dispute the debtors' objection to their claim. They were
14 included in the 11 omnibus claims objection. The response
15 deadline to that is October 3rd. And the 11 omnibus claims
16 objection is currently scheduled to be heard by this Court on
17 October 10th. If they have any defenses, they should be heard
18 at that time.

19 With that, I will turn the podium over to likely the
20 Committee --

21 THE COURT: All right.

22 MR. PETRIE: -- unless Your Honor has any questions.

23 THE COURT: No, not at this juncture. Thank you.

24 Let me hear from the Committee, please.

25 MR. AULET: Good afternoon, Your Honor. Kenneth

1 Aulet of Brown Rudnick for the official Committee.

2 Your Honor, I would join in the debtors' request that
3 the objections be overruled. As Your Honor is well aware, the
4 Committee's settlement was extremely hard fought in this case.
5 And one of the things we're proud of in this case is that every
6 creditor got a huge amount of disclosure.

7 Now, if you look at some of the usual cases where
8 releases like this have been approved, it's not necessarily a
9 huge amount of information that's been given out. But here,
10 the debtors' put out a hundred-plus page report. The Committee
11 put out a hundred-plus page report. And both reports were
12 expressly referenced in the disclosure statement. And you
13 know, all parties were encouraged to read them.

14 We certainly don't like every aspect of the
15 settlement, and I'm sure that the debtors and the settlement
16 parties don't either. But at the end of the day, this
17 settlement and getting this plan approved is the best path
18 forward at this time for the customers of BlockFi.

19 There's one, you know, statement that counsel for the
20 debtors made about, you know, some settlement parties
21 anticipating frivolous claims. To be clear, the Committee has
22 no -- has not made -- reached any view that any potential
23 claims are frivolous. You know, in our view, the third-party
24 releases and the gatekeeper function are a negotiated part of
25 the plan.

1 We are certainly not taking position, and I don't
2 think that anybody has offered an opinion on if any specific
3 claim is frivolous. But what we have agreed to and what we
4 request be approved is the settlement that has been embodied in
5 the plan after very, very hard-fought negotiations.

6 I also want to address the final objection to the
7 modification of the plan. At the end of the day, this
8 objection just asks that the Court order that the entire plan
9 be resolicited again. This is not a case where we can simply
10 -- there's 9,000 that the leave claims, simply accept those
11 claims at face value not only because some claims are
12 overstated, but some claims are under stated.

13 You know, if you look at some of the omnibus
14 objections that have been filed, they're actually asking the
15 claim amount be increased because it was very important to the
16 Committee. We have hundreds of thousands of individuals who
17 are not experienced in bankruptcy. And we did not want the
18 claims process to be essentially a quiz on if the claimants
19 could properly identify what debtor was liable, properly fill
20 out the form to properly set forth the claim.

21 And so there are, and I expect there will be,
22 additional objections to make sure that people get more than
23 what they claimed because they made a mistake on the claim
24 form. We need to get the claims population right.

25 And there is no way that asking all of the customers

1 of BlockFi to sit in bankruptcy for another two months after
2 they overwhelmingly accepted the plan, just so they can be
3 asked did you mean it because one of the objections that was
4 received was for Three Arrows Capital that wanted to make very
5 sure that they were deemed to have opted out. They've asserted
6 hundreds of millions of dollars of claims. If any reasonable
7 party thought that the plan released the ability to object to
8 claims, Three Arrows would have been beating down the doors of
9 the debtors demanding to be included in the opt out release,
10 not demanding be taken out of it.

11 So you know, with that, Your Honor, we'd urge that
12 the Court overrule the objections and confirm the plan.

13 THE COURT: All right, thank you, Mr. Aulet.

14 Let me turn to the -- I want to hear all objections,
15 and then any responses. Let me turn to the governmental
16 objectors. Mr. Maza, I'll let you -- you want to catch your
17 breath? Why don't we hear from -- we'll hear from the U.S.
18 Trustee first.

19 MR. SPONDER: Thank you, Your Honor.

20 THE COURT: Thank you.

21 MR. SPONDER: Thank you, Your Honor. And good
22 afternoon. Jeff Sponder on behalf of the United States
23 Trustee.

24 As you know, Your Honor, the U.S. Trustee filed an
25 objection to the third amended joint plan at Docket Number 1476

1 on the basis that the exculpation clause is impermissibly
2 broad, the debtor releases are over broad, the opt out clause
3 is insufficient, the non-debtor third-party releases are not
4 fair and necessary to the reorganization. The injunction
5 provisions are impermissible.

6 The plan is not a settlement subject to approval
7 under 9019. And the gatekeeping provision should be removed.
8 In addition, the U.S. Trustee objects to certain of the wind-
9 down provisions in the plan.

10 As Counsel mentioned, as a result of discussions
11 between the U.S. Trustee and the debtors, the debtors filed
12 last night a third amended joint plan with additional technical
13 modifications at Docket Number 1609. The third amended joint
14 plan now includes modifications agreed upon between the debtors
15 and the United States Trustee that include modification to
16 Article 1 Section 121 as to the definition of exculpated
17 parties, that it includes only specific estate fiduciaries,
18 removing Article 4(d)(12) from the plan which provided an
19 indemnification and limitation of liability to the plan
20 administrator, modifies Article 2(g) and Article 12(c) which
21 concerns statutory fees and provides that the debtors and the
22 wind-down debtors are jointly and severally liable, and it
23 modifies Article 1, Section 191 which is the definition of
24 releasing parties to set forth that no holder of a claim or
25 interest that is deemed to reject the plan shall be a releasing

1 party.

2 Your Honor, I realize that we have had -- we filed
3 similar objections in various cases over the years which have
4 been overruled by Your Honor. In fact, one such case was
5 decided just a few weeks ago. With that knowledge and
6 understanding, the United States Trustee intends to rest on his
7 objection filed again at Docket 1476, but would still like to
8 address some of the remaining issues including certain of the
9 releases, the injunction and gatekeeping provisions, and the
10 plan as a settlement under Rule 9019.

11 But first, Your Honor, this plan provides for third-
12 party releases, as we all know, for the benefit of the release
13 parties. The non-debtor third-party releases are referred to
14 as consensual, but the definition of releasing party includes
15 all holders of claims that vote to accept the plan, and who do
16 not affirmatively opt out of the releases provided by the plan.

17 All holders of claims that are deemed to accept the
18 plan and who do not affirmatively opt out of the releases
19 provided by the plan, all holders of claims who abstain from
20 voting on the plan, and who do not affirmatively opt out of the
21 releases provided by the plan, and all holders of claims who
22 vote to reject the plan and do not affirmatively opt out of the
23 releases provide by the plan.

24 It is unclear, Your Honor, if holders of claims or
25 interest whose ballots are returned to the debtors marked

1 undeliverable are releasing parties. Creditors who are deemed
2 to reject the plan whose ballots are returned undeliverable
3 should not be deemed to have consented to the third-party
4 releases. With that said, Your Honor, I believe Counsel argued
5 and agreed today that -- during argument today that those are
6 outside of the definition of the releasing parties.

7 Your Honor, likewise, U.S. Trustee submits that those
8 parties who vote to reject the plan and who do not
9 affirmatively opt out of the releases provided by the plan are
10 not agreeing to consensual third-party releases, and thus
11 including them in the definition of releasing party is contrary
12 to applicable case law, including the standards set forth in
13 Washington Mutual and other cases that we've cited in our
14 objection.

15 The U.S. Trustee submits that those creditors who
16 rejected the plan but did not affirmatively opt out of the
17 releases did not provide affirmative consent. To the contrary,
18 Your Honor, those parties that rejected the plan in all
19 likelihood believed that with their rejection, they were in
20 fact rejecting the releases as well as with, you know, no need
21 to check the opt out box.

22 Marking the rejection box should establish a complete
23 rejection of the plan, including the releases. Accordingly,
24 Your Honor, the U.S. Trustee submits that those holders of
25 claims how rejected the plan but who did not affirmatively opt

1 out of the releases should be deleted from the definition of
2 releasing parties.

3 Second, Your Honor, through the plan, the debtors
4 request an injunction precluding and permanently enjoining all
5 persons or entities from interfering with the use and
6 distribution of the debtors' assets in a manner contemplated by
7 the plan. And those that have been fully satisfied under the
8 plan are permanently enjoined from any set off or relief except
9 for payments or distributions contemplated under the plan.

10 Section 1141(d) (3) does not grant a liquidating
11 debtor a discharge, which is the situation we have here. In
12 addition, Your Honor, 1141(a) sets forth that the provisions of
13 a confirmed plan bind the debtor and any entity acquiring
14 property under the plan and any creditor except if the plan is
15 a liquidating plan under 1141(d) (3), which again is what we
16 have here.

17 Instead, Your Honor, where we should look at is
18 Section 362(c) (1). And that section applies. And that
19 provides that the stay of an act against property of the estate
20 under Subsection A of this section continues until such
21 property is no longer property of the estate. And in addition,
22 Section 362(c) (2) provides that the stay of any other act under
23 Subsection A continues until the earlier of the time the case
24 is closed or dismissed.

25 Further, Your Honor, the debtors include a

1 gatekeeping provision with the U.S. Trustee submits represents
2 an inappropriate burden on the claim holders and should be
3 deleted. As provided in the objection, there's no reason why a
4 court in which a relevant action has been filed between non-
5 debtors cannot make the determination as to whether the claim
6 was released under the plan.

7 Again, we ask the Court of follow Judge Owen's
8 decision in the In re Gulf Coast Healthcare LLC case and not
9 the Fifth Circuit decision.

10 Your Honor, the U.S. Trustee is amenable to a
11 limitation being placed on the injunction, which is exactly
12 what occurred in the Bed Bath & Beyond case a couple of weeks
13 ago. There, the debtors agreed to the following limiting
14 language which seems to coincide with Section 362(c)(1). And
15 that is that the injunction would remain through and until the
16 date upon which all remaining property of the debtors' estates
17 vested in the wind-down debtors has been liquidated and
18 distributed in accordance with the terms of the plan.

19 Such limiting language should be included in the
20 injunction provision, especially in light of the addition of
21 the gatekeeping provision in the plan which requires parties to
22 obtain a final order from Your Honor to pursue a claim against
23 the debtors.

24 Third, Your Honor, the debtors in Article 4(a)
25 suggest that the plan itself is a settlement agreement subject

1 to approval under Rule 9019. However, sending a plan to
2 impaired creditors for a vote is not the same thing as parties
3 negotiating a settlement among themselves.

4 In addition, Your Honor, it appears that Article 4(a)
5 does not limit the settlement of claims to the debtor or the
6 estates, and does not appear to be permissible under Section
7 1123(b)(3)(A). For a plan to incorporate a settlement of
8 claims or causes of action of other parties, those parties must
9 have expressly agreed to settle or compromise those claims,
10 Your Honor.

11 In Docket 1609 in Article 4(a), the debtors have
12 agreed to remove any reference to Rule 9019 and Section 1123.
13 However, the debtors replace such language with the phrase, and
14 I quote, "to the extent provided by the bankruptcy code," which
15 would seem to incorporate Rule 9019 and Section 1123.

16 In addition, Your Honor, the paragraph provides that
17 the plan is deemed a motion to approve the settlement of all
18 claims and controversies which, again, would seem to suggest
19 that it's a 9019 motion.

20 Similarly, Your Honor, Article 8(b) appears to
21 impermissibly seek to provide for the settlement of third-party
22 claims. The releases described in Article 8(b) are not part of
23 the any agreement between the debtors and all parties affected
24 by the plan. Also, Articles 3(c), 3(a) to (e) and 4(a) to (c)
25 purport to treat the distributive provisions of the plan as if

1 they were part of a settlement. The debtors have not provided
2 any justification for such additional relief.

3 As a result, the United States Trustee requests that
4 Paragraph 4(a) be removed from the plan, as it is not necessary
5 or applicable, that the second paragraph of Article 8(b) be
6 modified to remove reference to Rule 9019 or any reference to
7 settlement, and as well as to remove the provision that the
8 releases are "a good faith settlement and compromise of such
9 causes of action" and that any references to settlement in the
10 distributive provisions of Articles 3(c)(3) and (4) be removed.

11 Lastly, Your Honor --

12 THE COURT: Let me just clarify because obviously
13 plans can incorporate settlements.

14 MR. SPONDER: Correct.

15 THE COURT: So what's the distinction here that your
16 office finds troubling?

17 MR. SPONDER: The entire plan is being included as a
18 settlement, that it's the entire plan. And what we're saying
19 is that the entire plan cannot be a settlement under 9019.
20 There can be, just like the Committee settlement, you can have
21 those type of settlements incorporated through the plan. Here,
22 it's the entire plan is now being set forth as a settlement.

23 THE COURT: So if the Court were to confirm the plan
24 and in the confirmation order make it clear that the
25 confirmation is being approved based on satisfaction of 1129(a)

1 factors and not the standards for approving a 9019, does that
2 address the concerns?

3 MR. SPONDER: Yes, Your Honor.

4 THE COURT: Okay.

5 MR. SPONDER: Lastly, Your Honor, the debtors through
6 Docket 1564 modified the treatment of Classes 3B and 3D to
7 allow a voluntary opt-in for a loan repayment treatment.
8 Docket 1564 also defined certain new terms such as loan
9 repayment amount, loan repayment election, loan repayment
10 treatment, and loan treatment deadline.

11 These modifications appear to change the treatment of
12 such claimants under the plan. However, as it appears that
13 this is an added election post-confirmation, such modification
14 would appear to be appropriate subject, Your Honor, to the
15 debtors, or the wind down debtors, providing notice to those
16 claimants to make it to let them know that there is that post-
17 confirmation election.

18 Your Honor, in sum, the debtors and the U.S. Trustee
19 were able to partially resolve the U.S. Trustee's objection
20 concerning exculpation, statutory fees, and the limitation of
21 liability and indemnification of the plan administrator. For
22 the reasons set forth in the U.S. Trustee objections, as well
23 as the argument that I've made today, the U.S. Trustee requests
24 that the remaining objections concerning the releases, the
25 injunction provision, the gatekeeping provision, and the plan

1 as a (indiscernible) settlement be sustained. In addition,
2 Your Honor, to require the debtors and/or the wind down debtors
3 to provide notice of the loan repayment treatment to those
4 parties that will be affected.

5 Thank you, Your Honor.

6 THE COURT: Thank you, Mr. Sponder.

7 Mr. Maza.

8 MR. MAZA: Thank you, Judge. Alan Maza on behalf of
9 the United States Securities and Exchange Commission.

10 I will start to indicate that the debtors and the
11 Committee worked with us with regard to certain aspects to seek
12 consensual resolution on issues as represented by counsel.
13 However, there are some remaining issues which we brought to
14 the Court's attention, some of which have been shared by other
15 stakeholders which we believe are concerning going from
16 confirmation or potential confirmation of the plan.

17 To begin with, I just want to, on behalf of the SEC
18 staff, state a reservation of rights regarding crypto
19 distributions which has been stated and incorporated in the
20 proposed confirmation order and was also stated in our
21 objection, and reservation of rights. The plan contemplates
22 transactions involving crypto assets, including the
23 distribution of certain crypto assets to shareholders and the
24 liquidation of crypto assets.

25 As set forth in our limited objection and reservation

1 of rights, the SEC is not opining about whether these
2 transactions comply with the securities laws and reserves its
3 rights to challenge transactions involving crypto assets.

4 Going beyond the reservation of rights, two issues
5 stand out. One is, as mentioned by the Office of the U.S.
6 Trustee or as alluded to by the debtors, there is a failure to
7 include any exception for willful misconduct versus negligence,
8 a classic exception that we find in almost all plans that are
9 filed. We find it actually disturbing that a bankruptcy court
10 would actually approve a release provision, even consensually,
11 that basically accepts fraud, willful misconduct, gross
12 negligence.

13 We've raised these issues with other judges in other
14 districts, and even judges that are favorable to opt outs and
15 other forms of consent do draw a line when it comes to this
16 exception and have directed debtors at disclosure statement
17 hearings or confirmation hearings when brought to their
18 attention to, at a minimum, include that provision. One such
19 was in the Windstream Holdings in front of Judge Drain, who
20 certainly was in favor of the opt out.

21 While a specific case, per se, may be not easily
22 available, probably because it's an highly unusual issue or
23 it's resolved without the need for litigation, it does make
24 sense, as Judge Wiles said in the famous Aegean Marine case
25 that it just would be an anomaly that parties who have

1 peripheral interest in the Chapter 11 case would somehow walk
2 out of a case, a bankruptcy case with a better result than had
3 they filed their own personal bankruptcies, in which case fraud
4 would clearly be accepted under 523(a)(19) for an individual or
5 523(a)(2).

6 So the thought of going through a bankruptcy
7 proceeding as a third party and then having a bankruptcy court
8 say, no problem, you get out of the proceeding, somebody sues
9 you, don't worry about fraud, you're good. It's not consistent
10 with even bankruptcy analysis. So we rest on that objection
11 and we hope at a minimum, if these releases are approved, which
12 we're no fan of third-party releases, at a minimum the Court
13 could at least direct the debtor to put what is essentially a
14 classic template exception into those releases.

15 Now we get to the gatekeeper provision. As expressed
16 by the U.S. Trustee we support this objection. We believe this
17 is totally unnecessary. There have been so many plans filed to
18 date. Now all of the sudden this has become the flavor that
19 gets inserted into plans. You have to wonder how bankruptcy
20 courts functioned for the last, I don't know, how many years
21 without it.

22 Given the clear exceptional weight in the plan for
23 those stakeholders who have been carved out of the release,
24 either in the form of opting out or otherwise if they were
25 deemed to reject the plan, we don't see this as a necessary

1 provision. The unusual provision, which also includes the
2 bankruptcy court's adjudication of what is a "colorable claim,"
3 I put that in quotes, not only presents an unnecessary hurdle
4 and burden, which ultimately could discourage claimants from
5 bringing their actions which were already excepted from the
6 plan, but also unjustly expands the jurisdiction of the
7 bankruptcy court to go beyond the bankruptcy case and confirmed
8 plan to include reviewing and making dispositive findings with
9 respect to non-debtor claims, which are outside of the purview
10 of the bankruptcy arena. And, again, which are specifically
11 carved out of the plan.

12 Now, they will say that it's just a threshold
13 determination. But, truthfully, there is cases that say that
14 colorable goes beyond mere interpretation. And this would now
15 be going to application of a provision case in controversy.
16 And now we're asking the bankruptcy court now to start digging
17 into the possibility that this claim has some merit or not,
18 which now expands beyond interpretation of the bankruptcy plan.

19 That's not to say that the defendants of such an
20 action do not have the opportunity and under which is depleted
21 as an affirmative defense and come back to Your Honor for Your
22 Honor to review and then work with that determination. But to
23 set that up as the floor for how this operates is now bringing
24 this whole issue into a whole new uncharted territory, which
25 apparently was a non-issue for so many years and through so

1 many filed and confirmed plans throughout the last, you know, I
2 don't know, I don't want to say two generations, but it's
3 always, you know, could be 30 years. Who knows? As long as
4 I've seen plans, but I'm sure there's others here that may have
5 seen ones before that.

6 Further, to the extent that the debtors are relying
7 on the assertion that the settlement parties would not be
8 entering into this deal absent this provision, first of all,
9 it's questionable. It's not clear that this was the whole
10 nexus or foundation for the plan. However, it's been asserted
11 in declarations. But even those declarations talk about
12 settlement parties, not the expansive gatekeeper provision that
13 would be sought to be imposed on all these non-debtors suing
14 related parties that have nothing to do with the settlement.

15 So, if Your Honor is inclined, and again, we don't
16 believe it's supportable, but if Your Honor's inclined to
17 approve this gatekeeper provision, okay, so let's narrowly
18 tailor it for the settlement parties who were so keen on only
19 entering into this plan process under those conditions. Why
20 should somebody else who has nothing to do with this settlement
21 be forced to bear this prejudice, which is a prejudice, because
22 basically what we're saying is, even though you opted out, even
23 though you carved out, or you're carved out, you still have
24 this extra hurdle.

25 It is a burden. Whether they want to admit it or not

1 or whether ultimately it gets back to the bankruptcy court
2 anyway. But honestly, from the beginning, it's a hurdle and a
3 burden and a challenge for that particular non-debtor
4 stakeholder suing another non-debtor that they are now required
5 to stop before they file their complaint in state court or
6 whatever other non-bankruptcy jurisdiction. And then they have
7 to come to Your Honor. They have to go through all that. They
8 have to probably hire an attorney. They have to incur
9 additional costs. They have to come in front of Your Honor,
10 and Your Honor says, yes, go do what you want to do originally,
11 which you bargained for on the plan.

12 We don't support that kind of position. We don't
13 think the bankruptcy court should support that position. They
14 mentioned the Highland case, which is a case that's being
15 brought as the flagship case for this kind of provision.

16 But even Highland, it was a limited bankruptcy case
17 and the court even said on remand that it was just for looking
18 to protect the administration of the plan. In other words, a
19 certain subset of professionals would be protected. That's not
20 what's going on here. They have these extensive provisions
21 going to everybody. You want it? You want it? You got a
22 release. Yeah, you're excepted from release, you want to sue
23 Joe Schmo, nothing to do with the settlement and everything?
24 Huh-uh, got to go back to the bankruptcy court.

25 We don't see that as consistent with anything in

1 Highland. And it's not consistent with the plain meaning of
2 the plan. And it doesn't deprive the bankruptcy court at a
3 certain date if an affirmative defense is brought as
4 appropriate to coming back to the judge and saying, Judge
5 Kaplan, please, do I have permission? If that's a defense that
6 one of these parties wants to avail itself as an affirmative
7 defense consistent with federal civil procedure.

8 So, going forward, we would like the bankruptcy court
9 here to address these two issues with the debtor and absent the
10 debtor's amending the plan to include the exception for fraud,
11 willful misconduct, gross negligence, as found in many plans,
12 and either deleting the gatekeeper provision or otherwise
13 tailoring it to the narrative that's been presented to the
14 Judge that the Court deny confirmation.

15 Thank you, Judge.

16 THE COURT: Thank you, Mr. Maza.

17 All right. Again, I see hands raised, but let me go
18 to other objectors.

19 Mr. Etkin, were you going to make argument?

20 MR. ETKIN: Yes, Your Honor.

21 Your Honor, while our issues with the plan are
22 similar to those of the U.S. Trustee and the SEC, frankly, we
23 have a more narrow perspective. We're not a government agency.
24 I have a client. And we're focused on the claims in connection
25 with the securities litigation and the impact on those claims

1 with respect to what we believe are offensive provisions of the
2 plan.

3 I'm glad to see the debtor reached out and worked
4 with the U.S. Trustee and the SEC. No such luck for us. We've
5 had no contact with the debtor since the filing of the
6 objection.

7 Let me get to the standing issue first, Your Honor.
8 Kind of seems more like a heads-I-win, tails-you-lose argument.
9 From a standing perspective, as the presumptive lead plaintiff,
10 and we point this out in our papers, the presumptive lead
11 plaintiff himself has a pecuniary interest because the larger
12 the class, the larger the recovery, the more of an incentive
13 award he would get from the District Court.

14 If the class is narrowed, if the recovery is less
15 because of the impact of the releases, that incentive award may
16 not exist or it may be limited. But that's really not the
17 major issue with respect to standing.

18 We've also objected, as the U.S. Trustee and the SEC
19 has, to this gatekeeping provision. And Mr. Wyatt has an opt
20 out, even with respect to his individual claim, or as a class
21 representative, is impacted by this gatekeeping provision both
22 in terms of cost and in terms of unnecessary, we believe at
23 least, delay in litigating claims that for all purposes should
24 be resolved by the district court ultimately.

25 So standing, Your Honor the cases prefer to look at

1 party in interest from a broad perspective. And you can't be
2 really a party in interest with respect to certain issues and
3 not a party in interest with respect to other issues. Either
4 you're a party in interest, or you're not. And we believe it's
5 clear that Mr. Wyatt is a party in interest as contemplated by
6 the Code and that his interests are impacted in several ways by
7 the provisions that we find objectionable.

8 So moving on, Your Honor, to certain problems that we
9 pointed out with the ballot itself. You've heard an argument
10 thus far that there has been significant disclosure with
11 respect to the plan and a lot of patting on the back with
12 respect to that disclosure. But specifically, here are the
13 problems as they relate to Mr. Wyatt and his constituency.

14 Number one, the ballot includes certain definitions
15 specifically laid out but doesn't include two definitions that
16 are critical for a punitive class member to have a sense of
17 what's going on. One is the definition of the Committee
18 settlement parties, who are the beneficiaries of the release
19 specifically, and in fact, several of them are defendants in
20 the pending class action. And the definition of related
21 parties, which succeeds in bringing everyone else potentially
22 in the universe under the umbrella of these releases.

23 Those two critical terms are not defined in the
24 ballot although other terms are. And we believe that that
25 limits the ability of a class member to really determine

1 whether they should opt out or not. Second of all, Your Honor,
2 the opt out clause itself, or the opt out checkbox itself, you
3 don't get to it until Page 7 of the ballot. And this is all
4 the ballots under Class 3, 3A, B, C, D, E. So a creditor is
5 making a decision on whether to accept the plan or not, and
6 then has to wade through several more pages before they get to
7 the opt-out checkbox. We think that's a problem.

8 There's an informational statement in the ballot of
9 about a page and a half to give a creditor guidance with
10 respect to the vote and the ballot. Nowhere in that
11 informational statement, which is something that maybe a
12 creditor would read, nowhere does it talk about the opt out
13 generally, or certainly nowhere does it talk about any specific
14 claims that a creditor may be releasing if they potentially
15 have claims as a putative class member under the federal
16 securities laws.

17 With that, Your Honor, we believe that although there
18 was a lot of disclosure, key aspects in key places in the
19 documents failed to really provide putative class members with
20 the information that they would need to realize that they're
21 potentially giving up a valuable claim. Why not? But the
22 documents don't provide them with that information.

23 There's no indication specifically as to the pendency
24 of these securities class actions. And, Your Honor, the
25 debtors knew from the get go in this case, given that they

1 filed an adversary proceeding to enjoin those class actions
2 early on in the Chapter 11. So, Your Honor, from that
3 standpoint, we believe that there are serious due process
4 issues with respect to the information that was provided to
5 these particular creditors who Mr. Wyatt is looking to
6 represent in the class action to make an informed choice
7 assuming that the opt out mechanism itself is appropriate. We
8 have certain views with respect to that, but I'll get into that
9 in a moment.

10 Your Honor, let's talk for a moment about the concept
11 of consent. Here, consent, which we believe is being
12 engineered by the debtor, creates silence and inaction where
13 there's no information about the securities litigation, as I've
14 just pointed out, concerning the claims that they're
15 potentially giving up. We don't believe it's necessary, we
16 don't believe it's fair, and we don't believe it's equitable.

17 The Committee settlement is not conditioned on a
18 release of the settlement parties who are defendants in the
19 securities litigation. It can't be, just by virtue of the opt
20 out mechanism itself as was pointed out in some of the cross-
21 examination that was conducted earlier.

22 Your Honor, the opt out mechanism in this case
23 improperly places the onus on class members to, A, know of the
24 existence of the securities fraud based claims. And, Your
25 Honor, the securities cases are in their infancy, so there's

1 been no notice sent out to class members yet. There wouldn't
2 be in circumstances like that.

3 And then, the litigation was enjoined by this Court
4 through a stipulation and order. So there was nothing going on
5 in those cases other than, as the Court knows, the filing of
6 lead plaintiff motions, which was the only thing that was
7 allowed.

8 These securities fraud claims are not disclosed in
9 any plan related materials. And then these individuals are
10 being asked to successfully navigate and interpret a maze of
11 dense ballot and plan provisions to understand the impact of
12 the third-party release. Your Honor, this to us is not due
13 process, especially where the majority of the customers of the
14 debtor, and you've heard an argument and in some testimony that
15 they amount to hundreds of thousands of individuals. They're
16 not, for the most part, institutional investors. Most of them,
17 a lot of them, are individuals.

18 Your Honor, the debtors cite in their confirmation
19 brief, and I had a limited opportunity to take a look at it
20 given the fact that I was in synagogue to a certain point in
21 time last night. And then --

22 THE COURT: Now, you're making me feel guilty.

23 MR. ETKIN: Breaking (Indiscernible) --

24 THE COURT: Because I read it.

25 MR. ETKIN: No. Well, Your Honor --

1 THE COURT: Let's not go there.

2 MR. ETKIN: -- I'm impressed. I'm impressed.

3 But the debtor cited the Aegean Marine case, which
4 you've heard mention of, Judge Wile's case, in New York. We
5 happen to have been involved in that case. And the debtors
6 cite it favorably for the proposition that the -- excuse me for
7 one second, Your Honor -- that the clause protecting estate
8 fiduciaries, the exculpation provision, is appropriate.

9 But let me quote what Judge Wiles said about third-
10 party releases in general in that case. He said in the
11 transcript, which we could provide. It's part of the record in
12 that case. He said, and I'm quoting, "This is all about
13 consent and what consent means, right. So you're basically
14 urging me to say that you need me to manufacture consent for
15 you because we know in every one of these cases, there are
16 people who are going to get this big package and they're not
17 going to open it, or even if they open it, they're not going to
18 understand it, and they're not going to respond. We know that.
19 So all that this opt-out approach does is it seeks to
20 manufacture judicial deemed consent without an actual thought
21 process on behalf of the person whose consent is being sought."

22 Your Honor, debtors' counsel happened to be debtors'
23 counsel in that case as well. And to the extent that they cite
24 Aegean Marine for their benefit in connection with the
25 exculpation clause, you've got to take the burdens with respect

1 to that decision as well and can't say that the Court should
2 ignore it if they're asking the Court to look at it and endorse
3 it from the standpoint of the exculpation provision.

4 And, Your Honor, as was pointed out by Mr. Maza,
5 these individual defendants who are defendants in the class
6 action and are parties to the Committee settlement, aren't even
7 entitled to a release in their own bankruptcy case. There is
8 no provision of the Bankruptcy Code that authorizes a release
9 of third-party claims other than in the asbestos concept. So
10 what the debtors need to hang their hat on is that it's a
11 matter of contract, that they've consented as a matter of
12 contract because the plan is in essence a contract.

13 But when you look at contract law with respect to the
14 issue of consent, they, for the most part take the position
15 that there must be an express manifestation of consent. And at
16 Page 66 of their brief, they admit that it's really a matter of
17 contract, and that's what they're relying on with respect to
18 the propriety of the release and the so-called consensual
19 nature of the release.

20 Your Honor, that has not been demonstrated here on
21 the record. Consent simply shouldn't be implied on the basis
22 of notice. And the notice here does not even pass muster, as
23 we've pointed out, from a due process perspective, as it
24 relates to the securities claims.

25 Your Honor, I want to say a word about damages here.

1 Because regardless of what a Class 3 creditor recovers and it
2 varies from class to class, and frankly, most class members
3 fall into 3E under the plan. But the damages that these
4 customers, these holders of BIAs, are entitled to, or the
5 recovery that they're entitled to under the plan is a matter of
6 contract. So it's really the value of the crypto at the time
7 of the petition. That's how it's determined. And that is what
8 their claim would be.

9 The fact is that from the standpoint of the
10 securities laws, the damages are much more significant because
11 the securities laws can reach back to a point in time prior to
12 the filing, when the crypto was valued higher. I think it was
13 maybe 20 to 25 percent higher at that point in time. And the
14 allegations in the complaint are that by virtue of the
15 misrepresentations and fraud and other misconduct perpetrated
16 by the defendants, they invested and they lost that
17 differential by virtue of failures to disclose major issues
18 that ultimately resulted in the value dropping significantly
19 over a very short period of time.

20 So we're not talking about anything that these BIA
21 holders can recover in a bankruptcy context on their contract
22 claim. The damages are potentially significantly higher in the
23 context of a securities court claim.

24 Your Honor, it's important to note that this is a
25 liquidation. This is not a restructuring. And the cooperation

1 from the former or current directors and officers that was
2 negotiated as part of the Committee settlement is not dependent
3 on the release of those individuals. It is not a condition to
4 confirmation. We can't find it in the plan.

5 Your Honor, much has been said about indemnification
6 obligations that the debtors may have to certain of these
7 parties. And I want to talk about that solely in the context
8 of securities fraud claims.

9 Number one, securities fraud claims that form the
10 basis of indemnification requests, are statutorily subordinated
11 under the Bankruptcy Code, under 510(b). Just as the
12 litigation claims of my constituency are subordinated under
13 510(b) and those claims are not entitled to any recovery under
14 the plan. Contract claims, yes. Securities claims, no. So if
15 the debtors chose to assume those obligations for reasons I
16 can't possibly fathom rather than allow the Bankruptcy Code to
17 subordinate those claims, that, Your Honor, is, from our
18 perspective, that's on them.

19 Second of all, and equally important, is that most of
20 these individuals have already waived their indemnification
21 claims against the debtor as part of the Committee settlement.
22 So there is no risk with respect to those claims going forward.

23 The other thing that's important to point out is if
24 you look at the indemnification provision under the plan, and I
25 think it's Article VE at the top of Page 59 of the plan, the

1 plan specifically carves out any indemnification obligation to
2 any person for any cause of action arising out of or related to
3 any act or omission that is a criminal act or constitutes
4 actual fraud, gross negligence, bad faith, or willful
5 misconduct.

6 Now, there you have the clause that should be the
7 carve out with respect to the releases as well. But the
8 debtors utilize that carve out to deny any indemnification
9 obligations to anyone who ultimately is subject to a finding of
10 liability on that basis. And those are the claims in the
11 securities case.

12 So, there effectively couldn't be any indemnification
13 obligations running to these individuals if they're ultimately
14 found to be liable under the federal securities laws and with
15 respect to the claims raised in the securities litigation.

16 Your Honor, let me talk for a moment about the
17 gatekeeper provision and then, if you'll indulge me, I'd like
18 to go over some of the arguments the debtor made in the brief
19 that was filed yesterday that I think bear mention.

20 THE COURT: I'm going to ask if you could, 10-15
21 minutes?

22 MR. ETKIN: Yes.

23 THE COURT: Okay. Thank you.

24 MR. ETKIN: Sorry.

25 THE COURT: All right.

1 MR. ETKIN: We really echo the comments of the SEC
2 and the U.S. Trustee on the gatekeeper provision. All these
3 protections are already built in, especially in securities
4 litigation which is governed by the Private Securities
5 Litigation Reform Act. So those claims can't even go forward.
6 There can't be any discovery, nothing, until a motion to
7 dismiss is decided by the district court.

8 So, the district court is going to determine whether
9 those claims are actionable, whether they're subject to a
10 motion to dismiss, or colorable. That's fundamental to a
11 securities fraud litigation. And, Your Honor, you have enough
12 to do than to sit and ruminate over violations of the
13 securities laws and whether they're colorable or not, in the
14 debtors' words. That's a function of the district court.
15 These are non-core claims and there are serious jurisdictional
16 and constitutional authority questions that are baked into what
17 the debtor is requesting in connection with that gatekeeper
18 provision.

19 And now, Your Honor, with the remainder of my time,
20 I'd like to go over certain aspects of the debtors'
21 confirmation brief.

22 At Page 62 of their brief, in Footnote 175, they cite
23 several cases from this jurisdiction and others in favor of the
24 opt-out mechanism. What they don't say and what these cases
25 say, each and every one of them, Congoleum, Modell's, SLT

1 Holdco, Aceto, a case I'm somewhat familiar with,
2 Saint Michael's Medical Center. They all contained the fraud,
3 willful misconduct, and gross negligence carve out. All of
4 them.

5 If that carve out were in this plan, Your Honor, you
6 wouldn't have to worry about me holding my tongue and limiting
7 myself to 15 minutes. I wouldn't be here by virtue of the
8 standard carve out provision in these cases. And the debtors
9 cite each and every one of them.

10 They obviously cite Bed Bath and Beyond, a case that
11 Your Honor decided a few weeks ago. Similarly, Bed Bath and
12 Beyond, if you look at the plan, they have the same carve out
13 provision with respect to fraud, gross negligence, and willful
14 misconduct. And then they cite the Lannett Company, Inc., case
15 at Page 63 of their brief in the footnote. I happen to be
16 involved in that case too. And what happened with respect to
17 the same constituency, putative class members in a securities
18 fraud class action, they were allowed to opt out on a class-
19 wide basis. So, again, it was no issue for them in that case.
20 It was resolved.

21 Similarly, they cite the Court's decision in Cobalt,
22 which is a case that was before Judge Isgur in the Southern
23 District of Texas, a case I'm also somewhat familiar with, with
24 Kirkland and Ellis on the other side. In that case, they cite
25 favorably but neglect to point out that putative class members

1 were allowed to opt out on a class-wide basis so they would not
2 be bound by the release.

3 So there are ways to resolve these issues, ways that
4 we've utilized in the past to resolve these issues. But the
5 case law, even the string of cases that the debtors cite,
6 obviously favor the inclusion of that general fraud carve out.
7 And if you look at their brief, Your Honor, they give you the
8 reasons why that shouldn't be included in this case. And the
9 reason, at least as far as I can tell reading it, is because
10 there's so much fraud here and there'll be so much litigation
11 that we've got to avoid all of that. That's really what the
12 argument is, that this is a case littered with that kind of
13 misconduct.

14 That's not a reason to release those claims. And,
15 Your Honor, just a couple of comments on the arguments that the
16 debtors' counsel made with respect to their presentation a
17 little earlier. Everything that was referred to in that
18 argument is hypothetical, conjecture, without any factual
19 basis. The floodgates argument, I've heard that a few times
20 over the years with no basis as to how that's going to happen
21 and no basis to determine that litigation would be frivolous.
22 They'd be just showered with frivolous lawsuits.

23 There are ways to deal with that, too, Your Honor, if
24 it were to come to pass. But not by preventing someone, either
25 on a class-wide basis or individually, to assert those kinds of

1 claims, especially, especially in a case like this.

2 I also heard mention that we have the opportunity to
3 certify a class in the context of this case, and it's hard to
4 certify a class where a lead plaintiff hasn't been appointed
5 and the case has been enjoined so that just wasn't practical.
6 It wasn't an option with respect to this case given the timing.

7 Your Honor, we're not substituting our judgment for
8 the judgment of class members who likely don't have a clue as
9 to what they did or the impact of not opting out. We're just
10 trying to give them the opportunity to assert claims that they
11 have or not. That's what this is about.

12 It's about giving people the opportunity to assert
13 these claims and then the judicial system will do its part with
14 respect to determining whether these claims have merit or they
15 don't. But to cut them off at the knees at this particular
16 juncture without the opportunity to have them see the light of
17 day is really inappropriate and not justified.

18 We're not looking to blow up this plan, Your Honor.
19 We have no objection to all of the substantive provisions of
20 the plan regarding distribution, classification, all of that.
21 We're just looking to preserve rights for people who really
22 weren't in a position to make that decision themselves.

23 So with that, Your Honor, unless the Court has any
24 questions, and hopefully I kept to my 15 minutes.

25 THE COURT: You did a good job.

1 MR. ETKIN: Thank you, Your Honor.

2 THE COURT: Thank you, Mr. Etkin. At this point, I
3 don't have any questions.

4 I see there's a Joanne Gelfand who has a hand raised.
5 Is there anyone else in the courtroom who wishes to make
6 argument?

7 (No audible response)

8 THE COURT: Ms. Gelfand, I'll get to you in a moment.

9 MR. NEVE: Thank you, Your Honor. Brett Neve of
10 Latham and Watkins on behalf of the joint liquidators of Three
11 Arrows Capital.

12 Your Honor, I can confirm Mr. Petrie's comments and
13 representations that we have agreed to order language in the
14 order that would resolve our objection today. And that
15 language I understand will be included in a revised order that
16 will be submitted. And we thank the debtors and the Committee
17 for working with us to resolve those issues.

18 There are still, of course, a number of issues
19 outstanding as it relates to Three Arrows and its claims,
20 specifically the debtors' pending estimation motion, claims
21 objection, and our motion for relief from stay. We'll next be
22 before Your Honor on those issues on the 10th. Those issues
23 aren't for today. They don't affect confirmation today.

24 My comments are intended to briefly preview where we
25 see things going as it relates to Three Arrows. And in

17 THE COURT: Do you have a nice location picked out?
18 (Laughter)

21 I understand that we've reached out to chambers
22 regarding scheduling and plan on seeking to shorten notice so
23 that that can be heard together with the other issues that
24 affect process moving forward on the 10th. And given that
25 outreach, just wanted to preview for Your Honor that that would

1 be coming.

2 THE COURT: All right. Thank you, Counsel.

3 Thank you, Mr. Kanowitz for your restraint.

4 Anyone else in Court?

5 (No audible response)

6 THE COURT: Ms. Gelfand. And then I know my court
7 reporter and others would like a break.

8 Ms. Gelfand, let me hear from you. Thank you.

9 MS. GELFAND: Thank you, Your Honor. Joanne Gelfand,
10 Ackerman LLP, on behalf of creditor John Lymn.

11 Your Honor, I had hoped to be here in person. I'm so
12 sorry I'm not. Between the holiday and a little travel snafu,
13 I find myself on Zoom. Initially, Your Honor, I want the Court
14 and everyone in the courtroom to understand, there is no desire
15 to derail the plan. However, we had to bring this matter up to
16 the Court and that we've worked and tried to really settle this
17 with the debtor. We've been in constant touch with them since
18 the modification was filed last Thursday.

19 And, in fact, we were the party that brought it to
20 the debtors' attention that their release actually looked more
21 like a general release, and it actually released the objections
22 to claims. We didn't spring it on them and let them go through
23 confirmation with this problem in the plan.

24 The starting point, Your Honor, would certainly be
25 the release and the modification. The release is of all causes

1 of action, and as you know, this release is available to
2 accepting creditors who do not opt out of the third-party
3 release. The release language provides very broadly that all
4 causes of action are released, and they include in the release
5 language claims, cross claims, damages, controversies, demands,
6 obligations, liabilities, debts arising under law, and then the
7 debtors add this sentence to the definition of causes of action
8 being released. "For the avoidance of doubt, causes of action
9 include any right to object or to otherwise contest claims or
10 interests that claims objections are being released."

11 In response to our pointing this out to the Committee
12 and the debtor, a modification was filed, I believe, last
13 Friday. The modification creates an ambiguity in the plan.
14 The modification, which does not modify causes of action, it
15 modifies the article of the plan, Article 8, which is the
16 general release provision. At the end of this general release,
17 releasing all causes of action, including, as I've stated,
18 claims objections, the modification states as follows, "For the
19 avoidance of doubt, nothing in this plan shall release waiver,
20 otherwise limit the debtors, or (indiscernible) now we have a
21 plan (indiscernible) for confirmation that's ambiguous on its
22 face."

23 I know the debtor is asserting that taken as a whole
24 and bringing the disclosure statement into the analysis, it's
25 clear that claims objections were not waived. But that's just

1 not so. First of all, the plan is entirely consistent with the
2 release of the claims objections. First of all, of course, we
3 have the explicit language, and then we turn to Article 7,
4 which the debtor hangs their hat on.

5 Article 7 deals with claims objections and gives a
6 great deal of power to the wind down debtors to bring claims
7 objections, and we've been accused of trying to wipe out a
8 meaningful claims objection process. Nothing could be farther
9 from the truth, and that's just not what will occur.

10 We heard from the debtor today that more than 10,000
11 creditors opted out of the third-party release. That means
12 more than 10,000 creditors are not entitled to the release of
13 their claims objections. Kroll filed their certification and
14 they attached 326 pages listing the opt-out creditors 20 or 25
15 a page. So we will have a robust claims objection procedure as
16 to the opt-out creditors, Your Honor.

17 Your Honor, there are other things in the plan that
18 show it's consistent with the release. Again, going back to
19 Article 7 claims objections. The first sentence in Article 7
20 dealing with claims objections, is "Except as otherwise
21 provided herein." So the released claims have clearly been
22 excepted.

23 Then we go to Article 4(c)(2) of the plan.
24 Article 4(c)(2) speaks to the release of all claims "other than
25 retained claims." Then we go to the debtors' schedule of

1 retained causes of action. In the middle here, after going on
2 and on about what they're retaining and getting to these
3 claims, it says, "Unless any cause of action is expressly
4 released," excepting again from the retained causes of action
5 these released objections to the claim.

6 The debtor has asked the Court to consider the
7 disclosure statement in determining whether or not the release
8 covered claims objections. Clearly, it appears improper to
9 bring in this parole evidence. We know the disclosure
10 statement has many warnings about reliance, and of course it
11 provides, as they do, that the plan would govern any
12 inconsistency. Yet the disclosure statement is completely
13 consistent.

14 The debtor argues that Article 11(A)(2)(j) and (o)
15 dealing with treatment of claims and estimation show that the
16 objections to claims was never released. Again, both of these
17 sections have a preface, which is "except as otherwise provided
18 in the plan." So again, they're releasing these claims
19 objections.

20 We now have an ambiguous claim, excuse me, an
21 ambiguous plan as modified. Offering Mr. Lymn the opportunity
22 to change his vote just wasn't a fix. Mr. Lymn is one of many
23 creditors affected by this. This affects all accepting non-
24 opt-out creditors. The Committee had the timing a bit wrong.
25 I placed a call to the Committee on Friday, September 15th,

1 scratching my head about why the claims objections were
2 released. I will note were also released in the
3 (indiscernible) case. It's the exact same language, so it's
4 another common issue here.

5 Changing the vote was not in Mr. Lymn's interest. He
6 voted to accept the plan as is and to release the claim
7 objection against his claim. Your Honor, Rule 3019 is clear
8 that a modification may not adversely change the treatment of
9 any creditor. And in fact, the Eleventh Circuit last year in
10 the In re America-CV Station Group case, reversed the
11 bankruptcy court, finding that a shareholder who either was not
12 entitled to or rejected the plan was entitled to resolicitation
13 and new disclosure because the modified plan eliminated the
14 shareholder's right to purchase certain equity. The Eleventh
15 Circuit pointed to the language in 3019 saying the treatment of
16 any creditor, and determined that even the shareholder who may
17 not have been entitled to vote was covered by it and the court
18 knew it would be difficult to unwind things, but sent things
19 back, essentially saying, figure it out to the Southern
20 District of Florida, which is my hometown.

21 We would ask the Court to confirm the plan without
22 the modification. Otherwise, this does not comply with
23 Section 1129(a). It violates Section 1127 and 1120
24 (indiscernible) baffled by the (indiscernible) resolved
25 (indiscernible) one claim with the debtor.

1 Mr. Lymn is not the scoundrel here. He
2 (indiscernible) through the modification to the release.

3 THE COURT: Ms. Gelfand, unfortunately, we're having
4 transmission issues and a lot of your argument is not coming in
5 clear.

6 The Court has the benefit of the written objection.
7 The oral argument is proceeding along the same lines as the
8 written objection. I can accept the written objection and rule
9 on it. If you want to try to sum up, see if --

10 MS. GELFAND: I would like to do a reservation of --
11 I would like to just conclude with a reservation of rights,
12 Your Honor. Can you hear me?

13 THE COURT: Yeah. We have that on record. The
14 reservation of rights.

15 MS. GELFAND: Okay. Of all rights, and we would be
16 happy to, even now, if the Court's taking a recess, to speak
17 with the debtor.

18 Thank you, Judge.

19 THE COURT: Thank you, Ms. Gelfand. I don't know on
20 whose end the transmission problem is but thank you for your
21 efforts. You are free, obviously, to reach out for counsel. I
22 am taking a 15-minute break.

23 It is 3:30. We'll come back at 3:45 or so. And
24 thank you all.

25 (Recess at 3:29 p.m./Reconvened at 3:47 p.m.)

1 THE COURT: Before I turn to debtor's counsel, I
2 don't see anyone else remotely who wishes to be heard. We've
3 outlasted them.

4 Let me hear a reply, debtor's counsel.

5 MR. PETRIE: Yes, Your Honor.

6 For the record, this is Francis Petrie of Kirkland on
7 behalf of the debtors.

8 So not much has changed since my initial
9 presentation, in my view. We've heard from each of the
10 objecting parties, and there's two main points that I believe
11 came out of that.

12 First, the third-party release is consensual. And in
13 a consensual case, you and others have held that a lot of
14 things can be bargained for and anything can be released.
15 Though things like fraud at carve out cannot be discharged,
16 they can still be released in such a structure.

17 The opt-outs that we've seen in this case are higher
18 than you've ever seen. And each of those parties who consented
19 to that release understood the scope of what they were either
20 releasing or what they were not releasing.

21 Every individual in this case had the option to opt
22 out. And that structure was something we negotiated for in the
23 terms of the settlement. Even accepting parties had the option
24 to opt out here. But the release parties negotiated for that
25 limited structure and limited the universe of non-release

1 claims.

2 The massive amount of opt-outs I've received in this
3 case is evidence of their consent, if anything. There was
4 notice of what these individuals agreed to, and all they had to
5 do was perform basic diligence to figure out what they were
6 going to be releasing and when.

7 So then to take on the other main argument that came
8 out here, which was about the scope of the gatekeeper
9 provision.

10 First, the gatekeeper provision only applies to the
11 extent that this court has jurisdiction. It's not an attempt
12 to front run anything, and no party is better than this court
13 to make determination of determining the scope of the
14 confirmation order and the plan.

15 Those are the only things that we are asking this
16 court to do. And I think beyond that is not something that we
17 are actually looking for.

18 I'll also address a few other arguments that were
19 made by the U.S. Trustee. First is about the limitation to the
20 injunction.

21 The purpose of the injunction is designed to protect
22 what is being confirmed. We're not seeking a discharge through
23 this plan, and a time limit can't be agreed to, because at the
24 point property is distributed is when an injunction would be
25 most important.

1 A lot of their other arguments are mooted by the fact
2 that the third-party release is consensual in settling claims,
3 but we did remove language that made specific reference to 9019
4 in certain sections to replace it to the extent provided for by
5 the Code.

6 And just to be clear, the undeliverable ballots issue
7 for those parties who do not receive actual notice, they are
8 not subject to the releases. And we're happy to make the other
9 notice amendments that you requested about the parties who can
10 elect to make other post-confirmation elections under the terms
11 of the plan.

12 To address Mr. Wyatt's arguments, as I stated before,
13 in this circuit not opting out equals consent. First, we do
14 still maintain that he does not have standing to bring these
15 claims. He is not the lead plaintiff in a class action. He is
16 a large claim holder in a class action and the class has not
17 yet been certified.

18 And further, he has opted out of the release, so he
19 personally will receive no injury, and he has no standing to
20 object on behalf of others.

21 10,000 parties did opt out of providing the release,
22 and he has provided no evidence to the contrary that these
23 parties didn't know exactly what they were doing when they
24 opted out, nor is there evidence of any sort of damage that
25 would be suffered by his client.

1 As a result, we do confirm that he has no standing to
2 object to these claims on behalf of others. If they wanted to
3 preserve their claims, they could opt out, but they do not need
4 an individual passing their judgment for them.

5 It's also possible that there's a world where there's
6 claimants who actually are seeking to get the release from the
7 debtors, because they think BlockFi has a claim against them.
8 The possibilities are endless in this, and he has presented no
9 evidence to the contrary. However, the balance of the evidence
10 does cut in our favor here.

11 And then, just to briefly address the last objection
12 about the plan modification, I don't think -- what I said
13 earlier still stands. Nobody could read the plan to believe
14 that the claims objections are being released are terminated
15 resulting in an absurd result where a bunch of asserted claims
16 would be actually allowed against the estate. And we've
17 provided a lot of evidence about how that was not the intention
18 of that portion of the plan.

19 Thank you, Your Honor.

20 THE COURT: All right. Thank you.

21 MR. PETRIE: I do believe the Committee would like to
22 speak.

23 THE COURT: Mr. Aulet.

24 MR. AULET: So I have a few responses, and then I
25 believe Mr. Stark will want to speak at closing or now,

1 whichever would be appropriate.

2 THE COURT: That's fine.

3 MR. AULET: Thank you.

4 So, basically two responses to points.

5 The SEC and a number of other parties pointed to a
6 lot of the sections in the gatekeeper provision, but I just
7 wanted to direct your court's attention to another provision
8 that was very heavily negotiated.

9 It says, in essence, that provided a party opted out,
10 nothing in this plan or confirmation order prevents releases or
11 obstructs a properly pled direct claim.

12 And I think that, combined with all the statements
13 that the debtors have made on the record, makes clear what this
14 gatekeeping function is and is not. This is about making sure
15 a claim is a direct claim before letting it proceed. It's not
16 about making Your Honor the judge for any and all claims
17 against the release parties on the merits.

18 As for the issues regarding the modification of the
19 plan to make it clear beyond dispute that the claims can still
20 be objected to, there is any number of provisions in the plan,
21 both before and after the modification, that could be pointed
22 to to show that it was always intended that parties have the
23 right to object.

24 To the extent that there's any ambiguity, counsel
25 pointed out, it's been clarified in the plan. It's been

1 clarified on the record. Everybody understands now what this
2 plan means. This plan means that even if you did not opt out
3 of the release, your claim filed against BlockFi is still
4 subject to an objection to make sure that you receive the claim
5 that you are entitled to.

6 Anything else penalizes other creditors or
7 potentially the creditor themselves if they filed an amount
8 that's too low.

9 You could hold, simply based on all of the provisions
10 that make the wind-down debtor partially a successor to the
11 Committee as well, which has its own right to object to claims
12 as a party in interest. And any other creditor would always
13 have the right to object to any claims.

14 So to the extent that Your Honor thinks there's any
15 ambiguity left in the plan, I don't think that anybody would
16 object to something clearly being stated on the record that
17 it's clear that anybody's claims are subject to objection to
18 make sure that everybody gets the claim that they are entitled
19 to.

20 Thank you, Your Honor.

21 THE COURT: Thank you, Mr. Aulet.

22 Mr. Stark.

23 MR. STARK: Thank you, Your Honor. And thank you for
24 allowing us to switch counsel. I know that's not normal.

25 THE COURT: Not a problem.

1 MR. STARK: For the record, Robert Stark from Brown
2 Rudnick, also appearing on behalf of the Official Committee.

3 Just a few words, if Your Honor will allow me, just
4 retracting the lens a little bit, okay, and a little bit of
5 case summation, because I'm a little bit fearful at this
6 moment, after the argument.

7 And they were very persuasively stated, but they're
8 on teeny, minute aspects of a plan, and I worry that for
9 focusing on the bark on the tree, we lose sight of the entire
10 topography.

11 So if Your Honor will allow me just for a few
12 minutes, and I won't take too much time.

13 The first sentence of our statement in support of the
14 plan states as follows: These cases have been hard,
15 quote/unquote. Five words. And those five words were intended
16 to be poignant, not as a matter of advocacy, but as a matter of
17 fact.

18 The truth is, crypto bankruptcy cases, all of them,
19 are hard, and this case is hard. In our milieu here, unlike
20 Bed Bath & Beyond and Biopharma, and all the other cases that
21 have been cited to in the briefs and talked about today before
22 Your Honor, we have issues that not only go to typical
23 bankruptcy blocking and tackling, who gets what, who owns what
24 between wallets and BIAs and lending -- how hard was that
25 issue? And that's just normal blocking and tackling for any

1 bankruptcy case.

2 Then we delve into a thorny litany that begins and
3 then proceeds well beyond what I'm about to do now. How did we
4 get here? Who is responsible for the business failure? How do
5 we maximize value if we're not going to rehabilitate a
6 business? How do we wrap this up? Who is going to be
7 responsible for the wrapping up? And a million other tough
8 questions.

9 The litany is very long, as Your Honor knows so well.
10 And business failure always, automatically, seeks into blame.
11 And there's a lot of blame, and there's a lot of anger in this
12 case. Let's be honest about that. There's been a lot of anger
13 in this case.

14 And meanwhile, we've had massive monthly
15 deterioration about tracked where everybody's talked it known.
16 If this case does not end quickly, did not end quickly, massive
17 amounts of erosion every month.

18 And meanwhile -- and this is critically important --
19 we are separating people's life savings from their own bank
20 accounts. Pause on that for a minute. The customers, the six
21 hundred-odd thousand people who have deposited with BlockFi
22 cannot get their money for things that they need for their
23 daily lives.

24 That's a big responsibility that we in this room and
25 Your Honor have had to deal with for almost a year. And that's

1 a terrible burden.

2 In crypto bankruptcies, the crucible of Chapter 11
3 burns hotter. It just does. And in this case, it burned very,
4 very hot. This is not retail or Biopharma or any widget
5 company. This is crypto, and we have to think about it in that
6 milieu, because it is different. And we have to behave in this
7 case and think about things differently, and we've done that.

8 But even in this hot crucible, we have a job to do,
9 and we've done our job. We have to get to a resolution, and a
10 resolution that creditors can support and they do come out and
11 support in mass volumes. That, I think, is important.

12 But also of critical importance is that we have to be
13 able to walk away from this bankruptcy case, what happens
14 today, one way or the other, and be able to look back on today
15 in hindsight and ask ourselves was it a reasonably balanced
16 outcome? Was a rough justice fair? And do we have systemic
17 and process integrity?

18 Those are the three concepts that I'll throw out
19 today for Your Honor to think about, because we do think that
20 was done here. Of course there are attributes of the deal that
21 we don't like and they don't like and everybody doesn't like.
22 Certainly it wasn't fast enough or it wasn't inexpensive enough
23 or what have you.

24 But think back on it. It was quicker than every
25 other crypto bankruptcy case out there. It was a whole lot

1 less expensive than any other crypto case out there. It was
2 open. Everyone knows what happened and everybody could see
3 everyone's side, and everyone could choose their own path.

4 They could choose to give the release or not give the
5 release, no strings attached one way or the other, move forward
6 and make a decision. More disclosure than anyone has ever
7 seen. Okay. It is balanced.

8 Nobody really likes the outcome. Everybody feels
9 aggrieved in one way or the other, which I gather -- I hate to
10 say it, because it's trite, but isn't that the definition of a
11 deal, a settlement that's quality, when no one is happy with
12 it? Is it rough justice? Your Honor will be the determiner of
13 that. But the creditors have spoken. They voted en masse in
14 favor it.

15 And does it evidence systemic and process integrity?
16 The adversary process in this case was hot, because we were in
17 the heated crucible of crypto bankruptcy, and it came out with
18 a deal that was hot, that has been accepted and accepted
19 broadly, and we now have time to heal.

20 I'd like to add two more points, just to make sure
21 our topography is right. I don't want to lose sight of the
22 forest for the trees, to use another trite phrase.

23 And first is a comment about the Committee. Now, I
24 get it. At this moment, Creditor Committee lawyers love to get
25 up and talk about how great their committee and love their

1 committee, and it's rote. And I really at this moment don't
2 want to do that. Okay.

3 What I want to do is speak again is fact, and not
4 advocacy. Although it will come out as advocacy, it is 100
5 percent from the heart.

6 For the Committee, this was not a quote/unquote hard
7 case. For the Committee, this case was impossible. It was all
8 consuming, time and energy. It was gut wrenching in every
9 attribute of the word. It was an emotional roller coaster.

10 And it was more than just the analytical, economic
11 analysis that we have to do. It was emotional in many
12 respects.

13 To do this job, we analyzed, we re-analyzed, we
14 discussed, we analyzed again. We fought amongst ourselves.
15 Not weekly. Every single day. We analyzed, we analyzed, met,
16 fought, discussed, we analyzed and did it again. Okay.

17 This was -- I've been doing this for a while. This
18 was one of the hardest, if not the hardest committee assignment
19 I've ever had, and I will always remember it. It was that
20 hard.

21 As Your Honor knows, committee members are not paid.
22 And this was a full-time job, and many of them had to move away
23 from their daily employment activities to be able to pay
24 attention to this case as they needed to do that. That was
25 great sacrifice.

1 But here's an important part that I know Your Honor
2 is aware of as well. We faced criticism and worse almost every
3 day in the chat rooms. The pressures, the threats. What we
4 were doing and trying to do for everyone was faced with a
5 constant barrage of what are we doing and why are we doing it
6 and we must be doing something wrong.

7 The easiest thing is to throw in the towel. The
8 hardest thing to do is to be dogged about it through
9 litigation, first in mediation, then a second mediation, and
10 then a settlement.

11 And there's a truism, at least in terms of what I
12 find in life, is that it's very easy to threaten, it's very
13 easy to strife someone in an anonymous way, say in a chat room,
14 and almost anyone -- anyone can do that. Almost anyone can and
15 is willing to levy an attack in a courtroom, because you can in
16 America with minimal repercussions.

17 Fewer will do the work. And fewer still will have
18 the brainpower and, importantly, the stomach to settle. That's
19 the continuing. It's easy to attack and to threaten. It's
20 hard to settle. And that's what we had to do.

21 And I say all that in a way to laud the Committee for
22 all the did, but more importantly for purposes of now, at this
23 moment, looking at the topography, knowing as Your Honor, I
24 know, knows how hard it was to get here, let's not lose sight
25 of that data to inform how hard this was.

1 The second point is I'd like to go back to some
2 pretty tough days in July in this courtroom and in the hallway.
3 And there weren't many people with us. Your Honor was with us.

4 I've had the privilege to appear before bankruptcy
5 courts all around this country in many different kinds of
6 cases, and I've been involved in many cases, mired in complex
7 issues, and I've been sent to mediation many times. Many of
8 those times have failed.

9 And then what happens next is devolution of the case
10 into litigation, and hopefully a settlement on the courthouse
11 steps after a long administrative burn, and sometimes we go to
12 judgment.

13 Never before have I experienced a case where, when
14 mediation failed, rather than allowing the case to seque
15 automatically into that litigation devolution, the judge, Your
16 Honor, arrested the falling knife and said, "We're going to try
17 this one more time. Get in that room and figure it out, and I
18 will guide you."

19 Never before has a judge changed personal scheduling
20 and court scheduling to focus personally and specifically on
21 the case at hand to avoid the disaster that we knew was going
22 to happen next for all of those people who are listening who
23 are separated from their life savings and then from November
24 when the case filed until it got to a deal, you folks will sit
25 in a room until you figure it out. And figure it out we did.

1 That was a privilege to watch. And that's something
2 that everybody should be aware of. But what's critically
3 important as we listen to the objections today is to remember
4 -- because in bankruptcy we forget so quickly -- to remember
5 where we were on those hot afternoons here, when the air
6 conditioning wasn't working so well, and we figured it out.

7 And now we are, a couple of months later, with
8 overwhelming creditor support, we cannot lose sight of the
9 forest for the trees and go back to those days or spend more
10 months in bankruptcy over rather small issues.

11 It was an incredible privilege to work on this case.
12 It was an incredible privilege and an honor on my career to be
13 in this case before Your Honor, being guided by Your Honor, and
14 to working with this committee. I'm very thankful in my career
15 for that opportunity. It's time for this case to end.

16 Any questions from Your Honor?

17 THE COURT: No, I don't. Thank you, Mr. Stark.

18 MR. STARK: Thank you.

19 THE COURT: I appreciate your comments.

20 Is there anyone else who wishes to be heard? No one
21 wants to follow that. But I have to.

22 All right. Thank you all. Very well argued.

23 The record is closed. The Court has listened to oral
24 argument.

25 I'll echo Mr. Stark's reference to the uniqueness of

1 cryptocurrency cases, and this case in particular. Novel
2 issues, evolving precedent that changes day to day as our
3 sister courts in the Southern District decide issues and
4 Delaware decide issues for the first time anywhere in the
5 country and as this court decides issues for the first time.

6 It's been difficult, and it's been challenging. And
7 what we have in this Third Amended Plan, as modified with
8 technical changes, is a compromise. And to address Mr.
9 Sponder's concern, I agree, this is a settlement within a plan.

10 But we're confirming a plan. And, yes, so there's no
11 surprise, I intend to confirm the plan today. I find that the
12 plan satisfies the 1129(a) requirements.

13 But I need to address the issues and the objections
14 that have been raised. The plan embodies a settlement which
15 was aggressively and painstakingly negotiated through failed
16 mediations, through multiple settlement sessions, and it was
17 only truly the dedication of the parties in not wanting to see
18 a failed effort, and counsel.

19 And when I speak to parties, the Committee members,
20 the debtors' management, the professionals involved. All
21 really worked together to produce a settlement that satisfies
22 all and no one at the same time.

23 There are unique aspects of this settlement and this
24 plan that we do not see in other cases. And as Mr. Maza points
25 out, we are seeing some more recently than we've seen in 30

1 years, in three decades worth of cases. The law evolves, the
2 practice evolves, the needs of the parties change and sometimes
3 necessitate changes in how we practice.

4 Let me get to specifics. With respect to the opt-out
5 provisions, it is no secret that this court has approved in the
6 past in Sur La Table -- let me get my French accent -- in Bed
7 Bath & Beyond recently and Loxidah (phonetic) and a host of
8 cases. This court, I, as well as my colleagues within the
9 district, have approved opt-out releases, the lynchpin being
10 the proper notice.

11 And in here, there's no question, in this court's
12 view, that there is proper notice to the creditor body at
13 large, to the stakeholders, through a hearing notice, through a
14 disclosure statement, through a plan which has language
15 advising the parties of the ability to opt out and the need to
16 opt out to preserve their rights.

17 Beyond that, there are websites which -- with pages
18 addressing the issues that were put together by the debtor.
19 There were the plan and disclosure statement which had that
20 language. There's the ballot that had the language. There was
21 the solicitation letter drafted by the Committee explaining the
22 process to creditors.

23 There is no question that creditors were placed on
24 proper notice.

25 Now, Mr. Etkin quoted concerns raised by a colleague

1 and friend, Judge Wiles in the Southern District, with respect
2 to consensual releases. And let's be clear, these are
3 consensual releases because those who don't want to
4 participate, who want to bring their claims, notwithstanding
5 how they vote, had the ability and option to opt out and not
6 doing so, made a conscious choice.

7 Now, going back to Judge Wiles, he and I have a
8 different view as to faith in individuals, faith in -- or maybe
9 not even faith, but expectations of individuals and their
10 ability to protect their own interests and engage in individual
11 responsibility.

12 I think 10,000 plus creditors who opted out confirms
13 -- gives me comfort in knowing that the opt-out provisions
14 work, that creditors can be expected to protect their interests
15 and take the minimal effort of a checkbox on a digital form or
16 a paper form to secure their rights.

17 I expect, and I think as a society -- and I said this
18 at the Bed Bath & Beyond hearing -- we have a number of
19 examples where expect action to preserve your rights. You have
20 to answer a summons or complaint. You have to respond to a
21 jury demand. You have to unsubscribe. You have to reject
22 cookies.

23 There are things you have to do, and we do it all the
24 time. And simply checking a box to preserve your right is not
25 onerous, is not an obstacle, and is not a hindrance as long as

1 you're on notice of the need to do so. So we go back to that
2 notice provision.

3 And in this case, these facts and the manner in which
4 the process was undertaken, it was clear that there was notice.

5 Now, did the plan and disclosure statement describe
6 all of the possible claims or the securities -- potential
7 securities fraud claims? No. It didn't go into specific
8 claims. It referenced many, but there are a host of potential
9 claims that non-parties can bring against non-parties.

10 But what was clear was that there was going to be
11 release of all claims. It didn't need to go into specifics.
12 The releases and the language and the notice, it was clear that
13 by failing to opt out, you were -- the creditors were releasing
14 their claims, whatever they may be.

15 The Court views these as proper consensual releases,
16 consistent with the law in the Third Circuit, consistent with
17 the law as set forth by colleagues in similar cases.

18 As to the gatekeeping function, likewise, I'm sure
19 counsel is aware I did approve that recently in Bed Bath &
20 Beyond. It's a form of protection negotiated relief available
21 for those making a meaningful contribution to a Chapter 11
22 case, and it ensures the benefit of the bargain, so to speak.

23 It is not an assertion of jurisdiction over that
24 which I don't have. It's limited to what the Code and the
25 Judicial Code allow me to decide. But what it serves as is a

1 method of, frankly, preserving judicial economy and preserving
2 the centrality of the bankruptcy court as a forum to decide --
3 an appropriate forum to decide what the meaning of the plan is,
4 what the meaning of the confirmation order is and how does it
5 -- and how do potential claims fall within the plan and
6 confirmation order.

7 While the use of gatekeeping functions in plans may
8 be a newer phenomenon that we see a lot in the Fifth Circuit
9 and the bankruptcy courts and we have mixed views within our
10 circuit, the actual mechanism isn't new.

11 This court -- I've sat for 17 years. I can point to
12 countless cases where I've been asked to interpret confirmation
13 order, interpret a plan, because this court is best equipped to
14 do so.

15 It makes no sense to urge parties to make
16 contributions to a Chapter 11 case and in return secure
17 releases or secure certain rights that will be undercut by then
18 having to defend their position all across the country in front
19 of separate courts in separate forums, with inconsistent
20 results.

21 The gatekeeping function ensures that a single court
22 with the closes hands-on and understanding of the plan and the
23 terms of the confirmation order make an initial threshold
24 determination as to whether a claim is direct or derivative and
25 whether it's been released.

1 It serves the interest of those who bargained for
2 certain rights in making contributions and it serves the
3 interest of even the plaintiffs in not spending time and money
4 on a claim that will have no traction.

5 It is not burdensome. And as I said in other
6 hearings, we end up in the same place anywhere. When these
7 actions are brought, somebody is bringing it back to the
8 bankruptcy court to determine whether or not it's a discharge
9 injunction, it's a plan injunction violation, it's a stay
10 violation -- well, it wouldn't be a stay violation any longer,
11 but an injunction, whether it's inconsistent with the plan or
12 the terms of the order.

13 It comes back to this court anyway. So we're just
14 putting in place in language what is the practice. I have no
15 issue with the scope or the provisions of the gatekeeping
16 function.

17 Going back to some of the more specific concerns, I
18 will ask that the confirmation order make it clear that the
19 Court is approving the plan which embodies a settlement and
20 that approval of the plan is based on satisfaction of 1129, as
21 opposed to the Rule 9019 standards.

22 I will ask that there be language in the confirmation
23 order that directs the wind-down -- the individual in charge of
24 the wind-down to give the proper notices with respect to the
25 loan repayments. I would urge you to get the language asked

1 for by the U.S. Trustee.

2 I am not mandating any change to the release with
3 respect to willful misconduct or gross negligence or fraud
4 claims, because it goes back to the issue of the bargain that
5 was put in place in the settlement and the negotiated relief
6 and the fact that these claims, like all claims, you don't have
7 to break it down to certain claims.

8 Those who do not take advantage of the opt-out
9 knowingly waived rights to pursue claims of any sort, and so
10 there's no need to break it down further into subcategories.

11 I will lay out just for the record that the
12 discussions of opt-out, the benefits and burdens of opt-outs
13 weren't just limited to information available on websites and
14 in the documents.

15 All you had to do, as Mr. Stark suggested, is go on
16 any of the social media, go on Reddit. Pages and pages of
17 themes discussing the opt-outs. The public understood the
18 meaning of it. And it was a conscious decision in exchange for
19 ensuring that the plan goes forward, in exchange for ensuring
20 that there would be personnel knowingly, with the capacity to
21 arrange for in-kind distributions, to make the process work, in
22 exchange for waivers of certain clawback claims that agreed to
23 accept a plan that didn't offer everything that they would want
24 but allowed the case to emerge -- allowed the debtor to emerge
25 and start the process of getting individuals the funds to which

1 they were entitled.

2 With respect to the objection -- I know I'm doing
3 this haphazard, but you all spoke for a long time, and I'm just
4 trying to go through my notes.

5 With respect to the Wyatt claim, let me be clear. I
6 disagree that there is no standing. Cameron Wyatt had standing
7 to raise the objection. This is a combined disclosure
8 statement and confirmation hearing. Mr. Wyatt is a creditor,
9 an individual creditor at a bare minimum, and thus could raise
10 issues as to disclosure, and I don't know how you carve out
11 standing from one aspect of a hearing to another.

12 So I'm not overruling Mr. Wyatt's objections based on
13 standing. I am overruling them based on the merits. I
14 disagree as to the concerns raised with respect to the scope of
15 the releases, the process, and I find that there was due
16 process in the manner in which it would have proceeded.

17 With respect to the objection raised on behalf of
18 John Lymn, if I accepted the analysis proffered by counsel, we
19 would have an absurd result where you would, simply by
20 accepting -- casting an accepting ballot you, in effect, could
21 load up a claim and there could be no objections.

22 FTX could have added hundreds of millions of dollars
23 to a claim and just accepted -- filed an accepting ballot and
24 there could be no objection. The debtor can't negotiate away
25 another party -- their ability to object to a claim. It just

1 -- it's not feasible. It's not likely.

2 When you read the disclosure statement as a whole, I
3 think it makes it clear -- it's certainly acceptable for
4 approval that the claims process -- the claims resolution
5 process, the ability of the debtor and parties to object
6 continue, notwithstanding the releases, notwithstanding
7 affirmative votes.

8 But in any event, Mr. Lymn's claim is more properly
9 resolved through the claims resolution process. There is a
10 pending objection to the claim. Mr. Lymn is free to raise the
11 release in response to the debtors' objection, and I can
12 evaluate the issue further, but it's a valid part of the claims
13 allowance, not necessarily fatal to the plan confirmation
14 process.

15 The Court wants to note, of course, the overwhelming
16 acceptance of the plan by every class entitled to vote. That
17 has a bearing. And it should be the exception that a court
18 ignores the will of the parties that have the financial stake
19 in the matter.

20 There are times where it's appropriate. Today is not
21 one of them. None of these issues that have been raised
22 warrant upsetting the balance that's built into the settlement
23 that's part of the plan and that was negotiated.

24 I'm approving the disclosure statement as satisfying
25 requirements under 3016 and 3019.

1 Needless to say, I haven't had a chance to read
2 through -- I skimmed the revised proposed findings of fact and
3 conclusions of law.

4 Let me ask this of debtors' counsel. Is there
5 another version coming, or is that the last one?

6 MR. PETRIE: Your Honor, another version will be
7 coming.

8 THE COURT: There's always another version. I'll
9 await receipt of that and have a chance to take a look. If
10 there are language issues in the proposed findings of fact and
11 conclusions of law as revised, all parties are free to advise
12 chambers of concerns.

13 I don't anticipate having extensive hearings on them.
14 I could always take a conference call, if need be.

15 I want to thank the debtors' principals, management,
16 and, of course, the professionals for the effort in trying to
17 do the right thing to the best they can in a very difficult
18 situation, in unforeseeable circumstances. Likewise, the
19 Committee did extensive work.

20 And, again, also I want to note with respect to the
21 information available to the creditor body, to the stakeholders
22 that decided to opt out, let's not overlook that there were in-
23 depth investigations undertaken by both debtors' counsel and
24 independent directors and the Committee that these mammoth,
25 voluminous reports, in mostly unredacted version, were docketed

1 and made available through links.

2 There aren't many Chapter 11's where you would find
3 such transparency. And for that, I do thank the Committee and
4 its counsel, its professionals that insisted that that element
5 be part of the process. I think it was incredibly valuable to
6 assist the Court, but also the creditor body as a whole. As
7 long as we all don't look at Reddit too closely, we'll continue
8 to do the same.

9 Again, I appreciate the concerns raised by the Office
10 of the U.S. Trustee and the SEC. Very difficult choices. But
11 again, if it's a difficult choice, I think the Court ought to
12 lean in favor of the interest as expressed by the stakeholders
13 who voted so overwhelmingly to go forward.

14 Any issues or concerns that anyone wants to bring to
15 the Court? Mr. Sponder.

16 MR. SPONDER: Thank you, Your Honor. Jeff Sponder
17 from the Office of the U.S. Trustee.

18 Your Honor, you hit every objection of the U.S.
19 Trustee except for the injunction language, which we asked for
20 a limitation. I don't think I heard anything about it, but I
21 just wanted to alert you to that for a decision on that, if you
22 may.

23 THE COURT: I was going to overrule it. I understand
24 the debtors' concern with the time restraints on modifying the
25 injunctive language.

1 I guess it's not every case where it's appropriate,
2 like in all cases. But for purposes of the record, I am
3 overruling the objection. I am overruling the other objections
4 raised, except to the extent they have been addressed by the
5 debtor and modified in the technical changes in the modified
6 plan.

7 Mr. Etkin.

8 MR. ETKIN: Thank you, Your Honor. Just a quick
9 question.

10 The colloquy with respect to the gatekeeper provision
11 seemed to indicate, as well as Your Honor's statements seemed
12 to indicate the purpose is to deal with the question of whether
13 a claim is derivative or direct and also to deal with whether
14 the claim was released.

15 There is language in the gatekeeper provision, which
16 I still don't understand, relating to whether the claim is
17 colorable or not.

18 I didn't hear the debtor talk about that, and I would
19 just want some clarity as to whether that's going to remain in
20 the gatekeeper provision. And I believe it's going to, I
21 assume, create some of the same confusion, I feel, in terms of
22 wading into the merits of the claim.

23 THE COURT: All right. Let me have debtors'
24 response.

25 MR. PETRIE: Your Honor, I think we were clear on the

1 record several times that we're asking for two things in the
2 gatekeeper provision: First, a determination as to whether a
3 claim is direct or derivative; second, whether it's been
4 released by the plan.

5 And we would only ask for Your Honor to make those
6 rulings within the jurisdiction of this court.

7 THE COURT: Well, then why don't we include that
8 wonderful language we see all over the plan, for purposes of --
9 to be clear, for purposes of clarity, it can be cored as a
10 gatekeeper is expected to undertake this two-prong analysis.

11 MR. PETRIE: Yes, Your Honor. We can include that.

12 THE COURT: And, Mr. Etkin, it may not resolve the
13 issue as a whole, but it certainly should aid in clarity.

14 MR. ETKIN: It's better, Your Honor. Thank you.

15 THE COURT: I try to make it better.

16 All right. Mr. Kanowitz.

17 MR. KANOWITZ: Yes, Your Honor. We do have two other
18 matters to address, but happy to allow people to leave if
19 they're not going to be involved in this.

20 We hopefully will resolve or argue these things very
21 quickly, given the time of day. In fact, the U.S. Trustee has
22 agreed that it's only going to be oral argument and our
23 declarations on the redaction motion to be submitted. So I
24 think I can argue it in less than three minutes.

25 MS. BIELSKIE: Not much longer than that, Your Honor.

1 THE COURT: Okay.

2 MR. KANOWITZ: So it's up to you. Can we take a
3 five-minute break?

4 THE COURT: Let's just knock it out.

5 MR. KANOWITZ: Thank you, Your Honor. So Mr. Sirota
6 is timing me, because we have a tee time at 6:00.

7 Your Honor, this is a motion that the debtor filed a
8 long, long time ago, docket number four, believe it or not.
9 Mr. Renzi's declaration is at 276, which is what we would like
10 you to submit and rule on. And our reply is at 337, and our
11 other submissions were just recently made at 1594.

12 The bottom line is, Your Honor, we believe that under
13 107(b), but not with respect to the sale process, but with
14 respect to confidential information and with respect to 107(c),
15 with respect to the harm that individuals could happen if we
16 allow names of either corporations or individuals, email
17 addresses of corporations or individuals, or addresses of
18 individuals or corporations be out there in the public.

19 We just saw what happened in connection with the
20 Crowell security breach since the time we filed the motion.
21 We've given you a litany of -- a parade of horrors in other
22 cases, and even a name, a name of a company that goes out
23 there.

24 You could do a Google search. You could find out,
25 oh, you're involved in crypto. Oh, your officers and

1 directors, maybe they're individually involved in crypto.

2 So the bottom line is between the terms and
3 conditions, the applicable law, the Bankruptcy Code, and all
4 the other decisions on this, including probably Your Honor's
5 own thoughts about how to protect people from harm, I would ask
6 that Your Honor grant the motion.

7 There is no evidence in opposition to our motion.
8 It's just oral argument and speculation. And the bottom line
9 is we have to stop the harm before it gets out. And we have
10 been living under an interim order, and that interim order has
11 protected us to a certain extent, but when people have asked
12 for unredacted copies, we have given it to them, and that still
13 didn't even stop what happened with the Crowell security
14 breach.

15 So I would ask Your Honor to grant the motion. It is
16 opposed, but it is purely argument. There is no evidence to
17 support any of the Trustee's statements.

18 Thank you.

19 THE COURT: Thank you, Mr. Kanowitz.

20 Mr. Aulet?

21 MR. AULET: Your Honor, I will, likewise, be brief.

22 We would ask that you move our declaration at Docket
23 234 into evidence.

24 The U.S. Trustee's original objection included a
25 parade of horrors that have not come to pass. The debtors'

1 motion and the Committee's joinder noted a parade of horrors
2 that, frankly, has come to pass. Criminals did make an effort
3 to hack Crowell to get this exact information.

4 The Court in Celsius released this information, and
5 there have been nine notices of phishing attacks against
6 Celsius customers in that case.

7 For the reasons set forth in the Committee's papers,
8 we would urge that Your Honor find that this information, in
9 the context of a cryptocurrency bankruptcy, where transactions
10 are irreversible and once the money is gone, it's gone, to find
11 that cause exists under 107(c), as the undue risk of identity
12 theft or other unlawful injury, seal all of the customer
13 information.

14 Thank you, Your Honor.

15 THE COURT: Thank you, Mr. Aulet.

16 Ms. Bielskie.

17 MS. BIELSKIE: Thank you, Your Honor.

18 Lauren Bielskie with the Office of the United States
19 Trustee.

20 We are here at confirmation of a liquidating plan,
21 and the redaction motion is meant to exist not just during this
22 case, but in perpetuity, and not just for individuals, but for
23 non-individuals as well.

24 The asserted cause under Section 107(b)(1) simply
25 does not exist any longer. The debtors' platform and customer

1 list is not being sold and the debtors are liquidating.

2 And we don't believe that the non-individuals would
3 fall under 107(c). So at the very least, the information for
4 non-individual clients that was being protected as valuable
5 commercial information should now be disclosed on the
6 schedules.

7 So we should really just be talking about individuals
8 in Section 107(c)(1)(A), which requires a finding that
9 disclosure of information creates not just a risk, but an undue
10 risk of identity theft or other unlawful injury.

11 In the TCC's reply at Docket No. 278, they cite to a
12 New York Times article from February 18, 2018, which recounts
13 threats to physical safety, but it did note the spiking value
14 of Bitcoin at that time and identified victims that may have
15 been more unique to -- more unique than what's being portrayed
16 here.

17 One of the victims was the head of a Bitcoin exchange
18 in Ukraine. Another was a New York City man that was held
19 captive by a friend.

20 Another article from 2021 regarding physical violence
21 involved an individual described as the cofounder of the
22 Spanish Facebook, which could suggest that he wasn't targeted
23 just as a crypto holder, but for other reasons connected to his
24 wealth as well.

25 Two of the online articles cited in the TCC's reply

1 contain reports that after the disclosures in Celsius, lists
2 were created of the biggest losers and those investors were
3 subject to harassment and mockery. And while that's troubling,
4 Your Honor, it's not undue risk of identity theft or other
5 unlawful injury.

6 The debtor has informally provided our office with
7 additional articles and accounts suggesting physical threats,
8 but those threats were by creditors against principals of the
9 bankrupt crypto companies and their professionals. Again,
10 troubling, but not relevant to this issue, Your Honor.

11 On Saturday, the debtors filed a supplement to their
12 prior response highlighting, again, phishing scams, identity
13 theft, and other scams.

14 So it would appear, Your Honor, that what we're
15 really talking about here is the financial threats. And we
16 submit, Your Honor, that the creditors here are savvy in the
17 tech space. They understand, own, and deal in cryptocurrency,
18 and this indicates a level of sophistication that creditors in
19 non-crypto cases may not possess.

20 And given the online presence of these creditors and
21 what the debtors and the Committee have offered as an abundance
22 of instances of hacking and phishing to target holders of
23 cryptocurrency, they are aware of these threats and they could
24 take measures to educate themselves and protect themselves, the
25 same as individuals who have to be wary of other financial

1 scams, like mortgage closing scams, debt settlement scams, and
2 ransom money scams.

3 Do we redact the names of proposed buyers in the sale
4 motion because of the risk that they could be targeted with a
5 wire transfer scam? Do we redact the names and addresses of
6 creditors that are owed significant amounts of money by a
7 debtor because we think they may have a high net worth and
8 therefore be a target?

9 Your Honor recently said, and reiterated today in the
10 context of confirmation and what we should expect of
11 individuals of any level of sophistication, that when given a
12 ballot and opt-out forms and plans and disclosure statements
13 with pages and pages of legalese, that parties can't bury their
14 heads. They have to take action. They have to take steps to
15 protect their interests.

16 But should we expect less of holders of
17 cryptocurrency to protect their interests, especially knowing
18 for years now that there is an abundance of phishing and other
19 scams out there?

20 What I've learned during this case is that crypto
21 holdings are risky, and not just for their volatility. The
22 scams and the phishing attempts are not new. They are
23 prevalent and sophisticated and, in some instances, maybe a lot
24 of instances, effective. But it hasn't deterred individuals
25 from holding these assets. In the face of this known risk, it

1 is a choice.

2 What the Court has to consider in light of all of
3 that is whether disclosing names on these schedules is going to
4 create an undue risk.

5 As set forth in our papers, the Code and the
6 bankruptcy rules tell us the debtor shall disclose. There is a
7 longstanding common law right of public access to court
8 records.

9 Public access is codified in the Bankruptcy Code in
10 Section 107(a). Sections 107(b) and (c) offer limited
11 exceptions. And the debtor has the burden of proof to apply
12 any exception to the general rule.

13 And as the Third Circuit said in Cendant, "a showing
14 that disclosure will work a clearly defined and serious
15 injury."

16 So we submit, Your Honor, that crypto holdings are
17 risky, but disclosing a name does not create an undue risk of
18 identity theft or other unlawful injury. Instead of keeping
19 schedules sealed in perpetuity, it is time to unseal that
20 limited information, as well as full disclosure of any non-
21 individuals, because they are not protected by the exception in
22 107(c).

23 And, again, this doesn't appear as if the exception
24 in 107(b) is still being pursued, Your Honor.

25 Thank you.

1 THE COURT: Ms. Bielskie, let me just ask a question.
2 With respect to individuals, what is sought by the Office of
3 the U.S. Trustee, disclosure of the names and address, or just
4 the names?

5 MS. BIELSKIE: Just the names, Your Honor.

6 THE COURT: Just the names.

7 All right. Thank you.

8 I happen to be on a panel with Glenn on Monday at
9 Fordham University School of Law. This will be one of the
10 topics we are debating. I think I will decide this after the
11 debate.

12 I assume there is no need to decide in the next few
13 days?

14 MR. KANOWITZ: No, Your Honor. We could live on the
15 interim order as we have it.

16 THE COURT: All right. Thank you for the argument.
17 I'll think about it and see what Judge Glenn has to say.

18 Anything else?

19 MR. KANOWITZ: Yes, Your Honor. For calendar
20 purposes only, I believe, you carried the Wyatt motion to
21 modify the stipulation that was put into effect months ago on
22 the class action.

23 I think Your Honor -- your ruling would have denied
24 it, but you wanted to see where the plan was going to go. We
25 know where the plan is going. So hopefully we have an

1 effective date and we can move forward under that stipulation,
2 pursuant to its terms.

3 I don't believe --

4 THE COURT: Mr. Etkin, your thoughts on the motion?
5 It was carried to today?

6 MR. ETKIN: Yes, Your Honor. I'm glad Mr. Kanowitz
7 brought it up, because I know you had a docket order on it.

8 At this stage, Your Honor, with the plan being
9 confirmed, I don't know what the timing is with respect to the
10 effective date. I'd like to have some insight into that.

11 But leaving that issue aside, at this point, it
12 really makes no sense, because the injunction expires on the
13 effective date, so I don't know whether that's a couple of
14 weeks out or whatever, but if that's the case, then that's the
15 time frame. It's really moot at this point.

16 THE COURT: Is it better just to withdraw it as moot?

17 MR. ETKIN: I'll withdraw it as moot, Your Honor.

18 THE COURT: All right. Thank you.

19 Thank you all. Thank you. Tough case, tough day.
20 Take care.

21 ALL: Thank you.

22 * * * * *

23

24

25

C E R T I F I C A T I O N

WE, DIPTI PATEL, KAREN WATSON and LORI KNOLLMEYER,
court approved transcribers, certify that the foregoing is a
correct transcript from the official electronic sound recording
of the proceedings in the above-entitled matter and to the best
of our ability.

/s/ Dipti Patel

DIPTI PATEL

/s/ Karen Watson

KAREN WATSON

/s/ Lori Knollmeyer

LORI KNOLLMEYER

J&J COURT TRANSCRIBERS, INC. DATE: September 28, 2023

UNITED STATES BANKRUPTCY COURT
DISTRICT OF NEW JERSEY

IN RE:) Bankruptcy No. 24-12364-ABA
) Chapter 11
)
)
BOWFLEX, INC.)
) Camden, New Jersey
) August 19, 2024
Debtor.) 10:00 a.m.

TRANSCRIPT OF CONFIRMATION HEARING
BEFORE THE HONORABLE ANDREW B. ALTENBURG, JR.
UNITED STATES BANKRUPTCY JUDGE

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Proceedings recorded by electronic sound recording, transcript
produced by transcription service.

I N D E XARGUMENT:PAGE

By Mr. Ferrell	12
By Mr. Schepacarter	19
By Mr. Ferrell	24
By Mr. Schepacarter	25
By Mr. Ferrell	27
By Mr. Schepacarter	28
By Mr. Ferrell	34
By Mr. Schepacarter	36
By Mr. Ferrell	43
By Mr. Gage	46
By Mr. Schepacarter	48
By Mr. Ferrell	51

RULING:

By the Court	52
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1 (The following was heard in open court at 10:00
2 a.m.):

3 THE COURT: Good morning, everyone. How is
4 everybody today?

5 MR. DIPASQUALE: Great, thank you, Your Honor.

6 THE COURT: Great. This is Judge Altenburg. This
7 is my calendar for today, August 19th, 2024. We're here on
8 the matter of Bowflex of New Jersey, LLC, Case Number 24-12363
9 and Bowflex, Inc., Case Number 24-12364, which cases are
10 jointly administered under the Bowflex, Inc. case.

11 So, we're going to start out today -- today is
12 confirmation. What I'd like to do is, we're going to call on
13 the parties, and we're going to ask one person from each group
14 to identify -- speak up and identify who might be
15 participating on the phone call, so as we're not talking over
16 each other. And I'll call folks out directly. I know that
17 Mr. DiPasquale is here on behalf of the Debtors, so, Mr.
18 DiPasquale, would you like to enter your appearance, please?

19 MR. DIPASQUALE: Yes, Your Honor, good morning,
20 Joseph DiPasquale of Fox, Rothschild, co-counsel for the
21 Debtors.

22 THE COURT: And who is appearing with the Debtors
23 today?

24 MR. DIPASQUALE: Also, my co-counsel, Ian Ferrell,
25 with Sidley, and Mr. Ferrell will be presenting at today's

1 argument -- today's hearing. Thank you.

2 THE COURT: Okay. Anyone else like to enter their
3 appearance on behalf of the Debtor?

4 MR. FERRELL: Ian Ferrell of Sidley Austin. My
5 colleagues, also, Maegan Quejada and Matt Clemente are both
6 with us today and Robert Hoge, the general counsel and Chief
7 Wind-Down Officer at the Debtors is also joining us remotely
8 today.

9 THE COURT: All right. Great. And who do I have on
10 behalf of the Committee?

11 MR. GAGE: Good morning, Your Honor, Rich Gage,
12 Kelly, Drye & Warren, for the UCC.

13 THE COURT: Good morning, Mr. Gage.

14 And, Mr. Schepacarter?

15 MR. SCHEPACARTER: Good morning, Your Honor, may it
16 please the Court, Richard Schepacarter for the United States
17 Trustee. I'll be the one and only presenter for the United
18 States Trustee.

19 THE COURT: Thank you. Too long of a drive for you
20 today, Mr. Schepacarter?

21 MR. SCHEPACARTER: Well, it would be easier if I was
22 in Camden, but because the other parties were appearing by
23 Zoom, I wanted to be on the same --

24 THE COURT: That's fine.

25 MR. SCHEPACARTER: -- level playing field, so --

1 THE COURT: That's fine.

2 MR. SCHEPACARTER: -- but it would be much easier if
3 I was in Camden right now, so, thank you.

4 THE COURT: That's fine. And, Mr. Ferrell, I'm
5 sorry, how do you pronounce your witness's last name again?

6 MR. FERRELL: I can let him do the pronunciation to
7 make sure I do it correctly.

8 MR. HOGE: It is Hoge, just put a D between the O
9 and the G.

10 THE COURT: That's good because that's how I was
11 doing to pronounce it anyway, so --

12 MR. HOGE: Thank you, Your Honor.

13 THE COURT: All right. As I said, we're here for
14 confirmation of the second amended liquidated plan for the
15 Debtors, and just some housekeeping matters, I just want to
16 start off and see if we can kind of get to the nitty-gritty of
17 the U.S. Trustee's objection, dealing with the, in light of
18 the support by the Committee and in light of the documents
19 that have been filed. Am I -- I'm under the understanding
20 that except for the 1129(a)(8) and the Trustee's objection,
21 there is no dispute as to any of the elements with regard to
22 1129, correct, Mr. Ferrell?

23 MR. FERRELL: Your Honor, that is correct.

24 Certainly, if anyone on the line disagrees with that
25 assertion, you know, I'd be happy to go through that, but,

1 yes, our understanding is everything other than 1129(a) --
2 (a)(8), rather, and the U.S. Trustee's objection are all that
3 remain outstanding.

4 THE COURT: Mr. Schepacarter, do you agree to that?

5 MR. SCHEPACARTER: That is correct, Your Honor.

6 THE COURT: And, Mr. Gage?

7 MR. GAGE: That is correct, Your Honor.

8 THE COURT: All right. Now, I see no one else on
9 the line, other than the folks that are representing the
10 Debtors, the Unsecured Creditors Committee and the U.S.
11 Trustee. Is there anyone else out there that should be
12 appearing that has not appeared? I'm not aware of anybody
13 else who was signed up?

14 (No audible response.)

15 THE COURT: Okay. If there are, please raise your
16 hand. Okay. I see no hands being raised, so I'm going to go
17 ahead and move forward with this group of folks that are on
18 line with me, and I'll keep it at that.

19 All right. So, that being said, I don't think we
20 need to go over the 1129 elements. I think that they're
21 properly and adequately addressed in the memorandum of law, as
22 well as supported by the Committee's statement. So, we don't
23 need to focus this morning on, Mr. Ferrell, you making any
24 arguments with regard to 1129. I'll address them when I issue
25 my decision on this matter. There's no need for you to go

1 over it. They're well laid out, and there is no contest, so
2 there's no need to do it.

3 Now, Mr. Schepacarter, there has been changes to the
4 amended plan -- or to the plan since you first filed your
5 objection. Do all four of your objections still remain?

6 MR. SCHEPACARTER: That is correct, Your Honor. I'm
7 not going to get into it now, but I'll explain where the two
8 changes that they made just don't get us there. Thank you.

9 THE COURT: Okay, that's fine.

10 All right. That being said, I will ask that -- I'll
11 give the parties the opportunity -- Mr. Hoge, we're relying
12 heavily on your certification in support of confirmation, as
13 the general counsel, Chief Wind-Down Officer.

14 ROBERT HOGE, DEBTOR'S WITNESS, SWORN

15 THE COURT: Did you review this, sir, your
16 declaration before it was filed with the Court?

17 MR. HOGE: I did.

18 THE COURT: And is all the information that's
19 contained in there truthful to the best of your knowledge?

20 MR. HOGE: It is, Your Honor.

21 THE COURT: Do you have any changes that you'd like
22 to put on the record today with regard to that certification?

23 MR. HOGE: I do not.

24 THE COURT: Okay. Would any party that's on the
25 line like to cross-examine Mr. Hoge with regard to this

1 certification?

2 (No audible response.)

3 THE COURT: There is no one speaking. Does anybody
4 object to me introducing this certification as evidence of the
5 record in this matter?

6 MR. SCHEPACARTER: No objection. I should have
7 raised my hand earlier. We don't intend to cross and no
8 objection to the entry of the Hoge declaration.

9 THE COURT: How about you, Mr. Gage?

10 MR. GAGE: No objection, Your Honor.

11 THE COURT: All right. Mr. Ferrell, I hope I didn't
12 steal some of your thunder, but I'm just following my check
13 list here, so bear with me.

14 So, that being said, that also is -- oh, I'm not
15 going to get the name right. The representative of Epiq,
16 Court is on the line?

17 MS. KJONTVEDT: Good morning, Your Honor, Stephenie
18 Kjontvedt for Epiq.

19 THE COURT: Good morning. How are you today?

20 MS. KJONTVEDT: I'm fine, thank you.

21 THE COURT: All right. I'm going to ask you the
22 same questions.

23 STEPHENIE KJONTVEDT, DEBTOR'S WITNESS, SWORN

24 THE COURT: And, Ma'am, did you review this
25 certification before it was filed with the Court?

1 MS. KJONTVEDT: Yes, I did.

2 THE COURT: And did you contribute to this
3 information, as well?

4 MS. KJONTVEDT: Yes, I did.

5 THE COURT: And is this information truthful to the
6 best of your knowledge?

7 MS. KJONTVEDT: Yes, it is.

8 THE COURT: And do you have any changes or anything
9 you'd like to add to this certification?

10 MS. KJONTVEDT: No, I do not.

11 THE COURT: Does anybody on line wish to cross-
12 examine this witness? Mr. Schepacarter?

13 MR. SCHEPACARTER: For the record, Rich Schepacarter
14 for the United States Trustee, no, no cross-examination and
15 when you get to it, no objection to the entry of the Kjontvedt
16 declaration.

17 THE COURT: All right, thank you very much.

18 Mr. Gage?

19 MR. GAGE: Your Honor, the Committee does not intend
20 to cross-examine, and we also have no objection to her
21 certification being entered into the record.

22 THE COURT: All right. Thank you very much. Now,
23 Mr. Ferrell, again, I'm sorry I jumped to it. If you still
24 would like to ask questions from your witnesses, you certainly
25 may. I just wanted to -- I often forget to introduce the

1 stuff into evidence, and I don't want to get caught in this
2 case doing that. All right.

3 MR. FERRELL: No, Your Honor. I'm sure our
4 witnesses appreciate no cross or direct.

5 THE COURT: All right. Thank you. That being said,
6 Mr. Ferrell, it is your case.

7 MR. FERRELL: Thank you, Your Honor. Your Honor, I
8 certainly appreciate the efficiency at which you've been
9 working through this, however, I'd be remiss if not to
10 reintroduce my colleagues, here, from Sidley, Austin, Maegan
11 Quejada and Matthew Clemente from Fox, Rothschild, our co-
12 counsel. We have Joseph DiPasquale.

13 Additionally, I just need to make sure to take the
14 opportunity to express gratitude to the Court and to your
15 staff for all of the help that you have given throughout these
16 cases, operating on, you know, expedited time lines in certain
17 circumstances. We certainly appreciate how efficiently these
18 cases have been able to make their way through the Court in
19 order to maximize value for the Debtor's estates and its
20 stakeholders.

21 THE COURT: Thank you.

22 MR. FERRELL: We also would like to thank, of
23 course, Mr. Hoge and his team. As Your Honor is aware, when
24 the Debtors filed for bankruptcy, it had hundreds of
25 employees, and now, I believe that the Debtors are down to

1 approximately ten who have been working tirelessly making sure
2 that these cases operate smoothly. They, along with the
3 professionals, have been great assets throughout these cases.
4 Additionally, a number of the stakeholders with which we have
5 worked, including the Committee have been great partners
6 throughout these cases and have gotten us to the point where
7 we are seeking confirmation of a mostly consensual plan today.

8 With that, Your Honor, as the Court is aware, the
9 Debtors filed their petitions for Chapter 11 bankruptcy on
10 March 4th of this year. They spent the last several months
11 pursuing the sale of substantially all of the Debtor's assets.
12 That sale closed in April. And, otherwise, the Debtors have
13 worked to efficiently and expediently wind down their
14 operations.

15 Over that same period, the Debtors have engaged
16 numerous parties, including the Committee, to develop a
17 proposed confirmation of a plan that will provide for
18 recoveries to general unsecured creditors and of the creation
19 of the liquidating trust on or about the effective date. In
20 addition, since we appeared before Your Honor in June
21 requesting approval of the disclosure statement, we understand
22 that the Committee completed its investigation into the
23 Debtor's activities preceding these Chapter 11 cases.
24 Following that investigation, the Committee shared its
25 findings with the Debtors, and in that time, the Debtors and

1 the Committee have worked to negotiate, resolve the
2 Committee's outstanding issues, and now, present this plan,
3 which the Committee, itself, has filed a statement in support
4 of.

5 This plan is supported by the overwhelming majority
6 of voting creditors of both Debtor entities. Among other
7 thing, the plan provides for, one, the orderly and expedient
8 distribution of the Debtor's assets to creditors; two, the
9 preservation of the retained causes of action; three, the
10 liquidation of the remaining assets for the benefit of
11 creditors, and, four, the wind-down and dissolution of the
12 Debtor's estates.

13 As stated before, this proposed plan is highly
14 consensual. Based on the voting results, the Debtors received
15 overwhelming approval, including over 94 percent of voting
16 creditors of Debtor, Bowflex, Inc., and 100 percent of voting
17 creditors of Debtor, Bowflex, New Jersey, LLC. We believe
18 that the plan provides for the best possible outcome for
19 creditors and exhibits the unceasingly efforts of the Debtor's
20 directors, officers, professionals and key stakeholders to
21 create value for the benefit of the estates, and the voting
22 results demonstrate that the creditors agree.

23 The first plan was filed on May 23rd at Docket
24 Number 400. The revised plan, on June 18th, at Docket Number
25 466. Leading to today, the Debtors additionally filed the

1 declaration of Stephenie Kjontvedt at Docket Number 563, which
2 has already been admitted into evidence. On Tuesday, August
3 13th, the Debtors filed additional confirmation materials,
4 those being the first amended plan at Docket Number 584, the
5 black line of the plan for solicitation version at Docket
6 Number 585, the proposed confirmation order at Docket Number
7 586, the Hoge declaration at Docket Number 587, which has also
8 already been entered into evidence -- or as an exhibit,
9 rather, and the confirmation brief at Docket Number 588.

10 Additionally, last evening, the Debtors filed other
11 materials, including the second amended plan at Docket Number
12 607, the amended plan supplement at Docket Number 609 and the
13 revised proposed confirmation order at Docket Number 610. The
14 Debtors also filed a revised agenda last evening. The agenda
15 showed the status of the matters going forward today. And as
16 Your Honor is aware, the Debtors received two formal
17 objections to the plan, in addition to a number of informal
18 comments to the plan.

19 Jumping ahead, since we've gotten those declarations
20 entered into evidence already, Your Honor, moving onto the
21 confirmation, itself, as we discussed and as I am aware, the
22 Section 1129 factors and requirements for confirmation are
23 included in our briefing and in Mr. Hoge's declaration. I
24 will abstain from going through those, once again, unless Your
25 Honor has any specific questions at this time.

1 THE COURT: I actually don't. I was going to
2 suggest that, since it's uncontested, that there is no need to
3 rehash it. You lay it out fine. Mr. Hoge lays it out fine.
4 The Court accepts it, has reviewed it and has made its own
5 determination, so there is no need to do that. What I would
6 like to hear, though, is the changes that were made yesterday,
7 how does it differ from what was -- the first amended plan and
8 the like, so that the record is clear?

9 MR. FERRELL: Yes, Your Honor, so the change from
10 the first amended plan to the second amended plan simply
11 cleans up a few internal references and labeling to what are
12 sections versus articles to the plan. In particular, Your
13 Honor, what we would want to look at is what is titled Section
14 5E of the second amended plan. If you're looking at the
15 redline, Your Honor, this would be PDF page 41 or the plan
16 page 36.

17 THE COURT: I'm there, go ahead.

18 MR. FERRELL: If Your Honor looks at Section E,
19 paragraph one and paragraph two, Your Honor sees that a
20 reference to art, meaning articles, was changed to sections,
21 just reflecting that it's a specific section, that being 3I,
22 rather than the entire article three. A similar change is
23 made in paragraph two.

24 Additionally, in paragraph one, just based on
25 deletions from the solicitation of the version of the plan to

1 the first amended plan, the indemnification obligation section
2 was removed, therefore, that changed some internal references
3 that were now picked up during the revisions. So, this
4 amended plan just touches those.

5 THE COURT: So, these changes, as I see it, are
6 merely technical or clarifying in nature, correct?

7 MR. FERRELL: Yes, Your Honor.

8 THE COURT: Okay. All right, thank you.

9 MR. FERRELL: Yes, Your Honor. So, as we stated,
10 the Debtors received a number of informal comments to the plan
11 following the solicitation, in addition to the two formal
12 objections. The Debtors have modified the plan to address all
13 of these informal comments, in addition to resolving the Chubb
14 Company's objection.

15 We worked diligently to negotiate these changes and
16 incorporate these modifications into the plan and into the
17 proposed confirmation order. At this time, the only objection
18 that we have remaining outstanding is that of the United
19 States Trustee, however, I am happy to go through any of the
20 modifications that were made to address the informal comments
21 or that of the Chubb Company, as well.

22 THE COURT: Well, I'm concerned about -- not
23 concerned, but I'd like to know about the Chubb objection,
24 because as of Saturday, it was not resolved, so what happened
25 with Chubb? How is it getting resolved?

1 MR. FERRELL: Yes, Your Honor. So, the Chubb
2 Companies raised their objection that the -- or, sorry, that
3 the basis for their objections were that the plan improperly
4 altered the terms of the Debtor's insurance program --

5 THE COURT: Right.

6 MR. FERRELL: -- and must provide for worker's
7 compensation claims, and direct actions claims must continue
8 in the ordinary course. The changes that were incorporated
9 into the first amended plan addressed most, if not all of the
10 Chubb Company's objection, from when that first amended plan
11 was filed on the 13th until we updated, you know, over the
12 weekend. My understanding was, there were just these couple
13 of cleanups in Section 5E of the plan that we needed to
14 incorporate and also that Chubb's counsel was waiting on
15 client sign-off and confirmation that the objection was
16 resolved.

17 THE COURT: Did the resolution of the objections to
18 Chubb have any impact on the other creditors in this matter?

19 MR. FERRELL: No, Your Honor.

20 THE COURT: So, resolicitation of the plan would not
21 be necessary based upon the resolution with Chubb?

22 MR. FERRELL: Yes, Your Honor, that is our position.

23 THE COURT: Okay. All right. Thank you. Move on.

24 MR. FERRELL: Yes, Your Honor. Did Your Honor have
25 any other questions about --

1 THE COURT: No.

2 MR. FERRELL: -- other --

3 THE COURT: No, just I was curious as to it was
4 reported why -- how it resolved -- well, it wasn't resolved as
5 of Saturday, but I understand, now, it was mainly resolve
6 through the first amendment, and I've read those amendments,
7 and I'm satisfied with them. Okay.

8 MR. FERRELL: Yes, Your Honor. So, Your Honor, the
9 last remaining objection is that of the United States Trustee.
10 I'm happy to address any questions or to go through the
11 argument at this time. However, and so, certainly, we'll
12 follow Your Honor's instructions on that. However, our
13 position is that, of the four basis of the objection, those
14 being the exculpation provision, the general settlement
15 provision, the third-party releases and the gatekeeper
16 provision, we believe that, to correct the changes from the
17 solicitation burden of the plan, that the plan before Your
18 Honor today should address the exculpation provision and
19 general settlement provisions.

20 THE COURT: All right. With that being said, Mr.
21 Schepacarter, you said you still have some issues with regard
22 to the changes, as made. Perhaps, it would be best to hear
23 from you at this point.

24 MR. SCHEPACARTER: Okay. Hold on a second.

25 THE COURT: Sure. Let's -- let's -- by the way,

1 let's save the third-party releases for the last part. Let's
2 talk about the exculpation and the gatekeeper and the rest,
3 okay?

4 MR. SCHEPACARTER: Okay.

5 THE COURT: We'll deal with -- don't go into third-
6 party releases. We'll deal with that separately.

7 MR. SCHEPACARTER: It's funny that Your Honor -- for
8 the record, Rich Schepacarter, for the United States Trustee
9 -- it's funny Your Honor mentions it that way or plans to go
10 that way, because that's the way I was going to go.

11 THE COURT: All right. Well --

12 MR. SCHEPACARTER: I was going to save the punch
13 line for last, so --

14 THE COURT: -- I'm not going to say great minds.
15 I'm not going to go there.

16 MR. SCHEPACARTER: You don't want to be in my mind.

17 Again, those are the four issues, exculpation, the
18 settlement, the plans of settlement, the gatekeeper issue,
19 and, again, the last one is third-party release.

20 Let me discuss it this way, the primary role of the
21 United States Trustee program is to serve as the watchdog for
22 the bankruptcy process. Our mission statement basically
23 frankly states, our program is to promote the integrity and
24 the efficiency of the bankruptcy system for the benefit of all
25 stakeholders, debtors, creditors and the public. Your Honor

1 holds a special -- very special place in this bankruptcy
2 process here, the arbiter and the adjudicator of differences
3 that may -- that crop up from time to time.

4 This is a theme that kind of runs through some of
5 the objections, and it's that, the Bankruptcy Code is meant to
6 be a comprehensive federal scheme to govern the entirety of
7 the bankruptcy process, and although flexibility is necessary,
8 the federal scheme cannot remain comprehensive if interested
9 parties can sort of do what they want with respect to certain
10 aspects of the plan.

11 With respect to exculpation, now, they did make some
12 changes to the exculpation. So, they took out related
13 parties, which was this whole, broad dragnet of all the
14 parties, basically, that you could think of. And they change
15 it to name 15 separate categories, specific categories of
16 parties, current control persons, directors, members of the
17 Committee, Debtor's estates' Board of Directors, managers,
18 equity holders, members, employees -- and that's a key --
19 agents, advisory board members, and then they have financial
20 advisors, attorneys, accountants, investment bankers,
21 consultants, representatives and other professionals.

22 Now, the Third Circuit in the PWS Bruno case, which
23 is -- it's a Delaware case -- we cite that, and that's been
24 cited by numerous courts for the fact that there is a --
25 basically, it's a fiduciary duty that is the standard. What

1 they would have you want to believe is that you measure
2 exculpation against what a party may have contributed or
3 didn't act in bad faith or their actions, you know, were --
4 exhibited a lack of wilful misconduct, actual fraud or gross
5 negligence. But the issue is really the fiduciary duty. And
6 the parties that they've named don't always -- and I don't
7 think they really have a fiduciary duty.

8 It should be limited to -- and I'll get into this
9 in a few minutes -- the directors, officers, the Committee,
10 the Committee members, the Debtor's professionals and the
11 Debtors, of course, the parties that actually have a fiduciary
12 duty under the Bankruptcy Code, whether that's under 1103 or
13 the other sections in the Code for the -- like the Debtors.
14 Those parties actually have a fiduciary duty. It's hard to
15 imagine that somebody who is an employee of Bowflex who,
16 basically, works, we'll just say, in the loading dock,
17 necessarily has a fiduciary duty in the context of a
18 bankruptcy case. They may have to -- they might have to do
19 their job, whatever that is, but it's a different standard
20 with respect to -- especially directors and officers in the
21 context of fiduciary duty.

22 I know we indicated in our brief, and we do rely on
23 our brief, as well, in this case, but the courts have
24 repeatedly interpreted the PWS Bruno case as requiring a
25 party's exculpation to be based on its status as a fiduciary.

1 We cite to Indianapolis Downs, Tribune. And Judge Shannon,
2 who wrote Indianapolis Downs, stated the same thing in its PTL
3 Holdings case, which I think is a slip opinion, and then,
4 again, the Third Circuit in the Walton vs. Houlihan Lokey
5 talked about the exculpation of a fiduciary in the context of
6 that case.

7 Just to mention, in the Mallinckrodt case, Judge
8 Dorsey, although he ruled against us in a number of other
9 aspects, sustained our objection to exculpation and limited it
10 to fiduciaries -- estate fiduciaries. Judge Wall (inaudible)
11 in a case, and this is a case that's not a reported case, but
12 she entered an order denying confirmation until they modified
13 the exculpation provision so that, "exculpation shall only
14 apply to parties who served in the fiduciary capacity to the
15 Debtors or the Estate during the bankruptcy case."

16 And the Debtors cite to, in one of their footnotes,
17 footnote 187, in their memorandum, they cite to a 2013 Judge
18 Kevin Gross case, where Judge Gross had earlier conferred
19 exculpation on the non-estate fiduciary. But later on, in
20 March of 2017, in the Emerald Oil case, not (inaudible), but
21 it's -- I can tell you what Judge Gross stated. He said that
22 -- and this is a quote from the transcript. It's at page 40,
23 lines 16 to 24.

24 "And let me just said, I have reexamined my
25 position. I looked at PWS Holding again. I've looked at what

1 the other judges are doing in their cases. And, in the
2 future, I am not going to allow such expansive rights of
3 exculpation. I will say that. They will be limited to estate
4 fiduciaries in the future, the debtors, debtors' officers and
5 directors, debtors' counsel, the Committee, its counsel and
6 for actions taken" -- and they left out in but -- "actions
7 taken in the bankruptcy case."

8 So, the plan, although modified, gets us to, what
9 we'll say, instead of starting at the 20 yard line, gets us to
10 about the 50 yard line, but we're still not there. We're not
11 in the end zone with respect to exculpation, and, again, it
12 needs to be limited to the parties that I just mentioned that
13 Judge Gross had mentioned, and that's the parties with the
14 fiduciary and those limited parties.

15 So, that's all I have on that, Your Honor. If you
16 have any questions, and you want to stop here, and you --

17 THE COURT: Well, I want to hear Mr. Ferrell's
18 response.

19 MR. SCHEPACARTER: Okay. Thank you.

20 THE COURT: Mr. Ferrell, why not limit it to those
21 who serve in a fiduciary capacity?

22 You're on mute.

23 MR. FERRELL: Thank you, Your Honor, Ian Ferrell
24 with Sidley, Austin, for the record.

25 Your Honor, the -- in the Third Circuit, exculpation

1 provisions like the ones set forth in the plan are regularly
2 approved. The courts evaluate the appropriateness of
3 exculpation provisions based on a number of factors, including
4 whether the plan was proposed in good faith, whether liability
5 is limited and whether the exculpation provision was necessary
6 for plan negotiations.

7 Exculpation provisions that are limited to claims
8 not involving a criminal act, actual fraud, wilful misconduct
9 and/or gross negligence are customary, and generally approved
10 in this district under appropriate circumstances. The
11 footnote 187 that Mr. Schepacarter has cited to includes a
12 number of citations, all of which include plans and
13 confirmation orders that include exculpation provisions very
14 similar, if not identical, to that exculpation provision
15 presented here today in this plan.

16 Additionally, just even on Friday in Sam Ash Music,
17 I believe, the exculpation provision, also, in the District of
18 New Jersey, included this same list of individuals who would
19 be covered by that exculpation provision.

20 THE COURT: All right. Thank you.

21 Mr. Gage, do you have anything you'd like to add?

22 MR. GAGE: No, Your Honor.

23 THE COURT: All right. All right. Anybody have
24 anything else they'd like to add?

25 (No audible response.)

1 THE COURT: All right. Let's move onto the next
2 objection, Mr. Schepacarter.

3 MR. SCHEPACARTER: Thank you, Your Honor. Again,
4 Richard Schepacarter for the United States Trustee.

5 This is the -- so, we're moving on, this is the
6 objection to the settlement provision. It's a general
7 settlement provision that, basically, the plan -- this is what
8 it states -- "shall constitute a good faith compromise and
9 settlement of all claims, interests, causes of action and
10 other controversies, released, settled, compromised, satisfied
11 or otherwise resolved pursuant to the plan."

12 And the problem with this provision is that
13 settlements should be between, basically, two parties, so that
14 it could negotiate a settlement. For example, we have a
15 settlement with the Chubb Company, right, so they can announce
16 their settlement. They've negotiated. They've discussed.
17 They've gotten to a mutual agreement, because a settlement, as
18 we state in our brief, a settlement is an agreement ending a
19 dispute or a lawsuit. And I think this is the key here,
20 because the agreement is a mutual understanding between the
21 parties.

22 In a plan, necessarily, and this kind of gets us
23 into the last point, but I'm not going there yet, the parties
24 aren't necessarily before the Court. So, we're talking about
25 third-party settlements or third-party -- I shouldn't say

1 settlements -- third-party claims that may be out there,
2 although they may either opt-in or opt-out or whatever it is,
3 there is no agreement between those parties. Those parties
4 haven't passively expressly agreed to that -- to this
5 settlement. So, you can't say it's a settlement of all claims
6 under the plan.

7 The plan is basically -- stands on its own. We had
8 cited some other cases, which is the Arrow Mill and some other
9 cases that were in this District, and those cases, basically
10 -- I went and reread them last night -- well, I wasn't reading
11 all the amendments to the plan and the like, but the
12 amendments -- those cases basically stand for the concept that
13 the discharge is sort of by law, but the other part of it, the
14 resolution of third-party claims and the like, are agreement
15 of the parties. And you don't necessarily have that here,
16 when you say -- you just put a blanket settlement over all
17 claims in interest, whatever they may be, because all parties
18 haven't agreed to resolve all claims in interest.

19 When I used to do debtor work, I used to think that
20 was the right way to think that the plan settled everything,
21 but it necessarily doesn't do that. Settlement requires an
22 agreement between the settling parties, and where you don't
23 have an express settlement agreement on all of those claims
24 and all of those issues, you can't have that blanket to say,
25 this settles everything. It would be nice to have a global

1 settlement among all of the parties that are involved, but you
2 can't have that here, especially with respect to the third-
3 party release and the third-party claims.

4 And it also, at the bottom part of that provision,
5 it purports to treat the distributive provisions of the plan
6 as if they were a settlement. Again, there is no
7 justification for that. So, the plan can settle issues among
8 parties who have agreed to those settlements. You could bake
9 those into the plan. You don't need a 9019 motion, but in
10 this case, and the way the language reads, you're having a
11 problem where you don't have that -- those agreements, those
12 express agreements, and you can't just put a blanket
13 settlement over top of all the parties in interest in this
14 case.

15 That's all I have on that, Your Honor, if you have
16 any questions?

17 THE COURT: Nope. Mr. Ferrell, your response?

18 MR. FERRELL: Yes, Your Honor. Your Honor, we -- as
19 a first matter, just to any extent that this would involve or
20 implicate the third-party releases, our -- you know, any
21 response to that, of course, is included in our memorandum,
22 relating to why we believe the third-party releases are
23 appropriate, themselves. Otherwise and more generally, the
24 original version of the plan filed at Docket Number 400 did
25 invoke Rule -- or Section 1123 of the Bankruptcy Code and

1 Bankruptcy Rule 9019.

2 The revisions that we made to the plan at Docket
3 Number 467 and which have carried over into the plan before
4 Your Honor today, removes these explicit references to 1123
5 and Bankruptcy Rule 90 -- or 9019. Instead, the language of
6 the plan is consistent with the language that is regularly
7 approved in this court -- or in this District, rather.

8 It provides just for the general settlement -- it
9 provides that the general settlement applies "to the greatest
10 extent permissible under the Bankruptcy Code and the
11 Bankruptcy Rule." As stated, this language is regularly
12 approved in this District, and at least has been represented
13 both in memoranda by debtors and in confirmation hearing
14 transcripts that this language has been approved or agreed as
15 acceptable to the United States Trustee, such as in In Vitae,
16 Cyxtera and (inaudible).

17 THE COURT: All right, thank you.

18 Mr. Schepacarter, any response?

19 MR. SCHEPACARTER: Yes, Your Honor, again, Rich
20 Schepacarter for the United States Trustee.

21 Just because something was ruled upon in another
22 case doesn't make it the law today or in this case. There is
23 a number of decisions where our office might -- for example,
24 might not have objected. Sometimes, things slip through. I
25 mean, it happens. Sometimes --

1 THE COURT: But shouldn't parties -- shouldn't
2 parties expect a consistency from the Bankruptcy Courts when
3 they come to them?

4 MR. SCHEPACARTER: Well, they should, but that
5 doesn't necessarily mean that those other decisions --
6 whatever those decisions were, they may have been based on the
7 facts and circumstances in those cases. I don't think it's
8 proper to go and say, well, this was -- these provisions were
9 approved in X, Y and Z cases, when it may not be proper here.
10 And it's probably not proper here, as well, because of the
11 fact that, for example, he could say the first thing with the
12 first argument I had on exculpation. Just because the
13 exculpation provisions may have been approved in another court
14 doesn't necessarily make it what should be approved here.

15 Same thing with this situation, although there's not
16 necessarily express Third Circuit law on this point, I think
17 the prospect of the premise is clear that you can't have a
18 blanket settlement of everything when those parties haven't
19 assented to whatever is being settled (inaudible) being
20 severed.

21 THE COURT: If I rule --

22 MR. SCHEPACARTER: The claims --

23 THE COURT: -- if I rule --

24 MR. SCHEPACARTER: Okay.

25 THE COURT: -- against you on the third circuit --

1 or the third-party release matter, does all this -- make all
2 your arguments moot here?

3 MR. SCHEPACARTER: No. No, because exculpation
4 stands on its own.

5 THE COURT: Right.

6 MR. SCHEPACARTER: The gatekeeper will stand on its
7 own. I haven't gotten to that yet, but the --

8 THE COURT: I'm talking about here.

9 MR. SCHEPACARTER: -- gatekeeper will stand --

10 THE COURT: I'm talking about here, about the
11 settlement language.

12 MR. SCHEPACARTER: No, because I don't think that
13 necessarily -- I will get to that issue, but I don't
14 necessarily think that there -- I think they're somewhat
15 mutually exclusive. I don't see them to be --

16 THE COURT: Okay.

17 MR. SCHEPACARTER: -- exactly the same. I mean,
18 they are in common. I think I mentioned that. You still have
19 a third-party release situation. So, you're still talking
20 about somewhat of an affirmative consent, but you don't
21 necessarily have affirmative consent here. You don't have the
22 affirmation that every claim has been -- has been settled.
23 Well, what about the opt-out parties? Are they still settled?
24 I mean, you know, I guess they are if they agree to it, but
25 they don't necessarily agree to everything under the plan. I

1 don't think you can just say that the plan settles everything.
2 It settles concepts under the plan, distributions to a certain
3 extent, but it doesn't necessarily settle claims that haven't
4 been affirmatively settled between and among the parties,
5 so --

6 THE COURT: That seems to be dangerous for a Court
7 to say the plan doesn't settle everything. Where's the
8 finality come in? If I -- if I say the plan doesn't settle
9 everything -- the plan doesn't resolve everything that it
10 provides for, where's the finality?

11 MR. SCHEPACARTER: Well, it does under 1141, but it
12 doesn't necessarily make it a settlement under these
13 provisions --

14 THE COURT: Okay.

15 MR. SCHEPACARTER: -- under the settlement
16 provisions to settle everything under the plan.

17 THE COURT: Okay.

18 MR. SCHEPACARTER: The plan is final as to 1141, but
19 -- and that's with issues with respect to the plan, but not as
20 to issues that are outside of it.

21 THE COURT: All right, thank you.

22 MR. SCHEPACARTER: So, thank you.

23 THE COURT: Mr. Ferrell, any response?

24 MR. FERRELL: No, Your Honor. I -- in short, just,
25 I believe that our brief stands, as we've presented thus far,

1 and as Your Honor has raised, during this discussion, there is
2 an importance to have finality in the plan. Certainly, a
3 number of -- you know, like, for example, the third-party
4 releases, we continue to maintain, are appropriate. And to
5 the extent that they are encapsulated in this argument, we
6 would rely on the appropriateness of that in response, here,
7 as well.

8 THE COURT: All right. Anyone else have anything
9 they'd like to add? Mr. Gage?

10 MR. GAGE: Your Honor, we don't have anything
11 substantive, other than just to say that, to the extent that
12 this touches on the third-party releases, we'll rely on our
13 statement in support of confirmation, and any arguments we
14 make on that later.

15 THE COURT: All right, thank you. All right, Mr.
16 Schepacarter, now, let's go to the gatekeeping argument.

17 MR. SCHEPACARTER: Okay. Moving on, the gatekeeping
18 provision, this language creates a gatekeeper role for the
19 Court that forces non-debtors who wish to pursue a claim for
20 cause of action against another non-debtor to come to this
21 Court for determination of whether such claim is released.
22 Again, we brief this in our objection.

23 THE COURT: Right.

24 MR. SCHEPACARTER: And, the gate -- just let me
25 point out a couple things. One is, if the case closes, and

1 this case isn't as bad as some of the other cases where you
2 have hundreds of debtors, but if the case closes, the non-
3 debtor, to perform under the gatekeeping provision, would have
4 to reopen the case, come before Your Honor, and then have an
5 adjudication of whatever that third-party non-debtor versus
6 non-debtor claim and come back to this Court.

7 As we stated, a similar provision was rejected by
8 Judge Karen Owens in the Gulf Coast Healthcare case, where she
9 noted that the plan says what it says, and other courts should
10 be entitled to exercise their authority to interpret that.
11 And imposing such a requirement should also impose unnecessary
12 administrative hurdles and cost to the parties, especially
13 when these cases are closed.

14 So, I think that that's a big portion of the issue.
15 As I said, I just wanted to point out those things.

16 THE COURT: Okay.

17 MR. SCHEPACARTER: You know, if somebody believes
18 that they want to enforce the release, for example, they could
19 file a motion to enforce the plan. They could simply do that,
20 so --

21 THE COURT: Wouldn't that require the opening of the
22 case?

23 MR. SCHEPACARTER: It might, if it's closed, and --

24 THE COURT: So, the Debtor, if there is a proceeding
25 that's going against the Debtor or somebody that's protected

1 by the plan, the burden would be on them to reopen the case to
2 find the action violates --

3 MR. SCHEPACARTER: Right, if it's dealing with the
4 releases, yeah, but not a third-party non-debtor claim that's
5 outside of the context of the bankruptcy, itself.

6 Thank you.

7 THE COURT: Okay, thank you.

8 Mr. Ferrell?

9 MR. FERRELL: Yes, Your Honor, Ian Ferrell. We
10 understand that the United States Trustee has made a number of
11 citations to Judge Owens' opinion as it relates to the
12 gatekeeper provision, certainly, the Debtors understand,
13 however, the vast weight of the case law in this District has
14 approved the gatekeeper provision and has found it to be
15 appropriate and confirmable.

16 In short, the purpose of the gatekeeper provision is
17 to insure that the Debtors and released parties receive the
18 protections to which they are otherwise afforded under the
19 plan and do not become bogged down in litigation relating to
20 the plan. By its design, the provision requires an individual
21 asserting a claim or cause of action against a released party
22 to, first, obtain an order from this Court, determining that
23 it is authorized to bring the claim.

24 The gatekeeper provision, just for clarification,
25 does not require this Court to rule on the underlying merits

1 of the action, rather, it just makes a threshold inquiry into
2 whether or not there is an ability to bring the cause of
3 action or whether it has been addressed as part of the plan or
4 the confirmation order.

5 What we're asking for this Court to do is to answer
6 an initial threshold inquiry and to engage in the construction
7 of the terms of the plan and the confirmation order. Although
8 bankruptcy courts are of limited jurisdiction, certainly,
9 interpreting its own order is within this Court's authority.

10 Additionally, we would suggest and argue that this
11 Court is best positioned to be able to interpret the words
12 that it has entered into -- and to construct the terms or
13 interpret the terms of the plan and the confirmation order.

14 The Debtors do not believe that the gatekeeper
15 provision would impose a great burden or administrative hurdle
16 that the U.S. Trustee suggests it does. And, in fact,
17 creditors have shown that they are willing to accept this
18 burden by voting in favor of the plan. The gatekeeper
19 provision preserves resources that would otherwise be expended
20 in potentially defending cases far and wide and in courts that
21 may interpret the plan or the confirmation order in
22 (inaudible) ways.

23 As stated, the gatekeeper mechanism is common in
24 this jurisdiction. The provision, itself, was negotiated
25 among the Debtor, the Committee and other stakeholders.

1 Accordingly, we would ask the Court to approve the plan with
2 the gatekeeper provision included.

3 THE COURT: Thank you.

4 Anyone else have a response?

5 (No audible response.)

6 THE COURT: All right, thank you.

7 All right, we're going to move on to the third-party
8 release provisions. I am going to say I have thoroughly
9 reviewed both party's arguments on both sides. I understand
10 the arguments, so there is no need to rehash the well-thought
11 and well-laid-out pleadings. You can highlight your
12 positions, but there is no need to repeat verbatim what's been
13 submitted in your pleadings.

14 Okay, Mr. Schepacarter?

15 MR. SCHEPACARTER: Thank you, Your Honor, and I will
16 try to be brief. I'll try to get -- I'll try to get to the
17 point, so to speak.

18 THE COURT: Okay, I would appreciate that.

19 MR. SCHEPACARTER: Thank you, Your Honor. And I
20 appreciate Your Honor's thorough review of the pleadings. I
21 know that a lot of things were filed over the weekend and late
22 at night, and we appreciate your ability and thoroughness and
23 diligence in reviewing all of the pleadings and reading our
24 briefs.

25 THE COURT: Well, I have a great staff, what can I

1 tell you?

2 MR. SCHEPACARTER: I think we're all in agreement in
3 that. We can all stipulate to that.

4 The problem -- how can I say it? I'm trying to get
5 the more important parts. After the Supreme Court's decision
6 in Purdue, it's clear that releases by non-debtors -- of non-
7 debtors can only be consensual, so you can't have a non-
8 consensual release. Now, the problem, here, is, and, again, I
9 know Your Honor has read all this, literally, every case is
10 the Purdue case, unless the parties can show that the releases
11 are consensual.

12 The issue, here -- and this plan isn't as severe as,
13 maybe, other plans are, because everybody had, at least, the
14 opportunity to opt-out, even parties who were impaired --
15 unimpaired. Everybody had the opportunity to opt-out. But
16 the issue still is, with respect to the opt-out, you still
17 have creditors that have not affirmatively consented -- so,
18 you have some parties that actually opted-out, but you have a
19 number of -- and I don't know how many other parties were sent
20 questionnaires or -- strike that -- sent ballots, sent
21 information sheets and didn't return them. I guess they're
22 called the "abstaining creditors."

23 So, I'm not sure that an abstention is that you just
24 don't return the envelope or just don't return the ballot.
25 That's not necessarily an abstention. Usually an abstention

1 is, you have a vote, and you can say, yay, nay or I abstain.
2 That's not the situation where you have somebody that just
3 didn't return a ballot, and that's the problem with respect to
4 the Purdue case as it fits into the third-party releases and
5 affirmative consent, because you don't have anybody
6 manifesting that affirmative consent.

7 Like I said, the opt-out box just isn't enough to
8 establish that affirmative consent. Let's see, we cited, and
9 they kind of deigned -- demeaned our cases, the cites that we
10 made to Congoleum, Arrow Mill and (inaudible), and they're
11 from three of the most esteemed judges in this District who
12 have ever served in this District, Judge Ferguson, Judge
13 Gindin, Judge Gambardella. All three of them acknowledged
14 that there needs to be some affirmative consent with respect
15 to -- with respect to plan voting.

16 In Arrow Mill, Judge Gindin stated that -- he
17 stated, furthermore, these parties are not protected from the
18 consequences of pre-petition acts by the ability of the Code
19 -- use the Code to enforce discounted settlements on
20 creditors. And he said that, "While the Bankruptcy Code
21 expressly orders that contractual obligations of the bankrupt,
22 it does not contemplate the same effect on obligations on
23 third-parties." And said that, it's -- "Accordingly, it's not
24 enough for a creditor to abstain from voting for a plan or
25 even to vote, yes, to a plan. A creditor's approval of the

1 plan cannot be seemed an act of assent, having significance
2 beyond the confines of the bankruptcy proceeding." That's
3 Judge Gindin.

4 Judge Gambardella, in an earlier case, stated that,
5 "A creditor's approval of the plan cannot be deemed an act of
6 assent, having significance beyond the confines of the
7 bankruptcy proceeding."

8 And then, Judge Ferguson stated that, "For a release
9 to be consensual, the creditor must have unambiguously
10 manifested assent to the release of the non-debtor from the
11 liability of its debts."

12 So, those are three, I think, cases that came out of
13 New Jersey. Maybe New Jersey was considering this issue well
14 before anybody else was, and we didn't know it back then. or,
15 at least, we didn't recognize it so much back then.

16 As we stated in our objection, the Emerge Energy
17 situation that, again, another Judge Owens case, she rejected
18 the Debtor's argument deeming silence as consent. Failing to
19 return a ballot, as I argued, you can't say that failing to
20 return a ballot was intentional. The ballot may not have
21 gotten to the person. I don't know if there was any -- I
22 didn't see, in the Kjontvedt declaration any -- and maybe I
23 missed it -- I didn't see anything that referred to ballots
24 that were returned undeliverable. So, how can you -- if it's
25 not -- if it's found to be undeliverable or, in the context of

1 Purdue, now, it's not returned, there is no affirmative
2 consent. There's just nothing to say that the person is --

3 THE COURT: Mr. Schepacarter, I asked you if you
4 wanted to ask questions of the representative, and you
5 indicated that you were satisfied with the certification.

6 Now, you --

7 MR. SCHEPACARTER: Right.

8 THE COURT: -- seem to be suggesting that you're
9 not.

10 MR. SCHEPACARTER: No, I read it. I mean, I didn't
11 see anything in there.

12 THE COURT: All right.

13 MR. SCHEPACARTER: I mean, if she wanted to say,
14 these are the parties who didn't --

15 THE COURT: All right. But I don't know how you can
16 make reference to something that's not in a certification
17 that's been accepted into evidence.

18 MR. SCHEPACARTER: Understood. I understand, Your
19 Honor.

20 THE COURT: Thank you.

21 MR. SCHEPACARTER: Understood.

22 THE COURT: I think one of the parties made an
23 argument, it's kind of a new argument, I guess, with respect
24 to what I would say is the default judgment issue or the class
25 action issue. And it's sort of a contractual issue. And I

1 think it was the Committee that mentioned this. And they say,
2 you know, the contract, certain things could be silent. If
3 you don't respond to a default judgment, it could be judged
4 against you. But that's with respect to claims that go right
5 between those parties.

6 So, with respect to a lawsuit, you have a plaintiff
7 and a defendant. If you don't answer the complaint, you have
8 the defendant right there, but in the third-party release and
9 the third-party claim situation, you have claims all over the
10 place, a number of claims against even unnamed parties, and we
11 don't even know who they are. So, you can't say it's some
12 sort of a one-on-one thing. I have a lawsuit. I didn't
13 answer the lawsuit. But, now, I have all of these other
14 claims, so I don't know all these other parties that may or
15 may not exist. How am I going to say that that same type of
16 situation, the one-on-one contractual privity type of
17 situation.

18 Same thing with a class action suit, you get that
19 card in the mail that says, you are named as a party -- a
20 potential claimant in a class action because your bank charged
21 fees that it shouldn't have charged, so you look at it and
22 say, okay, that's the issue, the fee issue. That's the one.
23 I'm not worried about it, and I throw the card away. Okay.

24 This is a different situation. This is a situation
25 where you have parties all over the place, and you don't know

1 what claims are being -- with these third parties, agents and
2 the like, and how are you going to determine what claims, of
3 all of those claims, that you're -- that you're -- you're
4 dealing with? So, like I said, Purdue, I think, changes the
5 landscape. I think it makes it where you need to have
6 affirmative consent. I know they didn't talk about what
7 consent is, but I think that, where you have a situation where
8 parties have not filed ballots, have not sent ballots back, I
9 don't think you can, by silence, say, you have affirmative
10 consent.

11 I thought I heard somebody say one time that I see
12 consent as sort of being, well, you know, I yell to my wife,
13 she's up the stairs, I'm going to go play golf on Friday, and
14 we go on the rest of the day, and I assume that she heard me,
15 but if she doesn't hear me, so be it. Well, this is a little
16 different situation. It's not a one-on-one where I'm dealing,
17 you know, just with one person.

18 When you're talking about third-party releases, it
19 would be like your whole neighborhood is now going to do
20 whatever they're going to do, and you're supposed to be able
21 to listen to that, try to figure out each person, what you're
22 dealing with with respect to each person.

23 So, I'll be happy to answer questions or reply to
24 others' arguments. I'll reserve that right, if I can. Thank
25 you, Your Honor.

1 THE COURT: You're welcome, Mr. Schepacarter, thank
2 you.

3 Mr. Ferrell?

4 You're muted.

5 MR. FERRELL: Yes, apologies, Your Honor. I saw it
6 once I was half-way through my sentence. It was a good one,
7 too. Sorry.

8 THE COURT: Sorry we missed it.

9 MR. FERRELL: Your Honor, Ian Ferrell, for the
10 Debtors. No, Your Honor, we would like to think that this
11 plan is not severe. In fact, this plan's language is fairly
12 standard and is regularly approved in this District. As Mr.
13 Schepacarter identified, the Purdue case, you know, certainly
14 changes things, but what that does is, it changes third-party
15 releases, as it relates to those that are non-consensual.

16 So, in order to -- it does not address and does not
17 weigh in on what consent -- or what it means to be a
18 consensual third-party release. In this District, a third-
19 party -- this District regularly recognizes the opt-out
20 mechanism as being sufficient to constitute what would be a
21 consensual third-party release. The opt-out mechanism and the
22 third-party release generally is reasonable, appropriate and
23 fully consistent with decisions by courts in this District.

24 The third-party release language and the opt-out
25 mechanism was clearly and conspicuously included in materials

1 that went to all affected parties, including the plan, the
2 disclosure statement, the solicitation materials, the ballots
3 and the opt-out forms. Further, the Committee letter, which
4 was included in the solicitation materials include a
5 recommendation for the parties to opt-out of the third-party
6 releases.

7 The obligation to affirmatively check a box to opt-
8 out appears in all of these documents and should come as no
9 surprise to any parties. In fact, we had over 80 opt-out
10 returns in this case, showing that that mechanism did work.
11 The law is clear that a release is consensual where parties
12 have received sufficient notice of a plan's release provisions
13 and it had an opportunity to object and/or opt-out and failed
14 to do so. This includes when a voter abstains from voting
15 altogether.

16 As such, it is clear that all applicable
17 stakeholders had proper notice of their rights and could have
18 chosen to opt-out of the third-party releases, and as stated,
19 a number of parties did just that. Specifically, to address
20 the argument about undeliverable ballots or opt-out forms,
21 Your Honor, I would also like to direct the Court's attention
22 to the solicitation order, which was entered at Docket Number
23 474.

24 THE COURT: Give me a moment.

25 MR. FERRELL: Yes, Your Honor.

1 (Pause in proceedings.)

2 THE COURT: Okay.

3 MR. FERRELL: Your Honor, paragraph 21 of that
4 solicitation order, in short, authorizes Debtors to rely upon
5 the address information for holders of claims and interests
6 maintained by the Debtors and/or their agents provided to Epiq
7 by the Debtors and/or their agents as of the voting record
8 date. To that end, the Debtors and Epiq don't have an
9 obligation to perform additional research for updated
10 addresses based upon solicitation materials.

11 In short, you know, our position is that the
12 solicitation order has authorized the Debtors to send
13 addresses to those that are on file, and that is what the
14 Debtors are allowed to rely upon for purposes of solicitation
15 and, ultimately, third-party releases.

16 Additionally, Your Honor, I understand or, as Your
17 Honor is aware, the Committee, the only voting creditor class
18 in this class, in its statement in support of confirmation,
19 has also supported the third-party releases.

20 With that, Your Honor, I think I might have kept it
21 shorter than the gatekeeper-provision argument, and I'm happy
22 to answer any questions or go further on any of the points.

23 THE COURT: I'm fine.

24 Mr. Gage, did you indicate you wanted to speak on
25 this issue?

1 MR. GAGE: Yes, Your Honor, the Committee would like
2 to be heard on this issue. Again, for the record, Rich Gage,
3 Kelly, Drye & Warren, on behalf of the Committee. Before
4 getting into that, I just want to say the Committee
5 appreciates the hard work of everyone involved in this case,
6 including the Court and its staff, the Debtor's management
7 team and, of course, their professionals. We also appreciate
8 the service of the members of our Committee.

9 And while we appreciate the special role that the
10 U.S. Trustee plays in bankruptcies, we think that the
11 objection is misguided, and we -- we would say that the
12 Committee, you know, fully supports the plan as proposed, and
13 we believe that the third-party releases are appropriate.
14 We'll mostly rely on our statement in support of confirmation,
15 which is -- which Your Honor has indicated that you've read,
16 and just for the record, it's -- it's on Docket Number 583.

17 Just a few points in response to the U.S. Trustee,
18 you know, we agree that Purdue is sort of a -- it's a
19 monumental decision in a lot of ways, but it really does not
20 disturb the consistent case law, the overwhelming case law
21 that existed before Purdue and, you know, continues after
22 Purdue as it relates to what is consent. Right. It does not
23 -- Purdue decided that non-consensual releases were
24 inappropriate but did not weigh in at all on consensual
25 releases or what consent is.

1 And we think that the case law on this is pretty
2 consistent. There are some outliers, obviously, as the
3 Trustee has pointed out, but the overwhelming majority
4 recognized that this type of implied consent, where there is
5 sufficient notice and an opportunity to opt-out is, sort of,
6 in the wheelhouse of what is considered consent in these
7 situations.

8 And, just on the -- the U.S. Trustee had mentioned
9 about, you know, potential non-return of ballots or, you know,
10 what we can read into that. I know that the Debtors have
11 responded to that, but just one other point on that is that,
12 to the extent there is any issue about the notice, that's
13 something that can be argued later on. That's a demanding
14 standard to say that you didn't receive the notice and all
15 that, given the way that the Bankruptcy Code is structured.
16 But to the extent that there is some argument, that's
17 something on the back end that we don't have to deal with
18 today.

19 The Trustee had mentioned that some of the cases we
20 cited or the principles we cited with regard to class actions
21 and default judgments and contracts, you know, there's, like,
22 a one-to-one relationship, and we're asking for things that
23 are, sort of, ancillary to the, you know, Debtor/creditor
24 relationship.

25 But I think those principles are more about the

1 notice, right, and the idea that folks are presumed to read
2 certain important notices that they receive like those in
3 bankruptcy. There's a lot of situations in bankruptcy where
4 that kind of negative notice is deemed sufficient. And I
5 think that, here, it's not just an opt-out box, that they're
6 very clear and conspicuous notices that explained exactly what
7 was going on, in terms of the third-party releases that were
8 in the plan, and that kind of notice is sufficient when
9 partnered with the opportunity to opt-out. And there is no,
10 you know, sort of objection here that there wasn't a
11 sufficient opportunity to opt-out, you know, in terms of
12 timing or anything like that. So, we think that this is
13 plainly sufficient, given general principles of contract and
14 litigation and the special rules in bankruptcy. These third-
15 party releases were consensual and therefore appropriate.

16 Unless Your Honor has any questions, we'll otherwise
17 rely on our statement in support.

18 THE COURT: No, thank you very much.

19 Mr. Schepacarter, any response?

20 MR. SCHEPACARTER: Just briefly, Your Honor. With
21 respect to that -- as I indicated earlier, with respect to
22 the, sort of, default judgment and that class action issue,
23 it's a little different when you get that lawsuit or you get
24 that card that says, here's your claim. Like, that's one
25 issue, not a whole number of issues. So, you get the

1 bankruptcy, you look at the releases, you have no idea, all of
2 those parties that are named, what claims you may have against
3 those parties, because they're not even named. They're just
4 identified by sort of a category, agent, employee, et cetera.
5 And it says related parties, whoever they may be. And then I
6 have all these claims that I may or may not have against those
7 parties that I don't even, sort of, know about at the time
8 that I don't even, like, recognize. It's not like, like, my
9 bank charged me two months of interest or somebody sued me
10 because of whatever, I had a car accident, and I knew I had
11 the accident. It's, like, a one event. This is like events
12 are all over the place.

13 And that's all I have to add, Your Honor, thank you.

14 THE COURT: But under -- but under that theory, Mr.
15 Schepacarter, I mean, can't that -- if they received absolute
16 proper notice, but they don't understand they have a claim,
17 you're suggesting that they could never be released. They
18 might know if they're claimants or not sure. Under a theory
19 of, they received proper notice, and under your theory it's,
20 well, if they don't know what their claim is, then, they still
21 shouldn't be bound. That's how I'm interpreting what you're
22 saying.

23 MR. SCHEPACARTER: No. It's an easy fix. The easy
24 fix is, they opt-in. I'm agreeing to the provision. I
25 affirmatively agree to it. It's a little different.

1 THE COURT: So, your position is, they have to opt-
2 in, no matter what?

3 MR. SCHEPACARTER: Not no matter what, but they have
4 to opt-in when they see whatever the provisions are, and I
5 affirmatively --

6 THE COURT: Opt-in or opt-out? I'm sorry. Opt-in
7 -- we're using opt-in. This is not an opt-in case; this is an
8 opt-out case.

9 MR. SCHEPACARTER: This is not an opt-in, no.

10 THE COURT: Right.

11 MR. SCHEPACARTER: But it -- it -- an opt-in -- opt-
12 in provisions and an opt-in process --

13 THE COURT: Yeah, we're not talking about that. I'm
14 not going to get into the argument of opt-in. This is not an
15 opt-in case.

16 MR. SCHEPACARTER: Right, understood.

17 THE COURT: It's an opt-out. Okay.

18 MR. SCHEPACARTER: But I think that's -- to answer
19 Your Honor's question, I think that would be the case. Thank
20 you.

21 THE COURT: All right, thank you.

22 Anyone else?

23 MR. FERRELL: Very briefly.

24 THE COURT: Yes, go ahead, Mr. Ferrell.

25 MR. FERRELL: Very briefly, Your Honor, Ian Ferrell,

1 for the Debtors. Just to address the point of the number of
2 released parties, I would, again, you know, refer back to the
3 consistent precedent in this case, which includes released
4 parties and the definition that we have incorporated into the
5 plan is consistent with precedent in this District. Just with
6 the size and the magnitude of complex Chapter 11 cases and in
7 order to get finality and to make the plan enforceable, a
8 number of parties need to be included in the released parties
9 definition.

10 Additionally, very briefly, I believe that the
11 Committee had raised one point about, you know, notice being
12 sufficient or not, which, you know, is consistent with what we
13 had discussed. But, just very quickly, we'd like, of course,
14 to direct -- or we'd like to refer to the Cyxtera confirmation
15 briefing -- or confirmation hearing. In that hearing, Judge
16 Sherwood or -- yeah, Sherwood, rather -- had expressed more
17 comfort with an opt-out provision in third-party releases,
18 particularly, in light of a gatekeeping provision and found
19 that, if there had been an issue with, you know, notice and
20 appropriate consent that the Court, again, would be very
21 familiar with what happened and be the appropriate place to
22 bring this.

23 And, so, ultimately, the gatekeeper provision, the
24 third-party release provision and the other provisions in this
25 plan do work together, ultimately, to really see that this

1 case is resolved appropriately, efficiently and with finality.

2 THE COURT: Thank you.

3 All right, anyone else?

4 (No audible response.)

5 THE COURT: No? All right.

6 I am actually prepared to rule on confirmation,
7 today, in light of the arguments made today, and the well
8 thought out and ample pleadings provided by all parties in
9 this matter. Before I do so, I just want to confirm for the
10 record's sake so that it's not an issue when it comes down the
11 road, we do have the second amended joint plan with some minor
12 changes. As I understand it, there is no objection to
13 confirmation of the second-amended -- releases aside, Mr.
14 Schepacarter -- and the clauses, the objections aside -- the
15 terms of the language of the document, itself, and the changes
16 that were made, there is no objection, correct, Mr.
17 Schepacarter?

18 MR. SCHEPACARTER: I'm not as quick on the audio
19 button as I should. For the record, Richard Schepacarter, for
20 the United States Trustee. No, the other provisions, some of
21 which -- some of the issues have been negotiated.

22 THE COURT: Right.

23 MR. SCHEPACARTER: And we negotiated a number of
24 different provisions.

25 THE COURT: Right.

1 MR. SCHEPACARTER: This is where we kind of boiled
2 it down to, so other than this, everything else is acceptable
3 to our office, thank you.

4 THE COURT: Mr. Gage, on behalf of the Unsecured
5 Creditors?

6 MR. GAGE: Yes, Your Honor, no objections to the
7 plan from the Committee.

8 THE COURT: And, likewise, no objection to Document
9 609, the first amended plan supplement, Mr. Gage?

10 MR. GAGE: That's correct, Your Honor, no objections
11 to the plan supplement.

12 THE COURT: And, Mr. Schepacarter?

13 MR. SCHEPACARTER: No. There were some changes to
14 the plan supplement, but I don't think it changes anything in
15 the context of the plan, itself, the provisions that --

16 THE COURT: Right.

17 MR. SCHEPACARTER: Thank you.

18 THE COURT: All right, so there is no objections to
19 the documents that have been filed. Those are what the Court
20 has considered and has reviewed for purposes of confirmation
21 today. So, if the parties would bear with me for a few
22 moments. Now, I get to have my day in the sun.

23 And I do truly appreciate the arguments and the
24 thought process today. You, certainly, all of the parties
25 have enlightened me even further, but I've already made

1 changes to my thoughts, and I've included my thoughts for
2 today in what I am going to set forth.

3 As I said, this matter before the Court involves the
4 Chapter 11 bankruptcy cases of Bowflex, New Jersey, LLC, Case
5 Number 23-12363 and Bowflex, Inc., Case Number 24-12364, which
6 cases are jointly administered under the Bowflex, Inc. case
7 number. We are here for confirmation of the second amended
8 joint Chapter 11 plan of liquidation of Bowflex, Inc. and its
9 Debtor-affiliate, Document Number 607, as supplemented by the
10 notice of filing of first amended plan supplement, Document
11 Number 609, which the Court will refer to collectively as "the
12 plan" going forward.

13 Initially, two objections were lodged as to
14 confirmation of the Debtor's original joint chapter 11 plan,
15 the objection of the plan by the U.S. Trustee, Document Number
16 552, as further supplemented, and the objection to
17 confirmation of plan on behalf of Chubb Companies, Document
18 Number 571. Since then, the objection of Chubb Companies has
19 been resolved, and as can be noted by the text today, only the
20 Trustee's objections remain.

21 One note, the Court finds that the proposed
22 modifications of the first and second amended plans were and
23 are technical or clarifying in nature and thus, are not -- is
24 that a problem? Can you folks still hear me? Yeah, okay.

25 And were and are technical or clarifying in nature,

1 and thus, are not material changes nor do they adversely
2 affect a change in treatment of the claim of any creditor or
3 interest of any equity security holder warranting a
4 resolicitation. I'm referring to Federal Rule of Bankruptcy
5 Procedure 309 -- 3019A and A.H. Robins Company, 88 B.R. 742,
6 affirmed 880 F.2d 694.

7 Here, notably, not one unsecured creditor or, for
8 that matter, any other creditor, objected to the plan.
9 Indeed, the Unsecured Creditors Committee, hereinafter "the
10 Committee", after extended negotiation with the Debtor has
11 filed it's well-written statement in support of confirmation
12 of the plan, Document Number 583, which fully supports
13 confirmation of the plan.

14 Finally, the Debtor has submitted the declaration of
15 Robert Hoge, general counsel and Chief Wind-Down Officer of
16 the Debtors in support of confirmation, Document Number 587,
17 and its thorough and proficient memorandum of law, Document
18 588, in support of confirmation. All parties appeared for a
19 confirmation hearing and have made their arguments. Evidence
20 has been submitted by way of pleadings and in-person
21 confirmation testimony of the certifications of Mr. Hoge and
22 the representative from Epiq. A sufficient record has been
23 established, and the record is closed.

24 The Court has considered the legal and factual basis
25 set forth in the parties' arguments, and testimony, including

1 the arguments made today and the submissions in the matter are
2 -- and this matter is ripe for disposition. The matter is a
3 core proceeding pursuant to 28 U.S.C. 157(b)(2)(A), (L) and
4 (O). The Court has jurisdiction pursuant to 28 U.S.C. Section
5 1334, 28 U.S.C. Section 157 and the standing order of
6 reference issued by the United States District Court for the
7 District of New Jersey on July 23rd, 1984, as amended on
8 September 18th, 2012, referring all bankruptcy cases to
9 bankruptcy courts.

10 As will be fleshed out more fully and included in
11 the Court's order confirming the plan, the following
12 constitutes this Court's findings of facts and conclusions of
13 law, as required by Federal Rule of Bankruptcy Procedure 7052.
14 With that in mind, the Court hereby incorporates the
15 declaration of Mr. Hoge, the Committee's statement and the
16 Debtor's memorandum of law in support of confirmation into its
17 decision. The Court finds that -- as well as the Trustee's
18 objections.

19 The Court finds that all requirements regarding
20 deadlines for the notice and service, solicitation and voting
21 for and the objection to the plan have been met, as evidenced
22 by the certificate of service for the notice of 1) hearing to
23 consider confirmation of Chapter 11 plan of liquidation for
24 Bowflex, Inc. and its Debtor-affiliate and 2) related voting
25 and objection deadlines, Document Number 509, as well as the

1 other forms and notices set forth on the Docket.

2 To begin with, the Court notes that the proponent
3 can demonstrate by a preponderance of the evidence that it's
4 plan satisfies all of the applicable elements of Section
5 1129(a), and that's In Re: Boy Scouts of America, 642 B.R.
6 553, affirmed 650 B.R. 87. The Court must confirm the plan as
7 consensual. If the plan is not consensual, one that does not
8 satisfy 11 U.S.C. Section 1129(a)(8), a Court may still
9 confirm a plan, as long as the plan meets the other
10 requirements of 1129(a) and does not discriminate unfairly and
11 is fair and equitable as to the dissenting impaired class.
12 And that's Armstrong World Industries, Inc., 432 F.3d 507,
13 Third Circuit.

14 The Court independently considers each of these
15 requirements for confirmation. That's In Re: TCI II Holdings,
16 LLC., 484 B.R. 117. To start with, except for 1129(a) and the
17 Trustee's specific argument that the plan contains
18 impermissible provisions, no argument has been made by any
19 party that the plan does not satisfy the remaining
20 requirements of 1129(a). Nonetheless, the Court, in making
21 its independent determination, has reviewed and accepts the
22 undisputed and credible testimony and declaration of Mr. Hoge
23 in support of confirmation.

24 Likewise, the Court considers and accepts the
25 reasoning and analysis set forth in the uncontested Debtor's

1 memorandum of law and finds it correct regarding the
2 unchallenged elements necessary to satisfy Section 1129 of the
3 Bankruptcy Code. As part of its own determination, the Court
4 notes that 1129(a)(5), directors and officers, (a)(6),
5 approval of rate changes, (a)(13), retiree benefits, (a)(14),
6 domestic support obligations, (a)(15), individual debtors, and
7 (a)(16), nonprofit entities do not apply here.

8 Correspondingly, there is no challenge to the plan
9 with regard to the requirements of 1122, classification of
10 claims in interest, the contents of the plan under 1123,
11 except for the specific objection of the Trustee, which we'll
12 address shortly, 1124, impairment of claims in interest, and
13 1126, acceptance of the plan.

14 Briefly, as to the elements of 1129(a)(1),
15 compliance with the Bankruptcy Code, it is satisfied through
16 the application to the satisfaction of a Section 1123 and 1122
17 requirements. (a)(2), debtor's compliance with the Bankruptcy
18 Code is satisfied by way, of one example, through the noticing
19 and solicitation requirements previously discussed, (a)(3),
20 good faith, is satisfied as to the plan has been proposed with
21 the basis for expecting that a reorganization could be
22 effective. And that's the W.R. Grace & Company case, 729 F.3d
23 332, Third Circuit. Liquidation is a valid form of
24 reorganization. (a)(4), payment of professionals is properly
25 addressed. (a)(7), acceptance and best interest of creditors

1 test, is satisfied, because, here, each impaired class of
2 claims or holders of interest has either accepted the plan or
3 will receive not less than what they would receive under
4 Chapter 7. (a)(8), although Section 829(a)(8) has not been
5 satisfied with respect to the deemed or rejected classes, the
6 plan is still confirmable because it satisfies 1129(b)
7 elements, which will be shortly discussed. 1129(a)(9),
8 treatment of priority claims, is properly addressed. (a)(10),
9 acceptance by an impaired class, with 100 percent of the
10 Bowflex, New Jersey and 94.29 percent of the Bowflex, Inc. of
11 impaired class through voting, and that's Document Number 563.
12 (a)(11), feasibility, is present here, as the liquidated plan
13 is permissible, and the plan provides reasonable procedures by
14 which the Debtors and/or the liquidating trust may make the
15 necessary distributions, and (a)(12), 28 U.S.C. Section 1930,
16 fees, are properly addressed.

17 As previously stated, the plan does not satisfy
18 1129(a)(8), but the Court can still confirm the plan under
19 1129(b) so long as it's shown the plan does not discriminate
20 unfairly and it's fair and equitable. It is not lost on this
21 Court that no party has claimed that the plan does not satisfy
22 1129(b). Nevertheless, it must still find the elements are
23 satisfied. The Court determines that based upon the testimony
24 in the declaration of Mr. Hoge, that the plan satisfies the
25 requirements of 1129(b). First, all of the requirements of

1 Section 1129(a), other than (a)(8), have been met. Next, the
2 plan is fair and equitable with respect to the deemed rejected
3 classes, as it has been proposed in good faith, is reasonable
4 and no holder of any claim or interest that is junior to each
5 such class will receive or retain any other property under the
6 plan on account of such a junior claim or interest, and no
7 holder of a claim or interest in a class senior to such
8 classes is receiving more than payment in full on account of
9 its claim or interest.

10 Finally, the plan does not discriminate unfairly
11 with respect to the deemed rejecting classes because,
12 similarly situated claims and interest holders will receive
13 substantially similar treatment on account of their claims in
14 interest.

15 The Debtors make compelling arguments in their
16 memorandum of law with regard to these elements, as well as
17 the other elements, and the Court finds their analysis
18 persuasive. Accordingly, I can readily conclude that the plan
19 satisfies all of the elements required under Section 1129 of
20 the Bankruptcy Code, and the plan is ready for confirmation,
21 save for the objection of the Trustee.

22 The Court will discuss the Trustee's objections out
23 of order, as set forth in its formal objection. First, the
24 plan contains a provision whereby the plan, as a whole, is
25 treated as a settlement subject to a tacit approval under

1 Federal Rules of Bankruptcy Procedure 9019. The Trustee
2 argues that the plan cannot be confirmed because it purports
3 to contain settlements and to be, itself, a settlement with
4 releasing parties that have no formal agreements with the
5 Debtors or the many non-debtors receiving releases. The Court
6 does not find the Trustee's arguments persuasive here.

7 The revised language of the general settlement
8 provision in the plan and the amended plan and the draft
9 proposed confirmation order explicitly state that the general
10 settlement applies to the greatest extent permissible under
11 the Bankruptcy Code and the Bankruptcy Rules and have not
12 included reference to Bankruptcy Rule 9019. This language is
13 consistent with the language regularly confirmed by other
14 courts in this District, and the Court finds the guidance in
15 those cases sound and sees no reason to deviate from this
16 practice. See, for example, In Re: In Vitae, Bankruptcy Case
17 Number 24-11363, a Judge Kaplan case; In Re: Cyxtera
18 Technologies, Inc., Case Number 23-14853, a Judge Sherwood
19 case; and In Re: Thrasio Holdings, Case Number 24-11840, a
20 Judge Gravelle case. Consequently, the Trustee's objection in
21 this regard is overruled.

22 Next, the Trustee argues that the plan cannot be
23 confirmed because it contains a gatekeeper provision. The
24 Trustee argues that the plan creates an impermissible
25 gatekeeper rule for this Court that forces a non-debtor, who

1 wishes to pursue a claim or cause of action against another
2 non-debtor, to come to this Court and only this Court for a
3 determination of whether such a claim or cause of action is
4 released. Essentially, the provision provides that no party
5 may commence, continue, amend or otherwise pursue a cause of
6 action against the defined parties without first requesting a
7 determination from this Court that it has a colorable claim,
8 and the Court authorizes the party to pursue that claim.

9 The Debtors argue the purpose of the gatekeeper
10 provision is to insure that the Debtors and other released
11 parties do not become bogged down in vexatious, meritless
12 litigation of claims that have been released under the plan in
13 Courts that are unfamiliar with the Chapter 11 case, and that
14 the release and the exculpation provision is contained in the
15 plan and approved by the Court. The Court agrees.

16 As noted by the Debtors, the gatekeeper provisions
17 do not contemplate that this Court will necessarily rule on
18 the underlying merits of the action, rather the Court is
19 making an inquiry as to whether or not there is an ability to
20 bring an action or whether it has been addressed as part of
21 the plan or the confirmation order.

22 Without question, this Court has authority to
23 provide for such a revision, and there is ample support for
24 such a position. See, for example, just in this District,
25 alone, the Invitae matter, as well as the Cyxtera and the

1 Thrasio cases previously discussed, also, In re: WeeWork, Case
2 Number 23-19865, a Judge Sherwood case, BlockFi, Case Number
3 22-19361, a Judge Kaplan case, In re: Bed, Bad & Beyond, Case
4 Number 23-13359, a Judge Papalia case, In re: National Realty
5 Investment Advisors, LLC., 22-14539, another Judge Sherwood
6 case, and Princeton Alternative Income Fund, LLP, Case Number
7 18-14603, another Judge Kaplan case.

8 The Court finds the reasoning by the Court in the
9 Bed, Bath & Beyond case persuasive. That Court recognized
10 that, absent the gatekeeping function, courts across the
11 country are likely to construe and interpret the language of a
12 plan and a confirmation in an inconsistent fashion, and that
13 there would be a minimal burden imposed on the Bankruptcy
14 Court in acting as the gatekeeper, because, in all likelihood,
15 in all of these situations, it's coming back before the
16 Bankruptcy Court anyway.

17 Also persuasive is the BlockFi case, where the Court
18 noted that it made no sense to urge parties to make
19 contribution to a Chapter 11 case, and in return, secure
20 releases or secure certain rights that will be undercut by
21 then having to defend their positions all across the country
22 in front of separate courts in separate forums with
23 inconsistent results. This also makes no sense to this Court,
24 and accordingly, the objection of the Trustee is overruled
25 here.

1 Now, as to the third-party releases, the Trustee
2 argues that the plan's third-party release provisions are
3 objectionable because they impose releases on claimants
4 without obtaining their affirmative consent, and they extend
5 to an unknown number of unnamed and unidentifiable release
6 parties. The Court is not convinced. The plan and the ballot
7 contains clear and conspicuous third-party release provisions,
8 which provide that any party who did not specifically object
9 to or opt-out of their inclusion shall release all defined
10 claims and causes of action that could be asserted against the
11 released parties.

12 Although a party could exercise their right to do
13 so, there is no need to formally object to the plan as simply
14 checking off the opt-out box on the ballot was enough. It is
15 undisputed that these third-party releases were heavily
16 negotiated and an integral part to the plan, as it is unlikely
17 the Debtors would have been able to bring their key
18 stakeholder groups to the bargaining table or effectuate a
19 value-maximizing transaction, as contemplated by the plan,
20 without them.

21 It is also not lost on the Court that not one actual
22 creditor objected to the plan with regard to the third-party
23 releases. What is more, the Unsecured Creditors Committee,
24 the entity charged with protecting the rights of the unsecured
25 creditors, negotiated the language of the releases and fully

1 support the confirmation of the plan. The Trustee argues that
2 the plan cannot be confirmed because the third-party releases
3 are impermissible under applicable law, and in particular, the
4 failure to opt-out is insufficient to establish consent to the
5 third-party releases.

6 The Trustee states that, given the Purdue Pharma
7 Court's emphasis on obtaining a claimant's consent before the
8 claims are bargained away or otherwise extinguished, it is
9 clear that merely voting for a plan is not sufficient to
10 evince a claimant's affirmative consent to third-party
11 releases. The Trustee further argues that merely providing an
12 opt-out box, in and of itself, is not sufficient to establish
13 consent to a third-party release by any of the Debtor's
14 claimants that do not return a ballot or notification with the
15 opt-out box checked, but as acknowledged by the Trustee, the
16 Supreme Court's ruling in Harrington vs. Purdue Pharma, 144
17 Supreme Court 2071, did not determine what constitutes a
18 consensual release provided for under a proposed Chapter 11
19 plan.

20 For that determination, this Court must look to
21 guidance from current case law. Courts in the Third Circuit
22 have regularly concluded that a plan may provide for release
23 of third-party claims against non-debtor upon the consent of
24 the party affected. That's Indianapolis Downs, 486 B.R. 286.
25 However, the Third Circuit has never articulated what it means

1 for a release to be consensual. That's In Re: Arsenal
2 Intermediate Holdings, LLC, 2023 Westlaw 265592. Third
3 Circuits have been split regarding whether or not the party
4 affirmatively consented to a release, known as a contract
5 theory, or whether deemed consent, based upon a failure to
6 object to a plan after adequate notice is sufficient, also
7 known as the due process theory.

8 This Court finds the due process theory to be the
9 better approach and more in line with the nature of the
10 bankruptcy process. Under this theory, courts that have
11 approved plans containing clear and conspicuous language
12 regarding third-party release and opt-out provisions have used
13 releases simply as plan provisions that must be consistent
14 with the provisions of the Bankruptcy Code, and as long as the
15 plan is validly certain, creditors must object and/or mark the
16 provision to preserve the right to legal recourse.

17 Indeed, this responsibility to participate and
18 preserve their rights is the very nature of our legal system,
19 especially in bankruptcy proceedings. As Judge Goldblatt
20 stated in the Arsenal Immediate Holdings case at page five,
21 "As a practical matter, the functioning of the bankruptcy
22 system generally depends on requiring parties that object to
23 the relief proposed in a plan to come to the Court to raise
24 their objection."

25 He goes on, further, to say, "In our adversarial

1 proceeding, that is the role of the contract/counter party.
2 If and when a party raises an objection, the Court will hold a
3 hearing, and the Debtor will be held to its burden of proof.
4 But a party that is validly certain does not raise an
5 objection will be deemed to have consented to the relief.
6 That happens in Bankruptcy Court every day, and there is
7 nothing controversial about it."

8 In fact, the Committee's statement provided in
9 support of confirmation provides multiple examples of where
10 the rights of parties, including a party to a contract, are
11 affected by the application of due process theory through the
12 bankruptcy process. With this in mind, the due process theory
13 makes the most sense to this Court, and I conclude that, as
14 long as the terms of the third-party release are set forth
15 clearly and conspicuously, and impaired creditors have the
16 option of opting-out by checking the box off on their ballot
17 without the need for filing a formal objection to confirmation
18 and service was proper, then this Court will confirm a plan
19 containing such releases.

20 Simply put, it is incumbent upon the parties who
21 have been properly served with pleadings to protect their own
22 rights. There has been no question that these ballots and the
23 information have been properly served in accordance with this
24 Court's order. Approving plans with third-party releases and
25 opt-outs is not quite the hot topic button as it may seem.

1 Until the Third Circuit or the Supreme Court tells us
2 otherwise, application of the due process theory remains a
3 valid choice for bankruptcy courts to employ when approving
4 such plans.

5 There is a long line of recent cases that take this
6 approach, and the Court is persuaded by and adopts their
7 reasoning in those cases of several of my colleagues in this
8 District, confirming plans containing third-party releases.
9 For the sake of brevity, and because the approach is
10 consistent in each of the cases, I will not regurgitate the
11 facts and the findings of those cases, but, rather, merely
12 identify them as support for my position. They are the
13 Invitae case, whereby Judge Kaplan at Docket Number 869, in
14 the transcript, incorporating by reference its prior holdings
15 and expressed rationals on these issues as set forth in the
16 Court's previous rulings in BlockFi, Bed, Bath & Beyond and
17 Rite Aid. In Thrasio, at Docket Number 1153, the transcript,
18 confirming that and holding third-party releases were
19 consensual and not burdensome, where all creditors received
20 the opportunity to opt-out, notice of the releases was in bold
21 print and set off from other text and provided via disclosure
22 statement, claims administrator website and ballots. And
23 WeeWork, Case Number 23-19865, Judge Sherwood case, at Docket
24 Number 2072, which was the transcript, confirming the plan
25 containing opt-out and third-party releases. Cyxtera at

1 Document Number 905, the transcript, confirming plan and
2 holding third-party releases were consensual, where creditors
3 received notice and opportunity to be heard, and the process
4 to opt-out was easy. Bed, Bath & Beyond, 23-13359, at
5 Document Number 2280, transcript, confirming where creditors
6 were given adequate, clear and conspicuous notice via the
7 plan, disclosure statement and ballots, and because opting-
8 out, the order to protect their interest was not burdensome
9 upon the creditors. And BlockFi, Case Number 22-19361, Judge
10 Kaplan, Document Number 1621, transcript, holding that
11 creditors received due process via hearing notice, disclosure
12 statement, plan language, websites, ballots, solicitation
13 letter, and opt-outs are consensual, as creditors were given
14 the opportunity to preserve their rights. And In re:
15 Accutane, Case Number 21-10362, another Judge Kaplan case,
16 Document Number 642, the transcript. And SLT Holdco, another
17 Judge Kaplan case, 20-18368, the transcript located to
18 Document Number 549, holding that there was due process, and
19 that the third-party releases were consensual, where all class
20 members, including non-voting members of the classes received
21 the opportunity to opt-out of the releases.

22 In addition, as noted in the Committee's statement
23 and the Debtor's memorandum of law, a majority of the courts
24 in this District, this Circuit and throughout the country have
25 routinely confirmed plans, whereas, here, creditors were

1 provided notice and were given the opportunity to opt-out of
2 releasing claims, containing third-party releases and opt-out
3 provisions. See the Committee's statement at page nine,
4 paragraph 20, the Debtor's memorandum of law, at page 23,
5 paragraph 63 and 64.

6 Clearly, the language in the notices provided in all
7 of those cases were all covered in this case. This case
8 clearly provided such -- such type of information, and
9 thereby, it's very comparable. Respectfully, this Court does
10 not find the cases relied upon by the Trustee persuasive, as
11 they do not involve opt-outs, involved inconspicuous releases,
12 are factually distinguishable and/or applied a contract theory
13 that this Court is unwilling to adopt.

14 For example, in the case of In Re: Emerge Energy
15 Services, 2019 Westlaw 7634308, the Judge Owens case relied on
16 by the Trustee, unlike the present case, confirmation was
17 contentious, as there was multiple objections to the plan,
18 including from the Unsecured Creditors Committee. Here, the
19 Committee endeavored to work cooperatively with the Debtors to
20 facilitate a value-maximizing sale, preserve potentially
21 valuable residual assets and implement an efficient wind-down
22 of the Debtor's domestic and foreign operations.

23 The Committee also conducted a thorough
24 investigation to the claims proposed to be released under the
25 original plan, and based upon that investigation, negotiated

1 the plan revisions to narrow the scope of the estate's
2 releases. See the Committee statement at paragraph one.
3 Moreover, cognizant of the pending Purdue decision that the
4 Debtors and the Committee structured the plan's 30-party --
5 excuse me -- third-party releases to insure compliance with
6 long-standing precedent that remains unauthored after Purdue.
7 See the Committee's statement at paragraph four.

8 Also, here, the Court entered an order approving the
9 disclosure statement, and that order set forth a notice of
10 requirements, which no one has objected to. The Debtors
11 mailed ballots to holders of unsecured claims in class three,
12 and notices to non-voting status to non-voter creditors and
13 interest holders. The ballots and non-voting notices
14 contained conspicuous notices that the plan contained releases
15 and allowed voting creditors and allowed holders of claims and
16 interest in non-voting classes to opt-out of the releases.

17 What is more, the solicitation package also
18 contained a letter from the Committee, which, among other
19 things, explained the Committee's concerns with regard to the
20 releases and advised the creditors of their right to opt-out
21 of the release, and specifically urged the parties to do so.
22 There was no such letter in the Emerge Energy Services cases
23 relied on by the Trustee. Here, the Committee went so far as
24 to spoon-feed the recipients by expressly demonstrating how
25 the ballot and notices to opt-out should be completed. The

1 Committee even provided the recipients with all of its reasons
2 why they should opt-out and object to the plan. As reflected
3 in the declaration regarding the solicitation and tabulation
4 of ballots cast, Document Number 563, only a de minimis number
5 of recipients opted-out, and no one objected to the plan.

6 The fact that the opt-outs were actually returned
7 demonstrates to this Court the effectiveness of the notice.
8 In addition to all of that, the Committee conducted an
9 investigation into the Debtor's historical conduct in a
10 potential claim that otherwise might be preserved to enhance
11 value for creditors. The Committee shared the results of its
12 investigation with Debtors resulting in a settlement limiting
13 the release, whereby only Debtors, directors and officers who
14 held respective positions on or after the petition, it will be
15 released, and our release is contingent on the directors and
16 the officers waiving any right to recovery based on any filed
17 or scheduled claims.

18 The claims against former directors and officers
19 will be preserved, and the liquidating trust will have the
20 authority to pursue those claims, if any. The plan also
21 appoints UMB Bank, N.A. as a liquidating trustee of the
22 liquidating trust to monetize remaining assets, reconcile
23 claims or make distribution to creditors. See the Committee's
24 statement, paragraphs 12 and 13. Because of this, the
25 Committee supports the plan, and it shows that proper

1 consideration for these releases have been provided.

2 The third-party releases, here, meet the standards
3 set forth in Purdue Pharma, as they are consensual. All
4 parties' interests were provided with proper notice, both
5 indirect and by publication. There was an ability to both
6 object and opt-out. The plan and ballots were clear and
7 conspicuous. Both express -- expressly and clearly state that
8 the holders of claims and interests who do not opt-out of the
9 release contained in the plan will be bound by third-party
10 releases.

11 And, based upon the testimony of Mr. Hoge and the
12 Committee statement, the Court finds that they are fair and
13 necessary for reorganization.

14 To be fair, due process works here. The terms of
15 the third-party release are set forth clearly and
16 conspicuously, and creditors had the option of opting-out by
17 checking the box on their ballot, without the need for filing
18 a formal objection to confirmation. Creditors were given
19 explicit instructions on how to opt-out and advised of the
20 consequences if they did not. Service was proper, in addition
21 to public notification.

22 It was incumbent for the parties to preserve their
23 rights. Due process being satisfied, the Court deems the
24 third-party releases consensual, and the objection of the
25 Trustee, in this regard, is overruled.

1 Finally, the Trustee argues that the plan's
2 exculpation provision is objectionable, because it is not
3 limited to fiduciaries of the Debtor's bankruptcy estate. The
4 Trustee argues that the plan's exculpation provision is
5 impermissibly broad, under controlling case law, because it is
6 not limited to estate fiduciaries.

7 The Debtors respond by noting that the exculpation
8 clause is an integral piece of the overall settlement embodied
9 in the plan, and is the product of good-faith arms-length
10 negotiations. Moreover, the exculpation provision is narrowly
11 tailored to exclude acts of actual fraud, wilful misconduct
12 and gross negligence and relates only to acts or admissions in
13 connection with or arising out of the Debtor's restructuring
14 transaction and is limited to parties who have performed
15 valuable services as fiduciaries on the Debtor's estate in
16 connection with the Chapter 11 cases.

17 The Court notes that exculpation provisions, like
18 the one set forth in the plan, are regularly approved here, in
19 the courts in this District. Courts evaluate the
20 appropriateness of an exculpation provision based on a number
21 of factors, including whether the plan was proposed in good
22 faith, whether a liability is limited and whether the
23 exculpation provision was necessary for plan negotiations.
24 That's Congoleum, 326 B.R. 167 and Washington Mutual, 442 B.R.
25 314.

1 It's common in this District to include these
2 exculpation clauses. The record is clear that the case
3 reflects that the exculpated parties have participated in good
4 faith in formulating and negotiating the plan as it relates to
5 the Debtors, and they should be entitled to protection from
6 the exposure of any lawsuit related to this Chapter 11
7 process. See the Hoge declaration at pages 35 and 45.

8 Here, the Debtors and their officers, directors and
9 professionals actually engaged with the Committee, the U.S.
10 Trustee and other stakeholders, while developing the plan.
11 Such negotiations were extensive, and compromises derived
12 therefrom are necessary, are embodied in the plan and will
13 maximize the value to all stakeholders on enabling the Debtors
14 to emerge swiftly from Chapter 11 and give finality to all
15 stakeholders.

16 Further, the exculpation provision is limited to
17 acts during the Chapter 11 case. It does not extend beyond
18 such times. Accordingly, the exculpation provision, here, is
19 appropriate, justified and necessary under the facts and
20 circumstances of this Chapter 11 case or these cases, and the
21 Trustee's objection is overruled.

22 Any remaining provision, Bankruptcy Code, Section or
23 plan provision not specifically discussed are deemed satisfied
24 or approved, with the Court accepting the Debtor's reasoning
25 and analysis set forth in their memorandum of law, as well as

1 the Committee's statement as applicable and as correct.
2 Furthermore, any other objection or objections not
3 specifically referenced or discussed is or are overruled for
4 the same reason.

5 As the Court finds that all the necessary elements
6 under 1129 -- 11 U.S.C. Section 1129 and other applicable
7 Bankruptcy Code provisions have been met, and all objections
8 are overruled, the Debtor's second amended plan, as proposed,
9 Document Number 607 shall be and hereby is confirmed.

10 Now, if the Court may have a moment, I would like to
11 add that the Court recognizes the parties for all the work
12 that they have put into this case. The Court understands that
13 the parties are required to take positions. After all, this
14 is the very nature of an adversarial proceeding. Nonetheless,
15 I thank all counsel and all professionals for their hard work
16 and the professionalism that they have demonstrated throughout
17 this case.

18 We would not be here today, but for the cooperation
19 of all counsel and professionals involved, and you, too, Mr.
20 Schepacarter, you're included in this, too.

21 And from the very inception of this case, throughout
22 the final negotiation of this plan between the Debtor's
23 counsel and counsel for the Unsecured Creditors Committee,
24 and, as well as for counsel for Chubb with resolving their
25 objections, I appreciate the efforts of everyone in this case,

1 and I truly appreciate the professionalism expressed
2 throughout this case by all parties.

3 The process here has worked. This is a wonderful
4 thing, and I truly thank all of the parties involved. I do
5 instruct, however, Debtor's counsel to, please, order a
6 transcript of this hearing so that it could be placed on the
7 record.

8 And before I let you go, I need to just discuss the
9 proposed findings of facts and conclusions of law and the
10 order confirming the plan that was submitted over the weekend
11 in Document Number 610.

12 Who -- Mr. Ferrell, are you going to talk about that
13 one? Does anybody have any objection to the language included
14 in those findings of fact, other than the fact that I
15 overruled your objection, Mr. Schepacarter, does anybody have
16 any statements, any comments with regard to this proposed
17 findings of fact and order?

18 Mr. Gage?

19 MR. GAGE: No, Your Honor.

20 THE COURT: Mr. Schepacarter?

21 MR. SCHEPACARTER: No, Your Honor. I reviewed it
22 over the weekend, and based on the Court's ruling, it's
23 consistent with that, and it's consistent with the other
24 provisions of the plan, things that we actually did agree upon
25 and negotiate. Thank you.

1 THE COURT: I appreciate it. I will say that I did
2 ask --

3 MR. SCHEPACARTER: Thank you, Your Honor.

4 THE COURT: -- I did ask counsel, just to include
5 the language that said that, the Court's oral opinion is also
6 incorporated in the form of the order, so that there would be
7 no surprise, and that the two can go together.

8 Mr. Ferrell, anything else?

9 MR. FERRELL: Your Honor, just very briefly, on the
10 confirmation order, the Debtors will submit the confirmation
11 order again with the plan actually attached to it. As of
12 right now, the slip page for the exhibit, just indicate that
13 the plan is filed separately, but we would request that the
14 plan, you know, be attached to the confirmation order that is
15 entered by the Court.

16 Additionally, Your Honor, I just want to confirm
17 that Bankruptcy Rule 3020(e) is waived. The Debtors are
18 hoping to move quickly into the effective date, and
19 ultimately, to limit the amount of administrative claims -- or
20 expenses incurred by the estates.

21 THE COURT: Yes, I understand the insurance expires
22 at the end of the month, as well, right?

23 MR. FERRELL: That is true, Your Honor, yes.

24 THE COURT: So, does anybody have an objection for
25 me to waive the fine?

1 Mr. Schepacarter, no.

2 Mr. Gage?

3 MR. SCHEPACARTER: No objection.

4 THE COURT: Mr. Gage?

5 MR. GAGE: No objection.

6 THE COURT: All right. Submit that form of order to
7 my chamber's email, and we'll get it signed as soon as you get
8 a clean copy to us. Okay?

9 MR. FERRELL: Yes, Your Honor, thank you.

10 THE COURT: Anyone have any questions about today or
11 throughout the case? Anything?

12 MR. FERRELL: No, we thank you, Your Honor.

13 THE COURT: Thank you, all. I appreciate it. Job
14 well done.

15 MR. SCHEPACARTER: Thank you, Your Honor, much
16 appreciated.

17 ALL COUNSEL: Thank you, Your Honor.

18 THE COURT: Court adjourned.

19 (Proceedings concluded at 11:50 a.m.)

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C E R T I F I C A T I O N

I, Jacqueline Mullica, court approved transcriber,
certify that the foregoing is a correct transcript from the
official electronic sound recording of the proceedings in the
above-entitled matter on April 19, 2024 from 10:00 a.m. to
11:50 a.m.

/s/Jacqueline Mullica August 21, 2024

JACQUELINE MULLICA

DIANA DOMAN TRANSCRIBING, LLC

BANKRUPTCY ABSTENTION

CHRISTOPHER D. HAMPSON*

ABSTRACT

Courts have been finding ways to avoid hearing bankruptcy cases for a long time. This practice distinguishes bankruptcy from other types of federal cases. The federal district courts operate under the twin principles that they are courts of limited jurisdiction and have a “virtually unflagging” obligation to exercise it. But those twin principles are inverted in bankruptcy. That is because bankruptcy courts do more than just resolve disputes; they solve problems.

Bankruptcy jurisdiction is expansive and dramatic. When a debtor commences a bankruptcy case, the bankruptcy court has jurisdiction not only over the case itself and proceedings “arising in” the case, but also a broad swath of cases “related to” the bankruptcy proceedings. Yet, unlike their district court relatives, bankruptcy courts have much broader authority to dismiss or abstain from hearing cases before them. They can also reshape the contours of a bankruptcy case by lifting the automatic stay or by allowing custodians to maintain control of property of the bankruptcy estate.

Bankruptcy courts wield that authority in a host of pragmatic, equitable, and surprising ways: Pulling back when the case lacks a bankruptcy purpose, policing against a range of forum-shopping practices, abstaining when other insolvency proceedings are underway, and (most strikingly) stepping back when debtors and creditors are engaged in informal, out-of-court workouts. This Article refers to all these abstention or abstention-adjacent decisions as “bankruptcy

* Associate Professor of Law, University of Florida Levin College of Law. For insightful discussions and helpful comments, I’m grateful to Lynn LoPucki, Tony Casey, Melissa Jacoby, Ted Janger, Gary Lawson, Ralph Brubaker, David Skeel, Leandra Lederman, Stephen Ware, Jared Ellias, Kara Bruce, Chris Bradley, Pamela Foohey, Brook Gotberg, Laura Coordes, Alvin Velazquez, Elise Maizel, Michael Francus, Jiaying Jiang, Jeffrey Katz, and Sarah Jones, as well as panelists and participants at the American Bankruptcy Institute’s Northeast Bankruptcy Conference and Consumer Forum, the Southeastern Association of Law Schools 2025 Annual Conference, the 2025 Chicago-Harvard-Wharton Insolvency and Restructuring Conference, and the Criser Workshop Series at the University of Florida Levin College of Law. For disclosure, the author was actively involved in the litigation of several cases covered in this Article, including *EB Holdings*, *Rosenberg*, *MV Realty*, *3M/Aearo*, and *MOAC Mall Holdings*, though in many instances not the exact issue under discussion here. All discussion and analysis come from publicly available sources. Nader Abou Mrad (’25), Xianjun Liang (’26), Braden Ridlehoover (’26), and Ryan Burton (’27) provided superb research assistance. All errors are my own. My deep gratitude to Cecilia, Olivia, and Jonathan for their love and support—and for affirming me when (pardon the *vaterwitzangst*) I had to abstain from family activities to complete this research.

abstention,” a mix of permissive and mandatory rules that provide contours to the jurisdiction of the bankruptcy courts by limning bankruptcy’s “negative spaces.”

This Article maps out three situations when the bankruptcy courts pull back, explores what this unusual practice tells us about bankruptcy as an area of law, suggests how bankruptcy abstention might be refined, and proposes some lessons about the nature of courts along the way. While federalism principles can explain much of bankruptcy abstention, bankruptcy courts also pull back from re-adjudicating out-of-court workouts that they deem fair and efficient—even when the matters have not yet seen the inside of a courtroom. Bankruptcy courts also pull back when they perceive that the tools at their disposal are a poor fit for the problem they are being asked to solve. Bankruptcy abstention thus goes beyond federalism principles and demonstrates the character of the bankruptcy courts as courts of equity—courts that nurture what Alexander Bickel called the “passive virtues.” The Article suggests that we can rethink some of bankruptcy’s most contentious doctrines through that lens, coins the phrase “bankruptcy ripeness,” and provides new insight into the debate over bankruptcy exceptionalism. This reframing can, in turn, suggest guidance to attorneys, judges, and policy-makers for how best to fine-tune the bankruptcy system—as well as provide lessons for other courts of equity in the American legal system. Finally, the Article proposes that bankruptcy abstention represents a new battlefield for old debates about bankruptcy theory and suggests that bankruptcy scholars think of institutionalism as a third way of theorizing bankruptcy law.

CONTENTS

INTRODUCTION

Courts have been finding ways to avoid hearing bankruptcy cases for a long time.¹ In Oklahoma, during the Great Depression, a men’s clothing store called Smith-Cole, Inc. began to experience financial distress, and its creditors put it into a state court receivership.² The receiver sold all the property and was able to disburse twenty-five cents on the dollar to creditors. One of the creditors, International Shoe Co.,³ refused the payout and filed an involuntary bankruptcy instead. The lower court dismissed the case for lack of jurisdiction.⁴

¹ See *Ecclesiastes* 1:9 (King James) (“[T]here is no new thing under the sun.”).

² See *Int’l Shoe Co. v. Smith-Cole, Inc.*, 62 F.2d 972, 973–74 (10th Cir. 1933).

³ Many readers will have had at least “minimum contacts” with another case involving the American shoe manufacturer, *International Shoe Co. v. Washington*, 326 U.S. 310, 316 (1945).

⁴ *Int’l Shoe Co.*, 62 F.2d at 974. The Tenth Circuit commented that the matter had been “informally tried,” *id.* at 973, and indeed, the lower court dismissed the bankruptcy case in two perfunctory paragraphs, concluding that International Shoe could not meet the required number of parties for an involuntary case by itself. See Transcript of Record at 1094, 1100, *Int’l Shoe Co. v. Smith-Cole Inc.*, No. 706 (10th Cir. 1933) (on file with Nat’l Archives at

International Shoe appealed, arguing that its statutory right to file an involuntary petition squeezed out any role for equity.⁵ But the Tenth Circuit affirmed the bankruptcy court on equitable grounds:

Courts are organized to adjudicate controversies of substance, and not to declare abstract rules of law. There is neither charge, proof, nor intimation, that appellant or any other creditor would get a cent more if the effort now made to unscramble the state court proceedings were successful . . . Courts have enough to do in passing on substantial controversies without wasting their time in superintending the transfer of money from one pocket to another . . . The avowed purpose of the suit being to assert an abstract right at the expense of the creditors, and that being its inevitable result, the action was properly dismissed.⁶

This practice distinguishes bankruptcy from other types of federal cases. The federal district courts operate under the twin principles that they are courts of limited jurisdiction⁷ and have a “virtually unflagging” obligation to exercise it.⁸

Kan. City, Mo., Box 34, Accession 276-65-A-129, App. Case 706) (Order of Dismissal of *In re Smith-Cole* by E.D. Okla. court) [hereinafter *Smith-Cole*, Transcript of Record].

⁵ *Int'l Shoe Co.*, 62 F.2d at 974. *Smith-Cole* first raised the equitable basis for affirming the bankruptcy court on appeal, arguing that when a receivership was “being handled to the best interest and satisfaction of a vast majority of the creditors,” the bankruptcy court should not “cause delay and add extra expense.” *Smith-Cole*, Transcript of Record, *supra* note 4 at 1141. In its briefing to the Tenth Circuit, *Smith-Cole*’s counsel pointed to several prior opinions, including one penned by future President and Supreme Court Justice William Howard Taft. *See id.* at 1142–43 (observing that granting bankruptcy relief would not change distribution to creditors, so “[t]he bankruptcy proceedings will only increase the costs” (quoting *Simonson v. Sinsheimer*, 95 F. 948 (6th Cir. 1899))); *see also* Bojan Mishko Srbnovski, *The Two Poles of Article III: Formalism and Functionalism in Bankruptcy Jurisdiction*, 71 DRAKE L. REV. 173, 214–17 (2024) (analyzing *Simonson*, including subsequent history, as example of functionalism in bankruptcy law).

⁶ *Int'l Shoe Co.*, 62 F.2d at 974. A few years later, the Supreme Court ruled that a bankruptcy court had abused its discretion when it exercised jurisdiction over an “unsettled question[] of state property law”—whether the trustee had a fee simple or an easement to a rich oil field. *Thompson v. Magnolia Petrol. Co.*, 309 U.S. 478, 483 (1940); *see also* Susan Block-Lieb, *Permissive Bankruptcy Abstention*, 76 WASH. U. L.Q. 781, 798 (1998) (describing *Thompson* as forerunner to *Pullman* abstention which “provides that district courts should abstain from exercising their federal question jurisdiction where resolution of an unsettled question of state law would avoid the need to determine whether a state practice or procedure violates the Constitution of the United States”).

⁷ *See* U.S. CONST. art. III, § 2 (listing “cases” and “controversies” that fall within the judicial power of the United States); *see also*, *Royal Canin U.S.A., Inc. v. Wullschleger*, 145 S. Ct. 41, 47 (2025) (“‘Federal courts,’ we have often explained, ‘are courts of limited jurisdiction.’” (quoting *Kokkonen v. Guardian Life Ins. Co. of America*, 511 U.S. 375, 377 (1994))).

⁸ *Colorado River Water Conservation Dist. v. United States*, 424 U.S. 800, 817 (1976). The obligation is subject only to narrow exceptions. The *Rooker-Feldman* doctrine teaches that lower federal courts, pursuant to 28 U.S.C. § 1257, do not sit in appeal over state courts on matters of state law. *See Rooker v. Fidelity Trust Co.*, 263 U.S. 413, 415–16 (1923)

But those twin principles are inverted in bankruptcy.⁹ Bankruptcy jurisdiction is expansive and dramatic. When a debtor commences a bankruptcy case, the bankruptcy court has jurisdiction not only over the case itself and proceedings “arising in” the case, but also a broad swath of cases “related to” the bankruptcy proceedings,¹⁰ all of which the bankruptcy court (or the district court sitting in bankruptcy) can hear.¹¹

Preliminary relief offered in bankruptcy is similarly wide-ranging. Although the Supreme Court has severely curtailed the nationwide preliminary injunction,

(articulating that federal district courts do not have appellate jurisdiction over state courts hearing issues of state constitutional law); *District of Columbia Court of Appeals v. Feldman*, 460 U.S. 462, 476 (1983) (“[T]he United States District Court is without authority to review final determinations of the District of Columbia Court of Appeals in judicial proceedings.”); *Exxon Mobil Corp. v. Saudi Basic Indus. Corp.*, 544 U.S. 280, 293 (2005) (noting that *Rooker-Feldman* doctrine is limited to cases brought by state court losers who seek to invite federal district court review and rejection of those state court judgments); *T.M. v. Univ. of Maryland Med. Sys. Corp.*, 608 U.S. ___, (2026) (slip op. at 1) (extending doctrine to state-court judgments that are subject to further state appellate review). Federal courts can also decline to exercise jurisdiction under the ancient doctrine of *forum non conveniens* or abstain under certain narrow doctrines: *Pullman* abstention (to allow states to clarify the meaning of a potentially unconstitutional state law); *Burford* abstention (to allow states to regulate complex issues of state law); *Younger* (to allow states to complete a prosecution underlying a civil rights tort); and *Colorado River* (to allow parallel litigation to advance in state court). See *R.R. Comm’n v. Pullman Co.*, 312 U.S. 496, 498–500 (1941); *Burford v. Sun Oil Co.*, 319 U.S. 315, 332–34 (1943); *Younger v. Harris*, 401 U.S. 37, 53–54 (1971); *Colorado River Water Conservation Dist.*, 424 U.S. at 819–20 (1976).

⁹ Professors Susan Block-Lieb and Ralph Brubaker observed this inversion more than twenty-five years ago. See Block-Lieb, *supra* note 6, at 781–85 (noting how bankruptcy jurisdiction is “broader than federal question jurisdiction” while exercising a “limited functional purpose”). Professor Ralph Brubaker further theorized the interplay between expansive bankruptcy jurisdiction and expansive bankruptcy abstention, calling it “symbiotic” and “synergistic.” Ralph Brubaker, *On the Nature of Federal Bankruptcy Jurisdiction: A General Statutory and Constitutional Theory*, 41 WM. & MARY L. REV. 743, 798 (2000).

¹⁰ Bankruptcy’s jurisdictional statute can be found in 28 U.S.C. § 1334, and the removal statute, *id.* § 1452(a), governs the process by which pending state court actions can be removed to bankruptcy court. The leading test for bankruptcy’s “related-to” jurisdiction asks whether “the outcome of th[e] proceeding could conceivably have any effect on the estate being administered in bankruptcy.” *Pacor, Inc. v. Higgins*, 743 F.2d 984, 994 (3d Cir. 1984). This “any conceivable effect” test suggests, by negative inference, that a bankruptcy court would lack jurisdiction if it were “inconceivable” that an action could affect the bankruptcy estate. Bankruptcy courts keep using that word; hopefully it means what they think it means. *Cf. THE PRINCESS BRIDE*, Amazon Prime, at 16:25–33 (20th Century Fox 1987).

¹¹ In a seminal separation-of-powers decision, the Supreme Court decided in 2011 that the Constitution requires that Article III courts hear private causes of action that historically would have been heard at common law, equity, or admiralty, unless the claim arose under the bankruptcy statute or would “necessarily be resolved in the claims allowance process.” *Stern v. Marshall*, 564 U.S. 462, 499 (2011). In *Stern*, that meant that a compulsory counterclaim against the estate had to be heard by the federal district court.

the automatic stay in bankruptcy lives on. Indeed, on the same day that *Trump v. CASA, Inc.*¹² came down—instructing a Maryland district judge to tighten her preliminary injunction to be no “broader than necessary to provide complete relief to each plaintiff with standing to sue”¹³—her three bankruptcy colleagues down the hall at 6500 Cherrywood Lane saw twenty new bankruptcy cases filed, each of which came with an immediate, automatic, and global stay.¹⁴

Yet, unlike their district court relatives, bankruptcy courts have much broader authority to dismiss or abstain from hearing cases before them, as well as to reshape the contours of a bankruptcy case by lifting the stay or by allowing custodians to maintain control of property of the bankruptcy estate by excusing turnover. And bankruptcy courts wield that authority in a host of pragmatic, equitable, and surprising ways: pulling back when the case lacks a bankruptcy purpose, policing against a range of forum-shopping practices, abstaining when other insolvency proceedings are underway, and—most strikingly—stepping back when debtors and creditors are engaged in informal, out-of-court workouts.

This Article maps out three situations when the bankruptcy courts pull back, explores what this unusual practice tells us about bankruptcy as an area of law, suggests how bankruptcy abstention might be refined, and proposes some lessons about the nature of courts along the way. While federalism principles can explain much of bankruptcy abstention, bankruptcy courts also pull back from re-adjudicating out-of-court workouts that they deem fair and efficient—even when the matters have not yet seen the inside of a courtroom. Bankruptcy courts also pull back when they perceive that the tools at their disposal are a poor fit for the problem they are being asked to solve. Bankruptcy abstention thus goes beyond federalism principles and demonstrates the character of the bankruptcy courts as courts of equity—courts that nurture what Professor Alexander Bickel

¹² 145 S. Ct. 2540, 2545 (2025) (holding that federal district court may only grant preliminary injunctions to extent necessary to provide complete relief to each plaintiff with standing). The Supreme Court in *CASA* did not mention bankruptcy’s “automatic stay,” nor did it need to. The analysis undertaken by the majority, stemming from *Grupo Mexicano de Desarrollo, S.A. v. Alliance Bond Fund, Inc.*, 527 U.S. 308, 335–39 (1999), was whether the remedy was available in equity at the time of the Judiciary Act of 1789. *See CASA*, 145 S. Ct. at 2551 (discussing English bill of peace). But that analysis only matters because there is no other law giving federal courts the ability to enter a nationwide injunction. In bankruptcy, § 362 of the Code provides statutory authorization for the automatic stay. *See* 11 U.S.C. § 362.

¹³ *CASA*, 145 S. Ct. at 2562–63.

¹⁴ *See* 11 U.S.C. § 362 (detailing criteria for automatic stay and exceptions). To be fair, there is some debate about the extraterritorial application of the automatic stay. That said, the stay refers to “property of the estate” in several places, *see id.* § 362(a)(2)–(4), and that property, in turn, is defined to encompass all property “wherever located and by whomever held,” *id.* § 541(a). So the better view is that the stay does apply worldwide. *See, e.g.,* Amber M. Carson, *The Extraterritorial Power of the U.S. Bankruptcy Code’s Automatic Stay*, TEX. BAR COLL. (Apr. 30, 2019), <https://texasbarcollege.com/the-extraterritorial-power-of-the-u-s-bankruptcy-codes-automatic-stay/>. [<https://perma.cc/V66Q-F87A>] (interpreting broad reach of automatic extraterritorial stay).

called the “passive virtues.”¹⁵ This reframing can, in turn, suggest guidance to attorneys, judges, and policymakers for how best to fine-tune the bankruptcy system—as well as provide lessons for other courts of equity in the American legal system.

Today, the authority of the bankruptcy courts to dismiss, abstain, lift the stay, or excuse turnover all have statutory hooks. Bankruptcy courts can dismiss a Chapter 11 case for “cause,” which includes sixteen enumerated reasons to which courts have added the nebulous concept of “bad faith.”¹⁶ Under the statute and related caselaw, bankruptcy courts look not only at failure to comply with procedural and disclosure rules, but also at whether the debtor really needs bankruptcy,¹⁷ and (if so) whether the case has any reasonable chance of success.¹⁸

As for abstention, depending on the circuit,¹⁹ all our familiar friends from federal court—like *Rooker-Feldman*, *Colorado River*, and forum non conveniens²⁰—still apply in bankruptcy, in addition to a complex set of bankruptcy-specific abstention rules which come in mandatory and discretionary flavors. When federal jurisdiction exists over the civil action due only to the bankruptcy²¹ and the action can be “timely adjudicated” in state court, the bankruptcy

¹⁵ See generally Alexander M. Bickel, *Foreword: The Passive Virtues*, 75 HARV. L. REV. 40 (1961) (articulating fundamental principles of equity that Supreme Court uses to grant certiorari).

¹⁶ See 11 U.S.C. § 1112(b). The list is non-exhaustive per § 102(3), which specifies that the words “includes” and “including” in the Bankruptcy Code are not limiting. See *id.* § 102(3). Bankruptcy courts can also dismiss Chapter 7 cases. See *id.* § 707(a).

¹⁷ LTL Mgmt., LLC v. Those Parties Listed on Appendix A to Complaint (*In re* LTL Mgmt., LLC), 64 F.4th 84, 101 (3d Cir. 2023) (“[A] debtor who does not suffer from financial distress cannot demonstrate its Chapter 11 petition serves a valid bankruptcy purpose supporting good faith.”).

¹⁸ See 11 U.S.C. § 1112(b)(4)(A) (defining “cause” to include “substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation”).

¹⁹ See Block-Lieb, *supra* note 6, at 819 & n.187 (describing circuit split over whether § 1334 codifies or overrides judicial abstention doctrines). Block-Lieb is surely correct that Congress is presumed to legislate on the background of pre-Code practice, and nothing in the statute indicates that Congress meant to displace judicial abstention doctrines. See *id.* at 820-21.

²⁰ See *supra* note 8 and accompanying text (listing federal abstention doctrines); see also *Tiber Creek Partners, LLC v. Ellume USA LLC*, No. 23-1882, 2024 WL 1950071, at *5 (4th Cir. July 16, 2025) (corroborating that forum non conveniens applies in bankruptcy cases).

²¹ That is, a federal court could not otherwise have heard the matter via federal-question or diversity jurisdiction, whether it is newly filed in bankruptcy court or removed there pursuant to § 1452(a). 28 U.S.C. § 1452(a) (providing for removal to jurisdiction where bankruptcy is pending when federal court has jurisdiction under § 1334). Personal injury tort or wrongful death claims against the estate are handled in a unique way. While the bankruptcy court may estimate them for purposes of confirming a plan, only the federal district court can liquidate or estimate them for purposes of distribution. See *id.* § 157(b)(2)(B). Further, those

court must abstain from hearing it or remand it to state court.²² And yet the bankruptcy court may abstain from hearing civil actions “in the interest of justice” or “in the interest of comity . . . or respect for State law”²³ and can remand civil actions “on any equitable ground.”²⁴

Then, under § 305, the bankruptcy court may “at any time” dismiss a case or suspend all proceedings entirely when “the interests of creditors and the debtor would be better served by such dismissal or suspension.”²⁵ Bankruptcy courts underscore that this is an extraordinary, case-by-case remedy, and that the statute requires an analysis of the best interests of both creditors and the debtor.²⁶

Importantly, Congress has limited jurisdiction over appeals from these decisions. The decision of the bankruptcy courts to abstain from hearing either a proceeding or the whole case can be appealed only to the district court or to a bankruptcy appellate panel (“BAP”), but not to the courts of appeals or to the Supreme Court.²⁷

claims are not subject to the mandatory abstention provisions of § 1334(c)(2), per 28 U.S.C. § 157(b)(4). Congress thus balanced the need to have personal injury torts coordinated in a collective, federal proceeding while also ensuring that tort victims would have access to a jury trial.

²² See 28 U.S.C. § 1334(c)(2).

²³ See *id.* § 1334(c)(1).

²⁴ See *id.* § 1452(b).

²⁵ 11 U.S.C. § 305(a)(1). Note that Chapter 15 cases are treated differently. See *infra* notes 178-184 and accompanying text (explaining congressional intent for Chapter 15 to handle international cases with an eye to bankruptcy policy, international cooperation, and certainty for international trade and investment).

²⁶ Courts also emphasize that this is a fact-bound assessment that must be supported by factfinding on the record. See, e.g., *GMAM Inv. Funds Tr. I v. Globo Comunicacoes e Participacoes S.A.* (*In re Globo Comunicacoes e Participacoes S.A.*), 317 B.R. 235, 255-56 (S.D.N.Y. 2004) (reversing for further factfinding on abstention and forum non conveniens analysis); *Monsour Med. Ctr., Inc. v. Stein* (*In re Monsour Medical Center, Inc.*), 154 B.R. 201, 207 (Bankr. W.D. Pa. 1993) (“A determination under [§ 305] must be made on a case-by-case basis.”).

²⁷ See 11 U.S.C. § 305(c) (“An order . . . dismissing a case or suspending all proceedings in a case, or a decision not so to dismiss or suspend, is not reviewable by appeal or otherwise by the court of appeals . . . or by the Supreme Court of the United States.”); 28 U.S.C. § 1334(d) (“Any decision to abstain or not to abstain . . . is not reviewable by appeal or otherwise by the court of appeals . . . or by the Supreme Court of the United States.”); *id.* § 1452(b) (“An order entered under this subsection remanding a claim or cause of action, or a decision to not remand, is not reviewable by appeal or otherwise by the court of appeals . . . or by the Supreme Court of the United States.”); see also *Things Remembered, Inc. v. Petrarca*, 516 U.S. 124, 127 (1995) (dismissing appeal of remand order based on untimeliness of notices of removal). Due to the tight limits on abstention appeals, bankruptcy courts routinely underscore that the remedy should be used only rarely, to keep abstention as “the exception rather than a rule.” See *In re Lufttek*, 6 B.R. 539, 548 (Bankr. E.D.N.Y. 1980).

But the history of jurisdiction-stripping points in the opposite direction. The 1978 Bankruptcy Code originally provided for no appeals of abstention from entire cases. See

But dismissal and abstention are not the only ways bankruptcy courts pull back from exercising jurisdiction. They also have broad authority to reshape the contours of the bankruptcy case by lifting the automatic stay²⁸ and by excusing a pre-existing custodian from the normal requirement that everyone must turn over property of the estate to the bankruptcy trustee.²⁹

With all this at play, it is unclear whether the “virtually unflagging” obligation even applies to the bankruptcy courts.³⁰ Bankruptcy courts are different: they don’t just resolve disputes, they solve problems.

Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 305, 92 Stat. 2549, 2561 (codified as amended in scattered provisions of 11 U.S.C. and 28 U.S.C.). But three of the four published opinions in the Supreme Court’s groundbreaking decision on the new Bankruptcy Code, *N. Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982), strongly suggested that jettisoning Article III appellate review would violate the separation of powers even in that limited context. *See id.* at 76–77 (majority opinion) (clarifying that bankruptcy courts do not lie beyond reach of Article III courts); *id.* at 91 (Rehnquist, J., concurring) (“I would, therefore, hold so much of the Bankruptcy Act of 1978 as enables a Bankruptcy Court to entertain and decide Northern’s lawsuit over Marathon’s objection to be violative of Art[icle] III of the United States Constitution.”); *id.* at 100–01, 115 (White, J., dissenting) (discussing congressional intent of appellate review from Article I courts as opposed to Article III courts). Congress decided to get ahead of the question. *See* Judicial Improvements Act of 1990, Pub. L. 101-650, 104 Stat. 5089. In the Judicial Improvements Act of 1990, Congress provided for limited appeals of abstention decisions to the district courts and BAPs, even as it decried the “problems of cost and delay in civil litigation” and called for “differential treatment” of cases “according to their needs, complexity, duration, and probable litigation careers.” *Id.* § 102(1), (5)(A); *see also id.* § 309 (amending 11 U.S.C. § 305(c), 28 U.S.C. § 1334, and 28 U.S.C. § 1452). Additionally, Congress allowed for full appellate rights in situations where a party invoked the mandatory abstention provision and the bankruptcy court decided not to abstain. *See* 28 U.S.C. § 1334(d) (excepting “a decision not to abstain in a proceeding described in subsection (c)(2)” from limited jurisdiction that otherwise would apply). The better view is that the lack of full appellate review should not place a thumb on the scale one way or the other. Bankruptcy courts should not assume that appellate jurisdiction-stripping somehow signals that they should abstain less frequently than they otherwise would.

²⁸ *See* 11 U.S.C. § 362(d) (requiring courts to grant relief from stay “by terminating, annulling, modifying, or conditioning such stay” when requested by party in interest after notice and hearing).

²⁹ *See id.* § 543(d) (allowing custodian to maintain possession, custody, or control of property if that would better serve interest of creditors).

³⁰ Westlaw’s database contains almost 5000 federal district court opinions since the beginning of the century using the phrase “virtually unflagging,” but fewer than eighty bankruptcy court opinions. When the courts of appeals use the phrase “virtually unflagging” in the bankruptcy context, in the main they are thinking about bankruptcy *appeals*, particularly equitable mootness. *See, e.g., Excluded Lenders v. Serta Simmons Bedding, LLC (In re Serta Simmons Bedding, LLC)*, 125 F.4th 555, 585 (5th Cir. 2024) (Oldham, J.) (“We are aware of our virtually unflagging obligation to exercise the jurisdiction that the Constitution and Congress have conferred on us.” (internal quotations and citations omitted)); *In re Boy Scouts of America*, 137 F.4th 126, 159 (3d Cir. 2025) (Ambro, J.) (“In the normal course, there is a

This Article brings a fresh look to an old problem. Over the last few decades, most of the judicial, practitioner, and scholarly attention on the purpose and powers of the bankruptcy courts has focused on the “tools in the toolkit.” Can a bankruptcy court order a “structured dismissal”? No.³¹ Can it include nonconsensual third-party releases in a Chapter 11 plan? No.³² Can it surcharge a homestead exemption? No.³³ Many court-watchers suspect that equitable mootness will be next.³⁴

This string of Supreme Court cases nudging the bankruptcy courts back into strict adherence with the Code has brought many bankruptcy professionals to wonder whether bankruptcy courts are indeed “exceptional” and even whether they are still courts of equity.³⁵ After all, in the last several decades of the

virtually unflagging obligation of federal courts to exercise the jurisdiction conferred on them.” (internal quotations and citations omitted)).

³¹ See *Czyzewski v. Jevic Holding Corp.*, 580 U.S. 451, 464 (2017) (holding that bankruptcy court cannot “approve a structured dismissal that provides for distributions that do not follow ordinary priority rules without the affected creditors’ consent”).

³² See *Harrington v. Purdue Pharma*, 144 S. Ct. 2071, 2088 (2024) (holding that “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”); see generally Anthony J. Casey, *Does Chapter 11 of the Bankruptcy Code Authorize Nonconsensual Nondebtor Releases?*, 51 PREVIEW U.S. SUP. CT. CASES 25 (2023) (discussing criteria under Chapter 11 to extinguish claims held against nondebtor third parties without the claimants’ consent); Adam J. Levitin, *The Constitutional Problem of Nondebtor Releases in Bankruptcy*, 91 FORDHAM L. REV. 429 (2022) (arguing unconstitutionality of all nonconsensual nondebtor releases); Ralph Brubaker, *An Incipient Backlash Against Nondebtor Releases? (Part I): The “Necessary to Reorganization” Fallacy*, 42 BANKR. L. LETTER No. 2, Feb. 2022, at 1 (reviewing four recent court decisions regarding third-party releases that may represent “the high point in judicial permissiveness” followed by “a stark and severe backlash”).

³³ See *Law v. Siegel*, 571 U.S. 415, 422–24 (2014) (holding that Bankruptcy Court’s surcharge was unauthorized because it violated express terms of the Bankruptcy Code which referenced limitation in California’s homestead exemption).

³⁴ See, e.g., Bruce A. Markell, *The Needs of the Many: Equitable Mootness’ Pernicious Effects*, 93 AM. BANKR. L.J. 377, 380 (2019) (arguing that appellate courts have used equitable mootness too broadly in ways that undermine bankruptcy systems); Robert Miller, *Equitable Mootness: Ignorance is Bliss and Unconstitutional*, 107 KY. L.J. 269, 287–305 (2018) (outlining statutory and constitutional critiques of equitable mootness); Paul A. Avron, *Equitable Mootness: Is it Time for the Supreme Court to Weigh In?*, AM. BANKR. INST. J., Mar. 2017, at 70 (questioning constitutional tensions raised by equitable mootness exercised by Article I court without review from Article III court); Nicole Langston, *Reexamining the Doctrine of Equitable Mootness in Light of the Detroit Bankruptcy*, 31 COM. L. WORLD 8, 10 (2017) (“The doctrine of equitable mootness creates an extremely thin line between judicial equity and the separation of powers between the Article III judiciary and non-Article III bankruptcy courts.”).

³⁵ This very question prompted a symposium issue of the *American Bankruptcy Law Journal*—yet only one of the submissions accounted for bankruptcy courts’ abstention powers. See Diane Lourdes Dick, *Equitable Powers and Judicial Discretion: A Survey of U.S.*

Supreme Court interpreting the Bankruptcy Code, it has not once endorsed or blessed any of the creative, problem-solving mechanisms devised by bankruptcy lawyers in the halls outside the courtroom.³⁶

But the “tools in the toolkit” are only the easiest things to look at. That is because action is easier to see than inaction, and because the limits on appellate review of abstention bring at least some of this activity outside the purview of the courts of appeals and the U.S. Supreme Court.

This Article, by contrast, looks at the “negative spaces” of bankruptcy law. It stands out among both the federal courts and bankruptcy literatures for doing so. There is, of course, a sustained literature among federal courts scholars on abstention doctrine, but these pieces do not delve into bankruptcy abstention (which is by far the most interesting).³⁷ Bankruptcy scholars have analyzed bankruptcy abstention too, most prominently Block-Lieb³⁸ and Brubaker,³⁹ but their focus is mostly on bankruptcy jurisdiction vis-à-vis state courts.⁴⁰ Of course, plenty of bankruptcy scholars and professionals have written about out-of-court workouts, but usually not the bankruptcy doctrines that protect them from being unsettled.⁴¹ The leading exception is a 2003 article by Anup Sathy,

Bankruptcy Judges, 94 AM. BANKR. L.J. 265, 298-99 (2020) (reporting survey results of bankruptcy judges indicating that they relied on § 105(a) for, *inter alia*, finding equitable mootness, abstaining, or dismissing cases); *see also* Michelle M. Harner & Emily A. Bryant-Alvarez, *The Equitable Powers of the Bankruptcy Court*, 94 AM. BANKR. L.J. 189, 194-97 (2020) (recounting history of bankruptcy courts as courts of equity); Jay Lawrence Westbrook, *Equity in Bankruptcy Courts: Public Priorities*, 94 AM. BANKR. L.J. 203, 211-22 (2020) (analyzing role of public interest in bankruptcy cases); Bruce A. Markell, *Courting Equity in Bankruptcy*, 94 AM. BANKR. L.J. 227, 248-52 (2020) (arguing that bankruptcy courts are courts of equity); Laura N. Coordes, *Narrowing Equity in Bankruptcy*, 94 AM. BANKR. L.J. 303, 322-25 (2020) (distinguishing between equity and discretion).

³⁶ *See infra* note 326 (discussing Professor Seymour’s argument that Court’s grappling with bankruptcy exceptionalism does not endorse out-of-court workouts).

³⁷ *See, e.g.*, John Harland Giammatteo, *The New Comity Abstention*, 111 CALIF. L. REV. 1705, 1733-56 (2023) (describing new phenomenon of federal courts abstaining from hearing substantive, constitutional challenges to state court proceedings); Maggie Gardner, *Abstention at the Border*, 105 VA. L. REV. 63, 93-108 (2019) (analyzing and critiquing new doctrine of “international comity abstention”).

³⁸ *See generally* Block-Lieb, *supra* note 6 (exploring whether bankruptcy courts should exercise distinct abstention doctrine).

³⁹ *See generally* Brubaker, *supra* note 9 (characterizing supplemental bankruptcy jurisdiction).

⁴⁰ Similarly, Peter H. Carroll III presented a comprehensive catalog of bankruptcy abstention doctrines in 1988 but did not derive any theoretical lessons from them. *See generally* Peter H. Carroll III, *Abstention Under Section 305 of the Bankruptcy Code*, 25 BULL. SEC. CORP. BANKING & BUS. L. 29 (1988) (reviewing voluntary and involuntary cases resulting in abstention).

⁴¹ *See, e.g.*, Lillian E. Kraemer & Richard B. Paige, *Consensual Workouts—Bankruptcy Alternative for the 1990s?*, 15 BANKING & COM. LENDING L. 419, 421-27 (1994) (detailing arguments and incentives for consensual workouts over bankruptcy).

Jason A. Cohen, Melissa B. Jacoby, and Matthew N. Kleiman.⁴² Most recently, *LTL Management*⁴³ and *Bestwall*⁴⁴ have precipitated new writing from Professor Anthony Casey on “bad faith” dismissals and from Sarah Jones on the potential for abstention and venue transfer to address forum shopping.⁴⁵

This Article aspires to break new ground on these discussions, to bring a distinctive and more comprehensive analysis to the underlying questions, and to provoke future research. The Article’s approach is to uncover, analyze, and organize a strain of precedent. Bankruptcy courts naturally decline to abstain as well, but the Article does not attempt to quantify the rate at which they do so. That kind of hard-numbers approach would be challenging in the bankruptcy context because once the bankruptcy courts signal that they are not receptive to hearing a certain kind of case, clever attorneys will begin to shift cases out of the bankruptcy courts and into non-bankruptcy proceedings or out-of-court workouts, for which we have limited data.

This Article is organized pragmatically, not doctrinally. Instead of dedicating parts to each statutory font of authority for bankruptcy abstention (dismissal, abstention, lifting the stay, excusing turnover), I have assigned parts based on why bankruptcy courts do what they do. The Article, therefore, proceeds as follows: Part I examines when bankruptcy courts abstain because the case lacks a bankruptcy purpose: The debtor isn’t in financial distress, the tools of the bankruptcy process won’t help, or the legal fight is really a two-party dispute masquerading as a collective, insolvency proceeding.⁴⁶ Part II explores when bankruptcy courts abstain because the parties are forum-shopping, running away from state or federal regulators, filing bankruptcy as a tactical move in collateral litigation, trying to press the “reset” button on multi-district litigation, or even trying to move the insolvency case from one insolvency proceeding to another.⁴⁷ And Part III investigates when bankruptcy courts abstain because the parties are working it out through a purely private process.⁴⁸

⁴² Anup Sathy, Jason A. Cohen, Melissa B. Jacoby & Matthew N. Kleinman, *Using the Doctrine of Abstention to Protect Your Consensual Restructuring*, 22 AM. BANKR. INST. L. 24, 24 (2003) (discussing *In re NRG Energy Inc.*, 294 B.R. 71 (Bankr. D. Minn. 2003) and ways to protect consensual workouts through abstention).

⁴³ *LTL Mgmt., LLC v. Those Parties Listed on Appendix A to Complaint (In re LTL Mgmt., LLC)*, 64 F.4th 84, 100–01 (3d Cir. 2023) (discussing good faith standard for dismissal) (Ambro, J.).

⁴⁴ *Bestwall LLC v. The Off. Comm. of Asbestos Claimants of Bestwall, LLC*, 148 F.4th 233, 242–43 (4th Cir. 2025) (discussing scope of dismissal for bad faith).

⁴⁵ See, e.g., Sarah Jones, Note, *Ameliorating Bankruptcy’s Forum Shopping Crisis Through Abstention and Venue Transfer*, 76 FLA. L. REV. 405, 431–34 (2024); Anthony J. Casey, Good-Faith Filing in Chapter 11 at 12–18 (Aug. 24, 2022) (unpublished manuscript) (on file with the Boston University Law Review).

⁴⁶ See *infra* Part I.

⁴⁷ See *infra* Part II.

⁴⁸ See *infra* Part III.

From there, Part IV steps back and discusses several implications of this analysis for our understanding of bankruptcy purpose and power. I analyze three theoretical insights we can derive from this study, connecting bankruptcy abstention to federalism, equity, and private ordering.⁴⁹ I argue that while federalism can explain some of bankruptcy abstention, the long tradition of the bankruptcy court's pulling back from exercising jurisdiction over out-of-court workouts requires a different theoretical frame: an appreciation of the bankruptcy courts as courts of equity. The Article suggests that we can rethink some of bankruptcy's most contentious doctrines through that lens, coins the phrase "bankruptcy ripeness," and provides new insight into the debate over bankruptcy exceptionalism. That conclusion can, in turn, suggest guidance to attorneys, judges, and policymakers for how best to fine-tune the bankruptcy system as well as lessons for other courts of equity in the American legal system. Lastly, these insights further suggest a new way of thinking about bankruptcy theory. Rather than focusing only on fairness or efficiency, traditionalism or proceduralism, we can also analyze the character of the bankruptcy courts as institutions.

Several important legal and scholarly debates are outside the scope of this Article, although the analysis here may prove relevant to those debates. First, the Supreme Court has developed separation-of-powers doctrines in bankruptcy cases that govern which proceedings and cases may be heard by bankruptcy courts versus Article III courts.⁵⁰ While significant, these doctrines regulate the distribution of bankruptcy labor between different types of federal tribunals and thus differ analytically from the doctrines discussed in this Article, all of which regulate whether something is indeed a bankruptcy matter or rather something else. Second, the venue rules in bankruptcy are notoriously loose,⁵¹ and Professor Lynn LoPucki and others have long criticized the bankruptcy courts for (among other things) failing to transfer venue to a different, more appropriate bankruptcy court.⁵² This problem, too, is analytically distinct from the topic of this Article, because venue concerns regulate which bankruptcy court ought to hear a matter, not whether it should be heard in bankruptcy court at all.⁵³ Lastly,

⁴⁹ See *infra* Part IV.

⁵⁰ *Stern v. Marshall*, 564 U.S. 462, 499 (2011) (holding that Constitution requires that Article III courts hear private causes of action that historically would have been heard at common law, equity, or admiralty, unless the claim arose under the bankruptcy statute or would "necessarily be resolved in the claims allowance process").

⁵¹ See 28 U.S.C. § 1408 (providing that business can file bankruptcy in any venue where affiliate bankruptcy is pending).

⁵² See, e.g., LYNN M. LOPUCKI, *COURTING FAILURE: HOW COMPETITION FOR BIG CASES IS CORRUPTING THE BANKRUPTCY COURTS* 123–233 (2005) (critiquing forum shopping on national and international stage); Lynn M. LoPucki, *False Venue Claims Signed Under Penalty of Perjury*, 80 BUS. L. 689, 714–40 (2025) (cataloguing cases that turned on venue selection, including through reliance on apparently false factual declarations submitted to the court).

⁵³ For example, consider *In re NRG Energy, Inc.*, 294 B.R. 71 (Bankr. D. Minn. 2003). As part of an out-of-court workout, NRG Energy identified key constituencies, organized creditors into classes, and even offered to make distributions. During the process, some creditors

the Article focuses on business bankruptcy cases, not individual consumer cases. Consumer cases raise different legal issues and thus different types of policy. While consumer bankruptcy law is not hermetically sealed from business bankruptcy law, individual cases are subject to different and significant eligibility rules, like the means test.⁵⁴ And because the discharge is the *sine qua non* of most consumer cases, individuals cannot readily use state receiverships, an assignment for the benefit of creditors (“ABCs”), or out-of-court workouts as alternatives to the bankruptcy process.⁵⁵

I. WHEN THE CASE LACKS A BANKRUPTCY PURPOSE

Bankruptcy courts are problem-solving courts, and across innumerable opinions they have recognized that the two problems at the core of all bankruptcy cases are either “can’t pay” or “won’t pay” debtors. And the bankruptcy courts

even agreed to forbear from further debt collection activities. *Id.* at 76–79. The process broke down when some of NRG’s former executives and officers banded together and commenced an involuntary proceeding in the District of Minnesota. The involuntary petition had been pending for almost six months when the court decided to abstain under § 305. The court noted that the debtor’s workout was comprehensive, orderly, fair, and efficient, and “intentionally mimicked many of the functions of a debtor in the opening stages of a Chapter 11 case.” *See id.* at 76. *Id.* at 85 (“[T]here is a significant risk that forcing the maintenance of the bankruptcy jurisdiction over negotiations well-started under different assumptions and rules would unduly distort the process, reduce creditors’ ultimate realizations, and prejudice the results.”). The debtor asked to be dismissed from bankruptcy so that it could determine whether and when to file, and the court agreed, declining to hear concerns about forum-shopping and rejecting one creditor’s request that dismissal be conditioned on re-filing in Minnesota. *See id.* at 87 n.21. The petitioners had argued that NRG Energy would take its bankruptcy case to a more debtor-friendly forum, like the District of Delaware or the Southern District of New York, but the judge declined to consider that argument, noting that the Bankruptcy Code’s venue statute would govern that determination and that the court only had the abstention question before it: it would be premature to consider the venue of a bankruptcy case that had not yet been filed. *See id.* at 87 & n.20. Yet the court made that ruling with eyes wide open. *See id.* at 86 (“NRG may be positioning itself for a filing under Chapter 11 in one of these districts, right now; if its management has elided the issue to some degree in this case, not a soul has been fooled.”). Two days later, NRG Energy filed its voluntary petition for bankruptcy in the Southern District of New York along with a fully drafted, 103-page proposed plan. *See, e.g.*, Voluntary Petition at 2, *In re NRG Energy, Inc.*, No. 1:03-bk-13024 (Bankr. S.D.N.Y. May 14, 2003), Dkt. No. 1; Debtors’ Joint Plan of Reorganization Pursuant to Chapter 11 of the Bankruptcy Code, at 11–22, *In re NRG Energy, Inc.*, No. 1:03-bk-13024 (Bankr. S.D.N.Y. May 14, 2003), Dkt. No. 42; *see also* Sathy et al., *supra* note 42, at 40 (“Together, the decreased transactional costs associated with consensual negotiations coupled with a demonstration that the interests of creditors were the focus of NRG Energy’s general attention persuaded the court that the involuntary petition should be dismissed, even in the face of [creditor’s] arguments that dismissal would promote forum-shopping.”).

⁵⁴ *See infra* note 61 (explaining history of means test).

⁵⁵ *See infra* Part II.D (2)–(3) (discussing role of state receiverships and ABCs in insolvency proceedings).

are more likely to abstain from hearing cases when the case lacks a bankruptcy purpose.

To be sure, the Bankruptcy Code does not say what the purpose of bankruptcy is. But courts have long recognized that bankruptcy offers a process for preserving go-forward value when reorganization is possible and for orderly liquidation when it is not. The Bankruptcy Code accomplishes this result by providing an automatic stay, giving “breathing room” for negotiations.⁵⁶ It also erects a structure for classifying and prioritizing claims against the estate, for allowing parties to propose and vote on plans, and for binding holdouts who try to extract value for their recalcitrance.⁵⁷ We can also glean from Chapter 15 that a bankruptcy proceeding is collective and either judicial or administrative,⁵⁸ distinguishing it from two-party disputes and out-of-court workouts. Thus, while bankruptcy’s purpose is not spelled out in the Code, numerous provisions hint at it, and courts enforce its spirit by pulling back from cases that do not conform to bankruptcy ends. They do this by dismissing or suspending cases under §§ 305 or 1112 or by lifting the stay under § 362(b).⁵⁹

The difference between the federal district courts and the bankruptcy courts here is stark: While Federal Rule of Civil Procedure 12(b) authorizes federal courts to dismiss claims for lack of jurisdiction, improper venue, procedural failings, or failure to state a claim,⁶⁰ bankruptcy courts can also dismiss or abstain for additional, bankruptcy-specific reasons, such as when the interests of the creditors and the debtor “would be better served”⁶¹ by doing so or, in Chapter 11, if the estate is dropping in value and hope for rehabilitation grows dim.⁶² That degree of authorization to refrain from exercising jurisdiction would be unthinkable in any other court. Imagine if a federal district court dismissed a complaint because it concluded that the interests of the plaintiff and the defendant would be better served by not proceeding with the lawsuit.

This Part will discuss three types of cases where bankruptcy courts have developed a tradition of pulling back: cases where the debtor is not suffering financial distress; cases where efforts to reorganize are futile; and cases that are not collective at all, but rather two-party disputes.

⁵⁶ See 11 U.S.C. § 362.

⁵⁷ See 11 U.S.C. § 1129 (providing voting rules for Chapter 11 plan).

⁵⁸ In Chapter 15, a foreign representative asks a bankruptcy court to recognize and coordinate with a main insolvency proceeding happening abroad. To do this, bankruptcy courts must know what counts as an insolvency or bankruptcy proceeding. The Code defines “foreign proceeding” as “a collective judicial or administrative proceeding in a foreign country . . . under a law relating to insolvency or adjustment of debt in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganization or liquidation.” 11 U.S.C. § 101(23); see also *id.* § 1515(a).

⁵⁹ See *supra* notes 14, 16, 25 and accompanying text.

⁶⁰ Fed. R. Civ. P. 12(b).

⁶¹ 11 U.S.C. § 305(a)(1).

⁶² See *id.* § 1112(b)(4) (defining “cause” for dismissal).

A. *Financial Distress*

First, bankruptcy courts underscore that their courtroom is for debtors suffering from financial distress, just like an emergency room is for patients suffering from serious health problems. To be sure, bankruptcy courts recognize, as the Supreme Court did in *Constitutional Illinois National Bank & Trust Co.*,⁶³ that bankruptcy courts can preside over cases where the debtor “can pay” but is actively hiding assets or simply refuses to pay.⁶⁴ Even so, bankruptcy courts look critically at debtors who are not undergoing serious financial distress. The proceedings involving such “solvent debtors” are either thrown out of court or subject to old, pre-Code equitable principles under the “solvent debtor exception.”⁶⁵

To be clear, solvent debtors are not always running schemes or absconding with assets. Some debtors use bankruptcy to coordinate fair, pro rata payment to millions of claimants, for example, when Pacific Gas & Electric Company faced \$50 billion in liability stemming from Northern California wildfires and filed for bankruptcy in 2019.⁶⁶ Or sometimes, a debtor reaches the steps of the bankruptcy courthouse, indisputably insolvent, but the value of the estate goes up after the filing. That effect can occur when the debtor’s estate is tied to commodities whose value can fluctuate wildly, such as Ultra Petroleum⁶⁷ or Energy Future Holdings.⁶⁸ It can also occur when the estate trends upward alongside a general economic recovery. Hertz, the car rental company, was insolvent when it filed for bankruptcy. But as the nation emerged from the COVID-19 pandemic, so too did Hertz.⁶⁹

⁶³ *Const. Illinois Nat’l Bank & Tr. Co. v. Chicago, R.I. & P. Ry. Co.*, 294 U.S. 648, 672 (1935).

⁶⁴ *Id.* at 672–73 (“[T]he ‘subject of bankruptcies’ was nothing less than ‘the subject of the relations between an insolvent or nonpaying or fraudulent debtor, and his creditors, extending to his and their relief.’” (quoting *In re Reiman*, 20 F. Cas. 490, 496–97 (S.D.N.Y. 1874))). Indeed, some of bankruptcy’s most powerful tools, such as trustees, examiners, claw-back actions, and substantive consolidation, help creditors reach assets that may have been improperly or fraudulently shuttled away from creditors.

⁶⁵ *Ultra Petroleum Corp. v. Ad Hoc Comm. of Opco Unsecured Creditors (In re Ultra Petroleum Corp.)* 51 F.4th 138, 150–52 (5th Cir. 2022) (concluding that common law, judicially crafted solvent-debtor exception survived enactment of Bankruptcy Code)

⁶⁶ *Ad Hoc Comm. of Holders of Trade Claims v. Pac. Gas & Elec. Co. (In re PG&E Corp.)*, 46 F.4th 1047, 1052 (9th Cir. 2022).

⁶⁷ *See Ultra Petroleum Corp.*, 51 F.4th at 143 (5th Cir. 2022) (requiring debtor to pay whole amount despite increase in estate value).

⁶⁸ *See Delaware Tr. Co. v. Energy Future Intermediate Holding Co. (In re Energy Future Holdings)*, 842 F.3d 247, 250–51 (3d Cir. 2016) (holding that makewhole premium, meant to give lenders interest yield that they expect, does not fall away just because full principal amount is now due and noteholders are barred from rescinding acceleration of debt).

⁶⁹ *Wells Fargo Bank, N.A. v. Hertz Corp. (In re Hertz Corp.)*, 117 F.4th 109, 132–33 (3d Cir. 2024), *amended and superseded by* 120 F.4th 1181 (3d Cir. 2024) (noting that “[t]he COVID pandemic resulted in a liquidity crisis” and “[b]ankruptcy gave the then-insolvent Hertz . . . the opportunity to disallow claims for interest not yet mature at its filing”).

Congress has erected express tests for insolvency at some entry points to bankruptcy relief.⁷⁰ Municipalities must be insolvent to file under Chapter 9 of the Code,⁷¹ and for involuntary cases, the Code requires that petitioning creditors show that the debtor is “generally not paying such debtor’s debts” or that the debtor’s property is in the control of a custodian, such as a receiver, trustee, or assignee.⁷²

By contrast, since 1978, Congress has not imposed any express insolvency requirement at the threshold of voluntary Chapter 11 cases. That does not mean that bankruptcy courts always abstain from solvent debtor cases. Instead, bankruptcy courts apply a longstanding rule called the “solvent debtor exception.” While bankruptcy contains numerous equitable principles to reduce a debtor’s debt overhang, the solvent debtor exception means that a solvent debtor, as a general matter, must pay its debtors in full, before any equity returns to the old owners.⁷³

For example, consider a funded debt that the debtor agreed to pay back pursuant to a maturity schedule. The Bankruptcy Code allows claims for the unmatured principal,⁷⁴ but disallows claims for any unmatured interest,⁷⁵ effectively accelerating all outstanding loans but freezing the interest clock on all of them.⁷⁶ In a Chapter 7 liquidation, the Code’s distribution regime requires the trustee to

⁷⁰ For individuals, Congress also established a “means test” in 2005 that creates a presumption of abuse if debtors who can make sufficient payments on their general unsecured debt file for Chapter 7 instead of Chapter 13. *See* 11 U.S.C. § 707(b). While not framed as a solvency requirement, it effectively functions in much the same way, ensuring that solvent individuals cannot receive a quick discharge under Chapter 7 of the Code but must attempt to confirm a plan under Chapters 11, 12, or 13.

⁷¹ *See* 11 U.S.C. § 109(c)(1)–(3) (“An entity may be a debtor under [C]hapter 9 of this title if and only if such entity . . . is a municipality . . . [and] is insolvent.”).

⁷² *See id.* § 303(h). Congress has tinkered with those requirements over the years. Before 1898, under the 1847 and 1867 Acts, debtors filing for bankruptcy voluntarily had to plead that they were unable to pay their debts, but “the law [took] him at his word.” *Hanover Nat’l Bank v. Moyses*, 186 U.S. 181, 191 (1902). And until the 1978 Code, voluntary petitioners had to show that they were insolvent or unable to pay debts as they came due, while involuntary petitioners had to show that the debtor had committed one or more acts of bankruptcy. *See, e.g., In re Johns-Manville Corp.*, 36 B.R. 727, 732 (Bankr. S.D.N.Y. 1984) (“[W]ith specific regard to Chapter 11, the Code eliminates the requirement contained in former Sections 77(a), 130(1), 323 and 423 of the Act that the debtor be insolvent or unable to pay his debts as they mature.”).

⁷³ *Ultra Petroleum Corp. v. Ad Hoc Comm. of Opco Unsecured Creditors (In re Ultra Petroleum Corp.)* 51 F.4th 138, 150–52 (5th Cir. 2022) (“When a debtor can pay its creditors interest on its unpaid obligations in keeping with the valid terms of their contract, it must.”).

⁷⁴ 11 U.S.C. § 101(5).

⁷⁵ *Id.* § 502(b)(2) (stipulating that court may determine amount of claim allowed except to the extent that “such claim is for unmatured interest”).

⁷⁶ Nor can the debtor pick a favorite lender and attempt to assume the debt contract as an executory contract: contracts for loans, debt financing, or other financial accommodations are excluded from assumption in bankruptcy. *See id.* § 365(c)(2).

pay postpetition interest, at the legal rate, before the debtor receives any funds from the estate.⁷⁷ And in *Ultra Petroleum*, *PG&E*, *Energy Future Holdings*, and *Hertz*, courts imposed a similar requirement for solvent debtors attempting to confirm a Chapter 11 plan, even without a clear statutory mandate.⁷⁸ The courts reasoned that Congress legislated against the backdrop of the solvent debtor exception.

Other limited interventions in solvent debtor cases could involve a court lifting the stay, refusing to allow the debtor to reject executory contracts, or refusing to confirm a plan.⁷⁹

Some bankruptcy courts have refused to exercise jurisdiction over solvent debtor cases altogether. In some jurisdictions, the statutory hook is that a solvent debtor filing must be dismissed for cause under § 1112 for filing in “bad faith.”⁸⁰ This strain of caselaw became one of the ways that bankruptcy courts have rejected the “Texas Two-Step,”⁸¹ a stratagem in which an enterprise first consummates a divisional merger under Texas law, putting all the assets and operations into one company (“GoodCo”) and loading up an affiliate with all the liabilities (“BadCo”), then sends the affiliate into bankruptcy. To avoid a ruling that the transaction was a constructive fraudulent transfer (it still might be an actual fraudulent transfer, of course), GoodCo gives BadCo a funding agreement, offering to repay it for the liabilities. The premise behind the maneuver is twofold: first, the operating company, GoodCo, can continue operating without the expenses and hurdles of a formal bankruptcy case; second, the debtor company, BadCo, will have to dedicate its assets to repaying debts, but the enterprise has decided in advance how valuable the available assets will be.

Some Texas Two-Step cases confronted a solvency requirement because their funding agreements were uncapped or, put differently, too generous. Johnson & Johnson was facing liability over talc in its baby powder, so it created a new entity called LTL Management, loaded it up with the liability and an uncapped

⁷⁷ See *id.* § 726(a) (2026) (establishing order in which estate property should be distributed, where postpetition interest must be paid before debtor may receive distributions).

⁷⁸ See, e.g., *Ultra Petroleum Corp. v. Ad Hoc Comm. of Opco Unsecured Creditors* (*In re Ultra Petroleum Corp.*), 51 F.4th 138, 143 (5th Cir. 2022); *Ad Hoc Comm. of Holders of Trade Claims v. Pac. Gas & Elec. Corp.* (*In re PG&E Corp.*), 46 F.4th 1047 (9th Cir. 2022); *Delaware Tr. Co. v. Energy Future Intermediate Holding Co.* (*In re Energy Future Holdings*), 842 F.3d 247 (3d Cir. 2016); *Wells Fargo Bank v. Hertz Corp.* (*In re Hertz Corp.*), 117 F.4th 109 (3d Cir. 2024), *amended and superseded by*, 120 F.4th 1181 (3d Cir. 2024).

⁷⁹ See 11 U.S.C. § 1129(a)(3) (requiring that Chapter 11 plans be proposed “in good faith”).

⁸⁰ *id.* § 1112 (establishing requirements for conversion to Chapter 7 bankruptcy or dismissal “for cause,” and then defining “cause” under (4)(A)–(P)).

⁸¹ For a brief overview and case study of the “Texas Two-Step,” see Clara Jiang, *Breaking Down the Texas Two-Step: Johnson & Johnson’s Fight Against Mass Tort Liability*, COLUM. BUS. L.R. ONLINE (Feb. 4, 2025), <https://journals.library.columbia.edu/index.php/CBLR/announcement/view/759> [<https://perma.cc/XPQ4-MLA8>] (discussing Texas Two-Step in context of J&J’s talcum powder litigation).

funding agreement, and sent it into bankruptcy.⁸² Once there, the talc claimants in LTL Management asked the bankruptcy court to dismiss the case for cause. The bankruptcy judge denied the motions, but the Third Circuit reversed, insisting that a debtor in bankruptcy must be facing financial distress that is both “apparent” and “immediate enough to justify a filing.”⁸³

Asbestos claimants have made similar arguments in *Bestwall*, giving them a constitutional dimension.⁸⁴ They argued that the Bankruptcy Power in the U.S. Constitution is limited by an implicit insolvency requirement baked into the word “bankruptcies,” such that a bankruptcy court lacks subject-matter jurisdiction over solvent debtors. The Fourth Circuit recently rejected that view in a split decision.⁸⁵ That said, the majority opinion underscores that the asbestos claimants were really trying to shoehorn a constitutional argument into a jurisdictional one.⁸⁶ It remains to be seen whether the Fourth Circuit in *Bestwall* will follow the Third Circuit in *LTL Management* when the bad faith arguments are wrapped into a final, appealable order (or resurrected at the end of the case).⁸⁷

⁸² The *LTL Management* case has been tortuous. It began in bankruptcy court in North Carolina, but the judge transferred the case to the District of New Jersey. *See In re LTL Mgmt.*, 637 B.R. 396, 409 n. 10 (Bankr. D.N.J. 2022) (“This case is venued now where it should be. The appropriateness of the original filing in North Carolina can be debated, but that discussion should not color the primary inquiry as to whether the case at this point should proceed in the bankruptcy court.”), *rev’d and remanded by*, *LTL Mgmt. v. Those Parties Listed on Appendix A to Complaint (In re LTL Mgmt.)*, 64 F.4th 84 (3d Cir. 2023).

⁸³ *In re LTL Mgmt.*, 64 F.4th at 102.

⁸⁴ The asbestos claimants had previously tried, and failed, to get the bankruptcy court to dismiss the case for bad faith. *See In re Bestwall LLC*, 605 B.R. 43, 54 (Bankr. W.D.N.C. 2019). When they attempted to get the Fourth Circuit to take up their appeal on an expedited schedule, the Fourth Circuit declined. *See* Off. Comm. of Asbestos Claimants of Bestwall, LLC v. Bestwall LLC (*In re Bestwall LLC*), No. 19-408, 2019 WL 13512209 (4th Cir. Nov. 14, 2019).

⁸⁵ *Bestwall LLC v. Off. Comm. of Asbestos Claimants of Bestwall, LLC*, 148 F.4th 233, 241–42 (4th Cir. 2025) (holding that no federal court, including bankruptcy courts, has “endorse[d] the proposition that bankruptcy courts do not have subject-matter jurisdiction unless a debtor has a sufficient degree of financial distress” (citation omitted)), *cert. denied*, 2026 WL 1513280 (June 1, 2026) (mem. op.).

⁸⁶ *Id.* at 240.

⁸⁷ The Fourth Circuit would have to confront how to square the rule in *LTL Management* with longstanding circuit precedent that states “[d]ecisions denying access at the very portals of bankruptcy, before an ongoing proceeding has even begun to develop the total shape of the debtor’s situation, are inherently drastic and not lightly to be made.” *Carolin Corp. v. Miller*, 886 F.2d 693, 700-01 (4th Cir. 1989). Similarly, in *General Growth Properties*, a bankruptcy court declined to dismiss a Chapter 11 petition when balloon payments were not yet due. *In re General Growth Props., Inc.*, 409 B.R. 43, 57 (Bankr. S.D.N.Y. 2009); *id.* at 60 (“In light of the statute, this Court declines the invitation to establish an arbitrary rule, of the type desired by Movants, that a debtor is not in financial distress and cannot file a Chapter 11 petition if its principal debt is not due within one, two, or three years.”).

We can make several statutory and pragmatic observations about this line of cases. To start, a finding of “cause” under § 1112(b) requires the bankruptcy court to convert or dismiss the case; it is not discretionary.⁸⁸ The statute includes a list of sixteen examples of cause, all of which look more like futility⁸⁹ or misconduct in the litigation—not a “can-pay,” “will-pay” debtor. Even though the list is not exclusive,⁹⁰ additional types of “cause” ought to resemble the items in the enumerated list under the canon of *ejusdem generis*.⁹¹

Critics of using financial distress as a gateway to bankruptcy, most prominently Professors Anthony Casey⁹² and Brook Gotberg,⁹³ underscore the difficulties in litigating a squishy standard of financial distress at the outset of a case. Enterprise valuation, whether in bankruptcy or not, is famously tricky. Requiring the bankruptcy courts to hold a contested solvency hearing at the beginning of the case seems imprudent, especially when the solvent debtor exception provides numerous opportunities for the bankruptcy court to intervene in the name of fairness, efficiency, or formation.

⁸⁸ See 11 U.S.C. § 1112(b) (providing that court “shall convert . . . or dismiss” the case, “whichever is in the best interests of creditors and the estate”). To be fair, the Code does include some carve-outs. The court might decide to appoint a trustee or an examiner instead, a measure that makes more sense in the context of mismanagement. See *id.* 1104(a). Other than that, the Code provides only one narrow exception: so long as the cause was not futility of the bankruptcy case under paragraph (4)(A) and the debtor is still on track to confirm a plan within statutory deadlines, and if the debtor had “reasonable justification” for the offending act or omission and can readily cure it, then the court can identify “unusual circumstances establishing that converting or dismissing the case is not in the best interests of creditors and the estate.” *id.* § 1112(b)(2).

⁸⁹ See *infra* Section I.B (discussing futility as dismissal/abstention tactic by bankruptcy courts).

⁹⁰ In the Bankruptcy Code, the word “includes” and “including” are not limiting, per 11 U.S.C. § 102(3).

⁹¹ Even if we were to focus on Texas Two-Step cases, those prepetition actions most resemble fraudulent transfers, and while Congress could have included prepetition fraudulent transfers as a reason for dismissing a bankruptcy case for cause, it did not do so. By comparison, Congress did think that intentional fraudulent transfers shortly before or after filing the case are a reason to deny an individual debtor a discharge in Chapter 7. See *id.* § 727(a)(2) (stipulating that court will grant discharge unless debtor intentionally defrauds creditor with respect to property held by debtor or estate).

⁹² See Casey, *supra* note 45 (arguing for rule requiring dismissal only when court finds proceedings would be objectively futile).

⁹³ See Brook Gotberg, The Burden of Financial Distress (unpublished manuscript) (on file with Boston University Law Review) (disagreeing with Third Circuit’s decision to affirm dismissal of bankruptcy in *LTL Management* due to court’s conclusion that Johnson & Johnson was not in financial distress).

Scholars and practitioners are right to point out that the Code imposes no strict insolvency requirement at the gateway to bankruptcy.⁹⁴ But that is not the end of the analysis. First, the Bankruptcy Power or the “cases or controversies” restriction of Article III might carry a financial distress requirement—something future work will explore. Second, if they do impose limits on the Bankruptcy Court, courts will need to ask whether those constitutional requirements are met by some combination of statutory good faith requirements, common law doctrines of good faith and the solvent debtor exception, and equitable doctrines like abstention, which both predate the Code and are codified in it. Third, courts will need to ask whether constitutional avoidance might counsel in favor of an otherwise strained reading of the statutory text.

Courts should be careful not to take a blinkered view of the Code. Section 1112 is not the only statutory text that empowers a bankruptcy court to dismiss a solvent debtor case—nor even the most natural one. An equitable abstention standard, codified in § 305, gives the bankruptcy courts discretion and provides a comprehensive, objective test: whether “the interests of creditors and the debtor would be better served by such dismissal or suspension.”⁹⁵ If so, the bankruptcy court may abstain. Shifting the “solvent debtor” cases away from dismissal and toward abstention might provide courts with the discretion to abstain from cases where solvency is coupled with other “bad facts”—like forum shopping or other forms of what Professor Lindsey Simon calls “bankruptcy grifting.”⁹⁶ Whether abstention is enough to insulate the Code from constitutional scrutiny is a separate problem.

B. *Futility*

Second, and conversely, bankruptcy courts tend to dismiss or abstain from hearing cases when they cannot see how the bankruptcy process can help. To be sure, bankruptcy provides debtors with lots of tools for managing financial distress. Upon filing for bankruptcy, debtors can negotiate under the calm of the automatic stay,⁹⁷ ask the court for permission to borrow funds to finance a turnaround,⁹⁸ assume or reject executory contracts,⁹⁹ recover funds from preferential

⁹⁴ See, e.g., Casey, *supra* note 45 (challenging Third Circuit’s “financial distress test” from *LTL Management* as being “in direct conflict with the [Bankruptcy] Code”) (manuscript at 16).

⁹⁵ 11 U.S.C. § 305(a)(1).

⁹⁶ See generally Lindsey D. Simon, *Bankruptcy Grifters*, 131 YALE L.J. 1154 (2022) (highlighting the use of bankruptcy among defendants in mass-tort, opioid, and sexual abuse cases to relieve themselves of substantial liability).

⁹⁷ See 11 U.S.C. § 362.

⁹⁸ See *id.* § 364.

⁹⁹ See *id.* § 365.

or fraudulent transfers,¹⁰⁰ and, most importantly, propose a plan of reorganization that can bind holdouts.¹⁰¹

Yet sometimes those tools are not enough. For example, the financial distress might be so pronounced that the bankruptcy court concludes that the debtor does not have an ongoing business to reorganize.¹⁰² So, rather than convert a reorganization case to a liquidation,¹⁰³ the court might dismiss or abstain from hearing it altogether, telegraphing to the debtor that its rosy vision for a restructuring is misguided.¹⁰⁴

Futility operates at both the case level and the asset level. When the debtor has no equity in a piece of collateral and the asset is “not necessary to an effective reorganization,” the court must lift the stay to allow the secured creditor to repossess it.¹⁰⁵ When the debtor is underwater on several pieces of important collateral and no effective reorganization is on the table, that rule suggests that the court should dismiss the whole case. After all, it defeats the purpose of the bankruptcy case to keep the debtor in the courtroom while sending the secured creditors outside to repossess core assets.¹⁰⁶

When bankruptcy courts abstain due to futility, that does not always mean that an insolvency could never help the debtor. The problem, in some cases, is that the judge does not yet have enough information to decide.

¹⁰⁰ See *id.* §§ 544, 547, 548.

¹⁰¹ See *id.* § 1129.

¹⁰² For example, in *Davis Heritage GP Holdings*, the court sized up the debtor’s assets as “one parcel of vacant land in Mississippi that is fully encumbered” and ownership interests in mezzanine companies with no estate assets, concluding that “this Debtor does not own anything that it can reorganize.” *In re Davis Heritage GP Holdings*, 443 B.R. 448, 458 (Bankr. N.D. Fla. 2011). Similarly, in *Fitzgerald Group*, the debtor partnership had automatically dissolved under state law, and the only remaining asset was a typewriter worth \$2,500. See *In re Fitzgerald Grp.*, 38 B.R. 16, 18 (Bankr. S.D.N.Y. 1983).

¹⁰³ Debtors in Chapter 11 can convert their cases to a Chapter 7 liquidation voluntarily under most circumstances. See 11 U.S.C. § 1112(a). But upon a party’s request, the court must dismiss the case, convert it, or appoint a trustee or examiner for cause, “whichever is in the best interests of creditors and the estate.” *Id.* § 1112(b)(1). Cause includes, among other things, “substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation.” *Id.* § 1112(b)(4)(A). That said, a bankruptcy court cannot convert farm or nonprofit bankruptcies to Chapter 7 and can only suggest that the debtor request conversion if the court believes that a liquidation is the best outcome. See *id.* § 1112(c).

¹⁰⁴ See, e.g., *Sapphire Dev., LLC v. McKay*, 549 B.R. 556, 557, 567-68 (D. Conn. 2016) (affirming bankruptcy court’s dismissal of case when debtor “has had no employees for almost a decade, has failed to pay taxes on the property to which it has title, has received income only from related entities, and has done nothing of significance in recent years other than hold the property on which its principal resides”).

¹⁰⁵ 11 U.S.C. § 362(d)(2).

¹⁰⁶ See also *id.* § 1112(b)(4)(A) (providing that cause for dismissal includes “substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation”).

In re MV Realty was such a case. The debtor, MV Realty, was a real estate brokerage company, based in South Florida, that wrote checks (for a few thousand dollars) to homeowners, in exchange for a promise that if the homeowners were to sell the home during the next forty years, they would hire MV Realty as a real estate broker or pay a 3% penalty on the sale. Most troublingly, to enforce their contract, MV Realty filed the agreements in the title system, effectively preventing homeowners from working with any other real estate brokers.¹⁰⁷

The bankruptcy judge faced a predicament. It was premature to call a reorganization utterly futile, but the estate's only assets of any value were thousands of these contracts, governed by the laws of more than a dozen states. And Attorneys General from Massachusetts to Florida were challenging the contracts in state court as fraudulent, unconscionable, against public policy, and illegal.¹⁰⁸ At the federal level, the Consumer Financial Protection Bureau (the "CFPB") opened an investigation.¹⁰⁹ Thus, the enterprise value of the bankruptcy estate was impossible to discern without making rulings of state law.¹¹⁰ And even though the automatic stay did not apply to the law enforcement actions,¹¹¹ any proposed reorganization necessarily turned on whether the contracts were lawful or not.

The bankruptcy judge could have ruled on those state-law issues, but he decided to abstain, declining to embark upon a multi-state survey of mortgage and contract law.¹¹² But once he had decided to let the state courts reach rulings on

¹⁰⁷ See *MV Realty PBC, LLC v. Off. of the Att'y Gen. (In re MV Realty PBC, LLC)*, 658 B.R. 194, 198 (Bankr. S.D. Fla. 2024).

¹⁰⁸ See, e.g., Press Release, Off. of the Att'y Gen., AG Campbell Reaches \$2.25 Million Settlement with MV Realty Over Deceptive Business Practices and Predatory Mortgage Agreements (Mar. 11, 2026) <https://www.mass.gov/news/ag-campbell-reaches-225-million-settlement-with-mv-realty-over-deceptive-business-practices-and-predatory-mortgage-agreements> [<https://perma.cc/2ZKJ-788G>]; Press Release, Off. of the Att'y Gen., Attorney General James Uthmeier Secures Judgment Against MV Realty for Scamming Florida Homeowners (Dec. 19, 2025) <https://www.myfloridalegal.com/newsrelease/attorney-general-james-uthmeier-secures-judgment-against-mv-realty-scamming-florida> [<https://perma.cc/W4DV-E4JV>].

¹⁰⁹ See Nate Beck, *CFPB Rebuffs Bid By MVRealty To End Investigation*, LAW360 (Mar. 6, 2024, at 14:17 ET), <https://www-law360-com.ezproxy.bu.edu/articles/1810223/cfpb-rebuffs-bid-by-mv-realty-to-end-investigation>.

¹¹⁰ See *MV Realty*, 658 B.R. at 204 ("[T]he plaintiff's potential for success in the state actions is a necessary consideration in determining whether they have a reasonable likelihood of successful reorganization.").

¹¹¹ See 11 U.S.C. § 362(b); *MV Realty*, 658 B.R. at 200, 202-03 (clarifying scope of automatic stay and declining to extend it over law enforcement actions).

¹¹² See *MV Realty*, 658 B.R. at 207-08 ("[T]he interests of comity and respect for state law far outweigh any countervailing factors under the usual analysis. The Court will abstain from this adversary proceeding . . ."). The bankruptcy judge had also decided not to interfere with a proceeding in North Carolina that could have stripped a valuable real estate license from the debtor. See *MV Realty of N.C., LLC v. N.C. Real Est. Comm'n (In re MV Realty PBC, LLC)*, No. 23-17590, 2023 WL 8592795 (Bankr. S.D. Fla. Dec. 9, 2023).

the merits, the propriety of retaining jurisdiction over the case made much less sense. With multiple motions to dismiss pending, and a hearing on the calendar, the debtor voluntarily dismissed the case.¹¹³ That decision appears to have been prescient. Since MV Realty exited bankruptcy, Florida lawmakers have passed a statute criminalizing MV Realty's business model¹¹⁴ and a judge forced MV Realty to clear the homeowners' titles.¹¹⁵

Whether the debtor is an empty shell or a messy scramble, the doctrine calls for bankruptcy courts to assess whether bankruptcy can provide a workable liquidation or reorganization process. If it cannot, they may find a way to abstain from hearing the case altogether.

C. Two-Party Disputes

Third, bankruptcy law allows courts to abstain from hearing disputes between only two parties. Indeed, bankruptcy courts may take this step even when the debtor is undergoing financial distress that bankruptcy could otherwise remediate.¹¹⁶ The justification for not exercising jurisdiction is that a bankruptcy proceeding must be collective,¹¹⁷ and that other courts are adequately equipped to handle most two-party disputes.¹¹⁸ Indeed, bankruptcy courts bristle when

¹¹³ See Debtors' Notice of Consent to Voluntary Dismissal Without Prejudice, *MV Realty*, No. 23-17590 (Bankr. S.D. Fla. May 13, 2024), Dkt. No. 1419; see also Order Dismissing Cases, *MV Realty*, No. 23-17590 (Bankr. S.D. Fla. May 24, 2024), Dkt. No. 1523.

¹¹⁴ See FLA. STAT. § 475.279 (2023) (providing that "residential loan alternative agreements" lasting longer than two years are not liens, cannot be assigned, and must come with services beginning within ninety days; or agreement is unenforceable and considered unfair or deceptive trade practice).

¹¹⁵ See David Minsky, *Fla. Realty Co. Sued Over Home Liens Told to Pay Ch. 11 Bills*, LAW360 (Apr. 16, 2025, at 18:53 ET), <https://www.law360.com/bankruptcy-authority/articles/2325972/fla-realty-co-sued-over-home-liens-told-to-pay-ch-11-bills> (recounting judge's order to pay homeowners nearly \$500,000 previously received through predatory listing contracts); Motion for Order to Show Cause As to Why Defendants Should Not Be Held in Indirect Contempt of Court at 3, *Off. of the Att'y Gen. v. MV Realty PBC, LLC*, No. 22-CA-009958 (Bankr. S.D. Fla. Apr. 11, 2025) (noting that Court's Injunction Order immediately enjoined MV Realty from asserting or representing that it "holds any enforceable property interest . . . or any other encumbrance or cloud on title" on a home that arises from a Homeowner Benefit Agreement ("HBA")).

¹¹⁶ See, e.g., *Cedar Short Resort, Inc. v. Mueller (In re Cedar Shore Resort, Inc.)*, 235 F.3d 375, 381 (8th Cir. 2000) (affirming dismissal of Chapter 11 petition for bad faith "even though the debtor might be capable of effectuating a reorganization").

¹¹⁷ See *supra* note 58 and accompanying text (describing bankruptcy proceedings in context of foreign proceedings as "collective").

¹¹⁸ See, e.g., *In re Outta Control Sportfishing, Inc.*, 642 B.R. 180, 185 (Bankr. S.D. Fla. 2022) (noting that bankruptcy courts dismiss cases arising from two-party disputes when dispute can be handled by other forum). Conversely, the fact that a debtor and one of its creditors are litigating in state court does not rule out a bankruptcy case. See, e.g., *In re Sapphire Dev., LLC*, 523 B.R. 1, 8–9 (D. Conn. 2014) (reversing bankruptcy court's abstention decision when debtor had three mortgages, a tax lien, and several unsecured creditors in addition to

judgment creditors run straight to them after winning a money judgment, using the court as a sort of debt collection agency.¹¹⁹ Conversely, courts are more hospitable to debtors when they explain their need for tools available only in bankruptcy court, such as fraudulent conveyance actions, equitable subordination, or even the appointment of a trustee.¹²⁰

Some courts have put a federalist gloss on this requirement, explaining that the restriction to collective proceedings helps keep bankruptcies within constitutional limits. As the Fourth Circuit put it in a commercial landlord-tenant dispute that wound up in bankruptcy court,

[This case] was at bottom a straightforward contractual dispute between a landlord and tenant and should not have been creatively refashioned as a bankruptcy matter or constitutional controversy brought “for the sole purpose of halting and/or delaying [the debtor’s] ultimate eviction” If these sorts of suits are deemed proper subjects for bankruptcy, then those courts (to their own dismay) would be well on their way to becoming courts of general jurisdiction. Both the bankruptcy and district courts refused to permit this, and we affirm the judgment.¹²¹

The principle against hearing two-party disputes in bankruptcy court stands as a statutory requirement for involuntary cases, which can only be brought by three or more qualifying creditors when the debtor has twelve or more such creditors.¹²² But it shines through in voluntary cases too, through dismissal, abstention, and lift-stay orders.¹²³

matter pending in state court). Ironically, upon remand, the bankruptcy court dismissed the case as a bad faith filing. *See In re Sapphire Development, LLC*, No. 13-50043, 2015 WL 5579545 (Bankr. D. Conn. June 26, 2015), *aff’d*, 549 B.R. 556 (D. Conn. 2016).

¹¹⁹ *See, e.g., In re Mountain Dairies, Inc.*, 372 B.R. 623, 635 (Bankr. S.D.N.Y. 2007) (“The bankruptcy court is not a collection agency.”); *In re SBA Factors of Miami, Inc.*, 13 B.R. 99, 100 (Bankr. S.D. Fla. 1981) (dismissing petition where “[p]etitioners are using this involuntary proceeding as a substitute for customary collection procedures”).

¹²⁰ *See, e.g., 9281 Shore Rd. Owners Corp. v. Seminole Realty Co. (In re 9281 Shore Rd. Owners Corp.)*, 187 B.R. 837, 855 (E.D.N.Y. 1995) (reversing bankruptcy court’s dismissal of single-asset real estate (“SARE”) case when debtor needed tools unavailable in state court); *In re Sirius Sys., Inc.*, 112 B.R. 50, 55 n.1 (Bankr. D.N.H. 1990) (noting that court had declined to dismiss involuntary case when preference and fraudulent transfer actions could have increased estate); *id.* at 55 (declining to dismiss voluntary petition when two deadlocked shareholders jointly asked court to appoint Chapter 11 trustee to break deadlock in state court).

¹²¹ *Maryland Port Admin. v. Premier Auto. Servs., Inc. (In re Premier Auto. Servs., Inc.)*, 492 F.3d 274, 285 (4th Cir. 2007).

¹²² 11 U.S.C. § 303(b) (“An involuntary case against a person is commenced by the filing with the bankruptcy court of a petition . . . by three or more entities, each of which is either a holder of a claim against such person that is not contingent as to liability or the subject of a bona fide dispute as to liability or amount . . . [or] if there are fewer than 12 such holders, . . .”).

¹²³ *See, e.g., Argus Grp. 1700, Inc. v. Steinman (In re Argus Grp. 1700, Inc.)*, 206 B.R. 757, 765 (E.D. Pa. 1997) (dismissing when debtor filed for bankruptcy “to obtain federal-

Sometimes the one-on-one nature of the dispute is easy to see. In *Westerleigh Development Corp.*,¹²⁴ for example, two 50% shareholders were deadlocked in state court when one of them caused his family owned corporation to file an involuntary petition against the company. The bankruptcy court dismissed the bankruptcy case, noting that the debtor company could not even contest the involuntary petition, because “its only two shareholders are on either side of the case, with neither having authority to act for the corporation.”¹²⁵

Or consider Asanda Air, whose sole business was operating spas in Delta’s Sky Clubs.¹²⁶ When Delta delivered a notice terminating its contract, Asanda Air threatened to file for bankruptcy to invoke the automatic stay.¹²⁷ Delta sued in Georgia, but Asanda Air filed for bankruptcy the day before its answer was due.¹²⁸ “[T]his reorganization essentially involves the resolution of a two-party dispute,” concluded the bankruptcy court, pointing to the fact that Asanda Air hadn’t missed any payments to its only other unsecured creditor (PayPal), and that Delta was the only creditor actively litigating.¹²⁹

But other cases require deeper investigation, and bankruptcy courts rigorously police the two-party line. For example, Maury Rosenberg ran a medical imaging business called National Medical Imaging, LLC (“NMI”). Beginning in 2000, NMI entered into lease agreements on several pieces of very expensive medical imaging equipment, leases that it almost immediately struggled to pay. After a voluntary business bankruptcy, thirteen lawsuits in state court, and an involuntary business bankruptcy, Rosenberg’s creditors (indirectly owned by U.S. Bank) forced him to execute a personal guarantee of the leases.¹³⁰

In 2008, six lessor entities (collectively, the “DVI entities”) commenced two involuntary proceedings, one against Rosenberg personally and one against

court jurisdiction” over two-party dispute); *Wechsler v. Macke Int’l Trade, Inc. (In re Macke Int’l Trade, Inc.)*, 370 B.R. 236, 247 (B.A.P. 9th Cir. 2007) (affirming bankruptcy court’s abstention from two-party dispute when debtor had already commenced assignment for benefit of creditors (“ABC”) with other creditors).

¹²⁴ *In re Westerleigh Dev. Corp.*, 141 B.R. 38 (Bankr. S.D.N.Y. 1992).

¹²⁵ *Id.* at 40; *see also In re Runaway II, Inc.*, 168 B.R. 193, 198 (Bankr. W.D. Mo. 1994) (abstaining from two-party dispute between two 50% shareholders).

¹²⁶ *See In re Asanda Air II LLC*, 600 B.R. 714, 717 (Bankr. N.D. Ga. 2019).

¹²⁷ *See id.* at 717–18.

¹²⁸ *See id.* at 718. As the bankruptcy court later noted, “[t]he Debtor presents no evidence that any other creditor acted, or even threatened action, which might justify the need for the automatic stay.” *Id.* at 722.

¹²⁹ *See id.* at 721–22. Of course, in other cases, the bankruptcy court concludes that a small number of creditors does not signify an improper purpose. *See, e.g., Busch L. Firm, LLC v. Frontline Med. Servs. LLC (In re Frontline Med. Servs. LLC)*, 665 B.R. 818, 828–29 (B.A.P. 10th Cir. 2024) (affirming bankruptcy court that determined bankruptcy case with three unsecured creditors was not filed in bad faith).

¹³⁰ *See In re Rosenberg*, 414 B.R. 826, 832–34 (Bankr. S.D. Fla. 2009), *aff’d in part, rev’d in part*, 2011 U.S. Dist. LEXIS 158828 (S.D. Fla. Sept. 28, 2011), *aff’d*, 472 F. App’x 890 (11th Cir. 2012).

NMI, his company. Bankruptcy Judge Jay Cristol, an icon of the Miami insolvency bench, determined that Rosenberg's obligations didn't run to the six DVI entities, which he called "pass through vehicles," but to an intermediate entity as part of a novation.¹³¹ That conclusion meant that NMI had only one petitioning creditor, not six, leaving the numerosity requirement for the involuntary petition unmet.¹³² The bankruptcy courts dismissed the involuntary petitions.¹³³

In other contexts, bankruptcy courts hold the concept of a "two-party dispute" loosely. When "one side of the v" is actually a coordinated group of creditors, bankruptcy courts may interpret that group as a single "creditor" for purposes of dismissal or abstention. Courts have abstained when the debtor is embroiled in disputes against shareholders as a group¹³⁴ or a syndicate of lenders as a group.

When the bankruptcy courts are uncertain whether enough creditors have joined an involuntary petition, they may abstain out of caution. In *EB Holdings*, a collective of hedge funds filed an involuntary petition against the parent company of Ecobat, a car-battery recycler, which had defaulted on a multimillion dollar payment-in-kind ("PIK") loan. Noting that litigation was pending in state court and citing concerns about numerosity,¹³⁵ the bankruptcy court abstained from advancing the bankruptcy case¹³⁶ but kept the automatic stay in place while the state court proceeding continued.¹³⁷

¹³¹ *In re Rosenberg*, 414 B.R. at 841 ("Taking all these factors into consideration, the Original Petitioning Creditors and Ashland Funding are not parties in interest and therefore lack standing as a matter of law to file an involuntarily petition against Rosenberg.").

¹³² *Id.* In Pennsylvania, the bankruptcy court gave preclusive effect to that ruling and dismissed the business case too. *See In re Nat'l Med. Imaging, LLC*, 439 B.R. 837 (Bankr. E.D. Pa. 2009) (dismissing business bankruptcy case), *aff'd*, 529 B.R. 607 (E.D. Pa. 2015), *aff'd*, 648 F. App'x 251 (3d Cir. 2016).

¹³³ *In re Rosenberg*, 414 B.R. at 848 ("[T]he Court concludes that this case should be dismissed with prejudice.").

¹³⁴ *See, e.g., Cedar Short Resort, Inc. v. Mueller (In re Cedar Shore Resort, Inc.)*, 235 F.3d 375, 381-82 (8th Cir. 2000) (describing shareholder complaint as two-party dispute). Similarly, in *In re Greenwood*, a filing timed to interrupt a state court fight between "two blocs of shareholders" indicated some bad faith, although other factors persuaded the court not to dismiss. *In re Greenwood Supply Co.*, 295 B.R. 787, 794 (Bankr. D.S.C. 2002).

¹³⁵ *In re EB Holdings II, Inc.*, 589 B.R. 704, 720 n.50 (Bankr. D. Nev. 2017) (highlighting that "[i]n this case, there may be an actual dispute over whether a sufficient number of qualifying creditors have joined in the involuntary petition, rather than a bona fide dispute as to liability or amount of the claims").

¹³⁶ *Id.* at 727-28.

¹³⁷ *See In re EB Holdings II, Inc.*, 591 B.R. 10, 24 (Bankr. D. Nev. 2018) ("Under these circumstances, the balance of harms does not support relief from stay so that GLAS can file another civil action in the Southern District of New York"). The parties eventually agreed to carry on their battle in bankruptcy court, and EB Holdings filed a voluntary, prepackaged bankruptcy in 2019. *See Order Approving Debtor's Disclosure Statement and Confirming the Pre-Packaged Chapter 11 Plan of Reorganization, In re EB Holdings II, Inc.*, No. BK-S-19-16364 (Bankr. D. Nev. Nov. 6, 2019), Dkt. No. 109.

For similar reasons, bankruptcy courts hesitate to hear cases when the debtor's motivation for filing is solely to frustrate foreclosure efforts. Drawing that line can be challenging, of course, since the whole point of the automatic stay is to impose an immediate pause on debt collection efforts.¹³⁸ But bankruptcy courts ask whether the debtor is facing debt collection activity on multiple fronts or merely seeking to move a foreclosure action to a more favorable forum.¹³⁹ A particularly egregious example of fleeing foreclosure is the so-called "new debtor syndrome": when a business transfers an encumbered asset to a newly formed entity (one that holds few to no other assets) and files it for bankruptcy.¹⁴⁰

Another common category of two-party disputes is the single-asset real estate case ("SARE."). In one of the seminal SARE cases, *Phoenix Piccadilly*,¹⁴¹ the Eleventh Circuit noted that the debtor had only one asset, which was subject to security interests and a pending foreclosure action.¹⁴² In 1994, Congress reacted to SARE cases by amending the automatic stay to allow creditors to resume foreclosure actions unless the debtor promptly files a plan of reorganization or starts making appropriate monthly payments.¹⁴³ While SARE cases are a type of two-party dispute that can be heard in bankruptcy court, Congress's express

¹³⁸ See 11 U.S.C. § 362(a) (stipulating circumstances under which petition functions as automatic stay).

¹³⁹ See, e.g., *In re Outta Control Sportfishing, Inc.*, 642 B.R. 180, 186 (Bankr. S.D. Fla. 2022) (dismissing bankruptcy petition as filed in bad faith when corporate debtor sought to avoid paying bond while negotiating mortgage payments on sport fishing vessel); *In re Trina Assoc.*, 128 B.R. 858, 871-72 (Bankr. E.D.N.Y. 1991) (noting that parties had settled foreclosure action in state court and concluding that it would be better to consummate that agreement in state court).

¹⁴⁰ See, e.g., *In re N.R. Guaranteed Retirement, Inc.*, 112 B.R. 263, 273-76 (Bankr. N.D. Ill. 1990) (discussing cases in which courts have cited "new debtor syndrome" as ground for relief).

¹⁴¹ *Phoenix Piccadilly, Ltd. v. Life Ins. Co. of Virginia (In re Phoenix Piccadilly, Ltd.)*, 849 F.2d 1393, 1394-95 (11th Cir. 1988).

¹⁴² *Id.* at 1394-95 (affirming district court's dismissal of case after finding bad faith).

¹⁴³ See 11 U.S.C. § 362(d)(3)-(4); see also *id.* § 101(51B) (defining "single asset real estate"). SARE debtors are also ineligible to elect Subchapter V of the Bankruptcy Code. See *id.* § 1182(1) (amending definition of "debtor" to include small business debtors as defined by § 101(51)(C)-(D)). As courts of equity, bankruptcy courts are resistant to efforts to elude these statutory provisions. In *McGrath*, for example, the debtors rented a warehouse to three commercial tenants, but a state court had ordered the tenants to pay the bank directly before the debtors filed for bankruptcy. *In re McGrath*, No. 3:20-bk-3689, 2021 WL 2405722, at *1 (Bankr. M.D. Fla. June 10, 2021). So, when they filed, the debtors were technically eligible for Subchapter V of the Bankruptcy Code because they did not receive any revenue from their commercial real estate. *Id.* at *2. "[T]hey technically escaped designation as a SARE," noted the bankruptcy court as it dismissed the case for cause. *Id.* at *4. "Now, they want to spin about and use a Subchapter V plan to grab back the rents and . . . reorganize a SARE in Subchapter V. This is a subversion of Congress' express exclusion of SAREs from Subchapter V and is not 'good faith.'" *Id.*

codification of a process for handling SARE cases reinforces the idea that most two-party disputes do not belong in bankruptcy court. Put differently, the SARE provisions are the exception that proves the rule.

Most strikingly, even though the Bankruptcy Code expressly allows a sole creditor to commence an involuntary bankruptcy when the debtor has fewer than twelve qualifying creditors, many bankruptcy courts still hesitate to exercise jurisdiction over such cases, with some courts adopting an “almost per se rule” against sole creditor involuntary cases.¹⁴⁴ Other courts push back, observing that the Bankruptcy Code expressly authorizes sole creditor involuntary cases and that equity should not override express statutory rules.¹⁴⁵ That said, the Code’s numerosity requirement can be met only by petitioning creditors who hold uncontingent, undisputed claims,¹⁴⁶ not creditors in general. When a sole petitioning creditor is the only creditor of any kind, bankruptcy courts are correct to recognize such cases as two-party disputes, even though the technical requirements for the involuntary petition are met. But one can readily imagine situations where the debtor is facing financial distress on multiple fronts but only one creditor technically qualifies to file the involuntary case. In such situations, bankruptcy courts should be careful not to apply a per se rule.

By dismissing, abstaining, or lifting the stay in these circumstances, the bankruptcy courts make clear that they are open for business for only certain kinds of cases. When bankruptcy courts fail to observe sufficient financial distress or more than two parties, they draw back from exercising jurisdiction over the case, invoking both legal and equitable principles when doing so. They

¹⁴⁴ See, e.g., *In re Mountain Dairies, Inc.*, 372 B.R. 623, 634-35 (Bankr. S.D.N.Y. 2007) (“Even if [creditor] were an eligible petitioner . . . this Court would be compelled to abstain . . . because this is essentially a two-party dispute for which the parties have adequate remedies in state court.”). Sole creditor cases are, for obvious reasons, more common in the individual context. See, e.g., *Wilk Auslander LLP v. Murray (In re Murray)*, 900 F.3d 53, 60 (2d Cir. 2018) (affirming dismissal of sole creditor case and noting that involuntary requirements “do permit single creditors to file an involuntary petition” but that “courts tend to scrutinize such petitions closely”). But see *Crown Heights Jewish Cmty. Council, Inc. v. Fischer (In re Fischer)*, 202 B.R. 341, 348 (E.D.N.Y. 1996) (holding that *per se* rule against sole creditor involuntary cases impermissibly conflicts with express language of Bankruptcy Code).

¹⁴⁵ See, e.g., *In re Corrine Int’l, LLC*, 516 B.R. 106, 142-43 (Bankr. S.D. Tex. 2014) (“The Bankruptcy Code allows an individual creditor to force a debtor into bankruptcy if certain criteria are met.”); *In re DemirCo Holdings, Inc.*, No. 06-70122, 2006 WL 1663237, at *3 (Bankr. C.D. Ill. 2006) (denying motion to dismiss involuntary petition because criteria were met and it was not filed in bad faith); *In re Euro- Am. Lodging Corp.*, 357 B.R. 700, 712-30 (Bankr. S.D.N.Y. 2007) (evaluating whether sole creditor’s claims meet criteria to force involuntary case); see also *In re Phoenix Swimming, LLC*, No. 25-10052, 2025 WL 1019906, at *8 & n.12 (Bankr. D.N.H. Apr. 4, 2025) (observing that debtor was generally paying its debts, other than sole petitioning creditor, and describing controversy as two-party dispute more appropriate for state court).

¹⁴⁶ See 11 U.S.C. § 303(b)(1); cf. *id.* § 101(5) (defining “claim”).

do the same thing when they conclude that even the massive bankruptcy toolbox cannot fix the debtor's problems.

II. WHEN THE PARTIES ARE EVADING OTHER FORUMS

As problem-solving courts, bankruptcy courts are also particularly keen to avoid exercising jurisdiction when the driving problem is already being handled in another forum. Federal district courts do this as well, of course, under the first-to-file rule and various other abstention doctrines.¹⁴⁷ But in bankruptcy the concern seems to be heightened, perhaps because legal disputes can blossom quickly into financial distress.

This Part will explore the various legal doctrines under which bankruptcy courts pull back to allow other legal processes to resolve bankruptcy-adjacent disputes: regulators, state courts, multi-district litigation, and other insolvency proceedings.

A. Regulators

First, bankruptcy courts have developed a doctrine of abstaining when the debtor is evading regulators rather than seeking to address financial distress.¹⁴⁸ Of course, trouble with regulators can come alongside financial distress.¹⁴⁹ But when the bankruptcy case is primarily a tactical move in a wrestling match with regulators, most bankruptcy courts are inclined to step back.

The National Rifle Association ("NRA") tried such a gambit in 2020. After the New York Attorney General sued to dissolve the NRA for misusing charitable funds, the NRA filed for bankruptcy in the Northern District of Texas.¹⁵⁰ Dismissing the case for cause, the bankruptcy court noted that the threat of an unpayable judgment often sends debtors to bankruptcy court, but the "existential threat" to NRA was different: It was "the intended relief sought in a state's regulatory action."¹⁵¹ Even though the NRA said it was facing a "barrage of litigation" and "death by a thousand cuts," it was in strong financial condition and

¹⁴⁷ See *Dunkin' Donuts Franchised Rest. LLC v. Wometco Donas Inc.*, 53 F. Supp. 3d 221, 234 (D. Mass. 2014) (applying first-to-file rule); see also *supra* note 8 and accompanying text (listing federal abstention doctrines).

¹⁴⁸ The same principle applies to criminal investigations, but since criminal proceedings are not subject to the automatic stay, fewer cases press the issue whether the entire case is an effort to evade regulators. See 11 U.S.C. § 362(b)(1).

¹⁴⁹ For example, in *Forest Hill Funeral Home & Mem'l Park*, the debtor was a funeral home trying to evade a Tennessee regulatory body that had filed a receivership hearing against it. *In re Forest Hill Funeral Home & Mem'l Park-East, LLC*, 364 B.R. 808, 822 (Bankr. E.D. Okla. 2007). The court decided to dismiss the case for bad faith and said it had enough basis to abstain. *Id.* at 825.

¹⁵⁰ *In re Nat'l Rifle Ass'n. of Am.*, 628 B.R. 262, 264 (Bankr. N.D. Texas 2021).

¹⁵¹ *Id.*

was facing down regulators, not creditors.¹⁵² The motivation for the bankruptcy was not to stop the regulatory action entirely, but to “take dissolution off the table.”¹⁵³ The court also noted that, if the NRA wanted to reincorporate in Texas, it could do so outside bankruptcy so long as it complied with applicable non-bankruptcy law.¹⁵⁴

MV Realty also fits into this category.¹⁵⁵ Sued by state AGs from Massachusetts to Florida, the debtor seems to have invoked bankruptcy protection as a tactical move to shift litigation away from unfriendly state courts and experienced regulators and into another forum.¹⁵⁶ Similarly, in 1999, SGL Carbon filed for bankruptcy after a Department of Justice investigation into price-fixing provoked costly class action antitrust lawsuits.¹⁵⁷

B. State Courts

Second, bankruptcy law allows courts to abstain from hearing bankruptcy cases that are filed to thwart state court litigation or merely to obtain a tactical

¹⁵² *Id.* at 272; *see also id.* at 281 (“[T]he Court believes the NRA’s purpose in filing bankruptcy is less like a traditional bankruptcy case in which a debtor is faced with financial difficulties or a judgment that it cannot satisfy and more like cases in which courts have found bankruptcy was filed to gain an unfair advantage in litigation or to avoid a regulatory scheme.”).

¹⁵³ *Id.* at 281 (quoting NRA’s lawyer during a hearing before court).

¹⁵⁴ *See id.* at 282 (“Reincorporating in Texas could be accomplished outside of bankruptcy pursuant to applicable regulations for New York not-for-profit organizations, which begs the question of what the Bankruptcy Code is being used for.”).

¹⁵⁵ *See supra* notes __–__ and accompanying text (discussing court’s equitable treatment of party similarly situated to NRA).

¹⁵⁶ *See* *MV Realty v. Off. of the Att’y Gen.*, (*In re* *MV Realty PBC, LLC*), 658 B.R. 194, 207–08 (Bankr. S.D. Fla. 2024) (abstaining and dismissing the adversary proceeding). While the debtor voluntarily dismissed its own bankruptcy case before the dismissal hearing, groups of creditors had already briefed arguments that the debtor had filed to gain a tactical advantage in the litigation against the AGs. *See, e.g.*, Motion of Comm. of Home Benefits Agreement Holders for Relief Under Section 1112(b) of the Bankruptcy Code at 7, *MV Realty*, 658 B.R. 194 (Bankr. S.D. Fla. Feb. 27, 2024), Dkt. 959 (“This proceeding both serves no valid bankruptcy purpose and was filed by Debtors to obtain a tactical litigation advantage.”); Brief for Nat’l Consumer L. Ctr. as Amici Curiae Supporting Motion to Dismiss at 11–12, *MV Realty v. Off. of the Att’y Gen.*, 658 B.R. 194 (Bankr. S.D. Fla. Apr. 10, 2024), Dkt. No. 1215 (“MV Realty wants to escape regulators with experience and expertise, and most importantly, regulators who have access to an array of effective state law remedies to protect consumers.”).

¹⁵⁷ *Off. Comm. of Unsecured Creditors v. SGL Carbon Corp.* (*In re* *SGL Carbon Corp.*), 200 F.3d 154, 156 (3d Cir. 1999) (“In 1997, the United States Department of Justice commenced an investigation of alleged price-fixing by graphite electrode manufacturers, including the SGL Carbon Group.”). Indeed, SGL Carbon explained in a press release that it had filed for bankruptcy “to protect itself against excessive demands made by plaintiffs in civil antitrust litigation and in order to achieve an expeditious resolution of the claims against it.” *Id.* at 157 (quoting SGL press release).

advantage.¹⁵⁸ As above, improper use of the Bankruptcy Code can be hard to disentangle from proper use. But the analysis that courts use frequently incorporates elements of bankruptcy purpose.¹⁵⁹ For example, when the owners or directors of a company are not trying to manage financial distress but are wrangling over control or management of the business, bankruptcy courts are more likely to point them to state court.¹⁶⁰

Bankruptcy courts try to police the difference between inappropriate, “tactical” use of bankruptcy as a gambit to advance the goals of preexisting litigation and appropriate, “legitimate” use of bankruptcy to manage financial distress.¹⁶¹ For example, courts distinguish between a debtor facing an avalanche in litigation costs (legitimate) from a debtor trying to skirt an unfavorable ruling by seeking a stay and trying to relitigate the matter before a new judge (tactical);¹⁶²

¹⁵⁸ See, e.g., *In re Reg'l Evangelical All. of Churches, Inc.*, 592 B.R. 375, 390 (Bankr. D. Kan. 2018) (dismissing when bankruptcy filing was carefully timed effort to thwart granting of remedy for breach of contract under state law); *Antelope Techs., Inc. v. Lowe* (*In re Antelope Techs., Inc.*), No. 07-31159, 2010 WL 2901017, at *7-8 (S.D. Tex. July 21, 2020) (affirming dismissal when debtor's board authorized bankruptcy petition and debtor sat on it for two years then filed just before trial), *aff'd*, 431 F. App'x. 272 (5th Cir. 2011); *Invs. Grp., LLC v. Pottorff*, 518 B.R. 380, 384 (N.D. Tex. 2014) (affirming dismissal when debtor filed for bankruptcy day before key deposition and less than two weeks before trial). Both debtors and creditors can attempt this move, though when creditors try it through an involuntary petition, they run the risk of damages for an improper involuntary case. Strikingly, courts have upheld the granting of attorneys' fees under § 303(i) even when the involuntary petition met all the statutory requirements and the court abstained. 11 U.S.C. § 303(i); see, e.g., *Crest One Spa v. TPG Try, LLC* (*In re TPG Troy, LLC*), 793 F.2d 228, 235 (2d Cir. 2015) (affirming bankruptcy court's award of attorneys' fees).

¹⁵⁹ See *supra* Part I.

¹⁶⁰ *In re Fax Station, Inc.*, 118 B.R. 176, 178 (Bankr. D. R.I. 1990) (abstaining from hearing “private dispute between competing interests over the ownership of a business”); *In re Win-Sum Sports, Inc.*, 14 B.R. 389, 394 (Bankr. D. Conn. 1981) (abstaining from attempt “to use the bankruptcy court as an alternate approach to state court procedures to resolve intra-company management and stockholder problems”).

¹⁶¹ This framing may be more helpful than “good faith” or “bad faith.” See *In re Liptak*, 304 B.R. 820, 828 (Bankr. N.D. Ill. 2004) (“[C]ourts have noted that focusing on terms such as good or bad faith in filing is misleading to some degree, as the question is really whether the debtor has presented a legitimate reorganizational objective within the scope of the Bankruptcy Code or rather has presented ‘tactical reasons unrelated to reorganization.’” (quoting *Marsch v. Marsch* (*In re Marsch*), 36 F.3d 825, 828 (9th Cir. 1994)) (internal citations omitted)).

¹⁶² For example, in *Bullseye Energy*, the court refused to dismiss or abstain when a small business debtor had been weighing up bankruptcy for years, had over 500 creditors, and filed bankruptcy in response to “the crushing weight of ongoing litigation expenses.” See *In re Bullseye Energy, LLC*, No. 20-11144, 2020 WL 6928198, at *6 (Bankr. N.D. Okla. Nov. 23, 2020) (“Eliminating the crushing weight of ongoing litigation expenses is a legitimate use of Chapter 11.”). But in *Tucson Estates*, the Ninth Circuit directed the bankruptcy court to abstain from presiding over a state court action when the debtor had spent six years in litigation

or between a debtor buried in an adverse judgment who needs bankruptcy but plans to appeal (legitimate) from a debtor merely trying to avoid paying a supersedeas bond by filing for bankruptcy (tactical).¹⁶³ The distinction is difficult to sketch on a principled basis, but the numbers matter: When the state court litigation looms large, the bankruptcy looks more like a tactic; when it comes alongside other, significant debts, the bankruptcy looks more legitimate. The timing of the bankruptcy filing is often an implicit factor in such cases, too: Debtors who “size up” state court litigation, realize that the potential for an adverse verdict puts them in financial distress, and file early are likely to find refuge in bankruptcy court.¹⁶⁴ Debtors who wait until the eve of trial are likely to encounter skepticism.¹⁶⁵

C. *Multi-District Litigation*

Third, bankruptcy courts abstain when the debtor seems to be trying to evade multi-district litigation (“MDL”). Of course, the presence of mass tort liability can sometimes blossom into full-blown financial distress, so a transition from multi-district litigation into bankruptcy court makes sense in some cases. But when the debtor appears to be running away from judges or juries that have issued adverse rulings—forum shopping at its worst—bankruptcy courts may hesitate to exercise jurisdiction.¹⁶⁶

The 3M/Aearo litigation is a poignant example of this phenomenon. 3M Corporation is a multinational technology and manufacturing company that produces Post-it Notes and Scotch Tape, among other products.¹⁶⁷ Beginning in 2016, servicemembers began to sue 3M and its subsidiary Aearo (which it had acquired in 2008) on the basis that their Combat Arms earplugs were defective

in state court and only filed for bankruptcy after having lost “a very important summary judgment motion.” *Christensen v. Tucson Ests., Inc. (In re Tucson Ests., Inc.)*, 912 F.2d 1162, 1169 (9th Cir. 1990).

¹⁶³ See, e.g., *In re Holm*, 75 B.R. 86, 87 (Bankr. N.D. Cal. 1987) (“[I]f the debtor has the ability to satisfy the judgment from non-business assets, then it is bad faith to attempt to use the bankruptcy laws to appeal without posting a bond. Stated another way, a Chapter 11 proceeding should be dismissed only if the debtor has the clear ability to survive without bankruptcy court protection.”).

¹⁶⁴ See, e.g., *In re The Bible Speaks*, 65 B.R. 415, 417, 432 (Bankr. D. Mass. 1986) (declining to dismiss when company filed for bankruptcy at *pro hac vice* stage of state court litigation and expense of litigation created cash flow problems); *In re Johns-Manville Corp.*, 36 B.R. 727, 730 (Bankr. S.D.N.Y. 1984) (declining to dismiss when tort claims were being filed daily and company had to book a reserve of at least \$1.9 billion for its asbestos liability).

¹⁶⁵ See, e.g., *Tucson Ests.*, 912 F.2d at 1169.

¹⁶⁶ See, e.g., *Asbestosis Claimants v. Apex Oil Co. (In re Apex Oil Co.)*, 980 F.2d 1150, 1153 (8th Cir. 1992) (affirming district court’s abstention from Jones Act and maritime claims so that they could be heard in the district where an MDL was pending).

¹⁶⁷ See *In re Aearo Techs. LLC*, No. 22-02890, 2023 WL 3938436, at *2 (Bankr. S.D. Ind. June 9, 2023).

and failed to protect them from tinnitus.¹⁶⁸ By 2019, the cases had been consolidated into a multidistrict litigation in the Northern District of Florida¹⁶⁹ and the “trickle of suits eventually became a tsunami”—the largest MDL in American history.¹⁷⁰

When several bellwether verdicts came down with sizeable verdicts against 3M and Aearo (including “eye-popping” figures such as \$72.5 million in one case for punitive damages),¹⁷¹ Aearo filed for bankruptcy in the Southern District of Indiana, claiming it was there to resolve its mass tort liability.¹⁷² The bankruptcy court dismissed the bankruptcy case for cause, concluding that Aearo was financially healthy (in large part due to a funding agreement from 3M).¹⁷³ But the court also went on to underscore that the bankruptcy had been filed as a tactical maneuver in the MDL process.

From the very beginning of these cases, Aearo made clear that the filings were not prompted by concerns over financial distress or impending insolvency but were initiated to manage the MDL process, a process that Aearo insisted was “broken.”¹⁷⁴ “These cases were and are a litigation management tactic and not a rehabilitative effort.”¹⁷⁵

A few months after the bankruptcy was dismissed, 3M and Aearo announced a \$6 billion global settlement in the MDL, reinforcing the wisdom in the bankruptcy court’s approach.¹⁷⁶

D. *Insolvency Proceedings*

Fourth, bankruptcy courts pull back from hearing bankruptcy cases when another insolvency proceeding is already pending, whether in a foreign jurisdiction

¹⁶⁸ *Id.* at *3.

¹⁶⁹ *In re 3M Combat Arms Earplug Prods. Liab. Litig.*, 366 F. Supp. 3d 1368, 1370 (N.D. Fla 2019).

¹⁷⁰ *In re Aearo Techs. LLC*, 2023 WL 3938436, at *3 (“The MDL is the largest in history by an order of magnitude and represents a staggering 30% of cases currently pending in the federal district courts.”).

¹⁷¹ *Id.* at *3 & n.7.

¹⁷² *Id.* at *4. Aearo also asked the bankruptcy court to confirm that the automatic stay applied to the MDL, arguing that the proceedings were subject to the stay or that the court should extend the stay over 3M pursuant to § 105(a). The court denied that request, pointing out that the funding agreement meant that the pending actions would not have any “actual economic effect” on the estate. *See 3M Occupational Safety LLC v. Those Parties Listed on Appendix A to the Complaint (In re Aearo Techs. LLC)*, 642 B.R. 891, 912 (Bankr. S.D. Ind. 2022).

¹⁷³ *In re Aearo Tech. LLC*, 2023 WL 3938436, at *17-18 (concluding 3M made all defense expenses for Aearo and no evidence suggested 3M would shift responsibility).

¹⁷⁴ *Id.* at *20.

¹⁷⁵ *Id.*

¹⁷⁶ *See, e.g.*, Brendan Pierson, *3M agrees to pay \$6 billion in U.S. military earplug lawsuit settlement*, REUTERS (Aug. 29, 2023 at 11:29 ET), <https://www.reuters.com/legal/3m-co-agrees-pay-6-billion-earplug-lawsuit-settlement-2023-08-29/>.

or under state law. Unlike abstaining from disputes pending in other forums,¹⁷⁷ the assessment here requires no analysis of whether a litigant truly needs bankruptcy. Pulling back under these circumstances is both eminently pragmatic and expressly supported by the Code itself.

1. Foreign Proceedings

To start, bankruptcy courts abstain when a foreign proceeding is pending or would be preferable to an American bankruptcy case. Chapter 15 of the Bankruptcy Code is dedicated to fair and efficient coordination with foreign insolvency proceedings.¹⁷⁸ That chapter empowers a foreign representative to apply to a U.S. bankruptcy court for recognition of a foreign proceeding, which, when granted, extends the automatic stay over the debtor's property in the United States. This recognition also gives the foreign representative the powers of a trustee, as the debtor-in-possession would have in Chapter 11.¹⁷⁹

In sharp contrast with other types of abstention in this Article, Chapter 15 recognition is very well defined. The Code even defines what counts as a "foreign proceeding":

[A] collective judicial or administrative proceeding in a foreign country, including an interim proceeding, under a law relating to insolvency or adjustment of debt in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganization or liquidation.¹⁸⁰

The Code also allows Bankruptcy Courts to deny recognition when it would be "manifestly contrary to the public policy of the United States."¹⁸¹

Yet Chapter 15 recognition is also tightly tied to bankruptcy abstention. When a foreign proceeding is already underway and a few creditors file an involuntary petition in the United States, the foreign representative may file a Chapter 15 petition, gain recognition, and then ask the bankruptcy court to abstain from hearing the involuntary case.¹⁸² Once the foreign proceeding has been

¹⁷⁷ See *supra* Part II.

¹⁷⁸ Unlike the other chapters of the Bankruptcy Code, Chapter 15 begins with a subsection laying out the purpose of the chapter. See 11 U.S.C. § 1501(a). That subsection makes clear that Congress intended to incorporate the Model Law on Cross-Border Insolvency to handle cross-border cases appropriately, with an eye to bankruptcy policy, international cooperation, and certainty for international trade and investment. See *id.*

¹⁷⁹ See *id.* § 1520 (providing effects of recognition of foreign main proceeding).

¹⁸⁰ *Id.* § 101(23).

¹⁸¹ *Id.* § 1506.

¹⁸² See *id.* § 305(b) ("A foreign representative may seek dismissal or suspension under subsection (a)(2) of this section."); see, e.g., *In re Bd. of Dirs. of Multicanal S.A.*, 314 B.R. 486, 521-22 (Bankr. S.D.N.Y. 2004) (recognizing Argentinian insolvency proceeding and abstaining from involuntary Chapter 11); *Universal Cas. & Surety Co. v. Gee (In re Gee)*, 53 B.R. 891, 904-05 (Bankr. S.D.N.Y. 1985) (recognizing Cayman Islands proceeding and abstaining from involuntary Chapter 11). In at least one case, the bankruptcy court short-

recognized, even creditors or the court sua sponte could ask for abstention from an involuntary petition.¹⁸³ The standard for such assessments is whether “the purposes of chapter 15 of this title would be best served by such dismissal or suspension.”¹⁸⁴

Bankruptcy courts do not always abstain from cases of foreign entities, particularly when no foreign proceeding is pending.¹⁸⁵ Early in the 2003 case of Avianca S.A., Colombia’s largest airline, the bankruptcy court was asked to abstain from hearing the case—a move that would have forced Avianca to file in Colombia.¹⁸⁶ The bankruptcy court declined to do so, underscoring that all of Avianca’s aircraft were leased from United States-based office,¹⁸⁷ and refused to create an obligation to file a Chapter 15 petition.¹⁸⁸ Indeed, the court even suggested that Avianca could not have reorganized under Colombian insolvency

circuited the statutory process. *See In re Spanish Cay Co., Ltd.*, 161 B.R. 715, 719 (Bankr. S.D. Fla. 1993). No foreign insolvency proceeding under Bahamian law had been filed at the time of the U.S. involuntary Chapter 11. Yet the court determined that Bahamian insolvency law should govern the case, lifted the stay to allow a creditor to file insolvency proceedings in the Bahamas, and entered an abstention order “contingent and effective upon the actual commencement of an insolvency proceeding in the Bahamas.” *Id.* at 724.

¹⁸³ *See* 11 U.S.C. § 305(a)(2) (describing when court may suspend case after recognition of foreign proceeding).

¹⁸⁴ *Id.* § 305(a)(2)(B). That principle suggests, of course, that when the debtor seeks recognition of a foreign main proceeding to coordinate a cross-border insolvency, courts should hesitate to abstain upon creditor request. *See, e.g., In re Oi Brasil Holdings Coöperatief U.A.*, 578 B.R. 169, 212-16 (Bankr. S.D.N.Y. 2017) (recognizing Dutch proceeding, maintaining recognition of prior Brazilian proceeding, refusing to abstain, and coordinating with foreign courts consistent with Chapter 15 and principles of comity).

¹⁸⁵ Sometimes courts split the baby. In *Soundview Elite*, the bankruptcy court acknowledged that the debtors had filed Chapter 11 petitions “at the eleventh hour” for the express purpose of preventing liquidators from being appointed in a Cayman Islands proceeding but did not think it amounted to bad faith. *See In re Soundview Elite, Ltd.*, 503 B.R. 571, 580-81 (Bankr. S.D.N.Y. 2014) (noting that significant portion of cases could not be filed if requesting stay was considered sufficient for bad faith finding). Instead, the court appointed a Chapter 11 trustee and lifted the stay to allow the proceedings in the Cayman Islands to continue. *Id.* at 583, 589. In *Yukos Oil*, the bankruptcy court dismissed the case not on forum non conveniens or comity grounds, but because the debtor manufactured jurisdiction in Texas through funds deposited shortly before the bankruptcy was filed. *In re Yukos Oil*, 321 B.R. 396, 410–411 (Bankr. S.D. Tex. 2005).

¹⁸⁶ *In re Aerovias Nacionales de Colombia S.A. Avianca*, 303 B.R. 1, 7-8 (Bankr. S.D.N.Y. 2003).

¹⁸⁷ *Id.* at 12 (distinguishing from cited cases where debtor had less U.S. contacts).

¹⁸⁸ *Id.* at 14-15 (discussing whether, under predecessor statute to Chapter 15, a foreign company had obligation to file foreign proceeding in its home country and commence Chapter 15 case in the United States).

law, which would have required it to cure defaults within ninety days or risk being forced into liquidation.¹⁸⁹

Similarly, in *Underwood v. Hilliard (In re Rimsat, Ltd.)*,¹⁹⁰ Judge Posner, writing for the Seventh Circuit, affirmed a bankruptcy court that declined to abstain when a receiver, appointed in the Federation of Saint Kitts and Nevis, expanded his powers in contravention of the automatic stay.¹⁹¹

Bankruptcy courts, moreover, sometimes range beyond the express provisions of the statute, abstaining from presiding over domestic bankruptcy cases when a foreign insolvency proceeding is underway but the debtor has not sought Chapter 15 recognition.¹⁹² Indeed, in *Tiber Creek Partners, LLC v. Ellume USA LLC*,¹⁹³ the district court dismissed a breach of contract action on forum non conveniens grounds. On appeal, the creditors argued that the debtor's representatives had to seek recognition under Chapter 15 before the foreign insolvency proceeding could be given any weight in the forum non conveniens analysis.¹⁹⁴ The Fourth Circuit rejected that logic, confirming that a foreign representative need not file for chapter 15 to make a forum non conveniens argument.¹⁹⁵

2. Assignments for the Benefit of Creditors

For similar reasons, bankruptcy courts abstain when state insolvency proceedings are underway.¹⁹⁶ The Bankruptcy Code empowers bankruptcy courts to

¹⁸⁹ *Id.* at 10 (pointing out that Chapter 11, by contrast, allowed the airline to reject burdensome leases in exchange for damages).

¹⁹⁰ 98 F.3d 956 (7th Cir. 1996).

¹⁹¹ *Id.* at 961 (affirming bankruptcy court). Additionally, the Court said that the Nevis receivership has “not been shown to be a sufficiently close substitute for the U.S. bankruptcy proceeding to warrant abstention.” *Id.* at 962.

¹⁹² *See, e.g., In re Compañía de Alimentos Fargo, S.A.*, 376 B.R. 427, 441 (Bankr. S.D.N.Y. 2007) (dismissing involuntary petition that creditors filed after four years into Argentine *concurso preventivo*, a reorganization proceeding, out of dissatisfaction with its progress).

¹⁹³ No. 1:23-cv-0148, 2023 WL 5987385, at *1 (E.D. Va. Aug. 1, 2023), *aff'd*, No. 23-1882, 2024 WL 1950071 (4th Cir. July 16, 2025).

¹⁹⁴ *Tiber Creek Partners, LLC*, 2024 WL 1950071, at *5.

¹⁹⁵ *Id.* The dissent disagrees with the majority on the outcome of the forum non conveniens analysis, but it does not disagree on the irrelevance of Chapter 15. *See id.* at *6-7 (Richardson, J., dissenting) (“[A]part from the disposition, I agree with almost everything the majority says about the district court’s *forum non conveniens* analysis.”).

¹⁹⁶ The Constitution does not mandate this result, of course: The Bankruptcy Clause gives Congress power to pass “uniform Laws on the subject of Bankruptcies.” U.S. CONST. art I, § 8. Still, Congress has not completely displaced state law in this field, and the states may pass insolvency proceedings so long as they do not discharge debt. *See Pobreslo v. Joseph M. Boyd Co.*, 287 U.S. 518, 525 (1933) (upholding Wisconsin assignment for the benefit of creditors (“ABC”) statute from charge of express preemption when it did not contemplate “discharge

abstain in favor of state proceedings both through the abstention statute and through excusing turnover under § 543.

Under an assignment for the benefit of creditors (“ABC”), a debtor conveys its property to an assignee, who then liquidates it and distributes the proceeds to creditors pursuant to their statutory priority.¹⁹⁷ ABCs receive special solicitude under the Bankruptcy Code. Under § 543(d), when property of the estate is already in the hands of a “custodian”¹⁹⁸ and a bankruptcy case is commenced, the general rule is that the custodian must immediately stop all disbursements and administrative actions and turn the property over to the trustee in bankruptcy.¹⁹⁹ But the court may excuse turnover where the interests of creditors “would be better served” by letting the custodian continue in possession and *must* excuse turnover when the debtor implemented an ABC more than 120 days before the bankruptcy.²⁰⁰ Numerous courts have described § 543(d) as a “modified abstention provision.”²⁰¹ Indeed, the legislative history of the provision states that it “reinforces the general abstention policy in section 305.”²⁰²

Since a debtor commences an ABC (usually under creditor pressure), the typical setup for such cases is an involuntary petition filed shortly after the debtor commences the ABC. *In re Short Hills Caterers, Inc.*²⁰³ provides a quintessential example. Short Hills Caterers was a kosher catering facility that commenced an ABC on April 18, 2008.²⁰⁴ The assignee began to gather information about the estate, made payroll and paid insurance, and sent a letter to creditors describing the ABC process.²⁰⁵ On May 5, the assignee gave an update over the phone to

of insolvent debtors”); *Sturges v. Crowninshield*, 17 U.S. 122, 199, 203 (1819) (noting that Contracts Clause prohibits states from discharging debts).

¹⁹⁷ See S. WALTER JONES, TREATISE ON THE LAW OF INSOLVENT AND FAILING CORPORATIONS 48 (1908) (defining ABCs as “a transfer by a debtor of some or all of his property to an assignee in trust, and to apply the same . . . to the payment of some or all his debts”).

¹⁹⁸ The Code broadly defines “custodian” to include: Any receiver or trustee of the debtor’s property appointed in a case or proceeding not under the Bankruptcy Code, an assignee in an ABC, or other similar trustees, receivers, or agents. See 11 U.S.C. § 101(11). Importantly, such custodians need not be based in the United States. In cross-border cases, custodians under foreign law still fall within the statutory definition.

¹⁹⁹ See *id.* § 543(a)-(b).

²⁰⁰ *Id.* § 543(d). Note the interplay here with the involuntary petition statute. If an assignee has been serving for 120 days or longer, the court must continue the receivership; if an assignee has been serving 120 days or fewer, however, the court must order relief against the debtor in an involuntary case. *Id.* § 303(h)(2).

²⁰¹ See, e.g., *In re Constable Plaza Assocs.*, 125 B.R. 98, 103 (Bankr. S.D.N.Y. 1991).

²⁰² S. REP. NO. 95-989, at 84-85 (1978); see also H.R. REP. NO. 95-595, at 370 (1977); *In re Pine Lake Vill. Apartment Co.*, 17 B.R. 829, 833 (Bankr. S.D.N.Y. 1982) (declining to excuse turnover when court had previously declined to abstain).

²⁰³ No 08-18604, 2008 WL 2357860 (Bankr. D.N.J. 2008).

²⁰⁴ *Id.* at *1.

²⁰⁵ *Id.*

an attorney for some of the creditors. Three days later, those creditors filed an involuntary case.²⁰⁶ The court abstained, underscoring the efficiency and fairness of the ABC and pointing out that New Jersey law empowered the assignee to avoid fraudulent transfers if necessary.²⁰⁷

Bankruptcy courts even abstain from more recent ABCs.²⁰⁸ In *In re Artists' Outlet, Inc.*,²⁰⁹ the ABC had been set up just a few months before the court ruled on the abstention motion.²¹⁰ But the assignee had already liquidated the assets of the corporation, and the court could not see why bankruptcy was needed.²¹¹

3. Receiverships

Bankruptcy courts also routinely let receivers remain in control of the property of the estate.²¹² As in *International Shoe Co.*,²¹³ this tradition predates the Bankruptcy Code and builds upon precedent tracing back at least to the early twentieth century.²¹⁴ Ordinarily, of course, the filing of the bankruptcy petition would “supersede” the custodianship, but as with ABCs, the Code empowers

²⁰⁶ *Id.*

²⁰⁷ *Id.* at *5.

²⁰⁸ By contrast, bankruptcy courts almost never intervene in ABCs that have been pending for more than six months. See *In re Cincinnati Gear Co.*, 304 B.R. 784, 785 (Bankr. S.D. Ohio 2003) (abstaining in favor of ABC pending for seven months when involuntary petition was filed).

²⁰⁹ 25 B.R. 231 (Bankr. D. Mass. 1982).

²¹⁰ *Id.* at 232 (abstaining from case on December 7 where debtor executed ABC on May 27; see also *Wechsler v. Macke Int'l Trade, Inc.* (*In re Macke Int'l Trade, Inc.*), 370 B.R. 236, 241 (B.A.P. 9th Cir. 2007) (affirming bankruptcy court's abstention from involuntary petition when ABC had been pending in state court for about a week).

²¹¹ *In re Artists' Outlet, Inc.*, 25 B.R. at 233 (“There is little money available for distribution to the unsecured creditors. The court can see no reason why protection of the bankruptcy court is *now* needed, although such protection may have been warranted prior to the sale of the assets of Artists' Outlet.”).

²¹² See *In re Picacho Hills Util. Co., Inc.*, No. 11-13-10742, 2013 WL 1788298, at *13 (Bankr. D. N. M. 2013) (suspending case to allow receiver to sell debtor's assets).

²¹³ See *supra* notes 2-6 and accompanying text.

²¹⁴ See, e.g., *In re Harper & Bros.*, 100 F. 266, 268 (S.D.N.Y. 1900) (denying involuntary petition when 90% of creditors approved of state court dissolution); *Lowenstein v. Henry McShane Mfg. Co.*, 130 F. 1007, 1009 (D. Md. 1904) (dismissing bankruptcy case when receivership had been pending for almost four months and two dissatisfied creditors “turned to the bankrupt court”); *Woolford v. Diamond State Steel Co.*, 138 F. 582, 599 (D. Del. 1905) (dismissing case and denying leave to amend when vast majority of creditors were satisfied with ongoing receivership and bankruptcy proceedings would therefore bring “no possible advantage” and would “enure [sic] only to [the creditors'] detriment”); *In re Hudson River Elec. Power Co.*, 173 F. 934, 945 (N.D.N.Y. 1909) (denying involuntary petition when equitable receivership was pending before federal court “for the benefit and advantage of all”); *In re Commonwealth Lumber Co.*, 223 F. 667, 672 (W.D. Wash. 1915) (noting that involuntary petitioners chose to administer estate in state court and could not later “repudiate the proceedings”).

bankruptcy courts to “continue” the receivership and “excuse” the receiver from the duty to turn the assets over to the trustee in bankruptcy.²¹⁵ Plus, of course, the bankruptcy court can simply abstain from the case entirely. In at least one case, the bankruptcy judge dismissed the case even though it was the receiver that had sought bankruptcy relief, concluding that the receiver lacked authority to file the bankruptcy on behalf of the corporation.²¹⁶

Bankruptcy courts frequently take one or either of these measures when the state or federal receivership has been pending for some time²¹⁷ or will be more efficient at a simple dissolution than the more convoluted bankruptcy process.²¹⁸ While state receiverships are far more common, including under statutory regimes like the Uniform Commercial Real Estate Receivership Act (“UCRERA”), bankruptcy courts have also abstained from exercising jurisdiction over federal receiverships.²¹⁹

There is, of course, significant overlap between the bankruptcy purpose cases and the forum-shopping cases. In some of them, it is hard to discern which feature of the case drove the decision. Sometimes dogs and tails wag each other. But even when debtors have colorable claims to multi-party financial distress

²¹⁵ See, e.g., *In re 245 Assocs., LLC*, 188 B.R. 743, 748-49, 753-54 (Bankr. S.D.N.Y. 1995) (declining to compensate receiver who did not promptly cease administration or move court to continue receivership upon filing of bankruptcy).

²¹⁶ See Order, *In re Associated Grocers of Maine, Inc.*, No. 11-11196 (Bankr. D. Me. Sep. 15, 2011); Audio Recording of Hearing, at 01:22-01:37, *In re Associated Grocers of Maine, Inc.*, No. 11-11196 (Bankr. D. Me. Sep. 15, 2011) (on file with the Boston University Law Review).

²¹⁷ See *In re L & M Video Prods., Inc.*, No. 07-31798, 2007 WL 1847387, at *6 (Bankr. N.D. Ohio June 25, 2007) (abstaining from bankruptcy case filed when receivership had been pending for over two years); *In re Onyx Recs., Inc.*, 42 B.R. 156, 157 (Bankr. S.D.N.Y. 1984) (abstaining when receiver had been in place for seven years). When bankruptcy courts refuse to abstain from receiverships, it is sometimes because the receiver has not had enough time to make meaningful progress in the case. See, e.g., *In re R & K Realty*, No. 5:21-1430, 2021 WL 4047472, at *6 (declining to abstain when involuntary petition was filed later on same day that receiver was confirmed).

²¹⁸ See, e.g., *In re Williamsburg Suites, Ltd.* 117 B.R. 216, 220 (Bankr. E.D. Va. 1990) (abstaining from involuntary Chapter 11 petition when principals agreed that single-asset company needed to be dissolved).

²¹⁹ *In re Michael S. Starbuck, Inc.*, 14 B.R. 134 (Bankr. S.D.N.Y. 1981) (abstaining from hearing involuntary case filed against debtors when SEC equity receiver had already spent 1,400 hours administering estate); see also 28 U.S.C. § 3013 (governing federal receivers). A few opinions have suggested that § 305 contemplates abstention due to the pendency of a “non-federal insolvency.” See, e.g., *In re Lang*, 5 B.R. 371, 374 n.4 (Bankr. S.D.N.Y. 1980) (noting § 305 accords courts authority to dismiss cases in appropriate circumstances); *In re Nina Merch. Corp.*, 5 B.R. 743, 747 (Bankr. S.D.N.Y. 1980) (noting legislative history of § 305 sheds light on court’s power to abstain). But this phrase is best understood as a shorthand for a non-Title 11 insolvency, not as a rule that federal receivers were not contemplated by the statute. As the court in *Colonial Ford* pointed out, the statute itself draws no such distinction. See *In re Colonial Ford, Inc.*, 24 B.R. 1014, 1020 n.11 (Bankr. D. Utah 1982).

that could be remediated by the tools of the bankruptcy court, bankruptcy courts abstain when the timing suggests that the debtor is really just trying to evade the authorities or the jurisdiction of another court.

When debtors or their creditors invoke an ABC or assignment to handle financial distress, it makes little sense to reduplicate efforts in bankruptcy court, especially when the custodian has already begun to administer the debtor's assets.

That said, ABC and assignment practice vary widely from state to state, just as foreign insolvency proceedings vary widely from jurisdiction to jurisdiction. Bankruptcy courts can refine their approach by borrowing from the Chapter 15 recognition context when considering whether to abstain or continue an ABC or receivership. For example, just as the court in *Avianca* examined whether the non-bankruptcy process had the tools to make a reorganization work (there, concerning the rejection of contracts), so too bankruptcy courts should examine whether the assignee or receiver has the right tools to resolve the case.²²⁰

All other things being equal, receiverships and court-supervised ABCs should receive more deference than purely contractual ABCs.²²¹ And receivers and ABCs that endeavor to liquidate or reorganize efficiently, and treat all creditors fairly, should earn greater deference from the bankruptcy court.²²²

²²⁰ An assignee under Florida law, by contrast to Colombian law, does have the power to reject unexpired leases of nonresidential real property or personal property. *See* FLA. STAT. 727.108(5) (2026) (providing that assignee shall "[t]o the extent reasonable in the exercise of the assignee's business judgment, reject an unexpired lease of nonresidential real property or of personal property under which the assignor is the lessee"); *see also, e.g., In re Nader Homes, Inc.*, No. 11-22760, 2011 WL 2267735, at *4 (Bankr. D.N.J. 2011) (refusing to abstain in favor of ABC when 63% of non-insider claims supported bankruptcy and Chapter 7 trustee could take advantage of longer look-back period for preference actions).

²²¹ In Florida, for example, the assignee must file a petition with the circuit court. FLA. STAT. § 727.104(2)(b) (2026) (stating assignee shall "[f]ile [] in the office of the clerk of the court in the county of the assignor's place of business if it has one"). For similar reasons, informal or quasi-receivers might get no deference at all. *See, e.g., In re Mylotte, David & Fitzpatrick*, No. 07-14109, 2007 WL 3027352, at *7-9 (Bankr. E.D. Pa. Oct. 11, 2007) (refusing to abstain when state court judge was acting as quasi-receiver and liquidation had not yet taken place).

²²² Here, the Uniform Law on the Assignments for the Benefit of Creditors provides great cause for optimism. *See* UNIF. ASSIGNMENT FOR BENEFIT OF CREDITORS ACT (UNIF. L. COMM'N 2025). The uniform ABC law requires assignees to notify creditors within thirty days of the effective date, § 7(a), and to "use reasonable care to maximize distributions," § 9(a)(2). It also empowers assignees to incur new debt, § 10(b)(2), assert any causes of action that the assignor could have asserted, § 10(b)(3), and avoid transfers made by any creditor that files a proof of claim, § 10(b)(12). *See also* § 10(d) (giving assignee strong-arm power similar to that given to trustee by 11 U.S.C. § 544). From there, the uniform law contains a detailed priority regime, incorporating both 31 U.S.C. § 3713 (requiring that non-bankruptcy insolvency regimes prioritize debts owed to U.S. government) and 11 U.S.C. § 507 (Bankruptcy Code's priority regime).

III. WHEN THE DEBTORS AND CREDITORS ARE WORKING IT OUT

Lastly, the law allows bankruptcy courts to abstain from adjudicating cases when the debtor and creditors are involved in an out-of-court workout. For those accustomed to nonbankruptcy courts, this feature of bankruptcy law is surely the most surprising. This is nothing like *Rooker-Feldman*, *Colorado River*, or forum non conveniens.²²³ No other courts are involved in the dispute or a related dispute. Imagine a federal district court abstaining from hearing a contract dispute because the parties were close to settling prior to the complaint, or a family court abstaining from hearing a divorce petition because the spouses were having encouraging conversations before things fell apart.²²⁴

Yet the practice has an express statutory basis in the Bankruptcy Code. First, the Code authorizes debtors to develop a prepackaged bankruptcy plan and even to solicit votes prior to commencing a case,²²⁵ and Congress clearly contemplated some debtors doing so.²²⁶ Second, the Code allows creditors to organize into a committee prior to the commencement of the case and to continue in that

Florida, too, has developed an ABC statute that includes all these elements. *See generally* FLA. STAT. § 727.101 (2026) (“The intent of this chapter is to provide a uniform procedure for the administration and orderly liquidation of insolvent estates . . .”). Florida first codified its ABC law in 1889 and completely reworked it in 1987 and 2007. *See* Jeffrey Davis, *Florida’s Beefed-up Assignment for the Benefit of Creditors as an Alternative to Bankruptcy*, 19 U. FLA. J. L. & PUB. POL’Y 17, 19 (2008) (providing history of ABC law development in Florida).

²²³ *See supra* note 8 and accompanying text.

²²⁴ Even in jurisdictions that have adopted alternative dispute resolution (“ADR”) procedures, the court retains jurisdiction over the matter while the ADR process plays out. The best parallel to this bankruptcy practice that I have encountered is a truth and reconciliation commission, which often proceeds only upon the promise of withholding criminal prosecution. *See, e.g.*, Sherrilyn A. Ifill, *Creating a Truth and Reconciliation Commission for Lynching*, 21 LAW & INEQ. 263, 270–71 (2003) (discussing South African government’s enactment of the Truth and Reconciliation Commission in “ambitious effort to engage the entire country in an honest public discussion about racial violence and white supremacy”). I thank Zach Kaufman for this point.

²²⁵ *See* 11 U.S.C. §§ 1121(a), 1126(b), 341(e), 1125(g). Prepackaged plans trace back to nineteenth-century receivership practice, were banned in the Bankruptcy Act under Chapter X, and brought back in the 1978 Bankruptcy Code. *See* Christopher D. Hampson & Jeffrey A. Katz, *The Small Business Prepack: How Subchapter V Paves the Way for Bankruptcy’s Fastest Cases*, 92 GEO. WASH. L. REV. 851, 878–79 (2024) (recounting history and statutory basis for prepackaged bankruptcy provisions); DOUGLAS G. BAIRD, *THE UNWRITTEN LAW OF CORPORATE REORGANIZATIONS* 138–39 (2022) (discussing bankruptcy attorney J. Ronald Trost’s advocacy for prepetition negotiations during drafting of 1978 Code).

²²⁶ *See, e.g.*, Robert K. Rasmussen & David A. Skeel Jr., *The Economic Analysis of Corporate Bankruptcy Law*, 3 AM. BANKR. INST. L. REV. 85, 97 n.54 (1995) (“Congress explicitly contemplated that some debtors would use this strategy.”).

capacity once the case is filed.²²⁷ Third, the legislative history of § 305 indicates that Congress expressly envisioned bankruptcy courts pulling back from disrupting out-of-court workouts.

A principle of the common law requires a court with jurisdiction over a particular matter to take jurisdiction. This section recognizes that there are cases in which it would be appropriate for the court to decline jurisdiction. For example, the court may dismiss or suspend under § 305(a) so long as an arrangement is being worked out of court, there is no prejudice to the rights of creditors in that arrangement, and an involuntary case has been commenced by a few recalcitrant creditors to provide a basis for future threats to extract full payment. The less expensive out-of-court workout may better serve the interests in the case.²²⁸

Indeed, the practice of abstaining from hearing out-of-court workouts under § 305 helps to safeguard prepetition practice. Otherwise, the prepack plan would identify holders of undisputed debts and admit that the debtor cannot pay its debts as they come due, two elements that must be met to file an involuntary case and that have proven devilishly hard to satisfy.²²⁹ Circulating a prepack, then, would give creditors exactly what they need to cut the process short and file an involuntary case in the forum of their choice.²³⁰

That is precisely what happened in the bankruptcy of Caesars Entertainment. Caesars is a Nevada-based casino-entertainment company, one of the largest in the world, that began to face financial distress after the Great Recession. After trying various out-of-court workouts, in late 2014, Caesars began to negotiate a prepackaged bankruptcy with its first-lien bank lenders and first-lien noteholders, some information about which it publicly disclosed.²³¹ Caesars

²²⁷ See 11 U.S.C. § 1102(b)(1) (stating that committee of creditors can consist of “the members of a committee organized by creditors before the commencement of the case under this chapter”).

²²⁸ H.R. REP. NO. 95-595, at 325 (1979) (discussing abstention); S. REP. NO. 95-989, at 35 (discussing involuntariness). Indeed, *Collier on Bankruptcy* calls it the “prototypical fact pattern” for § 305(a)(1) abstention. 2 COLLIER ON BANKRUPTCY ¶ 305.02 (16th ed. 2025).

²²⁹ See 11 U.S.C. § 303(b), (h). The difficulty lies in the requirement that the unsecured claim be not “the subject of a bona fide dispute as to liability or amount.” *Id.* Many courts have interpreted this requirement liberally, such that even if a creditor wins a final judgment on the merits, a notice of appeal can stop the creditor using that judgment to file an involuntary bankruptcy. Other courts have noted that even a dispute about *amount* (such as whether attorneys’ fees are recoverable) knocks out a claim from counting toward the statutory requirements. See, e.g., Donald L. Swanson, *Involuntary Bankruptcy: BAPCPA Amendment to § 303(b) Needs to be Revoked*, AM. BANKR. INST. J., Sep. 2025, at 12, 14 (citing 2023 bankruptcy opinion, which explains dispute as to any portion of claim means there is *bona fide* dispute).

²³⁰ See, e.g., Sathy et al., *supra* note 42, at 24 (noting risks of involuntary petition disrupting development of prepackaged or consensual plan).

²³¹ See *In re Caesars Ent. Operating Co.*, No. 15-10047, 2015 WL 495259, at *2 (Bankr. D. Del. 2015) (“The Debtor made a number of public disclosures regarding the negotiations over the course of the negotiations.”).

signed a restructuring support agreement (“RSA”) that committed it to file for bankruptcy between January 15 and January 20, 2015, but it did not select a forum.²³² When news outlets reported that Caesars planned to file in the Northern District of Illinois, three second-lien noteholders filed an involuntary case against Caesars in the District of Delaware.²³³ In support of their involuntary petition, the creditors filed copies of the draft restructuring and forbearance agreement, along with a slide deck laying out the terms of the proposed prepack deal.²³⁴

Three days later, Caesars filed its voluntary case in the Northern District of Illinois.²³⁵ Caesars and the participating first-lien creditors (who stood atop the capital structure and were projected to recover north of 90%) asked the Delaware court to transfer venue to Illinois under Rule 1014(b) and 28 U.S.C. § 1412. The second-lien creditors and others lower in the capital structure (10-12%) responded that the case should remain in Delaware.²³⁶

Judge Gross ruled that the bankruptcy case should proceed in Illinois, in an opinion that has attracted practitioner and scholarly attention. But despite it being a venue transfer decision, *In re Caesars* also contains key insights for bankruptcy abstention. When the involuntary petitioners argued that the bankruptcy should be heard in Delaware under the “first-filed” rule, the court noted that the involuntary petition was clearly an anticipatory filing, made “in anticipation of the opposing party’s imminent suit in another, less favorable, forum.”²³⁷ Had Caesars not been prepared to file its voluntary bankruptcy, it might well have asked the bankruptcy court to abstain. And the court’s warning about discouraging out-of-court workouts would have come into even sharper focus.

This Part will start by assessing involuntary petitions, brought by a “few recalcitrant creditors,” then turn to voluntary petitions, brought by the debtor.

²³² *Id.*

²³³ *Id.* (“On January 7, 2015, certain news outlets reported that the Debtor would possibly file its voluntary bankruptcy petition in the Illinois Court. On January 12, 2015 . . . [petitioning creditors] initiated an involuntary bankruptcy proceeding . . . in this Court”).

²³⁴ See Declaration of Joshua M. Mester in Support of Statement of Petitioning Creditors in Support of Involuntary Chapter 11 Petition Against Caesars Entertainment Operating Company, Inc. at Exhibits 9-15, *In re Caesars Ent. Operating Co.*, No. 15-10047, 2015 WL 495259 (Bankr. D. Del. Jan. 12, 2015).

²³⁵ *In re Caesars*, 2015 WL 495259, at *3.

²³⁶ *Id.*

²³⁷ *Id.* at *8 (quoting *E.E.O.C. v. Univ. of Pennsylvania*, 850 F.2d 969, 976 (3rd Cir. 1988)). Indeed, in both *Caesars* and in *NRG Energy*, the bankruptcy court signaled that it did not see the imminent filing of a voluntary petition as a reason, of itself, to file an involuntary petition. See *In re NRG Energy*, 294 B.R. 71, 86 (Bankr. D. Minn. 2003) (“If abstention is appropriate on the merits recognized by Congress, the result cannot be unseated by the prospect of a voluntary refiling for the very same relief in another forum”).

A. *A Few Recalcitrant Creditors*

First, involuntary petitions. Numerous bankruptcy courts have abstained from hearing involuntary cases when “a few recalcitrant creditors”—language straight from the 1977 House Report²³⁸—decide to pull the plug on a workout or an informal liquidation.²³⁹

In making this determination, bankruptcy courts assess whether an out-of-court workout would be more effective at paying creditors than an in-court proceeding. This decision turns on both the possibility of a turnaround and the good faith of the participants. In *In re Gen. Aeronautics Corp.*,²⁴⁰ the debtor was close to putting a gyroplane to market, had secured new investment funding, and had indicated an “amenability to settlement.”²⁴¹ The court suspended proceedings for sixty days and indicated that it would abstain permanently if the debtor followed through on its commitment to repay creditors.²⁴² Within that sixty-day period, the debtor settled with its petitioning creditors, confirmed its new financing, and provided strong reports about its research and development.²⁴³ The debtor and the petitioning creditors asked the bankruptcy court to dismiss the involuntary case, and the court agreed.²⁴⁴

Bankruptcy courts also assess whether the workout treats creditors equitably. When a debtor tries to design equitable or pro rata treatment to all creditors in the same class, as would happen in a Chapter 7 or 11 bankruptcy case, courts are more likely to bless the workout by abstaining. In *Rimpull Corp.*, a manufacturer of mining vehicles and parts suffered financial distress when the mining industry

²³⁸ H.R. REP. NO. 95-595, at 325 (1979).

²³⁹ See, e.g., *Cassco Machining, Inc. v. Rimpull Corp* (*In re Rimpull Corp.*), 26 B.R. 267, 272 (Bankr. W.D. Mo. 1982) (considering case at bar to be “paradigm case for abstention by a court of bankruptcy” where arrangement has been worked out between the debtor and creditor and such arrangement has been accepted by a vast majority of the creditors, among other factors); *In re Bioline Lab’ys, Inc.*, 9 B.R. 1013, 1022 (Bankr. E.D.N.Y. 1981) (“The involuntary case is being pressed only by a small group of recalcitrant creditors in the face of approval of the out of court settlement by over 60% of the unsecured creditors.”); *In re Lufttek, Inc.*, 6 B.R. 539, 548–49 (Bankr. E.D.N.Y. 1980) (noting that petition was filed by group of recalcitrant creditors).

²⁴⁰ 594 B.R. 442 (Bankr. D. Utah 2018).

²⁴¹ *Id.* at 451, 456, 481–82.

²⁴² The court added that “odds are low that creditors would receive a substantial dividend” in a liquidation and “the best chance for creditors to be paid a meaningful return is outside of bankruptcy.” *Id.* at 482.

²⁴³ See Petitioning Creditors’ Motion to Approve Settlement and Payments, *In re Gen. Aeronautics Corp.*, 594 B.R. 442 (Bankr. D. Utah Dec. 10, 2018) (No. 17-28510); Supplement to Status Report Regarding Alleged Debtor’s Progress on Operations and Claims, *In re Gen. Aeronautics Corp.*, 594 B.R. 442 (Bankr. D. Utah Dec. 14, 2018) (No. 17-28510); Order Dismissing Involuntary Petition and Case with Prejudice, *In re Gen. Aeronautics Corp.*, 594 B.R. 442 (Bankr. D. Utah Jan. 18, 2019) (No. 17-28510).

²⁴⁴ See sources cited *supra* note 243.

began to decline.²⁴⁵ The debtor worked out a restructuring of its secured debt with the bank and then sent a letter to its unsecured trade creditors, offering them the choice between 100% of the principal over five years or 40% over four months.²⁴⁶ While most of the trade creditors accepted the deal (67% by number and 76% by amount), some of the trade creditors commenced an involuntary proceeding.²⁴⁷ The court abstained, calling it a “paradigm case” for doing so.²⁴⁸

Similar principles govern out-of-court liquidations. For example, Arnolt Corp. made aircraft tailhooks for the U.S. Navy but fell into financial distress after losing its contracts with the U.S. Navy in 1992.²⁴⁹ The debtor and its secured creditor agreed to liquidate “in an orderly fashion outside of bankruptcy” because an orderly liquidation would generate more cash—all of which would go to the secured creditor anyway.²⁵⁰ Arnolt Corp. contracted with an auctioneer company to sell its equipment.²⁵¹ By the time the unsecured creditors filed an involuntary case, the liquidation was largely consummated.²⁵² The court noted that the out-of-court liquidation was value-maximizing, the debtor was distributing proceeds in the correct order (i.e., to the secured creditor), and no special tools like clawback actions were required.²⁵³

²⁴⁵ Cassco Machining, Inc. v. Rimpull Corp. (*In re Rimpull Corp.*), 26 B.R. 267, 268 (Bankr. W.D. Mo. 1982).

²⁴⁶ *Id.* at 271. The debtor added, “I wish we had more money to be able to pay you more. All I can say is that we intend to be in business for a long time, and I hope that the benefits of our future business with you will help offset some of this problem. We feel that this plan is the best we can offer.” *Id.*

²⁴⁷ *Id.* at 271-72.

²⁴⁸ *Id.* at 272 (“An arrangement has been worked out by the debtor with its creditors; it has been accepted by a vast majority of the creditors; the money is in place to fund a major part of the arrangement; and only a minority of creditors have dissented from the arrangement . . .”).

²⁴⁹ *In re Arnolt Corp.*, No. 93-30093, 1993 WL 580765, at *2 (N.D. Ind. 1993).

²⁵⁰ *Id.* at *1.

²⁵¹ *Id.* at *2.

²⁵² *Id.* at *7; *see also In re Wine & Spirit Specialties of Kansas City, Inc.*, 142 B.R. 345, 347 (Bankr. W.D. Mo. 1992) (abstaining from presiding over “a largely accomplished liquidation”).

²⁵³ *See In re Arnolt Corp.*, 1993 WL 580765, at *9 (“The court finds that the out-of-court liquidation agreement equitably provided for distribution of the proceeds from the sale of Arnolt's assets to Society.”). By contrast, in *In re McCullough & Co.*, the debtor company had executed a note and security interest in favor of the CEO, transferred all its assets to him, and filed articles of dissolution with the Missouri Secretary of State's Office. *In re McCullough & Co.*, 199 B.R. 179, 181 (Bankr. W.D. Mo. 1996). Declining to abstain, the court noted that none of the creditors had “expressed satisfaction with the current liquidation proceedings” or “expressed their confidence in the debtor's good faith and ability to conduct a self liquidation.” *Id.* at 185. The looming avoidance claim against the CEO also meant that the bankruptcy process could possibly enrich the estate, yielding a greater recovery for creditors than the Missouri dissolution process. *Id.*

The court applied similar principles in *Bioline Laboratories, Inc.*²⁵⁴ The debtor, a distributor of pharmaceutical drugs, was in financial distress and arranged for a bulk transfer under Article 6 of the Uniform Commercial Code, a transfer that would give the unsecured creditors a 50% recovery.²⁵⁵ Three of its trade creditors then filed an involuntary petition and insisted that another buyer would pay the same amount over a faster timeframe.²⁵⁶ When the court gave them an opportunity to post a \$500,000 bond, they missed the deadline, and the court allowed the bulk transfer to proceed and then abstained from hearing the case entirely.²⁵⁷

In applying this doctrine, bankruptcy courts consistently ask whether the involuntary petition has been filed by “a few recalcitrant creditors.”²⁵⁸ That is because § 305 asks whether abstention would be in the best interests of the debtor and the creditors as a whole. Conversely, some courts have refused to abstain when the creditors who wish to proceed in bankruptcy, though small in number, represent almost all the float.²⁵⁹

²⁵⁴ *In re Bioline Lab'ys, Inc.*, 9 B.R. 1013, 1013 (Bankr. E.D.N.Y. 1981).

²⁵⁵ *Id.* at 1014-15.

²⁵⁶ *Id.* at 1015 (detailing different potential purchaser of assets that can complete payments on earlier timeframe).

²⁵⁷ *Id.* at 1021-22 (noting that debtor had “diligently, faithfully and meticulously carried out the terms of the Asset Purchase Agreement so that the escrow agent now has sufficient funds to pay a substantial dividend to unsecured creditors”).

²⁵⁸ Under this widely cited framework, abstention is appropriate only if (1) the involuntary petition was filed by a few recalcitrant creditors and most creditors oppose bankruptcy, (2) there is a pending state insolvency or out-of-court arrangement, and (3) dismissal is in the best interests of the debtor and all creditors. Numerous decisions recite and apply this test. *See, e.g.*, *ProFutures Special Equities Fund, L.P. v. Spade (In re Spade)*, 255 B.R. 329, 332 (D. Colo. 2000) (holding abstention is warranted only when petition is filed by “a few recalcitrant creditors” and most creditors oppose bankruptcy, a state insolvency or out-of-court arrangement is pending, and dismissal is in best interest of debtor and all creditors); *Cassco Machining, Inc. v. Rimpull Corp (In re Rimpull Corp.)*, 26 B.R. 267, 268-71 (Bankr. W.D. Mo. 1982) (abstaining only where out-of-court arrangement was accepted by overwhelming majority of creditors and “a few recalcitrant creditors” filed the involuntary petition); *In re Kilberger*, No. 94-11870, slip op. at 2 (Bankr. N.D. Iowa Feb. 3 1995) (articulating same three-factor test); *In re Navient Sols., LLC*, 625 B.R. 801, 820 (Bankr. S.D.N.Y. 2021) (describing prototypical § 305(a)(1) case as one where a few recalcitrant creditors file involuntary petition to gain leverage in workout and quoting *Collier* to that effect); *In re Monitor Single Lift I, Ltd.*, 381 B.R. 455, 462-64, 463 n.5 (Bankr. S.D.N.Y. 2008) (relying on legislative history note that if workout is being arranged and “an involuntary case has been commenced by a few recalcitrant creditors,” abstention may be appropriate).

²⁵⁹ *See, e.g.*, *In re Kenval Mktg. Corp.*, 38 B.R. 241, 245 (Bankr. E.D. Pa. 1984) (declining to abstain when involuntary petitioners represented 72% of the float); *In re Wayne's Sport Haus, Ltd.*, 27 B.R. 521, 523 (Bankr. E.D. Mich. 1983) (declining to abstain when involuntary petitioners asked court to dismiss their own petition, but they represented only 44% of the float and had collusively settled with debtor); *In re Bioline Lab'ys, Inc.*, 9 B.R. at 1019 (declining to abstain when over 60% of the float wanted to stay in bankruptcy); *In re Grigoli*,

Strikingly, abstention law creates some tension with the express provisions of the Bankruptcy Code. The Code allows a small number of creditors to file an involuntary petition: at least three in most cases, at least one in others.²⁶⁰ But that is logically consistent with the abstention statute; in many cases, more creditors than the statutory minimum will be needed to convince the court to preside over an involuntary case. Abstention doctrine thus becomes one final hurdle for involuntary petitioners, something that makes involuntary cases even harder to bring than they already are.

In any event, bankruptcy courts do not assess numerical support alone. Where petitioners can show that they need the special tools of the bankruptcy court (like clawback actions), bankruptcy courts are more receptive to presiding over the case.²⁶¹ After all, while the participants in a workout can monetize assets and distribute funds, they cannot easily claw back funds from preferential or fraudulent transfers. Similarly, when creditors try to put a debtor into an involuntary liquidation but the debtor has a go-forward plan with creditor support, the court might well abstain rather than convert the case to Chapter 11.²⁶²

B. *The Debtor Gets Cold Feet*

Second, voluntary petitions. While extraordinarily rare, bankruptcy courts sometimes abstain from hearing voluntary petitions on the basis that the debtor and its creditors were engaged in an out-of-court workout. And there is some statutory basis for doing so: The abstention statute facially applies to both voluntary and involuntary cases, suggesting that Congress believed bankruptcy courts should sometimes abstain from voluntary proceedings.²⁶³

151 B.R. 314, 320–22 (Bankr. E.D.N.Y. 1993) (rejecting dismissal where two creditors held majority of claims but there is no pending out-of-court arrangement and majority of creditors by number had not indicated opposition to bankruptcy); *In re Sherwood Enters.*, 112 B.R.165, 170–72 (Bankr. S.D. Tex. 1989) (declining to abstain despite movant’s large claim because he failed to show that abstention would benefit debtor and other creditors).

²⁶⁰ See 11 U.S.C. § 303(b)(1)–(2).

²⁶¹ See, e.g., *In re Stillwater Asset Backed Offshore Fund Ltd.*, 485 B.R. 498, 509–10 (Bankr. S.D.N.Y. 2013) (refusing to abstain when “it would be very useful for the [debtor] to be armed with the avoidance and related powers of a U.S. bankruptcy trustee”). But see *In re Rimpull Corp.*, 26 B.R. at 272 (abstaining despite potential preference payment when petitioning creditors would be paid 100% of their principal under out-of-court workout).

²⁶² See, e.g., *In re Luftek, Inc.*, 6 B.R. 539, 548 (Bankr. E.D.N.Y. 1980) (abstaining when administrative expenses would “consume the meager assets of this debtor,” debtor’s president was willing to guarantee new loan, debtor was party to several valuable executory contracts, and debtor’s plan enjoyed significant trade creditor support). While a debtor can voluntarily convert a case to Chapter 11 under § 706(a), the court can only do so upon request of a party in interest. 11 U.S.C. § 706(b). But in cases like *Luftek*, no party might have made such a request, giving the court only the option of abstaining (or not).

²⁶³ The court in *Colonial Ford* recounted the history of the provision, noting that a Committee proposal would have allowed for abstention of involuntary cases only but was revised

In re Colonial Ford, a 1982 case from Utah, is the leading example.²⁶⁴ The debtor, an automobile dealership, had been locked in litigation for years with Ford, the United States Small Business Administration, and its other creditors.²⁶⁵ It ceased operations and, a few years later, agreed with its creditors to sell or refinance the dealership within nine months in exchange for a reduction in claims. When it couldn't find a buyer or lender, it filed for bankruptcy. The bankruptcy court opined that workouts are "expeditious," "economic," and "sensible,"²⁶⁶ described the arrangement as a common-law composition,²⁶⁷ and declined to exercise jurisdiction over the case.²⁶⁸ Abstention was appropriate because "the workout is comprehensive, and designed to end, not perpetuate, the creditor-company relations."²⁶⁹ The court concluded: "One 'reorganization,' under these circumstances, is enough."²⁷⁰

The more recent *Red River Talc*²⁷¹ case also has an element of workout dismissal. *Red River Talc* is the third attempt by a Johnson & Johnson subsidiary to manage its talc liability. After LTL Management was dismissed (twice) under the Third Circuit's futility doctrine, Johnson & Johnson undertook negotiations over a prepackaged case, eventually undergoing a new divisional merger under Texas law and filing Red River Talc for bankruptcy in the Southern District of Texas.²⁷²

The court dismissed for cause for multiple, interrelated reasons. While the opinion also analyzed problems with voting and nonconsensual third-party releases,²⁷³ one driving factor was that the circulated prepackaged plan stated that the debtor would not undergo a new divisional merger or file for bankruptcy unless it could obtain 75% approval from the asbestos claimants.²⁷⁴ As Judge Christopher Lopez put it:

to accommodate abstention of both voluntary and involuntary cases. See *In re Colonial Ford, Inc.*, 24 B.R. 1014, 1018 (Bankr. D. Utah 1982).

²⁶⁴ *Id.* at 1014.

²⁶⁵ *Id.*

²⁶⁶ *Id.* at 1016.

²⁶⁷ *Id.* at 1015.

²⁶⁸ *Id.* at 1023.

²⁶⁹ *Id.*

²⁷⁰ *Id.*; see also *In re Seff Enters. & Holdings, LLC*, No. BK 09-11862, 2009 WL 2843308, at *2 (Bankr. D. N.H. 2009) (emphasizing § 305's requirement to consider interests of all creditors and debtor).

²⁷¹ *In re Red River Talc LLC*, 670 B.R. 251 (Bankr. S.D. Texas 2025).

²⁷² See *id.* at 258.

²⁷³ See *id.* at 259. Nonconsensual third-party releases are no longer permissible as part of a Chapter 11 plan under *Harrington v. Purdue Pharma L.P.* See 144 S. Ct. 2071, 2104 (2024) ("The Court decides today to reject the plan by holding that non-debtor releases are categorically impermissible as a matter of law.").

²⁷⁴ See *Red River Talc*, 670 B.R. at 278.

The Court must weigh that LLT and J&J started the divisional merger and corporate restructuring to create Red River before it reached 75% voter support as they promised claimants in the Disclosure Statement. . . . Some claimants could have voted relying on the fact that J&J and LLT would only file a third bankruptcy if they had enough support to confirm a plan, not wanting to go through the motions of another bankruptcy case.²⁷⁵

That 75% figure was not arbitrary: It derives from the Code's requirement for a bankruptcy court to create an asbestos trust and issue an injunction channeling all asbestos claims to the trust.²⁷⁶ And after *Purdue Pharma*, Red River Talc needed to reach that figure to put nonconsensual third-party releases into the plan. So another way of assessing the opinion is through the lens of feasibility. Having designed the prepack around that figure, failing to reach it left the debtors without enough flexibility to confirm a plan, and the judge became convinced that designing a new plan should happen outside of bankruptcy, allowing the tort cases to proceed without the automatic stay.²⁷⁷

To be fair, the practice of abstaining from hearing bankruptcy cases that are otherwise appropriate—financial distress, no futility, not a two-party dispute, no forum shopping and no pending insolvency case elsewhere—is the hardest to justify for a federal court. The federal district courts might enlarge deadlines or adjourn hearings to allow settlement negotiations to take place, but they would not (and likely could not) give up jurisdiction in the first place.

Nothing about this practice is written in stone. When should bankruptcy courts abstain from presiding over out-of-court workouts? Encouraging creditors and debtors to negotiate their way through financial distress seems both formative and efficient: Both honesty and forbearance are virtues, and the costs of an out-of-court workout should be much lower than proceeding in bankruptcy court. The tougher concern to address, though, is whether such a process is fair.

The fairness concern is strongest for unsecured creditors. After all, without the automatic stay, secured creditors can foreclose and repossess. This is why involuntary bankruptcy is largely an unsecured creditors' remedy.²⁷⁸ Unsecured creditors have fewer pathways to a remedy, including suing in state or federal court or commencing an involuntary bankruptcy case. But if bankruptcy courts abstain from hearing the involuntary case despite the unsecured creditors' having met all the statutory requirements, that forecloses one of the few remaining paths to relief for unsecured creditors. Indeed, as numerous commentators have

²⁷⁵ *Id.* at 306.

²⁷⁶ See 11 U.S.C. § 524(g)(2)(B)(ii)(IV)(bb) (authorizing bankruptcy court to issue channeling injunction in asbestos cases under stringent requirements, including that 75% of the asbestos claimants vote in favor of plan).

²⁷⁷ See *Red River Talc*, 670 B.R. at 307 ("The entire construct of the Plan requires rethinking from a post-*Purdue* perspective.").

²⁷⁸ See 11 U.S.C. § 303 (permitting additional creditors holding unsecured claims to join involuntary petitions, and generally conditioning involuntary relief on existence of unpaid debts rather than inadequately collateralized secured positions).

made clear, there's ample reason to think that current business bankruptcy law provides too narrow a pathway to involuntary relief.²⁷⁹

Bankruptcy courts should apply clear and consistent principles to “recognize” out-of-court workouts akin to Chapter 15 recognition, asking whether the informal workout is truly collective and truly a process. This should mean, at a minimum, that the debtor or its creditors (whoever is leading the negotiations) has brought all impaired, in-the-money creditors to the table, and the group has agreed to embark upon an out-of-court process that will end after a reasonable time.

A debtor should not be able to forestall an involuntary bankruptcy forever by keeping an out-of-court workout in perpetual negotiation. Nor should a debtor and negotiating creditors be able to stop an involuntary petition by eligible creditors who are arguably in the money and were not invited to the negotiating table. The Caesars prepack met the first criteria (it bound the debtor to file bankruptcy between January 15 and January 20, 2015) but not the second.²⁸⁰ Under this proposed rule, the second-lien noteholders who filed the Caesars involuntary petition were entitled to do so, because they were impaired, in-the-money, and sidelined by the prepackaged negotiations. *Rimpull Corp.*, by contrast, is a good example of appropriate abstention.²⁸¹

Another way to think about this type of abstention is through the lens of waiver. Under the common law of contracts, parties can agree to continue negotiating with each other in good faith, even though they have not yet reached mutual assent on the underlying contract itself.²⁸² To be sure, consent requires an affirmative act. But here, creditor participation in the out-of-court workout is something like consenting to waive the right to file an involuntary bankruptcy, so long as the parties continue to negotiate in good faith—and only for a reasonable time. That would mean, for instance, that if a creditor agreed not to foreclose on a key asset but then surreptitiously tried to seize it, the deal is off, and the bankruptcy is on.

Indeed, while that waiver operates in the background as a default, the negotiating parties might wish to formalize it through a forbearance agreement that forestalls the filing of an involuntary proceeding through a date certain. Such agreements, like restructuring support agreements, would be upheld by the bankruptcy courts and would give further certainty to the background, common law principles.²⁸³

²⁷⁹ See, e.g., Swanson, *supra* note 229 (arguing for relaxed standards for creditors' eligibility to qualify as involuntary petitioner).

²⁸⁰ See *supra* notes ___–___ and accompanying text.

²⁸¹ See *supra* note ___ and accompanying text.

²⁸² See, e.g., *Quake Constr., Inc. v. Am. Airlines, Inc.*, 565 N.E.2d 990, 1006–08 (Ill. 1990) (Stamos, J., concurring) (suggesting that parties may bind themselves to continue negotiations or defer final assent pending execution of a formal agreement).

²⁸³ Unlike debtors, creditors can waive their right to file an involuntary case against a debtor without offending bankruptcy policy. In addition, courts may have authority to restrict

What if the debtor becomes dissatisfied with the negotiations and runs to the bankruptcy court? Should bankruptcy courts ever dismiss or abstain from hearing voluntary petitions because an out-of-court workout is proceeding? The answer is never—at least, never for that reason alone.²⁸⁴

While creditors can race each other to the courthouse, debtors can find complete relief only at the bankruptcy courthouse. Indeed, the Bankruptcy Code renders unenforceable contract terms that attempt to prevent the debtor’s property from passing into the estate²⁸⁵ or that make filing for bankruptcy a default.²⁸⁶ Since a waiver of filing for bankruptcy altogether offends the same policy, and to a much greater degree, bankruptcy courts have consistently struck down any

creditor filings in collateral, nonbankruptcy litigation. In *SEC v. Byers*, , the Second Circuit upheld a district court’s anti-litigation injunction that protected an SEC receivership from, among other things, involuntary bankruptcy proceedings. 609 F.3d 87, 89 (2d Cir. 2010); see also Mark G. Douglas, *No Unwaivable Right to File an Involuntary Bankruptcy Petition*, 9 BUS. RESTRUCTURING REV. No. 5, at 20-23 (Sept./Oct. 2010), https://www.jonesday.com/-/media/files/publications/2010/10/business-restructuring-review/files/brr-septembertoctober-2010/fileattachment/brr_sept_oct_10.pdf (analyzing impact of *Byers* on creditors’ right to file involuntary bankruptcy petitions).

²⁸⁴ Of course, all the grounds for abstention discussed above still apply, like lack of financial distress, futility, two-party disputes, and forum-shopping. See *supra* Parts I, II, and III. Similarly, the dismissal in *Colonial Ford* is better justified on the grounds that the debtor had no chance of reorganizing. See *supra* notes ___–___ and accompanying text. Colonial Ford had no ongoing operations and couldn’t sell or refinance the key property within the agreed timeframe; the appropriate remedy was not abstention under § 305, but conversion to Chapter 7 under § 1112. Accord Conrad B. Duberstein, *Out-of-Court Workouts*, 1 AM. BANKR. INST. L. REV. 347, 349 (1993) (considering it “abundantly clear that a successful Chapter 11 reorganization plan would not be realized” in *Colonial Ford*).

One narrow situation where it makes sense for the court to abstain from or dismiss a debtor’s voluntary petition is when, as in *Red River Talc*, the debtor circulates a prepackaged plan that establishes express conditions precedent for attempting to confirm the prepackaged plan, those conditions are not met, and the debtor plows forward with the prepackaged case anyway. See Voluntary Petition for Non-Individuals Filing for Bankruptcy at 2, *Red River Talc*, 670 B.R. 251 (Bankr. S.D. Tex. 2025) (No. 24-90505), Dkt. No. 1 (noting that acceptances of plan were solicited prepetition and plan was filed with petition); Debtor’s Statement Regarding Filing of Chapter 11 Case at 2, *Red River Talc*, 670 B.R. 251 (Bankr. S.D. Tex. 2025) (No. 24-90505) (describing “overwhelming support” for the prepackaged plan), Dkt. No. 3. But even there, the debtor would retain the right to scrap the prepackaged plan and file a freefall bankruptcy. The basis for dismissing or abstaining, then, is either (a) the bad faith act of pretending that the conditions for the prepackaged plan were met when they were not or (b) something more like futility, as in *Red River Talc*.

²⁸⁵ See 11 U.S.C. § 541(c) (providing that debtor’s interest in property becomes property of bankruptcy estate notwithstanding contractual or legal provisions that “restrict[] or condition[] transfer” of that interest).

²⁸⁶ See *id.* § 365(b)(2) (providing that trustee may assume executory contract notwithstanding contractual provisions making debtor’s insolvency or commencement of bankruptcy proceedings a contractual default).

debtor agreement that looks like or functions as a waiver of the right to file for bankruptcy.²⁸⁷

It is also hard to see how a bankruptcy court could properly abstain under § 305 from a voluntary case when the statute requires the judge to find that abstention is in the best interests of creditors and the debtor,²⁸⁸ and the debtor has determined that the out-of-court workout is not going according to plan and wishes to invoke bankruptcy protection.²⁸⁹

Setting aside the text of the statute, one might worry that such a rule might undercut out-of-court workouts. After all, this proposal means that while the workout is underway, the creditors cannot declare an impasse and run to bankruptcy court, but the debtor can. Viewed differently, while creditors can credibly bind themselves to an out-of-court workout, the debtor cannot. The *Colonial Ford* court expressed the concern nicely:

It would be anomalous to protect workouts from involuntary petitions while leaving them vulnerable to voluntary petitions. Creditors would be protected from the renegades in their number who sought involuntarily to commit a debtor to bankruptcy, but they would have no similar check

²⁸⁷ Courts split over whether prepetition agreements not to contest a creditor's motion to lift the stay are enforceable. For a discussion of the issue, see *In re DB Capital Holdings*, 454 B.R. 804, 816 (Bankr. D. Colo. 2011) (declining to enforce prepetition waiver of automatic stay contained in forbearance agreement because such waivers too closely approximate impermissible waivers of right to seek bankruptcy relief altogether). See also *In re Pease*, 195 B.R. 431, 433–35 (Bankr. D. Neb. 1996) (holding that prepetition waivers of automatic stay are *per se* unenforceable, since debtor cannot bind itself in its capacity as debtor-in-possession prior to filing case); *In re Jenkins Ct. Assocs.*, 181 B.R. 33, 37 (Bankr. E.D. Pa. 1995) (noting that waiver of stay can be so disruptive to reorganization process that it is functionally equivalent to waiver of bankruptcy relief altogether).

²⁸⁸ 11 U.S.C. § 305(a)(1). That inclusion is particularly meaningful in light of § 1112(b), which requires a court to dismiss a case for cause when in “the best interests of creditors *and the estate.*” See *id.* § 1112(b); *In re Sapphire Dev., LLC*, 523 B.R. 1, 7 (D. Conn. 2014) (reversing abstention decision when bankruptcy court did not consider interests of all parties, including debtor, in abstention decision); see also, e.g., *Hartigan v. Pine Lake Vill. Apartment Co.* (*In re Pine Lake Vill. Apartment Co.*), 16 B.R. 750, 753 (Bankr. S.D.N.Y. 1982) (“It defies credulity to say that the debtor’s interest would be better served by a dismissal when the debtor voluntarily sought the mechanics of Chapter 11 for the purpose of rehabilitation and a fresh start.”); *In re 82 Milbar Blvd. Inc.*, 91 B.R. 213, 215 (Bankr. E.D.N.Y. 1988) (“Section 305 is not limited to involuntary cases but ‘it certainly will have limited applicability . . . to voluntary cases.’” (quoting *In re G-N Partners*, 48 B.R. 459, 461 (Bankr. D. Minn. 1985))).

²⁸⁹ The court in *Colonial Ford* resisted this logic, arguing that the corporation is a web of overlapping interests, and the judgment of the corporation’s decisionmakers to file for bankruptcy was not dispositive for the question of whether doing so was truly in the corporation’s best interests. *In re Colonial Ford, Inc.*, 24 B.R. 1014, 1021–22 (Bankr. D. Utah 1982).

against debtors who compose their debts with the promise that matters will be left out of court and then stage an ambush in Chapter 11.²⁹⁰

If, by contrast, we empowered debtors to commit themselves to an out-of-court workout, that might create more pressure for debtors to continue negotiating.

This concern is easy to overstate, however. First, the abstention doctrine for creditors, as laid out above, is very narrow, both in terms of the workouts that would qualify (collective, proceeding) and in terms of its duration (time-limited, while parties are negotiating in good faith). And second, the moral hazard effect on debtors is limited. A workout is unlikely to succeed without the cooperation of the debtor anyway, and so once the debtor's commitment to the process vanishes, the deal is off—whether a bankruptcy petition is filed or not.

IV. THE INSTITUTIONAL VIRTUES OF THE BANKRUPTCY COURTS

As we have seen, the bankruptcy courts abstain in a dizzying array of circumstances, invoking equitable and pragmatic justifications for doing so. Although the bankruptcy courts may not be putting a unified theory into practice, we can discern common themes and organizing principles behind this area of law. While Parts I through III discussed doctrinal refinements in specific contexts, Part IV steps back to analyze three theoretical insights we can derive from this study, connecting bankruptcy abstention to federalism, equity, private ordering, and institutionalism.

A. *Bankruptcy Courts Are Federal Courts*

Bankruptcy courts are keenly attuned to their role within the American federalist system and use abstention doctrine to guard against mission creep. While bankruptcy is handled by administrative agencies in many other countries, the United States has long maintained an adjudicative approach to corporate (and individual) insolvency, rather than a bureaucratic one. That is especially true after the enactment of the Bankruptcy Code of 1978, which reduced the role of the Securities and Exchange Commission (“SEC”) and allowed debtors in Chapter 11 to remain in possession of the property of the estate. While that policy choice still leaves bankruptcy judges with some management discretion over the trajectory of the case, it also brings them a half-step closer to the “balls-and-strikes” view of judicial dispute resolution, since the day-to-day operation of the estate is in the hands of the debtor in possession or a trustee.

Bankruptcy courts frequently deploy abstention doctrine to ensure that they do not become federal courts of general jurisdiction. Such measures might be unnecessary for other Article I tribunals, whose jurisdictional grant is more tightly constrained to a single doctrinal area. The Courts-Martial, for example, preside over violations of the Uniform Code of Military Justice.²⁹¹ The Patent

²⁹⁰ *Id.* at 1020.

²⁹¹ 10 U.S.C. §§ 817–818.

Trial and Appeal Board,²⁹² the Court of Federal Claims,²⁹³ the Court of International Trade,²⁹⁴ and the Tax Court²⁹⁵ are similarly restricted to their own subject-matter specific areas.²⁹⁶ Such limitations cannot be imposed upon bankruptcy, which requires an assessment of the assets and liabilities of the debtor, triggering analyses of common law rights in property, tort, and contract—along with any statutory and regulatory regimes under which the debtor operates. Bankruptcy's remit is constitutionally ominous.²⁹⁷ Absent a limiting principle, the Bankruptcy Clause could provide a constitutional font for federal courts of general jurisdiction. In theory, that would leave only inability or unwillingness to pay as the triggering circumstances for a bankruptcy case. But once that threshold has been crossed, bankruptcy jurisdiction can become all-consuming in a way that threatens the American federalist system.

And so, we see the bankruptcy courts, both by design and by discretion, pulling back from adjudicating areas that would annex too much jurisdiction. Federalism concerns drive threshold decisions of financial distress and feasibility, ensuring that the bankruptcy courts are presiding only over disputes well within the core of their authority.²⁹⁸ Federalism concerns motivate the bankruptcy courts to abstain from hearing two-party disputes as well.²⁹⁹ As the Fourth Circuit said: "If these sorts of suits are deemed proper subjects for bankruptcy, then [bankruptcy] courts (to their own dismay) would be well on their way to becoming courts of general jurisdiction."³⁰⁰

Similarly, the federal courts also punish debtors or creditors who are fleeing regulators or unfavorable forums and pull back from presiding over disputes that

²⁹² 35 U.S.C. § 2 (establishing Patent and Trademark Office's authority to administer and enforce federal patent laws through specialized patent-related adjudicatory and regulatory functions).

²⁹³ 28 U.S.C. § 1491(a) (granting Court of Federal Claims jurisdiction only over specified categories of claims against United States).

²⁹⁴ 28 U.S.C. § 1581 (granting Court of International Trade exclusive jurisdiction over specified categories of civil actions arising from customs and international trade laws).

²⁹⁵ 26 U.S.C. § 7442 (limiting Tax Court's jurisdiction to matters arising under the Internal Revenue Code).

²⁹⁶ It is not quite true to say that there are *no* federal courts of general jurisdiction. The federal government has sweeping authority over Washington, D.C., and the territories, and the superior courts in those jurisdictions have the same authority as state courts. *See, e.g.*, D.C. CODE § 11-921.

²⁹⁷ Indeed, many bankruptcy disputes could not be heard in Article III courts under their diversity jurisdiction and so could only be heard in those courts under federal question jurisdiction, which in turn could be supplied by Congress under either the Commerce Clause or the Bankruptcy Clause. But while some of this common-law adjudication might count as interstate commerce, some of it is surely *intrastate*.

²⁹⁸ *See supra* Parts I.A and I.B.

²⁹⁹ *See supra* note __ and accompanying text.

³⁰⁰ *Maryland Port Admin. v. Premier Auto. Servs., Inc. (In re Premier Auto. Servs., Inc.)*, 492 F.3d 274, 285 (4th Cir. 2007).

are already being handled by other courts, whether state or federal.³⁰¹ Federalism justifies that practice, too: After all, the bankruptcy courts can help maintain the federal-state balance by declining to intervene when a matter is being handled appropriately at the state level, whether they cite the Code, principles of comity, or both.

Federalism concerns, however, do not readily explain why bankruptcy courts abstain from exercising jurisdiction over out-of-court workouts.³⁰² Compositions, extensions, forbearance, and prepackaged bankruptcy plans lie deep within bankruptcy terrain, and these transactions have not seen the inside of a courtroom either at the state or federal level. If some principle or tradition justifies that activity, it must be something else.

B. *Bankruptcy Courts Are Courts of Equity*

That something else might be supplied by a second organizing principle: Bankruptcy courts remain courts of equity, and bankruptcy abstention stands as the prime example of their equitable nature. Despite the Supreme Court's having removed several "tools" from the insolvency toolkit in recent years, the ability of bankruptcy courts to dismiss, abstain, lift stay, or excuse turnover is proof that equity lives on in the bankruptcy courts.³⁰³

As Professor Henry Smith sees it, equity is a "meta-law" that responds to "complex and uncertain problems by going to a new level of law."³⁰⁴ Those sorts of problems, for Smith, arise from polycentric disputes, conflicting rights, and opportunism, including "[m]ultiple parties with conflicting customary rights and potential third-party effects."³⁰⁵ These features, of course, are the bread and butter of bankruptcy practice, even though Smith does not discuss bankruptcy law expressly.³⁰⁶ Because insolvency means that the debtor cannot pay all of its creditors in full, the creditors are arrayed not only against the debtor but also against each other. Their legal fights involve not only liability fights with the debtor, but also bankruptcy-specific concepts like priority and dischargeability, in which

³⁰¹ See *supra* Part II.

³⁰² See *supra* Part III (summarizing judicial reasoning for bankruptcy courts' abstention in a variety of circumstances involving out-of-court workouts).

³⁰³ Nor does it undercut this point to say that these equitable powers are now codified, whether in § 305 or elsewhere in the Bankruptcy Code, or in the Judicial Code. When Congress endorses a court's equitable authority through a broad grant of discretionary power, as in § 305, it reinforces that power, rather than replacing it.

³⁰⁴ Henry E. Smith, *Equity as Meta-Law*, 130 YALE L.J. 1050, 1054 (2021).

³⁰⁵ See *id.* at 1056.

³⁰⁶ See *id.* at 1072–73 (discussing prevalence of "multi-party litigation with multiple interlocking claims" within equity law). It is therefore unsurprising that many of the maxims of equity have serious bite in bankruptcy court, like "[e]quity regards substance rather than form" (which lives on in bankruptcy doctrines like recharacterization and substantive consolidation) and "[e]quity will not allow a wrongdoer to profit from his own wrong" (equitable subordination). See *id.* at 1122–24.

varying classes of creditors end up jockeying with each other for position. For the same reason, rights in bankruptcy always conflict. And insolvency seems to tempt opportunism at every turn, whether through stigma or rapaciousness.

Equity lives on in bankruptcy abstention. As Smith quotes the old equitable maxims, consider the following: (a) Between equal equities the first in order of time shall prevail; (b) She who seeks equity must do equity; (c) He who comes into equity must come with clean hands; and (d) Equity aids the vigilant and diligent.³⁰⁷ Together, these four maxims help explain why bankruptcy courts have developed doctrines to withhold bankruptcy relief from debtors and creditors who are seeking to use the bankruptcy courts to unequitable ends. When a solvent debtor seeks to use the bankruptcy system for litigation or business advantage, bankruptcy courts pull back. When an equitable insolvency proceeding or out-of-court workout is already underway, bankruptcy courts defer to the first-in-time proceeding. When a bankruptcy petition looks like improper forum-shopping, bankruptcy courts decline to grant relief to petitioners with unclean hands.

The tradition of equity can help us understand the bankruptcy doctrine of equitable mootness too. Unique to bankruptcy, equitable mootness is a prudential doctrine under which courts pull back from unscrambling bankruptcy plans after they have been consummated, typically on appeal.³⁰⁸

One way to think of equitable mootness, of course, is that it is another form of prudential mootness³⁰⁹—in much the same way that the federal courts

³⁰⁷ *Id.* at 1126–27 (discussing four of six equity maxims).

³⁰⁸ A bankruptcy court might invoke equitable mootness on a motion to reconsider or motion for relief from judgment, but in that context equitable mootness may appear more like protecting the judge's prior handiwork rather than deferring to another legal decisionmaker. Some commentators trace the doctrine back to *Roberts Farms*, a 1981 case from the Ninth Circuit. *See* Trone v. Roberts Farms, Inc. (*In re Roberts Farms, Inc.*), 652 F.2d 793, 797 (1981) (“Are we not quite patently faced with a situation where the plan of arrangement has been so far implemented that it is impossible to fashion effective relief for all concerned? Certainly, reversal of the order confirming the plan of arrangement, which would knock the props out from under the authorization for every transaction that has taken place, would do nothing other than create an unmanageable, uncontrollable situation for the Bankruptcy Court.”). The two leading tests are as follows: The Seventh Circuit asks whether it is “prudent to upset the plan of reorganization” at a late date. *In re UNR Indus., Inc.*, 20 F.3d 766, 769 (7th Cir. 1994) (Easterbrook, J.). The Fifth Circuit asks “whether a stay has been obtained, whether the plan has been substantially consummated, and whether the relief requested would affect either the rights of parties not before the court or the success of the plan.” *See* Ronit, Inc. v. Stenson Corp. (*In re Block Shim Dev. Company-Irving*), 939 F.2d 289, 291 (5th Cir. 1991).

³⁰⁹ Professor Matthew Hall distinguishes between issue mootness and personal stake mootness, arguing that courts deploy more prudential considerations in personal stake mootness. Matthew I. Hall, *The Partially Prudential Doctrine of Mootness*, 77 GEO. WASH. L. REV. 562, 600-09 (2009) (analyzing the “far more flexible” judicial treatment of personal stake mootness when compared to issue mootness, the latter almost invariably resulting in dismissal). Equitable mootness, in that typology, is more like personal stake mootness: It is not that the

sometimes distinguish between Article III standing and “prudential standing.”³¹⁰ But we can also think of equitable mootness as another form of bankruptcy abstention.³¹¹ After all, if a bankruptcy court can abstain “at any time” from exercising jurisdiction when a state proceeding or an out-of-court workout is underway, surely it seems less strange that an appellate court might pull back from “unscrambling” a confirmed bankruptcy plan for similar reasons. That approach leaves open the need to refine equitable mootness, such that important questions of law can be adjudicated on appeal³¹² without jettisoning the doctrine completely.

issue has gone away but that the stakes of the various parties are too intertwined to disentangle easily.

³¹⁰ That said, the Supreme Court has recently signaled some discomfort with the term “prudential” and suggested that it stands in “some tension” with the federal courts’ “virtually unflagging” obligation to “hear and decide cases within its jurisdiction.” *See* *Lexmark Int’l, Inc. v. Static Control Components, Inc.*, 572 U.S. 118, 125-26 (2014) (citation modified); *see also* *June Med. Servs. L.L.C. v. Russo*, 140 S. Ct. 2103, 2142 (2020) (Thomas, J., dissenting) (arguing that the rule against third-party standing is constitutional, not prudential).

³¹¹ *See, e.g., Bank of New York Trust Co., NA v. Off. Unsecured Creditors’ Comm. (In re Pac. Lumber Co.)*, 584 F.3d 229, 240 (5th Cir. 2009) (“‘Equitable mootness,’ . . . is a kind of appellate abstention that favors the finality of reorganizations and protects the interrelated multi-party expectations on which they rest.”). This view would imply, of course, that equitable mootness is not jurisdictional and thus need not be assessed prior to the merits. *See, e.g., Texxon Petrochemicals, L.L.C. v. Getty Leasing, Inc. (In re Texxon Petrochemicals, L.L.C.)*, 67 F.4th 259, 262 (5th Cir. 2023) (noting that court could decide case on the merits without reaching equitable mootness). Of course, the Bankruptcy Code includes two statutory bases for not attempting “to unscramble an egg,” §§ 363(m) and 1127(b), both of which counsel against sweeping appellate relief when bankruptcy sales or plans have been consummated. *See, e.g., In re UNR Indus.*, 20 F.3d at 769 (citing 11 U.S.C. §§ 363(m), 1127(b)).

³¹² The Supreme Court has signaled a desire to regularize review of bankruptcy decisionmaking on appeal. In *MOAC Mall Holdings LLC v. Transform HoldCo LLC*, the respondent argued that the appeal was moot and that § 363(m) was jurisdictional, meaning that the petitioner’s late filing could not be excused. *See* Brief for Respondent at 48, *MOAC Mall Holdings LLC v. Transform HoldCo LLC*, 143 S. Ct. 927 (2023) (No. 21-1270), 2022 WL 14004058, at *33. The Supreme Court unanimously disagreed on both counts, and while it did not mention the doctrine of equitable mootness, its rejection of jurisdictional mootness reflects a broader skepticism toward outcome-determinative abstention doctrines. *See MOAC Mall Holdings LLC*, 143 S. Ct. at 295–98. Justice Samuel Alito, when he sat on the Third Circuit, expressed some skepticism about equitable mootness. *See In re Continental Airlines*, 91 F.3d 553, 571-72 (3d Cir. 1996) (*en banc*) (Alito, J., dissenting) (stating that doctrine of equitable mootness “is a judge-made abstention doctrine” the application of which may improperly permit courts to avoid deciding appeals within their Article III jurisdiction); *see also supra* note 310 (summarizing other examples of Supreme Court’s acknowledgements of the indefiniteness of equitable mootness doctrine).

Further, a few appellate courts have sent strong signals that they wish to reconsider the doctrine of equitable mootness, whether by collapsing it into regular mootness or sharply curtailing its use. In *Serta Simmons*, a 2024 case in which the Fifth Circuit performed surgery on a bankruptcy plan to provide a limited remedy to certain creditors, Judge Oldham quoted Judge

Indeed, the tradition of equity is related to prudential doctrines in the federal courts. We might think of the bankruptcy courts as nurturing the same “passive virtues” that Bickel attributed to the Supreme Court in his 1961 Harvard Law Review Foreword.³¹³ Bickel pointed out that a series of Supreme Court cases from that term were “significant for having brought into focus the uses and nonuses of techniques of withholding ultimate constitutional adjudication”³¹⁴—techniques like standing, ripeness, mootness, and the political question doctrine. Bickel described this practice as sounding in prudence, not principle.³¹⁵ And while the merits of these virtues are furiously debated, no one can deny that the federal courts still cultivate Bickel’s “passive virtues” today.

The same is true of the bankruptcy courts, even if we have not described it in those terms. For example, no scholar has yet described a doctrine called “bankruptcy ripeness” and this author has found no published legal opinion using that phrase.³¹⁶ And yet when a bankruptcy court declines to exercise jurisdiction over a debtor who is not suffering financial distress that is “immediate enough to justify a filing,” as in *LTL Management*,³¹⁷ what better way to think of its decision as a form of prudential, bankruptcy ripeness? Indeed, the controversy over the financial distress requirement in bankruptcy mirrors the furor over ripeness in the Article III courts. Bankruptcy scholars and practitioners can gain purchase on these debates by drawing from the developed federal courts literature on ripeness for the bankruptcy context.

Easterbrook’s famous quip that “real mootness” is the “*inability* to alter the outcome” and equitable mootness is the “*unwillingness* to alter the outcome.” *Excluded Lenders v. Serta Simmons Bedding, L.L.C.* (*In re Serta Simmons Bedding, L.L.C.*), 125 F.4th 555, 585 (5th Cir. 2024) (quoting *In re UNR Indus., Inc.*, 20 F.3d at 769). In the end, the Fifth Circuit decided that equitable mootness did not bar the appeal, because (according to the court) they could grant the relief of rescission without disturbing other parties’ rights. *Serta Simmons Bedding, L.L.C.*, 125 F.4th at 586. *Serta Simmons* is one of the starkest limits on equitable mootness from a court of appeals within the past several years.

³¹³ See generally Bickel, *supra* note 15 (arguing that Supreme Court is guided by “passive virtues” such as standing, ripeness, certiorari denials, and avoidance doctrines, to postpone or avoid unnecessary constitutional adjudication in politically sensitive cases).

³¹⁴ *Id.* at 40.

³¹⁵ *Id.* at 46 (highlighting the discretionary nature of the Court’s avoidance doctrine).

³¹⁶ When the bankruptcy courts publish opinions discussing ripeness (which they have done only a couple hundred times), they are assessing whether specific proceedings (or disputes) within the bankruptcy are ripe for adjudication, not the case as a whole. See, e.g., *Cassim v. Educ. Credit Mgmt. Corp.* (*In re Cassim*), 395 B.R. 907 (B.A.P. 6th Cir. 2008) (assessing the ripeness of a nondischargeability determination); *In re Caesars Ent. Operating Co.*, 562 B.R. 168 (Bankr. N.D. Ill. 2016) (assessing ripeness of dispute over allowability of unsecured deficiency claims).

³¹⁷ *In re LTL Mgmt., LLC*, 64 F.4th 84, 102 (3d Cir. 2023) (Ambro, J.) (holding Chapter 11 relief unavailable where Johnson & Johnson’s newly created talc-liability subsidiary possessed access to \$61.5 billion funding agreement and therefore was not in financial distress “immediate enough to justify” bankruptcy, despite facing massive present and future talc claims).

Of course, a bankruptcy court is not a “roving commission to do equity.”³¹⁸ The Supreme Court has said in a series of modern cases that the creativity of bankruptcy practitioners and the problem-solving of bankruptcy judges cannot justify maneuvers that conflict with the express terms of the statute, and it has cut back on the permissive use of § 105(a).³¹⁹ Yet the equitable authority of the bankruptcy courts to avoid taking action does not run afoul of that basic rule and the Supreme Court has not yet tried to intervene. The dialectic process between the “law” system and the “equity” system should not trouble us: As Smith points out, it has long been understood that equity follows the law, meaning that equity will both try to advance the spirit of the law by foreclosing clever workarounds and comply with the letter of the law by implementing statutory regimes when the lawmaker has anticipated and addressed opportunism.³²⁰ Indeed, we can see this process at play in the mass tort context. Bankruptcy courts have wielded their equitable authority to pull back from exercising jurisdiction over some of the worst offenders,³²¹ while at the same time scholars and policymakers are actively proposing statutory regimes to address the issue.³²²

³¹⁸ *United States v. Sutton*, 786 F.2d 1305, 1308 (5th Cir. 1986) (stating that Bankruptcy Code “does not authorize the bankruptcy courts to create substantive rights that are otherwise unavailable under applicable law, or constitute a roving commission to do equity”).

³¹⁹ The federal courts used to intone that bankruptcy courts are courts of equity with more enthusiasm than they do today. *See, e.g., Young v. Higbee Co.*, 325 U.S. 204, 214 (1945) (characterizing bankruptcy courts as “courts of equity” that “exercise all equitable powers unless prohibited by the Bankruptcy Act” when ordering equitable relief to ensure fair distribution among claimants); *In re Purdue Pharma, L.P.*, 69 F.4th 45, 90 (2d Cir. 2023) (Wesley, J., concurring), *rev’d*, 144 S. Ct. 2017 (2024) (observing that bankruptcy courts historically exercised broad equitable authority and emphasizing that Chapter 11 proceedings require courts to balance competing interests to achieve fair collective resolution for mass-tort claimants and creditors).

³²⁰ *See generally* Smith, *supra* note 304.

³²¹ The bankruptcy courts, to date, have pulled back from some of the most egregious misuses of the system, whether blatant forum shopping around the MDL (3M/*Aearo*) or the synthetic insolvency of the controversial Texas Two-Step maneuver (*LTL Management, Red River Talc*). *See supra* Part II.C (summarizing 3M/*Aearo* litigation); Part III.B (summarizing the *LTL Management* and *Red River Talc* litigation). Indeed, as of 2025, no Texas Two-Step plan has survived both bankruptcy court and appellate review. *See, e.g., Mike Lee, Don’t Mess With Texas (?): Analyzing the Texas Two-Step Bankruptcies*, 60 WAKE FOREST L. REV. 195, 202 nn.55, 60 (2025) (noting that *Aldrich Pump* and *DBMP* are still pending and are under a cloud of similar constitutional challenges). At the same time, solutions to other problems—like the silencing of victims during the bankruptcy process—remain elusive. *See generally* Pamela Foohey & Christopher K. Odinet, *Silencing Litigation Through Bankruptcy*, 109 VA. L. REV. 1261 (2023) (arguing that bankruptcy-driven resolutions of mass-tort and other “onslaught litigation” claims often suppress victims’ participation, curtail discovery and public airing of allegations, and pressure survivors into collective settlements that deprive them of procedural justice and meaningful voice).

³²² Some bankruptcy and civil procedure theorists have advocated for removing mass torts from the ambit of the bankruptcy courts altogether. *See, e.g.,* MELISSA B. JACOBY, UNJUST

Whether Congress updates the legal regimes or not, bankruptcy abstention can help give us purchase on the longstanding debate over whether bankruptcy is, or should be, “exceptional.” The scholarly debate traces back to 2002 and 2003, when Professor Ralph Brubaker analyzed whether bankruptcy is an “exceptional” area when it comes to sovereign immunity.³²³ A few years later, Professor Jonathan Lipson deployed the concept of “bankruptcy exceptionalism” to explore the constitutional and structural consequences of the Bankruptcy Power in the U.S. Constitution³²⁴ and Professors Rafael Pardo and Kathryn Watts explored the exceptionalism underneath bankruptcy administration.³²⁵ In the last

DEBTS 65–73 (2024) (arguing for revision to Bankruptcy Code’s definition of “claim” to include only funded debt); Abbe R. Gluck, Elizabeth Chamblee Burch & Adam S. Zimmerman, *Against Bankruptcy: Public Litigation Values Versus the Endless Quest for Global Peace in Mass Litigation*, 133 YALE L.J. FORUM 525, 525 (2024) (arguing that bankruptcy courts are institutionally ill-suited to resolve mass-tort and public-harm litigation); Simon, *Bankruptcy Grifters*, *supra* note __, at 1154 (arguing Chapter 11’s expansion to cover solvent nondebtors in mass tort cases allows “bankruptcy grifters” to improperly obtain the benefits of centralized settlement and liability releases without undertaking burdens or financial distress traditionally justifying bankruptcy relief). Other scholars have argued that specialized insolvency courts are well situated to handle mass tort bankruptcy cases efficiently. *See, e.g.*, Anthony J. Casey & Joshua C. Macey, Essay, *In Defense of Chapter 11 for Mass Torts*, 90 U. CHI. L. REV. 973 (2023) (arguing Chapter 11’s centralization of claims, mitigation of collective-action and holdout problems, and preservation going-concern value make it uniquely fit for mass torts). Still other scholars have proposed new statutory regimes. *See, e.g.*, Michael A. Francus, *Designing Designer Bankruptcy*, 102 TEX. L. REV. 1206, 1253–58 (2024) (advocating specialized statutory framework for “designer bankruptcies” that preserves efficiency and coordination benefits of mass tort Chapter 11 proceedings while imposing governance, funding, and oversight protections to prevent exploitation by solvent corporate groups); Lindsey D. Simon, *Mass Tort Designation* (forthcoming 2026) (proposing mandatory “Subchapter VI” for mass tort bankruptcies that would standardize Chapter 11 treatment of mass tort debtors, reduce gamesmanship, and impose procedural and representational safeguards).

³²³ *See* Ralph Brubaker, *Of State Sovereign Immunity and Prospective Remedies: The Bankruptcy Discharge as Statutory Ex Parte Young Relief*, 76 AM. BANKR. L.J. 461, 468 (2002) (arguing that bankruptcy is not constitutionally “exceptional” with respect to sovereign immunity); Ralph Brubaker, *Abrogation of State Sovereign Immunity Through Congress’s Bankruptcy Power: Considering the Framers’ Intent with Respect to the Attributes of Sovereignty, Uniformity, and Bankruptcy Exceptionalism*, 23 NO. 3 BANKR. L. LETTER 1, 11–12 (Mar. 2003) (contending conflicts between federal bankruptcy law and sovereign immunity are appropriately reconciled through traditional *Ex parte Young* principles permitting prospective relief against state officials).

³²⁴ *See* Jonathan C. Lipson, *Debt and Democracy: Towards a Constitutional Theory of Bankruptcy*, 83 NOTRE DAME L. REV. 605, 606 (2008) (arguing “bankruptcy exceptionalism” explains why Bankruptcy Clause has historically permitted departures from ordinary constitutional rules and structural norms).

³²⁵ *See* Rafael I. Pardo & Kathryn A. Watts, *The Structural Exceptionalism of Bankruptcy Administration*, 60 UCLA L. REV. 384, 386–88 (2012) (arguing bankruptcy administration rests on form of “structural exceptionalism” in which Congress has unusually delegated primary policymaking authority to courts rather than agencies).

couple of years, Professors Jonathan Seymour and Jared Mayer have resurrected the debate, taking the “against” and “for” positions, respectively.³²⁶ Earlier this year, Professors Lipson and Pamela Foohey argued that the Supreme Court’s *Purdue Pharma* opinion ended “statutory exceptionalism” but left open “structural exceptionalism.”³²⁷ Yet none of these recent pieces have grappled with bankruptcy abstention.

As I’ve argued above, bankruptcy abstention is better thought of as in keeping with the ancient tradition of equity or the “passive virtues” of the federal courts, not as a freewheeling exemption from legal rules. If “exceptionalism” is meant to convey a judiciary unbound from rules, standards, principles, or tradition, then the bankruptcy courts are not exceptional, nor should they be. But if we mean to capture the reality that the bankruptcy courts are the most jurisdictionally complex tribunals in the American legal system, whose authority is mediated, both internally and externally, by both statutory rules and ancient principles of equity and modern notions of pragmatism, then the bankruptcy courts are exceptional indeed.

C. *Public Values & Private (Re)ordering*

Finally, bankruptcy abstention provides a new battlefield for old debates about bankruptcy theory. The 1980s saw a scholarly debate between bankruptcy theorists of two main camps. The “traditionalist” view, championed by Vern Countryman, Senator Elizabeth Warren, and others, advanced a vision for bankruptcy law that saw bankruptcy as an appropriate domain for national policy-making.³²⁸ The nomenclature of traditionalist is a bit dated; the “tradition” was

³²⁶ Jonathan M. Seymour, *Against Bankruptcy Exceptionalism*, 89 U. CHI. L. REV. 1925, 1942-43 (2022) (arguing that bankruptcy exceptionalism improperly treats bankruptcy as a uniquely flexible, equity-driven field exempt from ordinary interpretive constraints applicable in other areas of federal law); Jared I. Mayer, *For Bankruptcy Exceptionalism*, U. CHI. L. REV. ONLINE 1, 8 (June 27, 2023), <https://lawreview.uchicago.edu/bankruptcy-exceptionalism> [<https://perma.cc/585B-E33R>] (positing that some degree of bankruptcy exceptionalism is both inevitable and justified because Chapter 11 functions as “special remedial scheme” that can efficiently aggregate and resolve mass-tort liabilities in ways ordinary litigation cannot). Seymour defines “bankruptcy exceptionalism” to mean a “special approach to judging.” See Seymour, *supra* at 1928, 1939. However, as uncovered above, the use of the term antedates the scholarly debates of recent years.

³²⁷ See Jonathan C. Lipson & Pamela Foohey, *The End(s) of Bankruptcy Exceptionalism: Purdue Pharma and the Problem of Social Debt*, 46 CARDOZO L. REV. 861, 867 (2025) (distinguishing “structural” exceptionalism which is characterized by departures from constitutional norms such as due process and Article III constraints in order to accommodate perceived exigencies of insolvency proceedings).

³²⁸ See, e.g., Vern Countryman, *The Concept of a Voidable Preference in Bankruptcy*, 38 VAND. L. REV. 713, 827 (1985) (rejecting narrow, creditor-remedy conception of bankruptcy law); Elizabeth Warren, *Bankruptcy Policy*, 54 U. CHI. L. REV. 775, 788 (1987) (“Congress intended bankruptcy law to address concerns broader than the immediate problems of debtors and their identified creditors.”); Elizabeth Warren, *Bankruptcy Policymaking in an Imperfect*

the progressive wave of bankruptcy scholarship tracing back to the New Deal.³²⁹ But the approach draws from deontological visions of substantive fairness, pointing out that bankruptcy law must decide which constituencies receive value, and how much, from any restructuring surplus or liquidating distribution.

By contrast, the “proceduralist” view, championed by Thomas Jackson, Douglas Baird, and others, see bankruptcy as a forum for adjudicating disputes, one whose federal utility is driven mainly by the need to prevent holdout problems and to apply a consistent, nation-wide procedure.³³⁰ Tightly associated with the Chicago School of law and economics, proceduralists as a general matter think that a debtor’s rights and liabilities are set by nonbankruptcy law, and that bankruptcy’s value lies in creating space for negotiation. But the substantive terms of the deal should be set not by Congress as part of its policymaking agenda, but rather by what we imagine the creditors would have decided *ex ante*: The “Creditors’ Bargain,” as Jackson and Baird termed it. This framework is inspired by teleological or utilitarian visions of incentives by advocating those rules which will best promote an efficient negotiation, whether inside bankruptcy court or outside it.

Bankruptcy scholarship does not neatly fit into one or the other camp, of course. Some scholars have built off the proceduralist view to suggest that private contracting should play an even more prominent role in bankruptcy reorganizations.³³¹ Tony Casey argues that bankruptcy does not implement a Rawlsian “Creditors’ Bargain” from behind some mythical veil of ignorance, but rather sets the terms for a real-life, *ex post* negotiation to take place—a perspective that seems inspired by, but orthogonal to, the proceduralist

World, 92 MICH. L. REV. 336, 340 (1993) (rejecting pure deference to “efficiency analysis” in bankruptcy policymaking in favor of dealing with broad spectrum of “distributive issues” implicated by bankruptcy policy).

³²⁹ See, e.g., David A. Skeel Jr., *Vern Countryman and the Path of Progressive (and Populist) Bankruptcy Scholarship*, 113 HARV. L. REV. 1075, 1078 (2000) (describing origins of progressive bankruptcy scholarship); Brook E. Gotberg, *Beyond Claims in Corporate Reorganization* (unpublished manuscript) (on file with Boston University Law Review) (arguing for prioritization of ESG policy principles in bankruptcy law).

³³⁰ See, e.g., Thomas H. Jackson, *Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors’ Bargain*, 91 YALE L.J. 857, 861–63 (1982) (construing bankruptcy as collective procedural forum designed principally to efficiently solve coordination and holdout problems among creditors using nationally consistent procedures).

³³¹ For example, Bob Rasmussen advanced a “menu theory” of bankruptcy. Robert K. Rasmussen, *Debtor’s Choice: A Menu Approach to Corporate Bankruptcy*, 71 TEX. L. REV. 51, 54 (1992) (advocating for “menu scheme” of bankruptcy that, in some scenarios, may call for an “efficient contract term” to govern claims); see Susan Block-Lieb, *The Logic and Limits of Contract Bankruptcy*, 2001 U. ILL. L. REV. 503, 507 (arguing that “[t]he choice between mandatory bankruptcy legislation and contract bankruptcy should consider *ex ante* incentives and reduce enforcement costs”).

perspective.³³² Plus, of course, bankruptcy law is not wholly one or the other, and top scholars frequently do not lock into one way of seeing the landscape.

Whatever its merits (or demerits), bankruptcy abstention seems to provide strong evidence in favor of the proceduralist view of the bankruptcy courts. If bankruptcy is meant to induce or implement a bargain between the debtor and its creditors, then when an out-of-court workout has already been consummated—apart from concerns about coercion or extortion³³³—the mission has already been accomplished, and nothing remains for the bankruptcy court to do. An analogous point holds for prepackaged bankruptcies, which the Code expressly authorizes.³³⁴ Bankruptcy abstention, then, provides a way for the courts to recognize and implement out-of-court workouts that accomplish the core goal of the bankruptcy case itself.

Yet bankruptcy abstention can also help us see that the traditionalist-proceduralist binary does not supply an exhaustive way of construing bankruptcy law. There is (at least) a third way. If the traditionalist framework draws from deontological notions of fairness and the proceduralist framework draws from teleological notions of efficiency, then a third framework—which we might call “institutionalist”—can draw from aretaic notions of virtue. The bankruptcy courts are not just distributive or dispute-resolving machines: They are institutions. And as institutions, they cultivate habits and practices that make them more adept at solving certain kinds of problems than others. Sometimes, the key to understanding creditor-debtor law is not by reference to the fairness of rules or the efficiency of incentives, but by the durable character or culture of the institutions we have formed to address financial distress.³³⁵

When parties seek from bankruptcy courts solutions which they are malformed to provide, we get what Professor Laura Coordes terms “bankruptcy

³³² Anthony J. Casey, *Chapter 11's Renegotiation Framework and the Purpose of Corporate Bankruptcy*, 120 COLUM. L. REV. 1709, 1711 (2020) (rejecting Creditor's Bargain theory and instead positing that “corporate bankruptcy law's proper purpose is to solve the incomplete contracting problem that accompanies financial distress”).

³³³ See LOPUCKI, *supra* note 52 (analyzing corruption in venue decisions in bankruptcy courts).

³³⁴ See *supra* note 225 and accompanying text.

³³⁵ Professors Mihailis Diamantis, Elise Bernlohr Maizel, and the author have all developed comparable framings in the corporate context. See Mihailis Diamantis, *The Corporate Artifact*, __ ALABAMA L. REV. (forthcoming 2027) (manuscript at 8–10) (theorizing corporations as artifacts with a *telos* or purpose); Elise Bernlohr Maizel, *Illegal Corporate Cultures*, 75 DUKE L.J. 1, 5–6 (2025) (theorizing corporate culture and centering it in analysis of corporate oversight and compliance); Christopher D. Hampson, *Bankruptcy and the Benefit Corporation*, 96 AM. BANKR. L.J. 93, 124–27 (2022) (theorizing character of corporate debtors in bankruptcy); Christopher D. Hampson, *Bankruptcy Fiduciaries*, 110 IOWA L. REV. 1701, 1729–37 (theorizing the obligations of the bankruptcy trustee through corporate character).

overload.”³³⁶ Bankruptcy abstention is part of how a healthy bankruptcy system responds to bankruptcy overload—though Coordes rightly points out that it can, as in *NRA* and *LTL Management*, take too long to reach a sensible result.³³⁷ This Article’s organization and cultivation of the doctrines that underlie the umbrella term of bankruptcy abstention not only helps bankruptcy judges manage their caseload but can also suggest pathways for legal reform.

CONCLUSION

In case after case, bankruptcy courts have developed a tradition of pulling back from exercising the expansive jurisdiction given to them by the Bankruptcy Code and the Judicial Code. They do this in a variety of ways: dismissing cases or abstaining from hearing them, lifting the stay, or excusing noncompliance with the turnover order. This Article has brought all these areas of law under the label of bankruptcy abstention. Some of the reasons for bankruptcy abstention are well understood and quite unsurprising, like refusing to entertain forum-shopping. Other reasons are far more striking, like abstaining from hearing a bankruptcy matter because the parties to the case were engaged in an out-of-court workout before someone lost patience and ran to the courthouse.

Bankruptcy’s “negative spaces” are curious, much like the dog that “did nothing in the night-time” in the old Sherlock Holmes story.³³⁸ Yet by appreciating when bankruptcy courts do not act, we can gain a deeper appreciation for the contours of adjudication in a complex and fascinating area of law—a lesson that applies not only to insolvency law, but also beyond bankruptcy.

³³⁶ See Laura N. Coordes, *Bankruptcy Overload*, 57 GA. L. REV. 1133, 1141–43 (2023) (defining concept of “bankruptcy overload” as problem whereby users of bankruptcy system demand more than it can provide).

³³⁷ *Id.* at 1178–79, 1181 (analyzing resources expended in eventual judicial abstentions in response to both *NRA*’s and *LTL Management*’s Chapter 11 filings).

³³⁸ See Sir Arthur Conan Doyle, *The Adventure of Silver Blaze*, in THE MEMOIRS OF SHERLOCK HOLMES 21 (1892) (renowned detective Sherlock Holmes pointing out that the “curious incident of the dog in the night-time” was that the dog did not bark when an intruder entered).



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Called into Doubt by Statute as Stated in [In re NRG Energy, Inc.](#),
Bankr.D.Minn., May 12, 2003

48 B.R. 459

United States Bankruptcy Court, D. Minnesota.

In re [G–N PARTNERS](#), aka G–
N Roberts Properties, a Minnesota
general partnership, Debtor.

Bankruptcy No. 4–85–342.

|
March 28, 1985.

Synopsis

Creditor moved for dismissal of bankruptcy case. The Bankruptcy Court, Robert J. Kressel, J., held that dismissal was clearly not in best interests of debtor and creditor made no showing that dismissal was in best interests of creditors.

Motion denied.

West Headnotes (3)

[1] [Federal Courts](#) [Bankruptcy](#)

Bankruptcy Court's power to decline jurisdiction over bankruptcy case without being subject to any review is extraordinary power which must be exercised with extraordinary care. Bankr.Code, [11 U.S.C.A. §§ 305, 305\(c\)](#).

[3 Cases that cite this headnote](#)

[2] [Federal Courts](#) [Bankruptcy](#)

Dismissal of bankruptcy case under statute titled “Abstention” would be appropriate where out-of-court “work-out” has been accomplished or is soon to be accomplished and a few recalcitrant creditors have filed involuntary bankruptcy petition. Bankr.Code, [11 U.S.C.A. § 305\(a\)](#).

[4 Cases that cite this headnote](#)

[3] [Bankruptcy](#) [Cause in general](#)

Creditor's motion to dismiss bankruptcy case would be denied where dismissal was clearly not in best interests of debtor and creditor made no showing that dismissal was in best interests of creditors. Bankr.Code, [11 U.S.C.A. §§ 305, 305\(a\)\(1\)](#).

[4 Cases that cite this headnote](#)

Attorneys and Law Firms

***460** John C. Thomas, Oppenheimer, Foster, Wolff, Shepard & Donnelly, Minneapolis, Minn., for movant.

William I. Kampf, Kampf, Lorey, Landsman & Zerby, St. Paul, Minn., for debtor.

Opinion

ROBERT J. KRESSEL, Bankruptcy Judge.

This case came on for hearing on the motion of Roberts Construction, Inc. (Roberts) to abstain. John C. Thomas appeared for Roberts and William I. Kampf appeared for the debtor.

Roberts' motion is made pursuant to [11 U.S.C. § 305\(a\)\(1\)](#) which provides that

The court, after notice and a hearing, may dismiss a case under this title, or may suspend all proceedings in a case under this title, at any time if—

(1) the interests of creditors and the debtor would be better served by such dismissal or suspension.

Interestingly, although the section is titled “Abstention”, that word is never used in the body of [§ 305](#) itself. [Section 305](#) by its terms talks only of dismissal or suspension of all proceedings¹. It is clear that what Roberts seeks is dismissal of the case. Its motion alleges the following grounds:

1. The jurisdiction of this court has been improperly invoked.
2. The interest of creditors would be better served by abstention of the court in this case.
3. Abstention is appropriate on the basis of judicial economy and administration of this case.

4. The interests of unsecured creditors will not be impaired by such abstention.

5. Debtor does not have a business entity that can be reorganized within the meaning of the provisions applicable to cases under Chapter 11 of the United States Code.

One thing is immediately evident from comparing § 305 to Roberts' motion. Section 305(a) states a single ground for dismissal; i.e., that the interests of creditors and the debtor would be better served. The motion lists five grounds, none of which is the statutory ground. The one that comes the closest is the second ground alleged in the motion. Unfortunately the statute provides for dismissal only if the interests of creditors *and the debtor* would be better served by dismissal, and the motion itself alleges only that the interest of creditors would be better served. Thus in some real sense Roberts' motion should be denied for failure to even allege grounds for dismissal under § 305(a)(1).

Section 305, unlike other dismissal sections, is applicable to all chapters of the Bankruptcy Code. 11 U.S.C. § 103(a). The usual dismissal sections for the respective chapter cases are found in §§ 707(a), 927, 1112(b) and 1307(c) and all provide for dismissal *461 "for cause". It is clear that Congress intended these latter sections to be the typical vehicle for creditors to seek dismissal of a bankruptcy case. Section 305 was designed for very limited circumstances. That is especially clear if § 305(a)(1) is read in conjunction with § 305(a)(2) which is an alternative ground for dismissal when there is a foreign proceeding pending which will provide essentially the same sort of relief to the parties as a Title 11 case.

[1] Congress has therefore given the Court the power to actually decline the jurisdiction that Congress has given it, but only in two limited circumstances. Congress has even made the decision to dismiss under § 305 non-reviewable by appeal or otherwise. 11 U.S.C. § 305(c). This power to decline jurisdiction over a bankruptcy case without being subject to any review is an extraordinary power which must therefore be exercised with extraordinary care. I think it therefore most inappropriate to expand the grounds for dismissal under § 305 beyond those clearly stated by Congress.²

[2] While there may be other situations in which dismissal under § 305(a) is appropriate, the one most clearly applicable is that in which an out of court "work-out" has been accomplished or is soon to be accomplished and a few recalcitrant creditors have filed an involuntary bankruptcy

petition. In fact, that example is precisely the one used by Congress. See H.R.Rep. No. 95-595, 95th Cong., 1st Sess., 325 (1977), U.S.Code Cong. & Admin.News 1978, p. 5787.

[3] That is certainly not this case and Roberts has made no showing that either the interests of the debtor or the creditors would be better served by dismissal. In fact the fundamental basis of its motion is that the debtor has obtained benefits from Title 11 for itself and its creditors that were not intended, which is exactly the opposite of saying that dismissal would better serve the interests of creditors and the debtor. In the alternative, Roberts seems to be arguing that the filing of the bankruptcy case garnered no benefit for the debtor or the creditors at all which, of course, begs the question.³ While § 305 is not limited to involuntary cases, it certainly will have limited applicability or at least § 305(a)(1) will have limited applicability to voluntary cases. Obviously by the voluntary act of filing the bankruptcy case, the debtor had indicated that it thought it was in its best interest to be in a bankruptcy case and it would be an unusual case to dismiss a bankruptcy case under § 305 over the objection of the debtor.⁴

Dismissal of this case is clearly not in the best interest of the debtor and Roberts has really made no showing that it is in the best interest of creditors to have the case dismissed either. The creditors are few in number and while they may have remedies under state law for the collection of their debts against the debtor and its general partners, no showing was made that those debts would be any easier to collect outside of bankruptcy. Obviously this Chapter 11 case hinges in its entirety on the debtor's success in its arguments that various provisions of Title 11 will allow it to exercise the option, thus generating a profit from which it can pay its creditors and of course have money left over for its partners. Thus it is *462 clear that although creditors may have other remedies, their quickest and most expedient remedy will be in a bankruptcy case. Thus Roberts has totally failed to allege or show any grounds for dismissal under § 305(a)(1).

I note that Roberts has made another motion for dismissal of this case under § 1112(b) and a hearing on notice to all creditors has been scheduled. Whether Roberts has grounds for dismissal under that section remains to be seen.

THEREFORE, IT IS ORDERED: the motion of Roberts Construction Company, Inc. to abstain is denied.

All Citations

48 B.R. 459, Bankr. L. Rep. P 70,544

Footnotes

- 1 I am not sure what it would mean to suspend all proceedings.
- 2 Others are obviously bolder than I. See, e.g., *In re Missouri*, 22 B.R. 600 (Bkcty.E.D.Ark.,1982); *In re Fast Food Properties, LTD.# 1*, 5 B.R. 539 (Bkcty.C.D.Cal.,1980).
- 3 Roberts is or was the seller of certain real property to the debtor for approximately \$55,000,000.00. The option has expired by its terms and the debtor is arguing in separate proceedings that the filing of the case somehow extends its opportunity to exercise that option. If the debtor is incorrect in that proposition, then obviously it has garnered no benefit from the filing but at that point, of course, Roberts won't care.
- 4 See, however, *In re Colonial Ford, Inc.*, 24 B.R. 1014 (Bkcty.Utah 1982). In that case the court concluded that at least in a Chapter 11 case "the interests of the debtor ... are coincidental with the interests of creditors." 24 B.R. at 1021. Most people would find this to be an astounding proposition. I certainly do.

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Declined to Extend by [Gustafson v. zumBrunnen](#), 7th Cir.(Wis.), October 1, 2008

126 S.Ct. 1735

Supreme Court of the United States

Vickie Lynn MARSHALL, Petitioner,

v.

E. Pierce MARSHALL.

No. 04–1544.

Argued Feb. 28, 2006.

Decided May 1, 2006.

Synopsis

Background: Widow brought adversary proceeding in her Chapter 11 bankruptcy case to recover for her stepson's alleged tortious interference with her expectancy of inheritance or gift from her deceased husband. The United States Bankruptcy Court for the Central District of California, [253 B.R. 550](#), granted judgment for widow, and stepson appealed. The District Court, [275 B.R. 5](#), treated bankruptcy court's judgment as proposed findings of fact and conclusions of law, and adopted them as modified. Both widow and stepson appealed. The Court of Appeals, [392 F.3d 1118](#), vacated and remanded. Debtor applied for certiorari which was granted.

Holdings: The Supreme Court, Justice [Ginsburg](#), held that:

[1] probate exception to federal jurisdiction reserves to state probate courts the probate or annulment of a will and the administration of a decedent's estate, and precludes federal courts from endeavoring to dispose of property that is in the custody of a state probate court;

[2] probate exception was not applicable to deprive bankruptcy court of jurisdiction over widow's claim that her stepson tortiously interfered with her expectancy of inheritance or gift from her deceased husband, and

[3] ruling of Texas probate court that it had exclusive jurisdiction over all of widow's claims against stepson could not deprive federal district court of jurisdiction over

widow's tort claim against stepson asserted in her bankruptcy proceeding.

Reversed and remanded.

Justice [Stevens](#) filed opinion concurring in part and concurring in the judgment.

Procedural Posture(s): On Appeal.

West Headnotes (6)

[1] **Federal Courts** 🔑 Probate matters; wills, trusts, and estates

Probate exception to federal jurisdiction reserves to state probate courts the probate or annulment of a will and the administration of a decedent's estate, and precludes federal courts from endeavoring to dispose of property that is in the custody of a state probate court; however, it does not bar federal courts from adjudicating matters outside those confines and otherwise within federal jurisdiction.

[1150 Cases that cite this headnote](#)

[2] **Bankruptcy** 🔑 Particular proceedings or issues

Probate exception to federal jurisdiction was not applicable to deprive bankruptcy court of jurisdiction over debtor's counterclaim asserting that her stepson tortiously interfered with her expectancy of inheritance or gift from her deceased husband, as claim sought an in personam judgment against stepson, and did not involve probate or annulment of husband's will or administration of his estate or seek to reach a res in custody of state probate court.

[903 Cases that cite this headnote](#)

[3] **Bankruptcy** 🔑 Exclusive, Conflicting, or Concurrent Jurisdiction

Ruling of Texas probate court that it had exclusive jurisdiction over all of widow's claims against stepson could not deprive federal

district court of jurisdiction over widow's claim against stepson for tortious interference with her expectancy of inheritance or gift from her deceased husband, asserted as counterclaim in her bankruptcy proceeding, as Texas could not reserve to its probate courts the exclusive right to adjudicate a transitory tort.

[221 Cases that cite this headnote](#)

[4] **Courts** 🔑 Local or transitory actions

Courts 🔑 Actions under laws of other state

A state cannot create a transitory cause of action and at the same time destroy the right to sue on that transitory cause of action in any court having jurisdiction; rather, jurisdiction is determined by the law of the court's creation and cannot be defeated by the extraterritorial operation of a state statute, even though it created the right of action.

[58 Cases that cite this headnote](#)

[5] **Courts** 🔑 Suits relating to wills, probate, and administrations of estates

Federal Courts 🔑 Probate matters; wills, trusts, and estates

Jurisdiction of the federal courts, having existed from the beginning of the federal government, cannot be impaired by subsequent state legislation creating courts of probate.

[365 Cases that cite this headnote](#)

[6] **Judgment** 🔑 Full Faith and Credit

A state court's final judgment determining its own jurisdiction ordinarily qualifies for full faith and credit, so long as the jurisdictional issue was fully and fairly litigated in the court that rendered the judgment.

[14 Cases that cite this headnote](#)

Among longstanding limitations on federal-court jurisdiction otherwise properly exercised are the so-called “domestic relations” and “probate” exceptions. Neither is compelled by the text of the Constitution or federal statute. Both are judicially created doctrines stemming in large measure from misty understandings of English legal history. In view of lower federal-court decisions expansively interpreting the two exceptions, this Court reined in the domestic relations exception in *Ankenbrandt* **1737 v. *Richards*, 504 U.S. 689, 112 S.Ct. 2206, 119 L.Ed.2d 468, and endeavored similarly to curtail the probate exception in *Markham v. Allen*, 326 U.S. 490, 66 S.Ct. 296, 90 L.Ed. 256.

Petitioner, Vickie Lynn Marshall (Vickie), a.k.a. Anna Nicole Smith, is the surviving widow of J. Howard Marshall II (J. Howard), who died without providing for Vickie in his will. According to Vickie, J. Howard intended to provide for her through a gift in the form of a “catchall” trust. Respondent, E. Pierce Marshall (Pierce), J. Howard's son, was the ultimate beneficiary of J. Howard's estate plan. While the estate was subject to ongoing Texas Probate Court proceedings, Vickie filed for bankruptcy in California. Pierce filed a proof of claim in the Federal Bankruptcy Court, alleging that Vickie had defamed him when, shortly after J. Howard's death, her lawyers told the press that Pierce had engaged in forgery, fraud, and overreaching to gain control of his father's assets. Pierce sought a declaration that his claim was not dischargeable in bankruptcy. Vickie answered, asserting truth as a defense. She also filed counterclaims, among them a claim that Pierce had tortiously interfered with a gift she expected from J. Howard. Vickie's tortious interference counterclaim turned her objection to Pierce's claim into an adversary proceeding, see Fed. Rule Bkrcty. *Proc.* 3007, in which the Bankruptcy Court granted summary judgment for Vickie on Pierce's claim and, after a trial on the merits, entered judgment for Vickie on her counterclaim. The court also held that both Vickie's objection to Pierce's claim and her counterclaim qualified as “core proceedings” under 28 U.S.C. § 157, which meant that the court had authority to enter a final judgment disposing of those claims. It awarded Vickie substantial compensatory and punitive damages. Pierce then filed a post-trial motion to dismiss for lack of subject-matter jurisdiction, asserting *294 that Vickie's tortious interference claim could be tried only in the Texas probate proceedings. The Bankruptcy Court denied the motion. Relying on *Markham*, the Bankruptcy Court observed that a federal court has jurisdiction to adjudicate rights in probate property, so long as its final judgment does not interfere with the state court's possession of the

*293 **1736 *Syllabus**

property. Subsequently, the Texas Probate Court declared that J. Howard's estate plan was valid.

Back in the federal forum, Pierce sought district-court review of the Bankruptcy Court's judgment. Among other things, the District Court held that the probate exception did not reach Vickie's counterclaim. Citing *Markham*, 326 U.S., at 494, 66 S.Ct. 296, the court said that the exception would bar federal jurisdiction only if such jurisdiction would “interfere” with the probate proceedings. It would not do so, the court concluded, because: (1) success on Vickie's counterclaim did not necessitate any declaration that J. Howard's will was invalid, and (2) under Texas law, probate courts do not have exclusive jurisdiction to entertain claims of the kind Vickie's counterclaim asserted. The court also held that Vickie's claim did not qualify as a “core proceedin[g]” over which a bankruptcy court may exercise plenary power, see 28 U.S.C. § 157(b)-(c). Accordingly, the District Court treated the Bankruptcy Court's judgment as proposed, rather than final, and undertook *de novo* review. Adopting and supplementing the Bankruptcy Court's findings, the District Court determined that Pierce had tortiously interfered with Vickie's expectancy by, *inter alia*, conspiring to suppress or destroy the *inter vivos* trust instrument J. Howard had directed his lawyers to prepare for Vickie, and to strip J. Howard of his assets ****1738** by backdating, altering, and otherwise falsifying documents and presenting them to J. Howard under false pretenses. The District Court awarded Vickie some \$44.3 million in compensatory damages and, based on “overwhelming” evidence of Pierce's willfulness, maliciousness, and fraud, an equal amount in punitive damages.

The Ninth Circuit reversed. Although the Court of Appeals recognized that Vickie's claim does not involve the administration of an estate, the probate of a will, or any other purely probate matter, it nonetheless held that the probate exception bars federal jurisdiction in this case. It read the exception broadly to exclude from the federal courts' adjudicatory authority not only direct challenges to a will or trust, but also questions which would ordinarily be decided by a probate court in determining the validity of the decedent's estate planning instrument, whether those questions involve fraud, undue influence, or tortious interference with the testator's intent. The court also held that a State's vesting of exclusive jurisdiction over probate matters in a special court strips federal courts of jurisdiction to entertain any probate related ***295** matter, including claims respecting tax liability, debt, gift, and tort. Noting that the Probate Court had ruled

it had exclusive jurisdiction over all of Vickie's claims, the Ninth Circuit held that ruling binding on the Federal District Court.

Held: The Ninth Circuit had no warrant from Congress, or from this Court's decisions, for its sweeping extension of the probate exception recognized in those decisions. Because this case does not fall within the exception's scope, the District Court properly asserted jurisdiction over Vickie's counterclaim against Pierce. Pp. 1744–1750.

(a) *Ankenbrandt* addressed the domestic relations exception's derivation and limits. Among other things, the Court, 504 U.S., at 693–695, 112 S.Ct. 2206, traced the current exception to *Barber v. Barber*, 21 How. 582, 584–589, 16 L.Ed. 226, in which the Court had announced in dicta—without citation or discussion—that federal courts lack jurisdiction over suits for divorce or alimony. Finding no Article III impediment to federal-court jurisdiction in domestic relations cases, 504 U.S., at 695–697, 112 S.Ct. 2206, the *Ankenbrandt* Court, *id.*, at 698–701, 112 S.Ct. 2206, anchored the exception in the Judiciary Act of 1789, which, until 1948, provided circuit court diversity jurisdiction over “all suits of a civil nature at common law or in equity.” The *Barber* majority, the *Ankenbrandt* Court acknowledged, 504 U.S., at 698, 112 S.Ct. 2206, did not expressly tie its announcement of a domestic relations exception to the text of the diversity statute, but the *Barber* dissenters made the connection. Because English chancery courts lacked authority to issue divorce and alimony decrees, the dissenters stated, United States courts similarly lacked authority to decree divorces or award alimony, 21 How., at 605, 16 L.Ed. 226. The *Ankenbrandt* Court was “content” “to rest [its] conclusion that a domestic relations exception exists as a matter of statutory construction not on the accuracy of [*Barber's*] historical justifications,” but, “rather,” on “Congress' apparent acceptance of this construction of the diversity jurisdiction provisions in the years prior to 1948,” 504 U.S., at 700, 112 S.Ct. 2206. *Ankenbrandt* further determined that Congress did not intend to terminate the exception in 1948 when it “replace[d] the law/equity distinction with the phrase ‘all civil actions.’ ” *Ibid.* The *Ankenbrandt* Court nevertheless emphasized that the exception covers only “a narrow range of domestic relations issues.” ****1739** *Id.*, at 701, 112 S.Ct. 2206. Noting that some lower federal courts had applied the exception “well beyond the circumscribed situations posed by *Barber* and its progeny,” *ibid.*, the Court clarified that only “divorce, alimony, and child custody decrees” remain outside federal jurisdictional bounds, *id.*, at 703, 704, 112 S.Ct. 2206. While

recognizing state tribunals' "special proficiency" in handling issues arising in the granting of such decrees, *id.*, at 704, 112 S.Ct. 2206, the Court viewed federal courts as equally equipped to deal with complaints alleging torts, *ibid.* Pp. 1744–1746.

*296 b) This Court has recognized a probate exception, kin to the domestic relations exception, to otherwise proper federal jurisdiction. See, e.g., *Markham*, the Court's most recent and pathmarking pronouncement on the subject. Among other things, the *Markham* Court first stated that, although "a federal court has no jurisdiction to probate a will or administer an estate, ... it has [long] been established ... that federal courts of equity have jurisdiction to entertain suits 'in favor of creditors, legatees and heirs' and other claimants against a decedent's estate 'to establish their claims' so long as the federal court does not interfere with the probate proceedings or assume general jurisdiction of the probate or control of the property in the custody of the state court." 326 U.S., at 494, 66 S.Ct. 296. The Court next described a probate exception of distinctly limited scope: "[W]hile a federal court may not exercise its jurisdiction to disturb or affect the possession of property in the custody of a state court, ... it may exercise its jurisdiction to adjudicate rights in such property where the final judgment does not undertake to interfere with the state court's possession save to the extent that the state court is bound by the judgment to recognize the right adjudicated by the federal court." *Ibid.* The first of these quoted passages is not a model of clear statement, and some lower federal courts have read the words "interfere with the probate proceedings" to block federal jurisdiction over a range of matters well beyond probate of a will or administration of a decedent's estate, including an executor's breach of fiduciary duty. This Court reads *Markham's* enigmatic words, in sync with the second above-quoted passage, to proscribe "disturb[ing] or affect[ing] the possession of property in the custody of a state court." *Ibid.* Though that reading renders the first-quoted passage in part redundant, redundancy in this context is preferable to incoherence. This Court therefore comprehends *Markham's* "interference" language as essentially a reiteration of the general principle that, when one court is exercising *in rem* jurisdiction over a *res*, a second court will not assume *in rem* jurisdiction over the same *res*. See, e.g., *Penn General Casualty Co. v. Pennsylvania ex rel. Schnader*, 294 U.S. 189, 195–196, 55 S.Ct. 386, 79 L.Ed. 850. Thus, the probate exception reserves to state probate courts the probate or annulment of a will and the administration of a decedent's estate; it also precludes federal courts from disposing of

property that is in the custody of a state probate court. But it does not bar federal courts from adjudicating matters outside those confines and otherwise within federal jurisdiction. Pp. 1746–1748.

(c) Vickie's claim does not involve the administration of an estate, the probate of a will, or any other purely probate matter. Provoked by Pierce's claim in the bankruptcy proceedings, Vickie's claim alleges the widely recognized tort of interference with a gift or inheritance. She *297 seeks an *in personam* judgment against Pierce, not the probate or annulment of a will. Cf. *1740 *Sutton v. English*, 246 U.S. 199, 208, 38 S.Ct. 254, 62 L.Ed. 664. Nor does she seek to reach a *res* in a state court's custody. See *Markham*, 326 U.S., at 494, 66 S.Ct. 296. Furthermore, no "sound policy considerations" militate in favor of extending the probate exception to cover this case. Cf. *Ankenbrandt*, 504 U.S., at 703, 112 S.Ct. 2206. Trial courts, both federal and state, often address conduct of the kind Vickie alleges. State probate courts possess no "special proficiency" in handling such issues. Cf. *id.*, at 704, 112 S.Ct. 2206. Pp. 1748–1749.

(d) This Court rejects the Ninth Circuit's alternate rationale that the Texas Probate Court's jurisdictional ruling bound the Federal District Court. Texas courts have recognized a state-law tort action for interference with an expected gift or inheritance. It is clear, under *Erie R. Co. v. Tompkins*, 304 U.S. 64, 58 S.Ct. 817, 82 L.Ed. 1188, that Texas law governs the substantive elements of Vickie's tortious interference claim. But it is also clear that Texas may not reserve to its probate courts the exclusive right to adjudicate a transitory tort. See *Tennessee Coal, Iron & R. Co. v. George*, 233 U.S. 354, 360, 34 S.Ct. 587, 58 L.Ed. 997. Jurisdiction is determined "by the law of the court's creation and cannot be defeated by the extraterritorial operation of a [state] statute ..., even though it created the right of action." *Ibid.* Directly on point, the Court has held that federal-court jurisdiction, "having existed from the beginning of the Federal government, [can]not be impaired by subsequent state legislation creating courts of probate." *McClellan v. Carland*, 217 U.S. 268, 281, 30 S.Ct. 501, 54 L.Ed. 762. *Durfee v. Duke*, 375 U.S. 106, 84 S.Ct. 242, 11 L.Ed.2d 186, on which the Ninth Circuit relied, is not to the contrary. *Durfee* stands only for the proposition that a state court's final judgment determining *its own* jurisdiction ordinarily qualifies for full faith and credit, so long as the jurisdictional issue was fully and fairly litigated in the court that rendered the judgment. See *id.*, at 111, 115, 84 S.Ct. 242. At issue here, however, is not the Texas Probate Court's jurisdiction, but the federal courts' jurisdiction to entertain

Vickie's tortious interference claim. Under our federal system, Texas cannot render its probate courts exclusively competent to entertain a claim of that genre. P. 1749.

(e) The Ninth Circuit may address on remand the questions whether Vickie's claim was "core" and Pierce's arguments concerning claim and issue preclusion. P. 1750.

392 F.3d 1118, reversed and remanded.

GINSBURG, J., delivered the opinion of the Court, in which ROBERTS, C. J., and SCALIA, KENNEDY, SOUTER, THOMAS, BREYER, and ALITO, JJ., joined. STEVENS, J., filed an opinion concurring in part and concurring in the judgment, *post*, p. 1750.

Attorneys and Law Firms

Kent L. Richland, for petitioner.

Deanne E. Maynard, for the United States as amicus curiae, by special leave of the Court, supporting the petitioner.

G. Eric Brunstad, for the respondent.

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Thomas C. Goldstein, Amy Howe, Kevin K. Russell, Goldstein & Howe, P.C., Washington, DC, Kent L. Jones, Sutherland, Asbill & Brennan LLP, Washington, DC, G. Eric Brunstad, Jr., Counsel of Record, **1741 Rheba Rutkowski, Robert A. Brundage, Susan Kim, William C. Heuer, Raquel J. Webster, Brian R. Hole, Eric A. Heining, Francesca L. Miceli, Allyson E. Kurker, Peter C. Tolsdorf, Sara R. Simeonidis, Bingham McCutchen LLP, Hartford, Connecticut, for Respondent E. Pierce Marshall.

Opinion

Justice GINSBURG delivered the opinion of the Court.

*298 In *Cohens v. Virginia*, Chief Justice Marshall famously cautioned: "It is most true that this Court will not take jurisdiction if it should not: but it is equally true, that it must take jurisdiction if it should... We have no more right to decline the exercise of jurisdiction which is given, than

to *299 usurp that which is not given." 6 Wheat. 264, 404, 5 L.Ed. 257 (1821). Among longstanding limitations on federal jurisdiction otherwise properly exercised are the so-called "domestic relations" and "probate" exceptions. Neither is compelled by the text of the Constitution or federal statute. Both are judicially created doctrines stemming in large measure from misty understandings of English legal history. See, e.g., Atwood, *Domestic Relations Cases in Federal Court: Toward a Principled Exercise of Jurisdiction*, 35 Hastings L.J. 571, 584–588 (1984); *Spindel v. Spindel*, 283 F.Supp. 797, 802 (E.D.N.Y.1968) (collecting cases and commentary revealing vulnerability of historical explanation for domestic relations exception); Winkler, *The Probate Jurisdiction of the Federal Courts*, 14 Probate L.J. 77, 125–126, and n. 256 (1997) (describing historical explanation for probate exception as "an exercise in mythography"). In the years following Marshall's 1821 pronouncement, courts have sometimes lost sight of his admonition and have rendered decisions expansively interpreting the two exceptions. In *Ankenbrandt v. Richards*, 504 U.S. 689, 112 S.Ct. 2206, 119 L.Ed.2d 468 (1992), this Court reined in the "domestic relations exception." Earlier, in *Markham v. Allen*, 326 U.S. 490, 66 S.Ct. 296, 90 L.Ed. 256 (1946), the Court endeavored similarly to curtail the "probate exception."

Nevertheless, the Ninth Circuit in the instant case read the probate exception broadly to exclude from the federal courts' adjudicatory authority "not only direct challenges to a will or trust, but also questions which would ordinarily be decided by a probate court in determining the validity of the decedent's estate planning instrument." 392 F.3d 1118, 1133 (C.A.9 2004). The Court of Appeals further held that a State's vesting of exclusive jurisdiction over probate matters in a special court strips federal courts of jurisdiction to entertain any "probate related matter," including claims respecting "tax liability, debt, gift, [or] tort." *Id.*, at 1136. We hold that the Ninth Circuit had no warrant from Congress, *300 or from decisions of this Court, for its sweeping extension of the probate exception.

I

Petitioner, Vickie Lynn Marshall (Vickie), also known as Anna Nicole Smith, is the surviving widow of J. Howard Marshall II (J. Howard). Vickie and J. Howard met in October 1991. After a courtship lasting more than two years, they were married on June 27, 1994. J. Howard died on August 4, 1995. Although he lavished gifts and significant sums of money

on Vickie during their courtship and marriage, J. Howard did not include anything for Vickie in his will. According to Vickie, J. Howard intended to provide for her financial **1742 security through a gift in the form of a “catchall” trust.

Respondent, E. Pierce Marshall (Pierce), one of J. Howard's sons, was the ultimate beneficiary of J. Howard's estate plan, which consisted of a living trust and a “pourover” will. Under the terms of the will, all of J. Howard's assets not already included in the trust were to be transferred to the trust upon his death.

Competing claims regarding J. Howard's fortune ignited proceedings in both state and federal courts. In January 1996, while J. Howard's estate was subject to ongoing proceedings in Probate Court in Harris County, Texas, Vickie filed for bankruptcy under Chapter 11 of the Bankruptcy Code, 11 U.S.C. § 1101 *et seq.*, in the United States Bankruptcy Court for the Central District of California. See 275 B.R. 5, 8 (C.D.Cal.2002). In June 1996, Pierce filed a proof of claim in the federal bankruptcy proceeding, *id.*, at 9; see 11 U.S.C. § 501, alleging that Vickie had defamed him when, shortly after J. Howard's death, lawyers representing Vickie told members of the press that Pierce had engaged in forgery, fraud, and overreaching to gain control of his father's assets, 275 B.R., at 9. Pierce sought a declaration that *301 the debt he asserted in that claim was not dischargeable in bankruptcy. *Ibid.*¹ Vickie answered, asserting truth as a defense. She also filed counterclaims, among them a claim that Pierce had tortiously interfered with a gift she expected. *Ibid.*; see App. 23–25. Vickie alleged that Pierce prevented the transfer of his father's intended gift to her by, among other things: effectively imprisoning J. Howard against his wishes; surrounding him with hired guards for the purpose of preventing personal contact between him and Vickie; making misrepresentations to J. Howard; and transferring property against J. Howard's expressed wishes. *Id.*, at 24.

Vickie's tortious interference counterclaim turned her objection to Pierce's claim into an adversary proceeding. *Id.*, at 39; see Fed. Rule Bkrtcy. Proc. 3007. In that proceeding, the Bankruptcy Court granted summary judgment in favor of Vickie on Pierce's claim and, after a trial on the merits, entered judgment for Vickie on her tortious interference counterclaim. See 253 B.R. 550, 558–559 (Bankr.C.D.Cal.2000). The Bankruptcy Court also held that both Vickie's objection to Pierce's claim and Vickie's counterclaim qualified as “core proceedings” under 28 U.S.C. § 157, which meant that the

court had authority to enter a final judgment disposing of those claims. See 257 B.R. 35, 39–40 (Bankr.C.D.Cal.2000). The court awarded Vickie compensatory damages of more than \$449 million—less whatever she recovered in the ongoing probate action in Texas—as well as \$25 million in punitive damages. *Id.*, at 40.

Pierce filed a post-trial motion to dismiss for lack of subject-matter jurisdiction, asserting that Vickie's tortious interference claim could be tried only in the Texas probate proceedings. *Id.*, at 36. The Bankruptcy Court held that *302 “the ‘probate exception’ argument was waived” because it was not timely raised. *Id.*, at 39. Relying on this Court's decision in *Markham*, the court observed that a federal court has jurisdiction to “adjudicate rights in probate property, so long as its final judgment does not undertake to interfere with the state court's possession of the property.” 257 B.R., at 38 (citing *Markham*, 326 U.S., at 494, 66 S.Ct. 296).

Meanwhile, in the Texas Probate Court, Pierce sought a declaration that the living **1743 trust and his father's will were valid. 392 F.3d, at 1124–1125. Vickie, in turn, challenged the validity of the will and filed a tortious interference claim against Pierce, *ibid.*, but voluntarily dismissed both claims once the Bankruptcy Court entered its judgment, *id.*, at 1128. Following a jury trial, the Probate Court declared the living trust and J. Howard's will valid. *Id.*, at 1129.

Back in the federal forum, Pierce sought district-court review of the Bankruptcy Court's judgment. While rejecting the Bankruptcy Court's determination that Pierce had forfeited any argument based on the probate exception, the District Court held that the exception did not reach Vickie's claim. 264 B.R. 609, 619–625 (C.D.Cal.2001). The Bankruptcy Court “did not assert jurisdiction generally over the probate proceedings ... or take control over [the] estate's assets,” the District Court observed, *id.*, at 621, “[t]hus, the probate exception would bar federal jurisdiction over Vickie's counterclaim only if such jurisdiction would ‘interfere’ with the probate proceedings,” *ibid.* (quoting *Markham*, 326 U.S., at 494, 66 S.Ct. 296). Federal jurisdiction would not “interfere” with the probate proceedings, the District Court concluded, because: (1) success on Vickie's counterclaim did not necessitate any declaration that J. Howard's will was invalid, 264 B.R., at 621; and (2) under Texas law, probate courts do not have exclusive jurisdiction to entertain claims of the kind asserted in Vickie's counterclaim, *id.*, at 622–625.

The District Court also held that Vickie's claim did not qualify as a “core proceedin[g] arising under [title 11](#), or arising in a case under [title 11](#).” 28 U.S.C. § 157(b)(1); see *303 264 B.R., at 625–632. A bankruptcy court may exercise plenary power only over “core proceedings.” See § 157(b)-(c).² In noncore matters, a bankruptcy court may not enter final judgment; it has authority to issue only proposed findings of fact and conclusions of law, which are reviewed *de novo* by the district court. See § 157(c)(1). Accordingly, the District Court treated the Bankruptcy Court's judgment as “proposed[,] rather than final,” and undertook a “comprehensive, **1744 complete, and independent review of” the Bankruptcy Court's determinations. *Id.*, at 633.

*304 Adopting and supplementing the Bankruptcy Court's findings, the District Court determined that Pierce had tortiously interfered with Vickie's expectancy. Specifically, the District Court found that J. Howard directed his lawyers to prepare an *inter vivos* trust for Vickie consisting of half the appreciation of his assets from the date of their marriage. See 275 B.R., at 25–30, 51–53. It further found that Pierce conspired to suppress or destroy the trust instrument and to strip J. Howard of his assets by backdating, altering, and otherwise falsifying documents, arranging for surveillance of J. Howard and Vickie, and presenting documents to J. Howard under false pretenses. See *id.*, at 36–50, 57–58; see also 253 B.R., at 554–556, 559–560. Based on these findings, the District Court awarded Vickie some \$44.3 million in compensatory damages. 275 B.R., at 53–57. In addition, finding “overwhelming” evidence of Pierce's “willfulness, maliciousness, and fraud,” the District Court awarded an equal amount in punitive damages. *Id.*, at 57–58.

The Court of Appeals for the Ninth Circuit reversed. The appeals court recognized that Vickie's claim “does not involve the administration of an estate, the probate of a will, or any other purely probate matter.” 392 F.3d, at 1133. Nevertheless, the court held that the probate exception bars federal jurisdiction in this case. In the Ninth Circuit's view, a claim falls within the probate exception if it raises “questions which would ordinarily be decided by a probate court in determining the validity of the decedent's estate planning instrument,” whether those questions involve “fraud, undue influence [, or] tortious interference with the testator's intent.” *Ibid.*

The Ninth Circuit was also of the view that state-court delineation of a probate court's exclusive adjudicatory authority could control federal subject-matter jurisdiction. In

this regard, the Court of Appeals stated: “Where a state has relegated jurisdiction over probate matters to a special court *305 and [the] state's trial courts of general jurisdiction do not have jurisdiction to hear probate matters, then the federal courts also lack jurisdiction over probate matters.” *Id.*, at 1136. Noting that “[t]he [P]robate [C]ourt ruled it had exclusive jurisdiction over all of Vickie[s] claims,” the Ninth Circuit held that “ruling ... binding on the United States [D]istrict [C]ourt.” *Ibid.* (citing *Durfee v. Duke*, 375 U.S. 106, 115–116, 84 S.Ct. 242, 11 L.Ed.2d 186 (1963)).

We granted certiorari, 545 U.S. 1165, 126 S.Ct. 35, 162 L.Ed.2d 933 (2005), to resolve the apparent confusion among federal courts concerning the scope of the probate exception. Satisfied that the instant case does not fall within the ambit of the narrow exception recognized by our decisions, we reverse the Ninth Circuit's judgment.

II

In *Ankenbrandt v. Richards*, 504 U.S. 689, 112 S.Ct. 2206, 119 L.Ed.2d 468 (1992), we addressed both the derivation and the limits of the “domestic relations exception” to the exercise of federal jurisdiction. Carol Ankenbrandt, a citizen of Missouri, brought suit in Federal District Court on behalf of her daughters, naming as defendants their father (Ankenbrandt's former husband) and his female companion, both citizens of Louisiana. *Id.*, at 691, 112 S.Ct. 2206. Ankenbrandt's complaint sought damages for the defendants' alleged sexual and physical abuse of the children. *Ibid.* Federal jurisdiction was predicated on diversity of citizenship. **1745 *Ibid.* (citing 28 U.S.C. § 1332). The District Court dismissed the case for lack of subject-matter jurisdiction, holding that Ankenbrandt's suit fell within “the ‘domestic relations’ exception to diversity jurisdiction.” 504 U.S., at 692, 112 S.Ct. 2206. The Court of Appeals agreed and affirmed. *Ibid.* We reversed the Court of Appeals' judgment. *Id.*, at 706–707, 112 S.Ct. 2206.

Holding that the District Court improperly refrained from exercising jurisdiction over Ankenbrandt's tort claim, *id.*, at 704, 112 S.Ct. 2206, we traced explanation of the current domestic relations *306 exception to *Barber v. Barber*, 21 How. 582, 16 L.Ed. 226 (1859). See *Ankenbrandt*, 504 U.S., at 693–695, 112 S.Ct. 2206. In *Barber*, the Court upheld federal-court authority, in a diversity case, to enforce an alimony award decreed by a state court. In dicta, however, the *Barber* Court announced—without citation or discussion

—that federal courts lack jurisdiction over suits for divorce or the allowance of alimony. 21 How., at 584–589; see *Ankenbrandt*, 504 U.S., at 693–695, 112 S.Ct. 2206.

Finding no Article III impediment to federal-court jurisdiction in domestic relations cases, *id.*, at 695–697, 112 S.Ct. 2206, the Court in *Ankenbrandt* anchored the exception in Congress' original provision for diversity jurisdiction, *id.*, at 698–701, 112 S.Ct. 2206. Beginning at the beginning, the Court recalled:

“The Judiciary Act of 1789 provided that ‘the circuit courts shall have original cognizance, concurrent with the courts of the several States, of *all suits of a civil nature at common law or in equity, where the matter in dispute exceeds, exclusive of costs, the sum or value of five hundred dollars, and ... an alien is a party, or the suit is between a citizen of the State where the suit is brought, and a citizen of another State.*’ ” *Id.*, at 698, 112 S.Ct. 2206 (quoting Act of Sept. 24, 1789, § 11, 1 Stat. 78; emphasis added in *Ankenbrandt*). The defining phrase, “all suits of a civil nature at common law or in equity,” the Court stressed, remained in successive statutory provisions for diversity jurisdiction until 1948, when Congress adopted the more economical phrase, “all civil actions.” 504 U.S., at 698, 112 S.Ct. 2206; 1948 Judicial Code and Judiciary Act, 62 Stat. 930, 28 U.S.C. § 1332.

The *Barber* majority, we acknowledged in *Ankenbrandt*, did not expressly tie its announcement of a domestic relations exception to the text of the diversity statute. 504 U.S., at 698, 112 S.Ct. 2206. But the dissenters in that case made the connection. They stated that English courts of chancery lacked *307 authority to issue divorce and alimony decrees. Because “the jurisdiction of the courts of the United States in chancery is bounded by that of the chancery in England,” *Barber*, 21 How., at 605 (opinion of Daniel, J.), the dissenters reasoned, our federal courts similarly lack authority to decree divorces or award alimony, *ibid.* Such relief, in other words, would not fall within the diversity statute's original grant of jurisdiction over “all suits of a civil nature at common law or in equity.” We concluded in *Ankenbrandt* that “it may be inferred fairly that the jurisdictional limitation recognized by the [*Barber*] Court rested on th[e] statutory basis” indicated by the dissenters in that case. 504 U.S., at 699, 112 S.Ct. 2206.

We were “content” in *Ankenbrandt* “to rest our conclusion that a domestic relations exception exists as a matter of statutory construction not on the accuracy of the historical justifications on which [the exception] was seemingly based.” *Id.*, at 700, 112 S.Ct. 2206. “[R]ather,” we relied on

“Congress' apparent acceptance of this construction of the diversity jurisdiction **1746 provisions in the years prior to 1948, when the statute limited jurisdiction to ‘suits of a civil nature at common law or in equity.’ ” *Ibid.* (quoting 1 Stat. 78). We further determined that Congress did not intend to terminate the exception in 1948 when it “replace[d] the law/equity distinction with the phrase ‘all civil actions.’ ” 504 U.S., at 700, 112 S.Ct. 2206. Absent contrary indications, we presumed that Congress meant to leave undisturbed “the Court's nearly century-long interpretation” of the diversity statute “to contain an exception for certain domestic relations matters.” *Ibid.*

We nevertheless emphasized in *Ankenbrandt* that the exception covers only “a narrow range of domestic relations issues.” *Id.*, at 701, 112 S.Ct. 2206. The *Barber* Court itself, we reminded, “sanctioned the exercise of federal jurisdiction over the enforcement of an alimony decree that had been properly obtained in a state court of competent jurisdiction.” 504 U.S., at 702, 112 S.Ct. 2206. Noting that some lower federal courts had applied *308 the domestic relations exception “well beyond the circumscribed situations posed by *Barber* and its progeny,” *id.*, at 701, 112 S.Ct. 2206, we clarified that only “divorce, alimony, and child custody decrees” remain outside federal jurisdictional bounds, *id.*, at 703, 704, 112 S.Ct. 2206. While recognizing the “special proficiency developed by state tribunals ... in handling issues that arise in the granting of [divorce, alimony, and child custody] decrees,” *id.*, at 704, 112 S.Ct. 2206, we viewed federal courts as equally equipped to deal with complaints alleging the commission of torts, *ibid.*

III

[1] Federal jurisdiction in this case is premised on 28 U.S.C. § 1334, the statute vesting in federal district courts jurisdiction in bankruptcy cases and related proceedings. Decisions of this Court have recognized a “probate exception,” kin to the domestic relations exception, to otherwise proper federal jurisdiction. See *Markham*, 326 U.S., at 494, 66 S.Ct. 296; see also *Sutton v. English*, 246 U.S. 199, 38 S.Ct. 254, 62 L.Ed. 664 (1918); *Waterman v. Canal-Louisiana Bank & Trust Co.*, 215 U.S. 33, 30 S.Ct. 10, 54 L.Ed. 80 (1909). Like the domestic relations exception, the probate exception has been linked to language contained in the Judiciary Act of 1789.

Markham, the Court's most recent and pathmarking pronouncement on the probate exception, stated that "the equity jurisdiction conferred by the Judiciary Act of 1789 ..., which is that of the English Court of Chancery in 1789, did not extend to probate matters." 326 U.S., at 494, 66 S.Ct. 296. See generally Nicolas, *Fighting the Probate Mafia: A Dissection of the Probate Exception to Federal Court Jurisdiction*, 74 S. Cal. L.Rev. 1479 (2001). As in *Ankenbrandt*, so in this case, "[w]e have no occasion ... to join the historical debate" over the scope of English chancery jurisdiction in 1789, 504 U.S., at 699, 112 S.Ct. 2206, for Vickie Marshall's claim falls far outside the bounds of the probate exception described in *Markham*. We therefore need not consider in this case whether there exists any *309 uncodified probate exception to federal bankruptcy jurisdiction under § 1334.³

**1747 In *Markham*, the plaintiff Alien Property Custodian⁴ commenced suit in Federal District Court against an executor and resident heirs to determine the Custodian's asserted rights regarding a decedent's estate. 326 U.S., at 491–492, 66 S.Ct. 296. Jurisdiction was predicated on § 24(1) of the Judicial Code, now 28 U.S.C. § 1345, which provides for federal jurisdiction over suits brought by an officer of the United States. At the time the federal suit commenced, the estate was undergoing *310 probate administration in a state court. The Custodian had issued an order vesting in himself all right, title, and interest of German legatees. He sought and gained in the District Court a judgment determining that the resident heirs had no interest in the estate, and that the Custodian, substituting himself for the German legatees, was entitled to the entire net estate, including specified real estate passing under the will.

Reversing the Ninth Circuit, which had ordered the case dismissed for want of federal subject-matter jurisdiction, this Court held that federal jurisdiction was properly invoked. The Court first stated:

"It is true that a federal court has no jurisdiction to probate a will or administer an estate But it has been established by a long series of decisions of this Court that federal courts of equity have jurisdiction to entertain suits 'in favor of creditors, legatees and heirs' and other claimants against a decedent's estate 'to establish their claims' so long as the federal court does not interfere with the probate proceedings or assume general jurisdiction of the probate or control of the property in the custody of the state court." 326 U.S., at 494, 66 S.Ct. 296 (quoting *Waterman*, 215 U.S., at 43, 30 S.Ct. 10).

Next, the Court described a probate exception of distinctly limited scope:

"[W]hile a federal court may not exercise its jurisdiction to disturb or affect the possession of property in the custody of a state court, ... it may exercise its jurisdiction to adjudicate rights in such property where the final judgment does not undertake to interfere with the state court's possession save to the extent that the state court is bound by the judgment to recognize the right adjudicated by the federal court." 326 U.S., at 494, 66 S.Ct. 296.

The first of the above-quoted passages from *Markham* is not a model of clear **1748 statement. The Court observed that *311 federal courts have jurisdiction to entertain suits to determine the rights of creditors, legatees, heirs, and other claimants against a decedent's estate, "so long as the federal court does not *interfere with the probate proceedings*." *Ibid.* (emphasis added). Lower federal courts have puzzled over the meaning of the words "interfere with the probate proceedings," and some have read those words to block federal jurisdiction over a range of matters well beyond probate of a will or administration of a decedent's estate. See, e.g., *Mangieri v. Mangieri*, 226 F.3d 1, 2–3 (C.A.1 2000) (breach of fiduciary duty by executor); *Golden ex rel. Golden v. Golden*, 382 F.3d 348, 360–362 (C.A.3 2004) (same); *Lepard v. NBD Bank, Div. of Bank One* 384 F.3d 232, 234–237 (C.A.6 2004) (breach of fiduciary duty by trustee); *Storm v. Storm*, 328 F.3d 941, 943–945 (C.A.7 2003) (probate exception bars claim that plaintiff's father tortiously interfered with plaintiff's inheritance by persuading trust grantor to amend irrevocable *inter vivos* trust); *Rienhardt v. Kelly*, 164 F.3d 1296, 1300–1301 (C.A.10 1999) (probate exception bars claim that defendants exerted undue influence on testator and thereby tortiously interfered with plaintiff's expected inheritance).

We read *Markham's* enigmatic words, in sync with the second above-quoted passage, to proscribe "disturb[ing] or affect[ing] the possession of property in the custody of a state court." 326 U.S., at 494, 66 S.Ct. 296. True, that reading renders the first-quoted passage in part redundant, but redundancy in this context, we do not doubt, is preferable to incoherence. In short, we comprehend the "interference" language in *Markham* as essentially a reiteration of the general principle that, when one court is exercising *in rem* jurisdiction over a *res*, a second court will not assume *in rem* jurisdiction over the same *res*. See, e.g., *Penn General Casualty Co. v. Pennsylvania ex rel. Schnader*, 294 U.S. 189, 195–196, 55 S.Ct. 386, 79 L.Ed. 850 (1935); *Waterman*, 215

U.S., at 45–46, 30 S.Ct. 10. Thus, the probate exception reserves to state probate courts the probate or annulment of a will and the administration of a decedent's estate; it also *312 precludes federal courts from endeavoring to dispose of property that is in the custody of a state probate court. But it does not bar federal courts from adjudicating matters outside those confines and otherwise within federal jurisdiction.

A

[2] As the Court of Appeals correctly observed, Vickie's claim does not “involve the administration of an estate, the probate of a will, or any other purely probate matter.” 392 F.3d, at 1133. Provoked by Pierce's claim in the bankruptcy proceedings, Vickie's claim, like Carol Ankenbrandt's, alleges a widely recognized tort. See *King v. Acker*, 725 S.W.2d 750, 754 (Tex.App.1987); 4 Restatement (Second) of Torts § 774B (1979) (“One who by fraud, duress or other tortious means intentionally prevents another from receiving from a third person an inheritance or gift that [s]he would otherwise have received is subject to liability to the other for loss of the inheritance or gift.”). Vickie seeks an *in personam* judgment against Pierce, not the probate or annulment of a will. Cf. *Sutton*, 246 U.S., at 208, 38 S.Ct. 254 (suit to annul a will found “supplemental to the proceedings for probate of the will” and therefore not cognizable in federal court). Nor does she seek to reach a *res* in the custody of a state court. See *Markham*, 326 U.S., at 494, 66 S.Ct. 296.

Furthermore, no “sound policy considerations” militate in favor of extending the probate exception to cover the case at hand. Cf. *Ankenbrandt*, 504 U.S., at 703, 112 S.Ct. 2206. Trial courts, both federal **1749 and state, often address conduct of the kind Vickie alleges. State probate courts possess no “special proficiency ... in handling [such] issues.” Cf. *id.*, at 704, 112 S.Ct. 2206.

B

[3] The Court of Appeals advanced an alternate basis for its conclusion that the federal courts lack jurisdiction over Vickie's claim. Noting that the Texas Probate Court “ruled it had exclusive jurisdiction over all of Vickie Lynn Marshall's *313 claims against E. Pierce Marshall,” the Ninth Circuit held that “ruling ... binding on the United States [D]istrict [C]ourt.” 392 F.3d, at 1136. We reject that determination.

[4] [5] Texas courts have recognized a state-law tort action for interference with an expected inheritance or gift, modeled on the Restatement formulation. See *King*, 725 S.W.2d, at 754; *Brandes v. Rice Trust, Inc.*, 966 S.W.2d 144, 146–147 (Tex.App.1998).⁵ It is clear, under *Erie R. Co. v. Tompkins*, 304 U.S. 64, 58 S.Ct. 817, 82 L.Ed. 1188 (1938), that Texas law governs the substantive elements of Vickie's tortious interference claim. It is also clear, however, that Texas may not reserve to its probate courts the exclusive right to adjudicate a transitory *314 tort. We have long recognized that “a State cannot create a transitory cause of action and at the same time destroy the right to sue on that transitory cause of action in any court having jurisdiction.” *Tennessee Coal, Iron & R. Co. v. George*, 233 U.S. 354, 360, 34 S.Ct. 587, 58 L.Ed. 997 (1914). Jurisdiction is determined “by the law of the court's creation and cannot be defeated by the extraterritorial operation of a [state] statute ..., even though it created the right of action.” *Ibid.* Directly on point, we have held that the jurisdiction of the federal courts, “having existed from the beginning of the Federal government, [can]not be impaired by subsequent state legislation creating courts of probate.” *McClellan v. Carland*, 217 U.S. 268, 281, 30 S.Ct. 501, 54 L.Ed. 762 (1910) (upholding federal jurisdiction over action by heirs of decedent, who died intestate, to determine their rights in the estate (citing *Waterman*, 215 U.S. 33, 30 S.Ct. 10)).

**1750 [6] Our decision in *Durfee v. Duke*, 375 U.S. 106, 84 S.Ct. 242, 11 L.Ed.2d 186 (1963), relied upon by the Ninth Circuit, 392 F.3d, at 1136, is not to the contrary. *Durfee* stands only for the proposition that a state court's final judgment determining *its own* jurisdiction ordinarily qualifies for full faith and credit, so long as the jurisdictional issue was fully and fairly litigated in the court that rendered the judgment. See 375 U.S., at 111, 115, 84 S.Ct. 242. At issue here, however, is not the Texas Probate Court's jurisdiction, but the federal courts' jurisdiction to entertain Vickie's tortious interference claim. Under our federal system, Texas cannot render its probate courts exclusively competent to entertain a claim of that genre. We therefore hold that the District Court properly asserted jurisdiction over Vickie's counterclaim against Pierce.

IV

After determining that Vickie's claim was not a “core proceeding,” the District Court reviewed the case *de novo* and entered its final judgment on March 7, 2002. 275 B.R.,

at 5–8. The Texas Probate Court's judgment became final on February 11, 2002, nearly one month earlier. App. to Pet. *315 for Cert. 41. The Court of Appeals considered only the issue of federal subject-matter jurisdiction. It did not address the question whether Vickie's claim was “core”; nor did it address Pierce's arguments concerning claim and issue preclusion. 392 F.3d, at 1137. These issues remain open for consideration on remand.

* * *

For the reasons stated, the judgment of the Court of Appeals for the Ninth Circuit is reversed, and the case is remanded for further proceedings consistent with this opinion.

It is so ordered.

Justice STEVENS, concurring in part and concurring in the judgment.

The administration of decedents' estates typically is governed by rules of state law and conducted by state probate courts. Occasionally, however, disputes between interested parties arise, either in the probate proceeding itself or elsewhere, that qualify as cases or controversies that federal courts have jurisdiction to decide. See, e.g., *Reed v. Reed*, 404 U.S. 71, 92 S.Ct. 251, 30 L.Ed.2d 225 (1971). In her opinion for the Court, Justice GINSBURG has cogently explained why this is such a case. I write separately to explain why I do not believe there is any “probate exception” that ousts a federal court of jurisdiction it otherwise possesses.

The familiar aphorism that hard cases make bad law should extend to easy cases as well. *Markham v. Allen*, 326 U.S. 490, 66 S.Ct. 296, 90 L.Ed. 256 (1946), like this case, was an easy case. In *Markham*, as here, it was unnecessary to question the historical or logical underpinnings of the probate exception to federal jurisdiction because, whatever the scope of the supposed exception, it did not extend to the case at hand. But *Markham's* obiter dicta—dicta that the Court now describes as redundant if not incoherent, *ante*, at 1748—generated both *316 confusion and abdication of the obligation Chief Justice Marshall so famously articulated, see *Cohens v. Virginia*, 6 Wheat. 264, 404, 5 L.Ed. 257 (1821); see also *ante*, at 1741. While the Court today rightly abandons much of that dicta, I would go further.

The Court is content to adopt the approach it followed in *Ankenbrandt v. Richards*, 504 U.S. 689, 112 S.Ct. 2206, 119 L.Ed.2d 468 (1992), and to accept as foundation **1751 for the probate exception *Markham's* bald assertion that the English High Court of Chancery's jurisdiction did not “extend to probate matters” in 1789. 326 U.S., at 495, 66 S.Ct. 296; see *ante*, at 1746. I would not accept that premise. Not only had the theory *Markham* espoused been only sporadically and tentatively cited as justification for the exception,¹ but the most comprehensive article on the subject has persuasively demonstrated that *Markham's* assertion is “an exercise in mythography.”²

Markham's theory apparently is the source of the Court's reformulated exception, which “reserves to state probate courts the probate or annulment of a will and the administration of a decedent's estate.” *Ante*, at 1748. Although undoubtedly narrower in scope than *Markham's* ill-considered description of the probate carve-out, this description also *317 sweeps too broadly. For the Court has correctly upheld the exercise of federal jurisdiction over actions involving the annulment of wills and the administration of decedents' estates. In *Gaines v. Fuentes*, 92 U.S. 10, 23 L.Ed. 524 (1876), for example, the Court held that a defendant in an action to annul a will should be permitted to remove the case to federal court. In so doing, it explained:

“[W]henever a controversy in a suit ... arises respecting the validity or construction of a will, or the enforcement of a decree admitting it to probate, there is no more reason why the Federal courts should not take jurisdiction of the case than there is that they should not take jurisdiction of any other controversy between the parties.” *Id.*, at 22.

Likewise, in *Payne v. Hook*, 7 Wall. 425, 19 L.Ed. 260 (1869), the Court explained that it was “well settled that a court of chancery, as an incident to its power to enforce trusts, and make those holding a fiduciary relation account, has jurisdiction to compel executors and administrators to account and distribute the assets in their hands.” *Id.*, 7 Wall., at 431. (In that same case, a federal court later appointed a Special Master to administer the estate. This Court upheld some of the Master's determinations and rejected others. See *Hook v. Payne*, 14 Wall. 252, 255, 20 L.Ed. 887 (1872).)

To be sure, there are cases that support limitations on federal courts' jurisdiction over the probate and annulment of wills and the administration of decedents' estates. But careful examination reveals that at least most of the limitations so recognized stem not from some *sui generis* exception, but

rather from generally applicable jurisdictional rules. Cf. *Ellis v. Davis*, 109 U.S. 485, 497, 3 S.Ct. 327, 27 L.Ed. 1006 (1883) (“Jurisdiction as to wills, and their probate as such, is neither included **1752 in nor excepted out of the grant of judicial power to the courts of the United States”). Some of those rules, like the rule that diversity jurisdiction will not attach absent an *inter partes* controversy, plainly are still relevant today. See, e.g., *Waterman v. Canal-Louisiana Bank & Trust Co.*, 215 U.S. 33, 44–45, 30 S.Ct. 10, 54 L.Ed. 80 (1909); see also *id.*, at 46, 30 S.Ct. 10 (reaffirming the *in gremio legis* principle). Others, like the rule that a bill in equity will lie only where there is no adequate remedy elsewhere, have less straightforward application in the wake of 20th-century jurisdictional developments. See, e.g., *Case of Broderick’s Will*, 21 Wall. 503, 510–512, 22 L.Ed. 599 (1875); *Ellis*, 109 U.S., at 503, 3 S.Ct. 327 (denying relief where plaintiff had “a plain, adequate and complete remedy at law”); see also Winkler, *supra* n. 2, at 112–113. Whatever

the continuing viability of these individual rules, together they are more than adequate to the task of cabinining federal courts’ jurisdiction. They require no helping hand from the so-called probate exception.

Rather than preserving whatever vitality that the “exception” has retained as a result of the *Markham* dicta, I would provide the creature with a decent burial in a grave adjacent to the resting place of the *Rooker–Feldman* doctrine. See *Lance v. Dennis*, 546 U.S. 459, 468, 126 S.Ct. 1198, 1204, 163 L.Ed.2d 1059 (2006) (STEVENS, J., dissenting).

All Citations

547 U.S. 293, 126 S.Ct. 1735, 164 L.Ed.2d 480, 74 USLW 4224, 46 Bankr.Ct.Dec. 122, Bankr. L. Rep. P 80,505, 06 Cal. Daily Op. Serv. 3604, 2006 Daily Journal D.A.R. 5171, 19 Fla. L. Weekly Fed. S 177

Footnotes

- * The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States v. Detroit Timber & Lumber Co.*, 200 U.S. 321, 337, 26 S.Ct. 282, 50 L.Ed. 499.
- 1 Among debts not dischargeable in bankruptcy, see 11 U.S.C. § 523(a), are those arising from “willful and malicious injury by the debtor,” § 523(a)(6).
- 2 “Core proceedings include, but are not limited to—
 - “(A) matters concerning the administration of the estate;
 - “(B) allowance or disallowance of claims against the estate or exemptions from property of the estate, and estimation of claims or interests for the purposes of confirming a plan under chapter 11, 12, or 13 of title 11 but not the liquidation or estimation of contingent or unliquidated personal injury tort or wrongful death claims against the estate for purposes of distribution in a case under title 11;
 - “(C) counterclaims by the estate against persons filing claims against the estate;
 - “(D) orders in respect to obtaining credit;
 - “(E) orders to turn over property of the estate;
 - “(F) proceedings to determine, avoid, or recover preferences;
 - “(G) motions to terminate, annul, or modify the automatic stay;
 - “(H) proceedings to determine, avoid, or recover fraudulent conveyances;
 - “(I) determinations as to the dischargeability of particular debts;
 - “(J) objections to discharges;

“(K) determinations of the validity, extent, or priority of liens;

“(L) confirmations of plans;

“(M) orders approving the use or lease of property, including the use of cash collateral;

“(N) orders approving the sale of property other than property resulting from claims brought by the estate against persons who have not filed claims against the estate;

“(O) other proceedings affecting the liquidation of the assets of the estate or the adjustment of the debtor-creditor or the equity security holder relationship, except personal injury tort or wrongful death claims; and

“(P) recognition of foreign proceedings and other matters under chapter 15 of title 11.” 28 U.S.C. § 157(b)(2) (2000 ed. and Supp. V).

- 3 We note that the broad grant of jurisdiction conferred by § 1334(b) is subject to a mandatory abstention provision applicable to certain state-law claims. Section 1334(c)(2) provides:

“Upon timely motion of a party in a proceeding based upon a State law claim or State law cause of action, related to a case under title 11 but not arising under title 11 or arising in a case under title 11, with respect to which an action could not have been commenced in a court of the United States absent jurisdiction under this section, the district court shall abstain from hearing such proceeding if an action is commenced, and can be timely adjudicated, in a State forum of appropriate jurisdiction.”

That provision is, in turn, qualified: “Non-core proceedings under section 157(b)(2)(B) of title 28, United States Code, shall not be subject to the mandatory abstention provisions of section 1334(c)(2).” § 157(b)(4). Because the Bankruptcy Court rejected Pierce’s motion for mandatory abstention as untimely, 257 B.R. 35, 39 (Bankr.C.D.Cal.2000), we need not consider whether these provisions might have required abstention upon a timely motion.

- 4 Section 6 of the Trading with the Enemy Act, 40 Stat. 415, 50 U.S.C.App., authorizes the President to appoint an official known as the “alien property custodian,” who is responsible for “receiv[ing,] ... hold [ing], administer[ing], and account[ing] for” “all money and property in the United States due or belonging to an enemy, or ally of enemy....” The Act was originally enacted during World War I “to permit, under careful safeguards and restrictions, certain kinds of business to be carried on” among warring nations, and to “provid[e] for the care and administration of the property and property rights of enemies and their allies in this country pending the war.” *Markham v. Cabell*, 326 U.S. 404, 414, n. 1, 66 S.Ct. 193, 90 L.Ed. 165 (1945) (Burton, J., concurring) (quoting S.Rep. No. 113, 65th Cong., 1st Sess., 1 (1917)).

- 5 Texas appellate courts have on occasion held claims of tortious interference with an expected inheritance “barred” by a prior probate court judgment, apparently applying ordinary principles of preclusion. See, e.g., *Thompson v. Deloitte & Touche*, 902 S.W.2d 13, 16 (Tex.App.1995) (final probate court judgment bars claim of tortious interference with inheritance expectancy because probate court “necessarily found that [the decedent] signed the will with testamentary capacity, and that it reflected his intent, was not the result of coercion or undue influence, and was valid”); *Neill v. Yett*, 746 S.W.2d 32, 35–36 (Tex.App.1988) (complaint alleging fraud and tortious interference with inheritance expectancy, filed more than two years after will was admitted to probate, was barred by both the statute of limitations and the final probate judgment, and failed to state the elements of the claim). Neither *Thompson* nor *Neill* questions the Texas trial courts’ subject-matter jurisdiction over the claims in question.

Pierce maintains that *Thompson*, *Neill*, and other Texas decisions support his contention that preclusion principles bar Vickie’s claim. See Brief for Respondent 36–38. Vickie argues to the contrary. See Brief for Petitioner 42, n. 30 (urging that preclusion does not apply because (1) Vickie’s claim was not litigated to final judgment in the Texas probate proceedings; (2) having presented her claim in the Bankruptcy Court years before she joined the Texas will contest, Vickie was not obliged to present her claim in the Texas proceedings; (3) the Bankruptcy Court’s judgment preceded the Probate Court judgment; and (4) the Texas Probate Court did not have before it important evidence). See also *Tex. Rule Civ. Proc.* 97 (2003); *Ingersoll–Rand Co. v. Valero Energy Corp.*, 997 S.W.2d 203, 206–207 (Tex.1999). The matter of preclusion remains open for consideration on remand. See *infra*, at 1750.

- 1 Notably, Justice Joseph Bradley, a strong proponent of the theory that federal courts sitting in equity cannot exercise jurisdiction over probate matters because in England in 1789 such jurisdiction belonged to the ecclesiastical courts, see *Case of Broderick's Will*, 21 Wall. 503, 22 L.Ed. 599 (1875), *Gaines v. Fuentes*, 92 U.S. 10, 24–25, 23 L.Ed. 524 (1876) (dissenting opinion), urged that “even in matters savoring of [e]cclesiastical process, after an issue has been formed between definite parties,” the controversy should be heard by a federal court. See *Rosenbaum v. Bauer*, 120 U.S. 450, 460–461, 7 S.Ct. 633, 30 L.Ed. 743 (1887) (dissenting opinion) (citing *Gaines*, 92 U.S., at 17, and *Hess v. Reynolds*, 113 U.S. 73, 5 S.Ct. 377, 28 L.Ed. 927 (1885)).
- 2 Winkler, *The Probate Jurisdiction of the Federal Courts*, 14 Probate L.J. 77, 126 (1997); see *ante*, at 1741 (acknowledging Winkler's analysis). Winkler also observes, citing Charles Dickens' *Bleak House* (1853), that *Markham's* “suggestion that the High Court of Chancery had lacked jurisdiction to ‘administer an estate’ was preposterous.” 14 Probate L. J., at 125, and n. 256.

UNITED STATES BANKRUPTCY COURT
DISTRICT OF NEW JERSEY

IN RE: . Case No. 26-10910-MBK
. (Jointly Administered)
. .
MULTI-COLOR CORPORATION, . U.S. Courthouse
ET AL., . 402 East State Street
. Trenton, NJ 08608
Debtors. .
. April 16, 2026
. 9:02 a.m.
.

TRANSCRIPT OF CONTINUED CONFIRMATION HEARING
BEFORE HONORABLE MICHAEL B. KAPLAN
UNITED STATES BANKRUPTCY COURT JUDGE

TELEPHONIC APPEARANCES:

For the Debtors: Kirkland & Ellis LLP
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Trustee: U.S. Department of Justice
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1 (Proceedings commenced at 9:02 a.m.)

2 THE COURT: Okay. Good morning, everyone. This is
3 Judge Kaplan. I'll let everybody adjust their screens. I'm
4 trying to do right now. All right. Thank you. We are hearing
5 the continued confirmation hearing and combined hearing with
6 respect to the approval of the disclosure statement, as well.
7 Let me first turn to Mr. Sponder. Good morning, Mr. Sponder.

8 MR. SPONDER: Good morning, Your Honor.

9 THE COURT: Have you had a chance to review the
10 flurry of filings from yesterday?

11 MR. SPONDER: Thank you, Your Honor. Jeff Sponder on
12 behalf of the United States Trustee. And, as always, the
13 United States Trustee wants to thank Your Honor for allowing us
14 the ability to review the pleadings filed immediately before
15 the confirmation hearing yesterday.

16 As such, Your Honor, we have had the opportunity to
17 review those pleadings. We had three issues, all with respect
18 to the proposed confirmation order. And I believe we are
19 resolved with the debtors. So those issues and any other
20 issues that we had with the pleadings filed, those no longer
21 exist. Thank you, Your Honor.

22 THE COURT: Good. I'm glad you were able to resolve
23 language issues. Then the Court is prepared to read into the
24 record its ruling with respect to the combined hearing. I will
25 give advance notice that it's somewhat lengthy, so make

1 yourselves comfortable as always, and bear with me and have
2 patience.

3 I have reviewed the amended plan, the disclosure
4 statement, the confirmation memorandum, the extensive
5 evidentiary record which includes the declarations of Misterys
6 Gabel, Meltzer, Laurinaitis, Basch, Banks, Kopa, Lee and Koza,
7 as well as the certified voting record. And I've considered
8 the arguments of counsel, filed objections, including the
9 objections of the United States Trustee.

10 What I'm going to do is place my findings on record
11 in a comprehensive way. This is a large, complex, and here is
12 probably the understatement of the year, an extremely
13 contentious and hard-fought case which has concluded in a
14 consensual result. And I think it's important to explain why
15 the plan not only satisfies Section 1129, but does so
16 convincingly.

17 The debtors entered into Chapter 11 to address
18 significant macroeconomic and operational pressures including
19 inflation, supply chain disruptions and demand volatility that
20 materially impacted revenues and liquidity. In response, they
21 engaged in months of negotiations with stakeholders, conducted
22 extensive diligence and strategic review, including the
23 analytical and investigative efforts of a special committee
24 comprised of two independent disinterested directors. The
25 debtors entered into a restructure and support agreement

1 pre-petition and solicited votes on a prepackaged plan before
2 filing.

3 The result, as I've indicated, is a fully consensual
4 restructuring which was the product of both pre and
5 post-petition negotiation and extended mediation efforts. The
6 global settlement reached reduces debt where approximately \$3.9
7 billion and extends maturities on approximately \$1.9 billion of
8 existing debt.

9 The plan raises new capital, roughly, in the rough
10 amount of \$889 million which includes equity and debt
11 financing. It leaves general unsecured creditors unimpaired,
12 it preserves the enterprise as a going concern, protects
13 roughly 5,000 employees and vendor relationships. It positions
14 the reorganized company for long-term viability and critically
15 it is supported by overwhelmingly creditor acceptance in all
16 voting classes.

17 This is a case where the Court is being asked to
18 approve the product of a market-tested, credit-supported
19 restructuring that now has the full support of the Unsecured
20 Creditors Committee, the Ad Hoc Secured Lenders, the
21 Cross-Holder Ad Hoc Group, the Excluded Lender Group. The
22 Court appreciates the efforts, as I've indicated yesterday, of
23 all parties and professionals in pursuing a global resolution
24 and the cooperative spirit.

25 With respect to solicitation and acceptance, the

1 record demonstrates that the debtors complied fully with the
2 solicitation requirements. The debtors conducted a
3 pre-petition solicitation in compliance with Sections 1125(g)
4 and 1126(b)(1) and (2), distributed solicitation materials,
5 balance and disclosure documents to all voting creditors. The
6 documentation contained extensive disclosure relative to the
7 adequate information necessary to assist creditors in order to
8 vote on the plan.

9 The debtors published notice in national and
10 international publications, provided opt-out forms and
11 non-voting notices where appropriate. The voting results are
12 compelling with respect to Class 4, 99 percent by amount
13 accepted. With respect to Class 5, 97 percent by amount
14 accepted. That level acceptance is not just sufficient, it is
15 overwhelming.

16 I find that the solicitation process complied with
17 the Bankruptcy Code and Rules. The debtor acted in good faith
18 under Section 1125(e) and the plan was accepted by impaired
19 classes under Section 1126.

20 With respect to the 1129(a) requirements, the plan
21 complies with Sections 1122 and 1123. And as reflected in the
22 Gabel declaration and the voting report, the classification
23 scheme separates claims based on legal rights and priority,
24 reflects the debtors' capital structure, is supported by valid
25 business and legal reasons, treatment within class is equal and

1 the plan provides detailed implementation mechanisms, proper
2 corporate governance provisions, adequate disclosure of
3 directors and officers. I find full compliance with Section
4 1129(a)(1).

5 With respect to 1129(a)(2), the debtors complied with
6 Sections 1125 and 1126. All notice and solicitation
7 requirements have been met and there's no evidence of any
8 procedural defect.

9 With respect to 1129(a)(3), the plan is plainly
10 proposed in good faith. The record reflects months of arm's
11 length negotiations, extensive mediation efforts, including
12 Court supervised mediation, a global settlement among all major
13 constituencies, a restructuring designed to preserve value and
14 maximize recoveries. And as the CRO testified in the
15 declaration, the plan is the culmination of significant efforts
16 to reach a fair and equitable resolution. This satisfies all
17 Section 1129(a)(3) requirements.

18 With respect to Section 1129(a)(7), the best interest
19 of creditors, the Kopa declaration establishes, specifically at
20 Paragraphs 9 and 10 through 19, that the plan satisfies the
21 best interests test. The liquidation analysis demonstrates
22 that secured creditors recover substantially more under the
23 plan than in liquidation, that junior creditors receive
24 meaningful recoveries versus negligible or zero recoveries in a
25 Chapter 7, and that general unsecured creditors receive 100

1 percent under the plan, again, versus near zero in liquidation.
2 The plan provides materially superior recoveries as opposed to
3 liquidation.

4 With respect to 1129(a)(11), feasibility, again, the
5 Court refers and accepts the representations made in the Gabel
6 and Koza declarations which support a finding as to the plan's
7 feasibility. Specifically, the Court has before it a detailed
8 plan of financial projections, a fully funded capital
9 structure, significant deleveraging, new liquidity and finance
10 commitments, the projections demonstrate the debtors' ability
11 to meet all obligations, operate as a going concern, execute
12 their business plan, and the plan itself was developed over
13 months and tested through extensive due diligence. It's been
14 reviewed by multiple stakeholders and advisors including
15 independent and disinterested directors. I find that the plan
16 is feasible.

17 With respect to 1129(a)(10), the voting report
18 confirms that at least one impaired class has accepted the
19 plan. Indeed, every voting class has accepted.

20 With respect to valuation and market testing, the
21 valuation evidence is robust and credible. Evercore determined
22 enterprise value ranging from 2.9 to \$3.4 billion using
23 discounted cash flow, comparable companies, and precedential
24 transactions. These are standard accepted methodologies just
25 as important as the market tests. Over 30 potential counter

1 parties were contacted. Multiple parties entered due diligence
2 obligations. Only one non-binding indication of interest was
3 received. The Court defers to the debtors' business judgment
4 with respect to its determination that that proposal was
5 inferior to the plan. Again, the plan reflects the highest and
6 best value available.

7 The plan is at its core a comprehensive settlement.
8 It resolves intercreditor disputes, capital structure
9 conflicts, litigation risk and competing restructuring
10 proposals. Under the Martin standard, Third Circuit, in the
11 Third Circuit and Rule 9019, the settlement is fair,
12 reasonable, in the best interests of the estate and,
13 importantly, supported by all major constituencies and the
14 product of extensive mediation and negotiations.

15 Turning to the U.S. Trustee objections. Let me be
16 clear at the outset what is before me is not a novel or
17 untested structure. The plan reflects a mainstream, heavily
18 litigated, repeatedly approved plan architecture in this
19 district supported by substantial authority and an extensive
20 factual record.

21 As acknowledged by the U.S. Trustee, I have
22 repeatedly in the past confirmed plans with the same provisions
23 at issue, overruling objections similar to what have been put
24 forward here today. The debtors' memorandum of law in support
25 of the plan and the disclosure statement approval is replete

1 with citations, descriptive parentheticals, and quotes from
2 previous bench rulings of this Court in Bed Bath & Beyond,
3 Powin, BlockFi, New Rite Aid, Invitae, and the most recent
4 ruling in United Site Services. As such, to save some measure
5 of time, I incorporate herein the argument set forth in the
6 debtors' memorandum, together with specific rulings in these
7 prior cases.

8 Notwithstanding, allow me to add a little additional
9 flavor. Let me start with a recent admonition coming out of
10 the Third Circuit in an unrelated case, DLJ Mortgage Capital v.
11 Stearns, in which the Third Circuit in the opening sentence
12 says, in litigation and in life alike, you must speak up when
13 it is time to do so.

14 So now let's turn to the opt-out mechanism and the
15 issues with respect to non-consensual third-party releases.
16 The starting point is Purdue which prohibits non-consensual
17 third-party releases, but expressly does not disturb consensual
18 ones. So the question is not whether third-party releases are
19 permissible, they are. The question, rather, is whether they
20 are consensual.

21 And the inquiry, as explained recently by the
22 District Court Judge Lee Rosenthal in The Container Store, is
23 governed by federal law, not state contract law because it
24 arises from the Court's authority to confirm a plan and binds
25 party through federal judgment. Now I wanted to be clear about

1 something. The Court agrees with Judge Rosenthal that
2 Bankruptcy Courts do not and should not simply rubberstamp
3 opt-out releases. Consent can be inferred -- cannot be
4 inferred merely because notice was given and an opt-out box
5 existed. That is not the law. Instead, the Court must engage
6 in a fact-specific determination, looking at whether under the
7 totality of the circumstances, it is appropriate to infer
8 consent.

9 The one key precedent pointed out by Judge Rosenthal
10 is the Supreme Court's decision in Phillips Petroleum v.
11 Shutts. And that case explains that the question is how
12 stringent the requirement for consent must be, not whether
13 consent must always be express. And as Shutts makes clear, a
14 party may be bound by failing to opt out where there is
15 adequate notice and where there are safeguards that protect the
16 absent parties' interests.

17 Supreme Court recognized that in many cases requiring
18 affirmative opt-in consent would be impractical and even
19 self-defeating, particularly where claims are small and
20 diffuse. And, importantly, Shutts teaches that a claimant may
21 sit back and allow the litigation to run its course, content in
22 knowing that there are safeguards provided for his protection.

23 This brings me to what I think is the most important
24 point in The Container Store analysis. Bankruptcy is not a
25 simple bilateral contractual setting. It is a collective

1 proceeding with built-in protections including notice and
2 disclosure requirements, creditor or voting rights, committee
3 representation acting as fiduciaries for creditor
4 constituencies, oversight by the U.S. Trustee, and ultimately
5 judicial review and applicable confirmation standards.

6 These all ensure that creditors are not passive, they
7 are represented, informed and able to participate. And because
8 of these protections, Bankruptcy Courts may, in appropriate
9 circumstances, find that creditors consent through silence when
10 they are given a meaningful opportunity to act.

11 Now the determination of consent is not binary. It
12 is based on a multi-factor, case-specific analysis and Courts
13 look to such factors as whether the notice was clear and
14 prominent, whether the opt-out mechanism was simple and
15 accessible, whether the opt-out right was separate from plan
16 voting, whether the releases were consistently disclosed
17 throughout the case, and whether the case was well publicized
18 and understood by creditors, whether creditors actually used
19 the opt-out mechanism, whether there was substantial support
20 for the plan, and whether creditors had incentives to
21 participate, and whether the overall treatment is fair and
22 necessary to restructuring, and, finally, whether the parties
23 actually opted out and exercised such rights. And I emphasize
24 no single factor is dispositive. This is a totality of the
25 circumstances inquiry.

1 Applying the framework here, the notice was clear,
2 conspicuous and repeated across multiple documents, including
3 the disclosure statement, balloting, opt-out forms, and the
4 combined hearing notice. Notice of the opt-out procedure was
5 published in The New York Times and the Financial Times. The
6 consequences of not opting out were explicitly stated.

7 Parties were given a meaningful and accessible
8 opportunity to opt out over 30 days, in fact, to review and
9 consider opt-out rights. The opt-out right was separately
10 presented and not buried. The releases were disclosed and
11 discussed throughout the case. There was overwhelming support
12 for the plan and, in fact, 623 parties actually opted out.

13 I also note, consistent with the restatement
14 principles discussed in The Container Store, that silence can
15 indeed constitute acceptance where the party is given reason to
16 understand that silence will operate as assent. The
17 surrounding circumstances justify that inference. That is
18 exactly what we have here. This is not passive inaction. It
19 is informed inaction in a structured process.

20 So taking all of this together, the governing federal
21 law, the procedural safeguards of the bankruptcy system and the
22 specific facts of this case, I find that the third-party
23 releases and the opt-out mechanism are consensual, permissible
24 and, therefore, the U.S. Trustee objection on this point is
25 overruled.

1 With respect to the objection regarding debtor
2 releases that are found in Article 8(c), the Court finds they
3 are properly tailored to comply with the law in this circuit.
4 Based upon un rebutted testimony found in Paragraphs 40 through
5 46 of the Gabel declaration, the Court finds that the debtors
6 and release parties as stakeholders and critical participants
7 in the plan process share the common goal of seeing the plan
8 succeed and having the debtors' business reorganized, that the
9 release parties made substantial contributions to the debtors
10 by expending significant time and resources negotiating the
11 plan and then giving up material economic interests to ensure
12 the success of these Chapter 11 cases, that absent the debtor
13 release which was an essential term to negotiating the RSA and
14 the plan, the debtors would not have been able to build the
15 extraordinary level of consensus with respect to the plan, that
16 holders of Class 4 and Class 5 claims overwhelmingly voted to
17 accept the plan, including the debtor release, and that the
18 plan provides for meaningful recoveries by substantially all
19 classes affected by the debtor release.

20 Moreover, based upon the analysis and investigation
21 undertaken by the disinterested directors, as outlined in the
22 Meltzer declaration and the Meltzer supplemental declaration,
23 any recoveries on release claims are highly speculative,
24 uncertain and would be time-consuming and costly to pursue.
25 Accordingly, the objection with respect to the debtor releases

1 is overruled.

2 With respect to the objection relative to the
3 settlement authority under 1123(b) (3) and Rule 9019, the U.S.
4 Trustee argues that the plan cannot be confirmed because it
5 characterized itself in part as a global settlement and that
6 Section 1123(b) (3) does not authorize settlement of claims
7 against the debtors. I disagree and I do so for several
8 reasons.

9 Section 1123(b) (3) (A) expressly permits a plan to
10 provide for settlement or adjustments of any claims or
11 interests belonging to the debtor or the estate. But that
12 provision does not exist in isolation. It must be read
13 together with 1123(b) (6) which allows a plan to include any
14 other appropriate provision not inconsistent with the
15 applicable provisions of this title.

16 Courts in the Third Circuit have consistently
17 interpreted these provisions together, not narrowly, and have
18 concluded that Section 1123(b) (3) does not prohibit, in fact,
19 permits plan-based settlements that resolve the broader
20 constellation of claims affecting the estate, including claims
21 asserted against the debtor. Indeed, as the debtors correctly
22 point out, Courts in this circuit have construed 1123(b) (3) (A)
23 to apply to settlements of claims against the estate, not just
24 claims belonging to it. The UST cites no controlling authority
25 to the contrary.

1 Even putting Section 1123 aside, the governing
2 standard is familiar. A plan-based settlement must satisfy the
3 same standards as a standalone compromise under Rule 9019, must
4 be fair, reasonable and in the best interests of the estate.
5 And, here, the record's overwhelming. This plan resolves
6 complex, intercreditor disputes, eliminates litigation risk,
7 reflects months of arm's length negotiations and Court
8 supervised mediation efforts, and is supported by virtually
9 every major constituency.

10 The standards for approval under 1123 and Rule 9019
11 are functionally the same and the debtors have established a
12 record that the settlement embodied in the plan is fair and
13 equitable and in the best interests of stakeholders. That is
14 exactly what I find here.

15 The U.S. Trustee has not identified any binding
16 authority that expressly prohibits a plan from embodying a
17 global settlement of claims against the debtor. In contrast,
18 the debtors have provided authority and this Court's own
19 experience confirms that such provisions are common, necessary,
20 proper and, thus, the objection is overruled.

21 With respect to the gatekeeping function, the U.S.
22 Trustee also challenges the plan's gatekeeping provision,
23 arguing that it is overbroad, unauthorized and an improper
24 extension of the Court's equitable powers. Again, I disagree.
25 The gatekeeping function is not novel. It is fundamental.

1 The starting point is that Bankruptcy Courts
2 routinely act as gatekeepers. That is not controversial. In
3 fact, the debtors' confirmation brief identifies several well
4 established examples such in the Madoff matter and Motors
5 Liquidation. Gatekeeping is simply an extension of that same
6 function similar to where Courts in standing disputes are asked
7 to assess whether claims are colorable before allowing the
8 litigation to proceed.

9 The provision reflects practical reality, not
10 expansion of power. I think it's important to be candid about
11 what happens in practice. As I noted in prior cases, and as
12 reflected in the record here, when these disputes arise, they
13 most often come back to the Bankruptcy Court anyway to
14 determine whether a claim violates plan injunctions or the
15 discharge. The gatekeeping provision does not create
16 jurisdiction. It channels disputes to the forum that will
17 inevitably decide them. It is, in effect, a procedural
18 mechanism, not a substantive expansion of rights.

19 The provision is narrowly tailored and protective.
20 The provision serves legitimate and important purposes. It
21 protects estate fiduciaries and release parties. It prevents
22 duplicative or collateral litigation. It ensures consistent
23 interpretation of a plan and it avoids the waste of resources
24 on claims that are barred. And, importantly, it benefits not
25 only the release parties, but also potential claimants by

1 preventing them from expending resources on claims that lack
2 viability. That is a practical real world benefit.

3 There is also a jurisdictional reality here. As
4 Courts in this district have recognized, the Bankruptcy Court,
5 with close hands-on understanding of a plan and confirmation
6 order, is the appropriate forum to interpret and enforce those
7 provisions. That is particularly true in cases like this where
8 the plan is complex. The releases are integral and the record
9 is extensive.

10 The provision does not impose a new burden, that the
11 record reflects even absent the gatekeeping provision, a party
12 asserting a post-confirmation claim must obtain a judicial
13 determination that the claim is not barred by the plan. All
14 the provision does is specify where and how that determination
15 is made. It does not eliminate claims, expand releases or
16 alter substantive rights.

17 This Court and others in this district have
18 repeatedly approved similar provisions. In BlockFi, I stated
19 plainly that such provisions reflect practical reality, that
20 they are appropriate and that I had no issue with the scope of
21 the provisions or the provisions of the gatekeeping function.
22 Nothing in the record here justifies a different result. As
23 with respect to Sections 105 and 1142, it is clear the Court's
24 ability exists under these sections to enforce its orders,
25 interpret its confirmation order, and prevent actions that

1 undermine the plan.

2 Now the Court views the gatekeeping provision as
3 fitting comfortably within this framework. The only change I
4 would ask is to have clarity that in undertaking the
5 gatekeeping function, the Court is not addressing the
6 colorability of the underlying substantive claims. And I want
7 to make that clear.

8 The Court is simply reviewing and determining whether
9 the plain -- the causes of action being pursued, the claims
10 that are being pursued, contravene the discharge or release
11 provisions of the plan. The analysis as to the colorability
12 and substantive merits of the underlying claims remains for the
13 forum that will be entertaining such claims in litigation. For
14 all of these reasons, the Court overrules the objections to the
15 gatekeeping function as set forth.

16 Finally, the Court rules that the waiver of Rule
17 3020(e) stay is appropriate. The Court is cognizant that the
18 restructuring support agreement requires that the debtors
19 emerge from Chapter 11 within 90 days of the petition date
20 which would be April 29th, 2026. Extending the debtors' time
21 in Chapter 11 will result in administrative, additional
22 administrative and professional costs, as well as a potential
23 disruption to the debtors' customer and vendor relationships.

24 The plan has the support of all voting classes and
25 nearly unanimous support from all of its stakeholders as

1 evidenced by the plan settlement. Accordingly, the U.S.
2 Trustee's objection with respect to the waiver of Rule 3020(e)
3 is overruled.

4 Stepping back, the record demonstrates a fully
5 negotiated consensus, restructuring, a market-tested outcome, a
6 plan that maximizes value, a plan that complies with all the
7 provisions of 1129(a) and where appropriate 1129(b), and the
8 plan has received the overwhelming support and approval of the
9 creditor body. For all of these reasons, the disclosure
10 statement is approved. The plan satisfies 1129 and the U.S.
11 Trustee's objections were overruled. The plan will be
12 confirmed.

13 Thank you for bearing with me. Let me turn to
14 debtors' counsel, Ms. Bentley. Is there any clarification, or
15 I'll turn to any party and counsel, are there any
16 clarifications you seek from the Court?

17 MS. BENTLEY: No, Your Honor. I just wanted to
18 extend thanks, again, to you and your chambers. Really
19 appreciate the time and the flexibility. As you noted, this
20 has been a tough one and we're just very happy to be here
21 today.

22 I will submit a revised proposed form of order
23 addressing the comments that Mr. Sponder noted at the outset,
24 but I think we are clear based on your ruling.

25 THE COURT: All right. I assume, having read the

1 filed stipulation that the adversary proceeding initiated by
2 BTG Pactual, the various motions that are on such as the
3 designation motion and the motion to intervene, the motion to
4 disband the Committee, all of these can be withdrawn without
5 prejudice pending the plan going effective. And I understand
6 parties will take the necessary steps with respect to any
7 pending appellate matters, is that correct?

8 MS. BENTLEY: That's correct, Your Honor.

9 THE COURT: All right. Does anyone else wish to be
10 heard with respect to any issues?

11 (No audible response)

12 THE COURT: Silence is good. I think I made that
13 clear in my opinion. So with that, I thank you all again. And
14 have a pleasant weekend. Take care.

15 I will assume, Ms. Bentley, you will be submitting a
16 new amended version, modified version of the confirmation
17 order?

18 MS. BENTLEY: Correct, Your Honor, shortly after this
19 hearing.

20 THE COURT: If you would add language that simply
21 incorporates by reference the oral bench ruling into the
22 confirmation order, I know it has its own explicit findings of
23 facts and conclusions of law. Let's have it also incorporate
24 my bench ruling.

25 MS. BENTLEY: Thank you, very much, Your Honor. Will

1 do.

2 THE COURT: All right. Take care, folks. Have a
3 good weekend.

4 UNIDENTIFIED ATTORNEYS: Thank you, Your Honor.

5 UNIDENTIFIED ATTORNEY: Yes, Judge.

6 UNIDENTIFIED ATTORNEY: Thank you, Judge.

7 (Proceedings concluded at 9:31 a.m.)

8 * * * * *

9 **C E R T I F I C A T I O N**

10 I, KELLI R. PHILBURN, court-approved transcriber,
11 hereby certify that the foregoing is a correct transcript from
12 the official electronic sound recording of the proceedings in
13 the above-entitled matter, and to the best of my ability.

14

15 /s/ Kelli R. Philburn

16 KELLI R. PHILBURN

17 J&J COURT TRANSCRIBERS, INC. DATE: April 17, 2026

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1 IN THE UNITED STATES BANKRUPTCY COURT

2 FOR THE SOUTHERN DISTRICT OF TEXAS

3 HOUSTON DIVISION

4 IN RE: § CASE NO. 25-90669-11
5 PINE GATE RENEWABLES, LLC, § HOUSTON, TEXAS
ET AL, § WEDNESDAY,
6 DEBTORS. § FEBRUARY 18, 2026
§ 1:01 P.M. TO 5:26 P.M.

7 **CONFIRMATION HEARING**

8 BEFORE THE HONORABLE CHRISTOPHER M. LOPEZ
9 UNITED STATES BANKRUPTCY JUDGE

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12 APPEARANCES: SEE NEXT PAGE

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(Please also see Electronic Appearances.)

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INDEX

<u>WITNESS:</u>	<u>Direct</u>	<u>Cross</u>	<u>Redirect</u>	<u>Recross</u>
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MARK RAJCEVICH				
By Mr. Jimenez .		20	.	.

<u>EXHIBITS:</u>	<u>Received</u>
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ECF 1441, 1442, 1459	17
ECF 1463, Exhibits 1-18	17

1 **HOUSTON, TEXAS; WEDNESDAY, FEBRUARY 18, 2026; 1:01 P.M.**

2 THE COURT: Okay. Let me call Case Number
3 25-90669, Pine Gate Renewables.

4 I'll take appearances in the courtroom. Anyone on
5 the line wish to make an appearance, please hit 5* and I
6 will unmute your line.

7 Mr. Davidson, good afternoon.

8 MR. DAVIDSON: Good afternoon, Your Honor. Tad
9 Davidson from Hunton Andrews Kurth for the Debtors, joined
10 by Philip Guffy and Brandon Bell, and our co-Counsel from
11 Latham, Andrew Parlen and Jason Gott.

12 THE COURT: Okay.

13 MR. DAVIDSON: After appearances, Mr. Parlen will
14 make a brief statement and then Mr. Gott will handle the
15 confirmation hearing, Your Honor.

16 THE COURT: Okay.

17 MR. DAVIDSON: Thank you.

18 MS. QUEJADA: Good afternoon, Your Honor. Maegan
19 Quejada, Sidley Austin, for Fundamental.

20 THE COURT: Okay. Good afternoon.

21 MR. PENCE: Hello. George Pence, P-E-N-C-E, for
22 Midland States Bank and North Mill Equipment Finance.

23 THE COURT: Good afternoon. Welcome.

24 MR. PENCE: Thank you.

25 MS. O'NEIL: Good afternoon, Your Honor. Holly

1 O'Neil with Foley & Lardner on behalf of Pathward, NA.

2 Thank you.

3 THE COURT: Good to see you, Ms. O'Neil.

4 MS. CATMULL: Good afternoon, Your Honor. Annie
5 Catmull here on behalf of Staff -- Staffing Support
6 Solutions, LLC.

7 THE COURT: Okay. Good afternoon.

8 All right. Let me unmute a few lines here. I've
9 got like six, so I'll start with a 202 number.

10 Mr. Jimenez, good afternoon.

11 MS. LERMAN: Good afternoon, Your Honor. Leah
12 Lerman on behalf of the United States of America.

13 THE COURT: Oh, good afternoon. I'm sorry. Could
14 you repeat that?

15 MS. LERMAN: Good afternoon, Your Honor. Leah
16 Lerman on behalf of the United States of America.

17 THE COURT: Okay. Good afternoon.

18 A 973 number?

19 MR. ZUBER: Good afternoon, Your Honor. Scott
20 Zuber from Chiesa Shahinian & Giantomasi on behalf of Surety
21 Hanover Insurance Company.

22 THE COURT: Good afternoon.

23 There's a 281 number.

24 MR. BEATTY: Your Honor, Max Beatty on behalf of
25 JB Electric and Solar LLC.

1 THE COURT: Okay. A 512 number.

2 MR. BRESCIA: Yeah, good afternoon, Your Honor.
3 Duane Brescia of Clark Hill for RLI Insurance Company, one
4 of the sureties in the case.

5 THE COURT: Good afternoon.

6 A 202 number.

7 MR. JIMENEZ: Good afternoon, Your Honor. Andrew
8 Jimenez for the United States Trustee.

9 THE COURT: All right. A 646 number.

10 MR. ABELSON: Good afternoon, Your Honor. Phil
11 Abelson, White & Case, on behalf of the Committee. With me
12 today is my colleague, Claire Campbell, as well as our
13 co-Counsel Brad Sandler and Shirley Jo from Pachulski.

14 THE COURT: Okay. Good afternoon.

15 And a 615 number.

16 MR. BUCHMAN: Good afternoon, Your Honor. Marc
17 Buchman, Manier & Herod, on behalf of Westchester Fire
18 Insurance Company, Markel Insurance Company, and Applied
19 Surety Underwriters.

20 THE COURT: Good afternoon.

21 Okay. For the lines that I have unmuted, you can
22 just keep yourselves on mute. Just monitor yourselves and
23 I'll keep your lines unmuted on this end.

24 I've got one more that just popped up, and 804
25 number?

1 MR. MUNCY: Yes, Your Honor, Johnie Muncy for
2 Staffing Support Solutions.

3 THE COURT: Good afternoon. Okay.

4 MR. MUNCY: Thank you, Your Honor.

5 MR. PARLEN: Good afternoon, Your Honor. Andrew
6 Parlen of Latham & Watkins for the Debtors.

7 As the Court will recall, last summer into the
8 fall, Pine Gate faced an extraordinary liquidity crisis.
9 The company was down to days of cash, it faced a nose dive
10 lights out liquidation.

11 The company engaged with its lenders and at the
12 beginning of October obtained a bridge financing and DIP
13 commitment of more than \$400 million in new money from
14 Fundament, from Brookfield, and from Carlyle.

15 On November 7th, the Debtors filed these cases and
16 on November 10th, a hundred days ago, the Debtors were here
17 for the First Day Hearing. That day, although we presented
18 the Court with the DIP financing package of the three DIPs
19 and laid out a sales process with a stalking horse bids,
20 there was real fragility, there was true uncertainty.

21 Was the DIP financing sufficient? Could the
22 business continue to endure the strain it was under? Would
23 employees stay? Would the case devolve into litigation?
24 Would the Debtors remain administratively solvent? Would
25 the asset sale close? Would we ever get to Plan

1 confirmation?

2 None of this was pre-ordained. It was not
3 inevitable. It probably wasn't even probable, to tell you
4 the truth.

5 But 100 days later, here we are in a confirmation
6 hearing, and that's thanks to a number of folks, many of
7 whom are here today.

8 One, the board, clear-eyed and steady under
9 extreme pressure. The management team, who led from the
10 front and never waivered. The employees, who kept
11 developing, kept operating, kept delivering, when it would
12 have been easier not to.

13 The lenders, Brookfield, Fundamental, Carlyle, our
14 project lenders, so many financial stakeholders who stepped
15 in and particularly Brookfield, Carlyle and Fundamental who
16 stepped in and stepped up when no one else would to finance
17 the company.

18 The Official Committee, which dropped into what
19 must have seemed like -- I know seemed like total chaos.
20 The Committee found its footing and then helped find
21 solutions.

22 And this Court -- honestly, Your Honor, your
23 flexibility and accessibility meant so, so much to this
24 company, to these Debtors when it was living -- when they
25 were living day-to-day, hour-by-hour at times.

1 So these 100 days, Your Honor, the Debtors have
2 obtained three different financings. They closed the sale
3 of the development business to Fundamental, which is now
4 operating as a standalone company. They closed the sale of
5 non-Debtor act, which was the ONM (phonetic) business.
6 They've received regulatory approval to close the Carlyle
7 portfolio sale to Norfar (phonetic), which will happen
8 imminently.

9 As soon as regulatory approval is received for the
10 Brookfield portfolio, that sale will close to Brookfield.
11 And in addition, the sale of the Sun Stone Solar Project
12 will shortly close to Amazon, and the JV interest in what we
13 call the "Hancock" portfolio, will transfer, as well.

14 So when all is said and done, Your Honor,
15 approximately 100 employees have transitioned to employment
16 with the purchasers and there may be more to come.

17 The Debtors have also entered into a number of
18 significant settlements. Settlements with each of their
19 primary lenders, Brookfield, Carlyle, Fundament, a
20 settlement with their JV partner Hancock Back Solar,
21 settlements with both preferred equity holders who can
22 generate settlements with their four founders in common
23 equity holders, settlements with three material surety bond
24 issuers, and a settlement, of course, with the UCC, whose
25 role in reaching these stakeholder resolutions cannot be

1 overstated and should be recognized.

2 So Your Honor, since the First Day Hearing nothing
3 in this case has been contested. Everything has been
4 solved. Even today, confirmation, as you'll hear from
5 Mr. Gott, is largely uncontested subject to the US Trustee's
6 remaining objections.

7 So Your Honor, here we are 100 days in, seeking
8 Plan confirmation and with that, I know Mr. Abelson for the
9 UCC would like to offer some remarks for the Court.

10 THE COURT: Mr. Abelson?

11 MR. ABELSON: Thank you, Your Honor.

12 Thank you, Mr. Parlen.

13 Again, just for the Record, Phil Abelson, White &
14 Case on behalf of the Committee.

15 Your Honor, as you'll recall, and I'll do a little
16 bit of what Mr. Parlen just did, when these cases were
17 filed, there was no clear path to any recovery for unsecured
18 creditors. All material assets were fully encumbered. All
19 available liquidity came from the DIP. And the three
20 secured lender groups were positioned to credit bid with no
21 cash coming into the estate.

22 Through the hard work of the Committee and its
23 professionals and the cooperation, the commercial approach
24 taken by the Debtors and the DIP Lenders, as well as their
25 professionals, we have a confirmable Plan with a projected,

1 but currently unknown recovery for unsecured creditors.

2 On that last point, the key will be to maximize
3 the cash available after the wind down is funded, including
4 the cash we negotiated for, so we can get as much as
5 possible for the unsecured creditors.

6 If (indiscernible) the Plan Administrator and GUC
7 Trustee. While we know the identity of the GUC Trustee,
8 we're still in the process of selecting the Plan
9 Administrator, which the Debtors and Committee need to
10 collectively agree on, and which we hope to be able to do
11 soon.

12 Relatedly, the Plan also builds in key structural
13 protections for their own secured creditors during the
14 post-effective date period. The Plan provides, for example,
15 for a detailed cooperation reporting framework from the Plan
16 Administrator to the GUC Trustee. The Plan Administrator
17 will consult with the GUC Trustee throughout the wind down,
18 and remit surplus cash to the GUC Trust as it becomes
19 available on and after the effective date.

20 This provides meaningful oversight by the GUC
21 Trust, ensuring that all available funds flow to the
22 unsecured creditors as quickly as possible, and the Court
23 retains jurisdiction to enforce these obligations, if
24 they're unmet.

25 For these reasons, the Committee respectfully

1 supports confirmation of the Plan.

2 Thank you, Your Honor.

3 THE COURT: Thank you.

4 Good afternoon.

5 MR. PARLEN: Good afternoon, Your Honor. And
6 barring anyone popping up with sort of opening remarks,
7 which I'm not seeing anyone.

8 THE COURT: Yeah, let me just ask.

9 Let me just see if anyone --

10 MR. PARLEN: Sure.

11 THE COURT: -- wishes to make kind of a brief
12 opening remark?

13 (No audible response)

14 THE COURT: All right. Counsel?

15 MR. GOTT: All right. Jason Gott for the Record
16 from Latham & Watkins for the Debtors.

17 We do have two items on the Agenda today actually.
18 The first is confirmation of the Debtors' Joint Chapter 11
19 Plan. The second is a simple post-petition financing motion
20 that we can get through quickly once we get through the
21 confirmation portion.

22 This morning we filed the proposed confirmation
23 version of the Plan at Docket Number 1460. This revised
24 version of the Plan contains some minor changes, none of
25 which affect creditor recoveries, and so none of which, we

1 submit, require any concern about resolicitation.

2 We also filed our proposed Confirmation Order on
3 Monday and then a revised version again this morning at
4 Docket Number 1462.

5 To set the stage process-wise, I'll note that we
6 have a very limited universe of open issues to deal with
7 today. 14 objections or joinders to objections to
8 confirmation were filed and we received informal outreach
9 from another three creditors.

10 Most of the responses were focused on opting out
11 of the Plan's third-party releases.

12 We also had some concerns raised by certain
13 creditors asserting secured claims.

14 But we've resolved all of the arguments and all of
15 the requests but for the objection of the United States
16 Trustee's Office.

17 I do make one more upfront statement for the
18 Record, and this is stated in our Confirmation Brief and
19 also expressly ordered in the form of Confirmation Order
20 that we filed this morning. We have five Debtor entities
21 that are not going to be sold in our 363 sales, but that are
22 also not going to be able to confirm a Plan because we do
23 not have an impaired accepting class of creditors at those
24 entities.

25 So we are withdrawing the Plan as to those five

1 entities and we will be filing a motion after this hearing
2 to have their Chapter 11 cases dismissed concurrent with our
3 Plan effective date. Those entities will be wound down
4 along with all the other Debtors and non-Debtors in the
5 corporate structure.

6 We recognize that that, among other aspects of our
7 Chapter 11 process are a bit unusual with so many of our
8 Debtor entities that filed Chapter 11 cases not actually
9 going through with a confirmed Plan while most will. And so
10 we're going to be filing a simple and clear list with our
11 notice of effective date -- assuming we get there --
12 detailing which Debtor entities have consummated the Plan
13 and which have not, so the parties can reference that in the
14 future.

15 Shifting now from table setting and beginning with
16 the evidentiary record for the confirmation hearing, unless
17 the US Trustee wishes to make any opening remarks
18 specifically on confirmation.

19 THE COURT: Why don't we just -- let's keep going.

20 MR. GOTT: Okay. So I'd ask that we start by
21 admitting into evidence our three Declarations in support of
22 Confirmation, in lieu of direct testimony by the Declarants.
23 Each of the Declarants is present today, via the Court's
24 video conference, and is available for cross-examination.

25 Those three Declarations are the Declaration of

1 Mark Rajceovich, the company's CRO from Alvarez & Marsal, at
2 Docket Number 1441; the Declaration of William Transier,
3 independent manager of the company, at Docket Number 1442;
4 and the Amended Declaration of Jeriad Paul, from our
5 solicitation agent at Omni, filed at Docket Number 1459
6 today.

7 THE COURT: Any objection to the admission of
8 these Declarations, subject to anyone's Cross, for purposes
9 of today's hearing?

10 (No audible response)

11 THE COURT: Okay.

12 MR. GOTT: No objection, Your Honor, subject to
13 (indiscernible) foundation.

14 THE COURT: Okay. They are admitted.

15 (ECF 1441, 1442, and 1459 received in evidence.)

16 MR. GOTT: Thank you.

17 And then I'd ask that the Court admit into
18 evidence all of the other exhibits noted in our Witness and
19 Exhibit List that's Exhibits 1 through 48, the most recent
20 version of that list was filed this morning at Docket
21 Number 1463.

22 THE COURT: Any objection to the admissions of 1
23 through 48 for purposes of today's hearing?

24 MR. GOTT: No objection, Your Honor.

25 THE COURT: Okay. They're admitted.

1 (ECF 1463, Exhibits 1 through 48, received in
2 evidence.)

3 MR. GOTT: And Your Honor, with Mr. Jimenez's note
4 about cross-examination, I'll pause if any would be taken at
5 this time before we get to argument?

6 THE COURT: Okay. Mr. Jimenez, is there anyone
7 you wish to examine?

8 MR. JIMENEZ: Yes, Your Honor, very briefly
9 because Mr. Rajcevich is the CRO of the Debtor.

10 THE COURT: Okay. Mr. Rajcevich, if you can just
11 hit 5* unless your line is already unmuted?

12 All right. There's a 3- -- can you hear me okay?

13 MR. RAJCEVICH: I can. Can you hear me?

14 THE COURT: Yep. And just so that we're -- who
15 will be conducting and representing for purposes of Cross?

16 MR. GOTT: Yeah, for defending the witness, it'll
17 be my partner, Ms. Quartarolo, who just came up on the
18 screen.

19 THE COURT: Quartarolo? Oh, that's why you turned
20 your camera on.

21 Ms. Quartarolo, can you -- yep, there you go.

22 Ms. Quartarolo, can you hear me okay?

23 MS. QUARTAROLO: Yes. Thank you.

24 THE COURT: Okay. Perfect.

25 Mr. Rajcevich, I know your Declaration is

1 admitted, but let me just go ahead and swear you in for --
2 just to confirm that we have a good, clean Record here.

3 Can you raise your right hand?

4 Do you swear to tell the truth, the whole truth,
5 and nothing but the truth?

6 THE WITNESS: I do.

7 THE COURT: Okay. Can you tell me -- you can put
8 your hand down -- is there anyone else in the room with you?

9 THE WITNESS: No.

10 THE COURT: Okay. We're going to proceed with
11 Cross-examination and because we're doing this virtually,
12 I'd just ask that you please just give everyone a moment to
13 make sure that they fully ask the question, answer the
14 question before, and if there's an objection that is raised,
15 I will -- I'll take care of it.

16 If everyone else that's on the line, if you can
17 please keep your phones on mute so that we can all hear each
18 other perfectly virtually, except for, obviously, the
19 witness and Counsel and Mr. Jimenez.

20 Mr. Jimenez, whenever you're ready, you may
21 proceed.

22 MR. JIMENEZ: Thank you, Your Honor.

23 Your Honor, if I could have the presenter role?

24 THE COURT: Of course.

25 (Pause in the proceedings)

1 MR. JIMENEZ: Okay. Mr. Rajceovich, are you able
2 to hear me?

3 THE WITNESS: Now, yes. I can hear you.

4 MR. JIMENEZ: Okay. Now I pulled up a copy of
5 your Declaration at Docket Number 1441. Before I proceed,
6 just let me know if the image is large enough for you to
7 read or if you need me to enlarge it?

8 THE WITNESS: No, it's fine. I can read it.

9 MR. JIMENEZ: Okay. Thank you.

10 CROSS-EXAMINATION

11 BY MR. JIMENEZ:

12 Q Okay. So you are familiar with the Declaration filed
13 that's filed on your behalf in this proceeding, correct?

14 A That's correct.

15 Q Okay. All right. So I want to make reference first to
16 paragraph 20. And I'll just read it quickly for the Record
17 so that I can set the stage and I can ask you some questions
18 about that paragraph.

19 The third-party release is an integral part of the Plan
20 and a condition of the settlement set forth therein. The
21 Debtors spent months engaging in good faith arm's-length
22 negotiations with the Creditors Committee and the DIP
23 Lenders regarding the terms of the Plan, including the
24 releases.

25 The third-party release was a material inducement for

1 the DIP Lenders to enter into such settlement and provide
2 their support for the Plan and the 362 sale transaction.

3 So you mention in this paragraph that the Committee and
4 DIP Lenders participated in the negotiations; is that
5 correct?

6 A Yes, sir.

7 Q I'm sorry. I couldn't hear a response.

8 A That's correct.

9 Q Okay. Who else participated in these negotiations?

10 A Well, the Committee, the DIP Lenders obviously, the
11 Debtors were aware of those negotiations, and the proposals
12 going back and forth between the various parties and were, I
13 guess, aware, you know, of the different terms being batted
14 around.

15 Q Did the existing equity holders participate in the
16 negotiations?

17 A If I recall correctly, they were part of the
18 negotiations, as well. There were settlements reached
19 between the UCC and equity holders.

20 Q Who represented the equity holders in these
21 negotiations?

22 A I believe -- well, if I think about Generate, Generate
23 had their own advisors. I believe it was Kirkland & Ellis.
24 I don't recall the SA and then I don't recall who is one of
25 the other equity holders, I don't recall either legal

1 Counsel offhand.

2 Q Okay. And just to be clear, I don't want to be
3 confusing parties. Generate is an equity holder, not a
4 secured lender?

5 A They're an equity holder.

6 Q Okay. Did holders of subordinated claims participate
7 in the negotiations?

8 A So the secured lenders, you know, Fundamental,
9 Brookfield, Carlyle, participated as part of the
10 negotiations with the UCC.

11 Q And the secured lenders are also holders of
12 subordinated claims?

13 A I believe that's correct in certain instances.

14 Q Okay. Can you please explain what is the basis for
15 your conclusion that the third-party releases are an
16 integral part of the Plan?

17 A Yeah, so as I think about those -- but I take a step
18 back and take it off the Plan that that was (indiscernible)
19 I call a grand bargain or second global settlement, and so
20 the Court for the Plan overall in terms of the one that
21 we're contemplating today, was part of that bargain, the DIP
22 Lenders supporting it, so Brookfield, Carlyle, Fundamental,
23 who Generate, that plan obviously includes the 363 sale
24 transactions that was -- you know, those negotiations are
25 conducted at arm's-length, and then also, you know, there

1 are settlement dollars, right, in terms of funds that are
2 going to be provided to the estate by those counterparties
3 as part of the agreement -- those releases that were
4 bargained for as part of that agreement, so all of them, I
5 certain view as hanging together as part of the grand
6 bargain.

7 Q All right. So let me focus your attention now to
8 paragraph 19.

9 And I'll just give you a moment to read paragraph 19.

10 THE COURT: Mr. Jimenez, just I want to make sure
11 that I'm -- I want you to continue with your examination.

12 Is where you're going -- why don't you just finish
13 the examination?

14 MR. JIMENEZ: Okay. Thank you, Your Honor.

15 THE COURT: No, no, no. I apologize. I should
16 have. Go ahead.

17 MR. JIMENEZ: I'm almost done.

18 THE COURT: No, no.

19 THE WITNESS: Yeah, I read paragraph 19, unless
20 you want to read it into the Record? (Indiscernible).

21 MR. JIMENEZ: Okay. I appreciate it.

22 BY MR. JIMENEZ:

23 Q So you make a reference that the balloting agent
24 received 249 opt-out elections from parties that hold claims
25 in interest, and that voted on the Plan or received opt-out

1 releases forms, and then you conclude that these speak to
2 the consensual nature of the third-party releases.

3 Could you please explain a little more, what are the
4 basis for your conclusion that this speaks to the consensual
5 nature of the third-party releases?

6 A Yeah, so I think, you know, the Plan overall, you know,
7 we do have an interim accepting class, with the exception of
8 the five Debtors that Mr. Gott explained earlier, you know,
9 those votes are in favor of the Plan for an impaired
10 accepting class with what we think are at least of the
11 criteria necessary to move forward today in this
12 confirmation. As part of the solicitation packages there
13 were an ability to opt-out via the release form. There are
14 other channels that people could claim or could opt-out.
15 Out of all the votes received, there were 249 that opted
16 out.

17 There are obviously a number of claimants and ballots
18 that did not seek to opt out. And so we do think that
19 overall every (indiscernible) being in the Declaration
20 overall that, you know, the Plan was consensual. We have
21 the votes necessary to achieve confirmation and we also
22 preserve claimants' rights to opt-out, if they so chose.

23 Q Okay. And taking aside the issue of being able to
24 confirm a Plan, speaking more narrowly to the consensual
25 nature of the third-party releases, are you aware that over

1 9,000 opt-out release forms and/or ballots were sent out?

2 A Yeah, I'm aware of that number.

3 Q Okay. And then is it your conclusion that by receiving
4 249 out of 9,000 is what forms to your conclusion that this
5 speaks to the consensual nature of the third-party releases?

6 A Yeah. I believe, you know, the 9,000 that were
7 distributed, 249 coming out as opt-outs is indicative that,
8 you know, it's consensual in terms of, you know,
9 (indiscernible).

10 To the extent that parties wanted to opt-out, they had
11 the ability to, so it's consensual in terms of giving them
12 that ability to opt-out while the others, you know, did not
13 and therefore are agreeing to the opt-outs.

14 Q Okay. And you are aware that this Plan is a
15 Liquidating Plan, correct?

16 A Yes, yeah.

17 Q Okay. Do you have any views as to why the third-party
18 releases are integral to a Liquidating Plan?

19 MS. QUARTAROLO: Objection, Your Honor. I think
20 this calls for a legal conclusion or expert opinion.

21 THE COURT: Mr. Jimenez, can you repeat the --

22 MR. JIMENEZ: I asked for --

23 THE COURT: -- I'm asking can you repeat the
24 question.

25 MR. JIMENEZ: -- I asked for a (indiscernible),

1 Your Honor.

2 THE COURT: I'm asking -- yeah, go ahead.

3 BY MR. JIMENEZ:

4 Q So could you please share your view as to why the
5 third-party release is an integral part in this Liquidating
6 Plan?

7 MS. QUARTAROLO: Objection, Your Honor. I think
8 that's been asked and answered.

9 THE COURT: He can answer again.

10 THE WITNESS: Okay. As I think the third-party
11 releases, you know, again are part of the -- what I spoke to
12 earlier as part of the grand bargain here in terms of, you
13 know, the overall Plan in terms of the support that's coming
14 from Brookfield, Carlyle, Fundamental, Generate, they all
15 bargained for those releases. Those parties are actually
16 contributing cash to the estate, which in large part is
17 going to fund the expenses associated with that wind down
18 and provide for some of the recoveries to unsecured
19 creditors as part of that wind down, as well.

20 So I do think that they're important. You know,
21 the releases are part of that overall package and it's not
22 clear to me that those parties would actually continue on
23 forward with their support of the Plan in the absence of
24 those releases.

25 MR. JIMENEZ: Thank you.

1 Thank you, Your Honor. Those are all of my
2 questions.

3 THE COURT: Okay. Thank you.

4 Does anyone have any further Redirect for this
5 witness?

6 MS. QUARTAROLO: No Redirect, Your Honor.

7 THE COURT: Okay. Thank you very much for your
8 time. You're officially off the witness chair.

9 THE WITNESS: Thank you. Okay. Thank you.

10 (Witness excused.)

11 THE COURT: All right. Let me just ask before we
12 proceed to argument if anyone else has any evidence they
13 wish to present to the Court?

14 (No audible response)

15 THE COURT: Okay. All right. Mr. Jimenez, I
16 think I -- in listening, I think you answered my question.
17 I had a question about kind of the scope of the objection,
18 but I think you -- I'll just wait and listen. I understand
19 what the argument is.

20 So let me just hear you out, Counsel.

21 MR. GOTT: For the Record again, Jason Gott from
22 Latham & Watkins for the Debtors.

23 So like I noted, we have the one remaining
24 objection from the US Trustee. The Trustee is really
25 focused on third-party releases and the injunction terms in

1 the Plan and so confirmation is unopposed to substantially
2 all of the Debtors cases under Section 1129 of the
3 Bankruptcy Code.

4 So unless Your Honor would like to focus on any
5 specific concerns on any of the various 1129 factors, I'll
6 just keep it focused on what's at issue.

7 THE COURT: Okay. And -- but can you also confirm
8 for me, there were a number of other objections that were --
9 just to kind of take them off the table, my understanding is
10 that those have been resolved through Plan confirmation
11 language and now we're going to argue whether *Container*
12 *Store* continues in this case, right?

13 MR. GOTT: So yes, Your Honor, all of the other
14 objections have been resolved via the inclusion of
15 confirmatory language about opt-out or other solutions baked
16 into our Confirmation Order.

17 THE COURT: Okay.

18 MR. GOTT: Of course, if anybody --

19 THE COURT: Yeah, I just wanted to -- just before
20 we kind of get into it, I just wanted to confirm that there
21 were -- my understanding based on the Agenda is that even
22 all the others have been resolved through confirmation
23 language and a proposed Confirmation Order. If parties
24 could -- no need to confirm it, if that's the case.

25 But if there's anyone who wishes to be heard on

1 any of their resolutions, now would be the perfect time to
2 do so. If not, I will take the signs that the language has
3 been resolved and that there's no outstanding dispute.

4 MR. JIMENEZ: So, Your Honor, Andrew Jimenez for
5 the US Trustee.

6 With respect to our objection, I think I will say
7 we have only two open items. Earlier today the Debtor filed
8 an Amended Plan that cleans up the definition of "exculpated
9 parties."

10 THE COURT: I saw that.

11 MR. JIMENEZ: That was one of our objections.
12 That change addresses our objection as to regards to the
13 definition of exculpated parties.

14 So I think what we're going to be left with is the
15 releases and the opt-out. And the gatekeeping, more
16 specifically that is included in the interim provision.

17 THE COURT: Okay. To make it more in line with --
18 in other words, --

19 MR. JIMENEZ: *Highland II*.

20 THE COURT: -- *Highland II* and then what is the
21 Trustee's position with respect to *Container Store* decision.
22 Is it -- are you still -- in other words, I can tell that
23 you're moving on the subordinated and equity getting no
24 recovery. I picked that part up.

25 MR. JIMENEZ: Yes.

1 THE COURT: So with respect to the injunction, can
2 you -- you don't have to argue that one to me. I understand
3 those points, but you certainly can.

4 And then I'll listen to the Debtors. I just want
5 to make sure I understand the entire scope of the objection
6 now and then with respect to the injunction, the gatekeeper
7 function, has that position changed any? Stays the same in
8 terms of what judicially -- I'm just going to -- want to
9 make sure that I understand exactly what the Trustee is
10 arguing.

11 MR. JIMENEZ: Right. So Your Honor, I think that
12 -- and the way the Plan is drafted here, Your Honor,
13 sometimes you get an injunction provision and you get a
14 separate gatekeeping provision.

15 THE COURT: Uh-huh.

16 MR. JIMENEZ: Here, the gatekeeper provision is
17 written into the injunction provision at section -- or
18 Article 10.5.

19 THE COURT: Okay.

20 MR. JIMENEZ: And I think our objection remains
21 consistent with what we've been arguing before. *Highland II*
22 controls this issue. The gatekeeping provision in this Plan
23 is overly broad because it expands the gatekeeping functions
24 to include those releases.

25 And this is contrary to Fifth Circuit precedent in

1 *Highland II* in which the Court narrowed the definition of
2 the protected parties in the gatekeeping provision to -- and
3 I also want to point out that *Highland II*, we were dealing
4 with a Reorganization Plan. This is a Liquidating Plan, but
5 I'll come back to that later.

6 THE COURT: Uh-huh. Uh-huh.

7 MR. JIMENEZ: But Your Honor, it's just that the
8 gatekeeper provision should be defined so that it
9 (indiscernible) to the definition of the exculpated parties.
10 So gatekeeping provision for the exculpated parties, which
11 under *Highland I* are defined who can be an exculpated party.

12 The problem with this Plan, Your Honor, is that it
13 also includes gatekeeping functions for the releases.

14 And I think the Debtors in the brief that they
15 filed back in Number 1439, the Debtors could -- I think they
16 argue that this Court shouldn't follow *Container Store's*
17 ruling for this particular case, although they ask that the
18 Court follow it in the issue of State law versus Federal
19 law.

20 But I think that *Container Store* is square as it
21 regards the gatekeeping provision with *Highland II*, Your
22 Honor. And the Debtors concede that the Fifth Circuit has
23 never considered gatekeeping functions as to releases, Your
24 Honor. And there's just no precedent to point to that would
25 allow gatekeeping functions to releases, whether they're

1 consensual or non-consensual.

2 Our position, Your Honor, regarding if the
3 releases are consensual or not, remains the same. We think
4 that *Container Store*, that the way it was resolved by the
5 District Court, at least the Court got it wrong. We still
6 stand by our position regarding State law.

7 THE COURT: Uh-huh.

8 MR. JIMENEZ: But the Court is familiar with our
9 argument and that has been briefed, so I'm not going to take
10 more time doing that.

11 And then, Your Honor, I do -- I think it's
12 important to point out that this case deals with a
13 Liquidating Plan, and I want to contrast this with *Container*
14 *Store*, because *Container Store*, we were dealing with a
15 Reorganization Plan.

16 And in *Container Store*, the Court I think made a
17 clear analysis about how in a reorganization, it releases
18 has certain importance and certain value because you have to
19 preserve jobs. You want to have a business that can
20 continue to work and that can continue to provide services
21 or products to their clients.

22 We have none of that here, Your Honor. This is a
23 Liquidating Plan where you don't have that imperative that
24 releases somehow has certain importance for the business to
25 be able to continue. That is not accepting here.

1 In this case, Your Honor, similar to *Container*
2 *Store*, we have two classes that get nothing. That is Class
3 Number 6, which has to (indiscernible) claims and Class
4 Number 8, which includes (indiscernible) equity.

5 Those classes are receiving nothing. And on the
6 analysis of the *Container Store*, consent cannot be inferred
7 from this party set that didn't opt-out because they're
8 getting nothing, Your Honor. And I think that same
9 reasoning should be applied in this case. Those parties are
10 getting nothing.

11 And I need to take this -- I say it's important
12 that we look at it because it's a Liquidating Plan. We need
13 to take a step forward and look at what's happening here
14 with the general unsecured claims.

15 The general secured claims, Your Honor, are
16 getting essentially nothing. Their projections is that they
17 will get .6 percent in the worst scenario and then the best
18 scenario is 4.6 percent out of the -- I think the estimated
19 claims are over \$400 million. So they're all secured
20 claims, Your Honor, are also getting nothing.

21 And I think similarly to the Classes 6 and
22 Classes 8, they should be treated in the same way that they
23 should not be bound to this third-party releases for failure
24 to opt-out, Your Honor, because they are getting nothing.
25 And I think that's an important distinction that we can get

1 from the *Container Store* ruling as -- we look forward as how
2 to deal with third-party releases in this Court, Your Honor.

3 THE COURT: Understood. Thank you.

4 All right. Counsel, would you give me -- what
5 thoughts do you have?

6 MR. GOTT: Thank you, Your Honor.

7 Let's just cut right to each of these points.

8 First, I want to focus on Class 6 and Class 8 that
9 Mr. Jimenez pointed out. That's the subordinated claims in
10 our equity holders.

11 This case is -- I won't say it's entirely unique,
12 but it's different from *Container Store*. It's different
13 from many cases where you have a dispersed shareholder
14 population and relates to shareholders that are, of course,
15 both your equity holders, but also your typical 510(b)
16 claimants if they have some sort of securities based claim.
17 That's the claim that really is getting addressed in a
18 510(b) class, and that's the same case with our Plan here.

19 Here, our equity holders are six. There are six
20 of them. There are four individuals who are the ultimate
21 common equity holders, and there are two preferred equity
22 holders. Every one of them has cut a specific settlement to
23 participate in this Plan on this Plan's term and that's in
24 the Record as Mr. Transier's Declaration. Just by way of
25 example, paragraph 16, you know, he lays out the discussions

1 and the results of those discussions with the equity holders
2 specifically.

3 So this is not a case where we have to -- where we
4 even have to infer consent from the equity holders to these
5 releases because they affirmatively agreed to settlements
6 that contemplate getting these releases and giving these
7 releases.

8 THE COURT: Uh-huh.

9 MR. GOTT: Another one of the topics that
10 Mr. Jimenez raised was that this was a Liquidating Plan,
11 rather than a Reorg Plan and that the releases should be
12 looked at differently.

13 I respectfully disagree with that. In a Reorg,
14 the discharge is what covers that go-forward protection for
15 the Debtor. Here -- and this is one of the arguments raised
16 in the US Trustee's objection, there is no discharge because
17 our Debtors are liquidating.

18 There's also no involuntary release protection for
19 the Debtors because the releases are fully consensual.

20 And so this isn't a question of, you know, do we
21 have to involuntarily build a barrier around the Debtors to
22 protect them for some go-forward purpose. The releases are
23 entirely based on consent and setting aside exculpation,
24 which you heard Mr. Jimenez say there's no issue with our
25 exculpation provision at this point. There's just no

1 non-consensual bar to creditor actions against the Debtors.
2 That's just not in our Plan.

3 So I think that concern is addressed by the text
4 of our Plan. It's --

5 THE COURT: Okay.

6 MR. GOTT: -- fully based on consent.

7 To the point about general unsecured creditors
8 getting nothing, you know, you heard from Mr. Abelson at the
9 outset of the hearing and Mr. Parlen, that's just not the
10 case. In fact, there's been a lot of work put into trying
11 to amalgamate as much of a recovery for unsecured creditors
12 as we can in this case. That work has been pretty
13 successful and we hope that it will actually turn out either
14 more successful than we can predict right now, but there is
15 a lot of work to be done on reconciling claims, liquidating
16 our straggler assets in order to muster as much of a
17 recovery as we can for general unsecured creditors, but I
18 will tell you that without the releases in the Plan, there
19 would definitely be no recovery for general unsecured
20 creditors because we would not have the settlements that we
21 have with our DIP lenders waiving all the extra debt claims
22 that would otherwise be sitting ahead of general unsecured
23 creditors. We would not have settlements with our preferred
24 equity holders and our common equity holders under which
25 they're providing over \$2 million worth of value, close to

1 \$3 million worth of value from those equity holders. That
2 value would not be there.

3 So I just disagree with the notion that, you know,
4 GUCs are getting nothing, we should assume that they -- I
5 guess folks are making a mistake by not opting out of the
6 releases.

7 This Plan is a -- you heard it from Mr. Parlen at
8 the outset of the hearing. This Plan is a good outcome for
9 general unsecured creditors in these circumstances, not in
10 the abstract, of course, but in these circumstances.

11 And then, Your Honor, I do want to touch on
12 *Container Store* and specifically on gatekeeping that we're
13 -- you know, we had some guidance last week from the
14 District Court. Now respectfully, we don't agree with that
15 Court's conclusion and it is, of course, not binding on this
16 Court, but it is -- you know, it's an important decision.

17 THE COURT: It is Judge Rosenthal, right? I've
18 got to think about it, so.

19 MR. GOTT: Yes, absolutely.

20 But we think there are a couple of key
21 distinctions about our Plan here, including the point of --
22 including the fact that our equity holders were all at the
23 table and participated in this, so there's no silent equity
24 holder concern to be worried about.

25 THE COURT: So why does there need to be a release

1 of them in the Plan because they participated? I don't --
2 if they're getting -- what is the Plan giving them that they
3 need a release? I'm just thinking about the *Container Store*
4 analysis. That's the analysis, right? That they're not
5 getting anything. So they may have participated, but
6 they're not getting anything under this Plan.

7 MR. GOTT: Well, they're getting the benefit of
8 the releases --

9 THE COURT: But they're not --

10 MR. GOTT: -- that they would not otherwise have
11 been.

12 THE COURT: -- I know, but that argument could
13 have been raised in *Container Store*, too, right?

14 MR. GOTT: Well, but here we have -- but there
15 are --

16 THE COURT: Anybody could have retained the
17 benefit of a release.

18 MR. GOTT: Sure, but our equity holders are
19 affirmatively contributing cash into this Plan in order to
20 procure the releases.

21 THE COURT: So why isn't it just part of the
22 settlement? Why is it part of the third-party release where
23 somebody had to opt-out?

24 MR. GOTT: Because it -- well, a settlement -- if
25 we -- the predicate of those deals that were cut with each

1 of the equity holders was that they would participate as
2 Released Parties under our Plan on the terms of the Plan as
3 it was contemplated as those deals were cut, which was an
4 opt-out structure.

5 So we don't have an opt-out structure.

6 THE COURT: No, they're participating as holders
7 of debt or holders of equity or both. Which capacity?

8 MR. GOTT: We don't --

9 THE COURT: Anything distinguish between the two?

10 MR. GOTT: Yeah, we're not -- we're not aware of
11 any, yeah, we're not aware of any cross-over like that.

12 THE COURT: Okay.

13 MR. GOTT: So I want to start on *Container Store*
14 by focusing on what does our Plan say about gatekeeping?
15 How is it like the Plan from *Container Store*? How is it
16 different?

17 THE COURT: Okay.

18 MR. GOTT: So the substance of what sorts of
19 claims are covered by the two provisions, very similar when
20 you look at the subject matter of the claims.

21 But to us the more important factor -- or the
22 distinguishing factor is the Who? Who has to abide by the
23 gatekeeping terms?

24 And here, the answer is written in the Plan as
25 only the releasing parties, so those who have not opted out.

1 Article 10.5 of the Plan says -- I'm going to
2 quote that the gatekeeping only applies to claims against
3 Released Parties, quote, "If such person or entity bringing
4 such claim or cause of action is a releasing party," end
5 quote.

6 So by any interpretation, a gatekeeper framework
7 can only apply, it can only be invoked, a party can only be
8 subject to it if the claimant has consented to giving the
9 releases and has consented to the application of the
10 gatekeeping framework.

11 So in other words, if I'm any one of the 250
12 parties that opted out of the releases, I don't even have to
13 think about the gatekeeping provision.

14 Now *Container Store's* provision, on the other
15 hand, applies universally. It says, "No person or entity
16 may commence or pursue a claim or cause of action,"
17 et cetera.

18 And as quoted in the *Container Store* opinion, it
19 does not include that caveat that our Plan has that it
20 simply does not apply if you are not a releasing party.

21 So in *Container Store*, even if a party had opted
22 out of the releases, they would still have to think about
23 the gatekeeper provision. They arguably would still have to
24 get their claim cleared by the Bankruptcy Court.

25 And it's that restraint on the ability to bring a

1 claim that release seems to have motivated the *Container*
2 *Store* court. You can see that toward the end of the opinion
3 where the Court raises First Amendment concerns around
4 interfering with access to the courts.

5 Your Honor, we also think that because of that,
6 because of that inherent connection between consent of the
7 creditors and the structure of our gatekeeper provision, we
8 think that reading the rulings of *Highland* and *Barton* as
9 applying to the framework is just stretching those cases
10 farther than they should be stretched.

11 The facts in both of those cases concerned
12 judicially imposed gatekeeping without consent by the
13 affected claimants.

14 And equating those two things, a consensual
15 framework with a non-consensual framework, is really not
16 compatible with prevailing law. It's not compatible with
17 the conclusion that the *Container Store* opinion reaches that
18 consensual releases are permissible in a way that goes far
19 beyond what's permitted for non-consensual exculpation.

20 Another point to consider, Your Honor, about the
21 *Container Store* opinion is that we don't think that the
22 Court adequately considered the important role of finality
23 for stakeholders that are caught up in a bankruptcy and how
24 that would justify ordering the gatekeeping framework on a
25 consensual basis like we have here.

1 Toward the end of the opinion, the *Container Store*
2 court dismisses the notion that gatekeeping can be approved
3 as tantamount to a consent decree on the grounds that,
4 quote, "The provision does not further the objectives of the
5 Code," end quote.

6 And we disagree with that.

7 Like I noted before, protection from lingering
8 claims and litigation and uncertainty is absolutely vital
9 really to any successful Chapter 11, but it's especially
10 true here.

11 Our settlements, again, each of those settlements
12 that are in the Record -- I'll get the exhibit number so I
13 can reference them.

14 (Pause in the proceedings)

15 MR. GOTT: Our settlements are at Exhibits 11, 12,
16 17, 23, 24, 30, 34, each of those settlements is predicated
17 on the settling party participating as Released Parties in
18 an opt-out structure under the Plan, and getting the benefit
19 of the gatekeeping framework that is tied to that consent
20 from the creditors.

21 And finally, Your Honor, we simply don't see a
22 reason to distinguish between the injunction that says,
23 "Thou shalt not bring a released claim," in the gatekeeping
24 framework that simply requires that a creditor who is going
25 to bring a claim against a party that is a Released Party,

1 has to come clear that claim with the Bankruptcy Court
2 first.

3 THE COURT: Can you walk me through the two prongs
4 that are in the gatekeeping? I just want to make sure that
5 I follow it.

6 So it says no person -- not only applies, I have
7 to determine two things: One, after notice and a hearing,
8 that such claim or cause of action as applicable represents
9 a colorable claim of any kind; and two, specifically that
10 the Bankruptcy Court -- I don't think the clauses work --
11 without the Bankruptcy Court specifically authorizing such
12 person to bring such claim or cause of action -- what is
13 that? What is Prong 2 mean?

14 MR. GOTT: It means --

15 THE COURT: So let's just say somebody brings a
16 lawsuit. Someone brings a claim. Someone brings something
17 to me. How does it -- what do I need to -- just kind of
18 theoretically?

19 MR. GOTT: Yeah. I think it would --

20 THE COURT: Finding. So I need to find that
21 there's a colorable claim and then that you're specifically
22 authorized to bring it.

23 What is that Prong 2 me?

24 MR. GOTT: Fair question.

25 So I don't think Prong 2 is calling for a finding

1 of specific authorization. I think it is a -- rather, what
2 the lead in says is without the Bankruptcy Court first
3 making a finding.

4 THE COURT: Specific --

5 MR. GOTT: And then second, specifically
6 authorizing the action.

7 So in other words, --

8 THE COURT: Don't I need to make a finding to
9 specifically authorize someone?

10 MR. GOTT: No, I think what that is calling for is
11 for the claimant to make a motion for authorization to
12 pursue the claim, and Your Honor would have to, first,
13 determine that the claim is colorable and not released, of
14 course.

15 THE COURT: Uh-huh.

16 MR. GOTT: And then second, grant the Order that
17 specifically authorizes the lawsuit to be filed.

18 So in other words, that is a -- that avoids a
19 backdoor of someone sort of attaching -- and this is by way
20 of example -- attaching new -- say, you have a creditor
21 comes in, gets permission to bring Claim Number 1. They
22 can't attach Claim Number 2 to that over in State Court when
23 they go file that lawsuit because they don't have specific
24 authorization to bring Claim Number 2.

25 They would have to bring that back through the

1 gatekeeper provision, as well.

2 So it's not that you have to find some other
3 source of authorization, if that's what Your Honor is
4 addressing?

5 THE COURT: No, no. I just want to make sure that
6 I'm -- just so that we're all clear about what that would
7 mean --

8 MR. GOTT: Yes.

9 THE COURT: -- if it came back --

10 MR. GOTT: Yes.

11 THE COURT: -- as how parties are construing the
12 language.

13 MR. GOTT: Yes, yeah. It would -- it means a
14 motion in front of the Court for authorization to bring that
15 claim in some other court and really the finding that Your
16 Honor would make is that it's colorable and not released.

17 THE COURT: Okay.

18 Okay. Tell me a little bit more about who the
19 equity holders are.

20 MR. GOTT: Absolutely.

21 THE COURT: I know it's different than a general
22 corporation.

23 MR. GOTT: Yep. So we have a two-tier equity
24 structure. We have --

25 THE COURT: Uh-huh.

1 MR. GOTT: -- preferred equity and common equity
2 ultimately at the very top of our structure.

3 The common equity is all held by a single
4 pass-through LLC that in turn is ultimately owned by four
5 individuals, the four founders of Pine Gate Renewables.

6 THE COURT: Uh-huh.

7 MR. GOTT: Each of those four founders has cut a
8 settlement with the estates with the support of the
9 Creditors Committee to pay roughly \$500,000 on promissory
10 notes that are owed to the company, but that are not due
11 until 2029 and 2030, so they're accelerating the payment
12 down on those notes. That's their settlement contribution
13 into this case, and again, that was -- specifically, in
14 fact, the words in the Plan say that specifically they are
15 not releasing parties unless and until they make those
16 payments.

17 That's the common equity. That's all the common
18 equity as is relevant here.

19 The preferred equity, while they are -- I want to
20 say there are three different entities that own the
21 preferred equity. It's two funds. It's Generate Capital
22 and it's Hoop (phonetic). So those two preferred equity
23 holders have been sitting on the board through this whole
24 process, they've been directly and actively involved in
25 steering this restructuring from day one, and likewise, each

1 of them has specifically cut a settlement under which they
2 will pay cash into the estates at the effective date --

3 THE COURT: Uh-huh.

4 MR. GOTT: -- in exchange for being Released
5 Parties under the Plan.

6 THE COURT: Okay.

7 MR. GOTT: And that's all of the equity, Your
8 Honor.

9 THE COURT: Okay. Mr. Jimenez, is there anything
10 else you wish to tell me?

11 MR. JIMENEZ: Yes, Your Honor, very briefly.

12 Following on this point of the gatekeeping
13 provision, Your Honor, I think that in *Container Store* the
14 Court pointed out that Fifth Circuit neither held nor
15 implied that consensual third-party releases could allow a
16 Bankruptcy Court to authorize gatekeeping provisions beyond
17 the bounds of the Barton Doctrine under Section 105.

18 And I think that there's basically a distinction
19 to be made between the exculpated parties and the Released
20 Parties and why the gatekeeping should be permitted only to
21 those exculpated parties, and I think the Fifth Circuit
22 precedent is very clear on that, and the Debtors have not
23 been able to point out to any legal precedent to justify
24 this gatekeeping function as it relates to the releases.

25 Also, Your Honor, I think to the point that we

1 have a small number of equity holders, I think the fact that
2 it's a small number, if they are onboard with this, if they
3 reach settlements and they are fine with the releases, why
4 not opt-out? If they are participating in the negotiations,
5 and the Debtor is asking the Court to read -- that there is
6 a consensus for those releases when you have clear classes
7 that are getting nothing and close to nothing.

8 And I want to make the distinction, Your Honor,
9 that I think *Container Store* tells us -- I think it's clear
10 it's telling us that when you're getting -- when claims are
11 running through and you're getting paid in full, that can be
12 interpreted as having consent. When you're getting nothing,
13 that also is clear that you are not giving consent when
14 you're getting nothing because you have no incentive to
15 return an opt-out ballot.

16 So there's a line, I guess that needs to be drawn
17 as to what you do between those two extremes, and I submit
18 to the Court that that line cannot be drawn in this case at
19 half a percentage or 4.5 percent as that is what is
20 projected here, Your Honor. That's still close to nothing,
21 another thing we can do here that zero secured claimants are
22 getting something and therefore, they're consent can be
23 implied because they're getting something under the Plan.
24 They really are getting nothing under this Plan and that is
25 an important distinction to make in this case.

1 THE COURT: Okay. Counsel, anything else?

2 MR. GOTT: No, not on the topic of gatekeeping.

3 THE COURT: Okay. Let me just ask: Does anyone
4 else wish to be heard in connection with Plan Confirmation?

5 MS. LERMAN: Your Honor?

6 THE COURT: Yes.

7 MS. LERMAN: Good afternoon, again. This is Leah
8 Lerman on behalf of the United States of America.

9 Your Honor, I just want to place on the Record
10 that our objection is resolved, but I would appreciate
11 seeing Confirmation Order, any further changes are made
12 prior to its submission for signature.

13 THE COURT: Thank you.

14 And just so I'm clear, I think there was something
15 filed on the Docket. Have you seen that language, Counsel?

16 MS. LERMAN: I have seen that redline, Your Honor.

17 THE COURT: You're saying if there's something
18 else that gets -- any other changes or anything, that you
19 want to be able to see it?

20 MS. LERMAN: Yes, Your Honor.

21 THE COURT: Yep. That makes sense to me.

22 MS. LERMAN: Thank you.

23 MR. JIMENEZ: Your Honor, if I may? One last
24 observation that I want to share with the Court.

25 THE COURT: Okay.

1 MR. JIMENEZ: The Plan that was -- the Amended
2 Plan that was filed a few hours ago, I noticed that two new
3 parties were included in the definition of Released Parties.
4 And those parties were not included in the definition when
5 ballots first went out, when the solicitation materials were
6 sent out. And I think --

7 THE COURT: And who are --

8 MR. JIMENEZ: -- I can --

9 THE COURT: -- which parties are your -- tell me
10 where you're looking. I just want to --

11 MR. JIMENEZ: I think they're referred to as the
12 Hoop (phonetic) settlement of parties and Generate
13 settlement.

14 THE COURT: You're looking at the -- I'm just
15 saying, you're looking at the redline?

16 MR. JIMENEZ: Yes, Your Honor.

17 THE COURT: Okay.

18 MR. JIMENEZ: Let me locate that page for you.

19 (Pause in the proceedings)

20 THE COURT: Oh, you're looking at Released Parties
21 at 1.214, the definition?

22 MR. JIMENEZ: Uh-huh.

23 THE COURT: Okay.

24 MR. JIMENEZ: And then -- and then -- page -- I'm
25 looking at the redline, 146-1, page 48 -- then at page 48

1 then two paragraphs were added to extend settlements that
2 were reached with Hoop and Generate.

3 THE COURT: You said the -- oh, yes. Got it.
4 I'll give you a chance.

5 MR. JIMENEZ: And Your Honor, and I anticipate
6 that the Debtors are going to say this settlement will bring
7 you more money, this is not a material change because more
8 money is coming in.

9 But Your Honor, I think that this adds to the
10 concern with the crosses because if you're giving third-
11 party releases, people should know who are the parties that
12 are getting it. This was done after the solicitation was
13 sent out, so parties who received the solicitation materials
14 really have no knowledge of this, unless they are
15 participating at the hearing today or they're looking at the
16 Docket and reviewing what was filed by the Debtor.

17 My observation, Your Honor, is that there should
18 be a better approach than to do this. I understand they're
19 trying to get more settlements and more money, but this has
20 an impact, Your Honor, especially when we're discussing
21 whether parties are affected by third-party releases are
22 receiving the full information of the extent and scope of
23 these releases.

24 And you know, I'd just ask the Court to consider
25 that at this point. It's certainly not our -- the focus of

1 our objection, Your Honor; this just happened. But I think
2 it's important to point it out to the Court.

3 THE COURT: Thank you.

4 Counsel?

5 MR. GOTT: Yeah, Your Honor. Those are clarifying
6 changes. Those are just identifying folks that were already
7 covered by the categorical descriptions of the Released
8 Parties.

9 THE COURT: Uh-huh.

10 MR. GOTT: Again, Hoop and Generate are
11 shareholders, current and former directors of the Debtors
12 appointed by Hoop and Generate. That's just directors and
13 managers that were already covered by the language. This is
14 clarifying, you know, so that there is -- frankly, I think
15 it -- I think it ought to be viewed as beneficial that these
16 parties are specifically identified, rather than merely
17 falling within the categorical descriptions of the
18 definition.

19 THE COURT: I'll take a look.

20 (Pause in proceedings)

21 THE COURT: So where's the original version, the
22 prior version? Where can I find that?

23 MR. GOTT: The prior version of the Plan, before
24 these changes?

25 THE COURT: Uh-huh.

1 (Participants confer)

2 UNIDENTIFIED: It's Docket 1173.

3 THE COURT: Can you say that --

4 UNIDENTIFIED: Docket 1173, one one seven three.

5 THE COURT: 1173?

6 UNIDENTIFIED: Correct.

7 THE COURT: Okay.

8 MR. GOTT: And Your Honor, to tick and tie the
9 concepts together, directors, managers, equity holders,
10 members, interest holders.

11 THE COURT: Uh-huh.

12 MR. GOTT: In fact, the language has:

13 "-- including preferred equity holders" --

14 THE COURT: I'm just looking --

15 MR. GOTT: -- "and regardless of whether such
16 interests are held directly or indirectly."

17 Those are all Related Parties.

18 THE COURT: Released parties, ah, yes.

19 MR. GOTT: Capital R, capital P. And each of the
20 Related Parties would be a Released Party.

21 (Pause in proceedings)

22 THE COURT: Okay. I haven't had a chance to study
23 this new Plan, the changes to it. I'm sure it's fine, but I
24 want to think about it, in light of the arguments and in
25 light of recent decisions that were made.

1 I'd note all other aspects of Plan Confirmation
2 are satisfied, all the 1129 factors are approved and
3 satisfied. 1123 is satisfied, 1122 is satisfied. Every
4 applicable provision of 1129 is satisfied.

5 The concept of the opt-out is approved by this
6 Court for all the reasons that I've stated before. It was
7 recently confirmed on a number of matters, in Judge
8 Rosenthal's very thoughtful decision in *Container Store*.

9 So this Plan should be confirmed. And I don't
10 want to make light of the amount of incredible work that
11 went into this case, three DIPs in one motion, a really
12 complicated case. The Committee has worked, and the Debtors
13 and their professionals. It's really a testament to
14 incredible efforts that were here, and I don't want to make
15 light of any of that. That is unquestioned.

16 The number of parties that have resolved their
17 objections here is a testament to where we are in the
18 settlements. I'm approving every one of the settlements
19 that contained herein.

20 I need to give a little thought about, really,
21 Class 6 and 8 and the scope of the gatekeeper provision in
22 this case.

23 I've got a hearing at 2:30 and I don't want to
24 rush it. Is there -- but I don't think it will take me
25 long. Can the parties come back at 5:00 and I'll just give

1 you the answer about all of that? And I'm not --

2 MR. GOTT: Oh, I'm sorry.

3 THE COURT: I'm not readdressing anything else,
4 other than Classes 6 and 8, whether they're considered
5 Released Parties, and the scope of the injunction under the
6 Plan. Everything else is approved, everything else is
7 confirmed.

8 And I do -- I've had an opportunity to review at
9 least the proposed form of the Confirmation Order. I don't
10 necessarily have an issue with these two parties being
11 included; specifically identified because they are kind of
12 within the definitions, so now they're specifically
13 identified. If they weren't, I'd have an issue with it, but
14 they were.

15 But the question still then changed the analysis
16 of 6 and 8 and the scope of the gatekeeper, and I think I
17 need to really give this a little bit of thought. I think
18 -- I'm pretty confident I can get you an answer by
19 5:00 p.m., and tell you exactly what my answer is on these
20 issues, but I want to take a little bit of time and just
21 think about them.

22 I've been thinking about it. But now that the
23 issue has been fleshed out a little bit more, I mean, I
24 still think we're all thinking a little bit more and more
25 about the *Container Store* and the effects of it.

1 I am -- maybe it just makes sense for me to just
2 stop right there and then just came back and the parties can
3 -- you're more than free to dial in, you don't need to come
4 in, if you want to, but you can if not. I'm just going to
5 step off, come back, and I'll conclude the ruling.

6 But for all purposes -- and I got it -- the Debtor
7 wants to hear everything. But what I'm saying is I'm not
8 taking up any other aspect of Plan -- the Plan is confirmed,
9 every other applicable section of the Code, every proposed
10 light term in the Confirmation Order, the proposed language
11 and every -- resolving everyone's objections in the
12 Confirmation Order are approved by me.

13 This is really coming down to this issue, and I
14 just want to make sure that I'm thinking through this
15 carefully and that I can give a thoughtful answer to the
16 U.S. Trustee's objection and the responses to the objection.
17 So, if you give me until 5:00 p.m., I'll give you an answer.
18 All right?

19 Thank you very much. We're adjourned.

20 MR. GOTT: Of course. Your Honor, if --

21 THE COURT: Yep.

22 MR. JIMENEZ: Thank you, Your Honor.

23 MR. GOTT: -- will we be able to take five minutes
24 to handle the second matter on the Agenda --

25 THE COURT: Yes.

1 MR. GOTT: -- very quickly?

2 THE COURT: Yes. Yes, yes.

3 MR. GOTT: I apologize.

4 THE COURT: We -- let's do that. No, let's do
5 that. When you said "non-complicated," I said that doesn't
6 exist in Pine Gate, but ...

7 (Laughter)

8 MR. GOTT: Yeah. This one is straightforward, and
9 it's much akin to a similar project-specific financing
10 motion we filed --

11 THE COURT: Oh, I did see that, yeah.

12 MR. GOTT: -- a couple of months ago.

13 Yeah, so, this is at Docket Number 1403, with the
14 revised form of interim order that we filed yesterday at
15 Docket 1451.

16 THE COURT: Yeah.

17 MR. GOTT: Submitted a Declaration in support from
18 Mr. Rajcevich that was on our Exhibit List, and would
19 request that be admitted into evidence to support this
20 motion.

21 THE COURT: It's admitted.

22 (Rajcevich Declaration received in evidence)

23 MR. GOTT: The motion was filed on an emergency
24 basis, so I'll just quickly lay out what's going on. If
25 anyone has any objections to raise, we can hear them.

1 The motion is a piece of the deal that we've
2 reached with the construction lender for the West River
3 Project called "Pathward." That deal is otherwise baked
4 into the Plan and the Plan supplements. And the Debtors are
5 going to transfer ownership of this project into a trust.
6 The trust -- the primary beneficiary of the trust will be
7 Pathward.

8 But to cover the costs of the Chapter 11 process
9 and of arranging this sort of orderly handover to the trust,
10 Pathward has agreed to fund \$500,000 of incremental loans to
11 the Debtors' estates. Half of that is intended to be lent
12 now; the other half is intended to be lent at the time Plan
13 goes effective. The interim order would approve all of that
14 borrowing to occur, given that we expect the effective date
15 to occur in the near term.

16 There's no extra strings or terms tied to the
17 incremental funding. There's no cross-collateralization or
18 priming of other liens. This is just an extension of the
19 existing construction facility. And so we submit it's a
20 sound exercise of business judgment and would request entry
21 of the interim order as proposed at 1415.

22 THE COURT: And when were you all contemplating
23 coming back for a final hearing?

24 MR. GOTT: At this -- in order to let the full
25 notice period run, it would likely be after the effective

1 date. So, you know, we can reach out to set a hearing --

2 THE COURT: Well --

3 MR. GOTT: -- if there --

4 THE COURT: -- I've got --

5 MR. GOTT: -- are any --

6 THE COURT: -- to put --

7 MR. GOTT: -- objections --

8 THE COURT: -- one in --

9 MR. GOTT: -- raised.

10 THE COURT: -- the order. That's the --

11 MR. GOTT: What's that?

12 THE COURT: I've got to put one in the Order.

13 MR. GOTT: Oh, we can take it up any time. We
14 filed it on the 12th of February, 21 days, we can take it up
15 any time, you know, the third week of March or later. And
16 we're fine pushing it out that far because we think it's
17 pretty straightforward.

18 THE COURT: Okay. Anyone wish to be heard?

19 (No verbal response)

20 THE COURT: For all the reasons that you -- oh,
21 Ms. O'Neil.

22 MS. O'NEIL: Thank you, Your Honor. Holly O'Neil
23 on behalf of Pathward. We are the proposed lender.

24 This was part and parcel to the terms we also
25 negotiated in relation to the Plan, so we would ask the

1 Court -- we think it's important to ask the Court to approve
2 it on an interim basis.

3 We can be flexible, obviously, with Counsel, in
4 terms of funding, even pending a final hearing. We also
5 have -- this has been vetted with -- I think with the key
6 constituencies, so I don't think that we have any
7 significant pushback from anybody in this regard.

8 Additionally, Your Honor, on a side note, I do
9 have a 5:00 o'clock flight. I won't even be able to dial
10 in, but I'm going to have one of my colleagues dial in. And
11 I just wanted to apologize to the Court.

12 THE COURT: No.

13 MS. O'NEIL: Under the circumstances --

14 THE COURT: No need to apologize. All right.
15 Thank you.

16 MS. O'NEIL: Thank you, Your Honor.

17 THE COURT: So I'm going to approve the interim
18 financing. I think it makes perfect sense. The terms of
19 the financing are reasonable and this is a sound exercise of
20 the Debtors' business judgment. Emergency consideration is
21 warranted. No one is being primed. And this is just a
22 really smart move by the Debtors. And I appreciate the
23 lenders working with the Debtors.

24 I'm going to set this for final hearing on
25 March 12th at 9:00 a.m., set an objection deadline of

1 March 5th at 5:00 p.m. And I'll get this signed and it will
2 hit the Docket shortly.

3 MR. GOTT: Thank you, Your Honor.

4 THE COURT: All right?

5 MR. GOTT: And that does conclude, for now, for
6 today.

7 THE COURT: Yep. Okay. Thank you very much.

8 I'll get this -- I'll get this one on the Docket
9 today, and I'll come back at 2:30. Thank you.

10 MR. GOTT: Thank you.

11 COURT SECURITY OFFICER: All rise.

12 (Recess taken from 2:13 p.m. to 5:01 p.m.)

13 THE COURT: Good afternoon. This is Judge Lopez
14 in a continuation of the *TPI* -- let's see. We are here in
15 court -- there was somebody here for *TPI Composites*; and, if
16 you are, I was told the Court is going to enter those
17 orders.

18 I'm now going to kind of recall a confirmation
19 hearing in Pine Gate, so this hearing is only going to be
20 about Pine Gate Renewables.

21 If you're here for any *TPI Composites* matters, the
22 Court has already ruled on those issues and will issue an
23 order on those. If you are here for Pine Gate, you are in
24 the right place.

25 So this is Case Number 25-90669. That is what the

1 Court is taking up, considered and approved Plan
2 Confirmation, subject to the Court reserving rights on two
3 discrete issues:

4 One was the scope of the third-party releases;
5 And two, what I call the "gatekeeper function,"
6 and it was also here.

7 So the Court took the matters under advisement.
8 The reason, in large part, is that, just a few short days
9 ago, on February 12th, a District Court for the Southern
10 District of Texas issued a decision relating to consensual
11 third-party releases and the scope of opt-in and opt-outs --
12 I should say within the scope of opt-outs and gatekeeper
13 provisions in the *Container Store* case.

14 And that was in -- it was on appeal in the
15 District Court. This case is 25-CV-00618. It's
16 Document 34, it was issued on February 12th.

17 And the Court wanted an opportunity to review the
18 revised Plan and to consider the *Container Store* decision.
19 I've read it, heard the arguments, wanted to think about the
20 arguments a little bit more, and here we are.

21 So I'd note at issue here, primarily, I'll take up
22 first, is what to do with two classes: One is a class of
23 subordinated claims and one is a class of equity. Both
24 classes have received nothing under the Plan and, therefore,
25 were deemed to reject the Plan.

1 Both classes' claimants still received an opt-out
2 form, and the Debtors believe and contend that -- kind of
3 argue, I guess, two points:

4 That one is that the *Container Store* decision is
5 not binding on this Court;

6 And two, I think more importantly, they think that
7 the facts are distinguishable.

8 The Office of the United States Trustee notes
9 that, in the *Container Store* decision, Judge Rosenthal, you
10 know, essentially saw that there were two classes under
11 there, and they were equity, and the subordinated class were
12 receiving nothing under the Plan, and if -- did not permit
13 the opt-out for these two classes, so -- and found -- so
14 they were -- those two classes were not bound by the
15 releases.

16 I think it's important to note, with respect to
17 the subordinated class, they are very similar to what Judge
18 Rosenthal was describing in the *Container Store*. They're
19 receiving nothing. And in addition to losing -- receiving
20 nothing under the Plan, would be giving up more by releasing
21 claims under that Plan. And therefore, I'm not going to --
22 I'm going to find that the opt-out does not apply to the
23 subordinated class.

24 I'm -- I take Judge Rosenthal's words very
25 seriously, and I'm going to adopt her reasoning for the

1 reason for the opt-outs and whether approved in this case.
2 I find that the -- not mentioned, but I would note that
3 these opt-outs were provided under separate notice, they
4 were conspicuous, they describe the scope of the releases.
5 So I'm going to find every other class is bound by them.
6 They were necessary, there's findings that they were
7 necessary to Plan Confirmation.

8 I would note this -- it's in the Record, in the
9 Declarations. But this case is largely the result of a
10 Herculean effort between the Debtors and their professionals
11 and Committee and its professionals and the lenders to reach
12 a deal in which unsecured creditors receive anything.

13 But the findings are what they are and they're not
14 -- they were -- the U.S. Trustee questioned and examined the
15 witness. I thought he was credible, answered all the
16 questions. These releases are there and they're fine.

17 But as to the class that did not have an
18 opportunity to receive anything under the Plan as a matter
19 -- based on the Plan, I'm going to find that the opt-outs
20 was not enough to bind them to the consensual third-party
21 releases.

22 So turning now to the equity. And equity is in a
23 little bit of a different position than the equity was in
24 the *Container Store*. Based upon what was told to the Court,
25 there are equity holders -- and there's just a few of them,

1 I believe the number was about four or five that are --
2 would be considered Released Parties as part of a settlement
3 under the Plan and assume that they provided \$500,000, that
4 they would considered Released Parties and also receive --
5 be part of the consensual third-party releases.

6 The U.S. Trustee notes, and is correct, that they
7 are not receiving anything under the Plan, as well. The
8 Debtor tells me that they want to be part of the third-party
9 releases, and that they want to be considered part of the
10 group here. I just don't have any evidence that that's the
11 case.

12 I think, if somebody wants to fully consensually
13 be part of a third-party release and be a Released Party, I
14 just have enough evidence in the Record before me to justify
15 that. So, as of right now, they're not bound. They're not
16 giving up any releases and they're not going to receive the
17 benefit, they are not going to be considered Released
18 Parties.

19 But what I'm going to do is hold it up for -- hey,
20 this decision just came out within the week ago, and I -- so
21 I'm going to confirm the Plan, but I'm going to give -- if
22 these equity holders -- and they may be represented by
23 Counsel, I believe they -- I remember I was informed that
24 they were. But I don't have any evidence in the Record to
25 go by that, but there was a representation that they were

1 represented. I'll give them a week, seven days.
2 February 25th, they can file something on the record and
3 indicate that they wanted to be a part of these consensual
4 third-party releases. And if that is the case, then it's
5 consensual, on both sides, and we're not relying on the opt-
6 out. They're essentially confirming that they wanted to be
7 a part of it, and that they were aware.

8 Now maybe they say that they were aware of the
9 opt-out and didn't opt out of the releases, so they could be
10 a part of them. But I just think the *Container Store*
11 decision makes one think a little bit more about it.

12 And so, if this was a big case -- well, this is a
13 big case. But if there were like, you know, a large number
14 of equity holders, I wouldn't do that. But what I'm told is
15 that there's a small, defined subset of them. And if they
16 want it, I mean, I'll give them a week to do so. And if
17 they -- within the week, by February 25th, if the answer is
18 there are three of them or four of them or all of them
19 agreed to be part of the releases, and there -- I've got
20 something on the Record, okay. But if not, I'm not going to
21 -- they're not going to be subject to the third-party
22 releases and won't be considered, not be bound by the third-
23 party releases.

24 So that's going to be the ruling on that. So
25 subordinated, no equity parties, which I'm told is a defined

1 group. They can identify themselves and, you know, a
2 pleading under penalty of perjury from Counsel, a
3 Declaration from Counsel, is fine with me on that
4 representation, if they're representing; if not, an
5 authorized representative can identify themselves as one of
6 the equity holders.

7 The original Plan did contemplate consensual
8 releases and including equity. So I've got no issues that
9 they were defined a little bit more specifically in the Plan
10 because they were defined in the original Plan, and there's
11 an Amended Plan on file that further kind of gives them a
12 name. I've got no issues with that.

13 I don't think they're -- we're not adding anyone.
14 We're just clarifying who these parties may be. If they
15 were added at the last minute, I do agree with the Office of
16 the United States Trustee; if there was a party that was not
17 contemplated in the original ones that are solicited and
18 were -- someone was trying to add them on the back end, I
19 wouldn't permit it, but I -- that's not what's happening
20 here.

21 So, long story short, subordinated, not bound,
22 equity has a week.

23 With respect to the gatekeeper provision, that
24 matter was remanded in the *Container Store* decision, as to
25 whether the scope of the gatekeeping provision was remanded

1 back to Judge Perez for additional briefing on this issue,
2 to determine -- to limit the gatekeeping provision within
3 the scope of *Highland II*, which, in turn, she said turns --
4 limits the provision to the Barton Doctrine.

5 And because the parties did not brief the issue,
6 the District Court remanded it and the Bankruptcy Court
7 must, in the first instance, determine who may, consistent
8 with *Highland II* and the Barton Doctrine, be included in the
9 gatekeeping provision. Again, this was just issued about a
10 week ago, so I think Judge Perez is scheduling briefing on
11 that issue, but that issue has not been decided in the
12 *Container Store*.

13 I've read the proposed injunction in this case,
14 and I'm going to make two comments on it:

15 One is, at this time, what I am comfortable doing
16 is limiting the gatekeeping injunction, reading *Container*
17 *Store* in the most conservative way; if not, I would need to
18 brief it to give myself -- but I know exculpated parties
19 works here, and that's what I'm going to limit the
20 gatekeeping provision to, exculpated parties, in connection
21 with this case. If parties want to -- I'm not going to --
22 I'm going to limit it. That is -- that, I know, is
23 consistent with *Container Store* and can allow for
24 confirmation now, as well.

25 Now what does that really, in effect mean? Is

1 that party -- someone may go file something somewhere, and
2 someone would file something for me to determine. I still
3 think I can have -- within the scope of a Confirmation Order
4 determine whether something falls within a released claim, I
5 can construe the Confirmation Order and enforce the
6 Confirmation Order. It just won't be in the first instance,
7 but as to exculpated parties, it will.

8 I reserve the right to think about this a little
9 bit more, but that's what I'm going to do in this instance.
10 It's what I would consider the most conservative reading of
11 *Container Store*, and I feel that's why I'm comfortable doing
12 it today.

13 I'm going to also --

14 (Pause in proceedings)

15 THE COURT: Yeah, I'm okay. Let's just keep it
16 there.

17 I'm just telling everyone that, with respect to
18 the gatekeeping for exculpated parties, I'm still holding
19 hard and fast to my ruling that, you know, I'm not taking up
20 the merits of any claim or cause of action. I can determine
21 whether, on the face of such a claim, you, it's a released
22 claim. But I'm not going to take up like the merits,
23 whether it's a meritorious claim or not. If it falls within
24 the scope of the releases, that's one thing. It's really
25 not for me to take up.

1 And so there's a provision in here that says that
2 I reserve jurisdiction to adjudicate any such claim to the
3 maximum extent provided by law. I'm just telling you I am
4 not taking up the merits of a claim. I'm going to make a
5 determination as to whether something is released or not,
6 and I think that's within the scope of my post-confirmation
7 jurisdiction, consistent with Fifth Circuit case law. But
8 I'm not adjudicating the merits of a released claim.

9 But if it's -- I should say, but if it's a
10 released claim, then -- right? That's just the answer. But
11 if it's not a released claim, I'm not taking up the merits
12 of anything. That will be adjudicated somewhere, but it
13 won't be before me.

14 That's my ruling. I think it's consistent with
15 *Container Store*, consistent with Fifth Circuit case law.

16 I'll give parties a week. I'm really -- I think
17 it's just fair to do so. And I think the decision just came
18 out a week ago, and things were solicited. And I don't know
19 why parties elected to or not elected to do something. But
20 I do agree deemed rejected classes, you're going to have --
21 it's just going to have to put something more in there. If
22 not, I think *Container Store* speaks to the answer and I'm
23 going to enforce it as such.

24 I think the general unsecured claims class, as I
25 read, will be bound by the consensual third-party releases

1 there. I find they're consistent with the holding in
2 *Container Store*, as well. Again, that's where I'm
3 comfortable today.

4 Mr. Parlen, I think, if you want to -- I don't
5 know how to get notice to the equity folks, but if -- I'll
6 just -- you know, let them know or their Counsel know what I
7 said today. It will be available and they've got a week, if
8 not, February 25th.

9 And if somebody wants to get an order out to me
10 that is consistent with that ruling --

11 UNIDENTIFIED: You're off --

12 THE COURT: -- I'm happy to --

13 UNIDENTIFIED: -- the Record, Your Honor.

14 THE COURT: -- to sign it.

15 And I know that there may be some folks -- and I
16 know the United States of America asked for a -- have to see
17 any revised order, and I know that that can get circulated.
18 I'm around tomorrow and tonight. Just, whenever you feel
19 that it's comfortable, upload an order with a redline and
20 I'll get it signed and get it on the Docket.

21 I don't know if anyone has any questions for me.
22 Hit 5* and I will unmute your like.

23 MR. GOTT: Your Honor?

24 THE COURT: Yes.

25 MR. GOTT: Can you hear me okay?

1 THE COURT: Just fine.

2 MR. GOTT: Your Honor, this is Jason Gott from
3 Latham & Watkins. I'm sorry. My video is not
4 functioning --

5 THE COURT: Oh, it's --

6 MR. GOTT: -- for me --

7 THE COURT: That's quite --

8 MR. GOTT: -- unfortunately.

9 THE COURT: -- okay.

10 MR. GOTT: So I think we -- I -- we certainly hear
11 you ruling loud and clear. We will work with the parties to
12 digest it and hopefully just, you know, work out some
13 revisions to the Confirmation Order to take it all into
14 account, if everyone is on board with it.

15 We wanted to propose that, as to, you know, sort
16 of affirming the consent of the equity class to being bound
17 by the third-party releases, the simplest way to do that
18 might just be for us to get permission to make a reference
19 to that effect in the Confirmation Order itself, if that's
20 acceptable to Your Honor. Your Honor, we can get that done
21 pretty quickly --

22 THE COURT: What do you --

23 MR. GOTT: -- because we are --

24 THE COURT: What are you --

25 MR. GOTT: -- you know, like we said earlier,

1 we're in very close contact with all of them.

2 THE COURT: Tell me what you mean by that, just so
3 we're all clear.

4 MR. GOTT: Sure. Yeah, it would just be a
5 provision that we would add to the Confirmation Order saying
6 that, you know, by affirmative consent of -- you know, and
7 then we list out each of the parties that has agreed to be
8 bound, we would just list them out and identify them in the
9 Confirmation Order and designate them as releasing parties.

10 THE COURT: I -- in other words, you're going to
11 put something in the Confirmation Order saying that, by
12 February 25, if affirmative consent is provided on the
13 Docket, then they are bound by it, and so it's just kind of
14 self-effectuating?

15 MR. GOTT: Well, actually, Your Honor, I think we
16 -- I think, even just tonight or by tomorrow, we'd be able
17 to get their consent --

18 THE COURT: Uh-huh.

19 MR. GOTT: -- to just state in the Confirmation
20 Order --

21 THE COURT: Yeah.

22 MR. GOTT: -- that they have -- they have
23 confirmed, they have assented, and they are releasing
24 parties.

25 THE COURT: Okay.

1 MR. GOTT: So, rather than (indiscernible) of them
2 having --

3 THE COURT: Oh --

4 MR. GOTT: -- to file --

5 THE COURT: -- yeah.

6 MR. GOTT: -- something --

7 THE COURT: But --

8 MR. GOTT: -- on the --

9 THE COURT: I've got no --

10 MR. GOTT: -- Docket (indiscernible).

11 THE COURT: I've got -- I mean, if that can be
12 done, that's fine. I just didn't want to -- you know, I
13 didn't know what it was going to take and parties to talk.

14 And if the parties who you are describing provide
15 something and it's on the Docket, and then there's an order
16 that submits -- that references it, I mean, that six of one,
17 half dozen of the other to me. That works for me.

18 MR. GOTT: Okay. Okay. Thank you, Your Honor.

19 THE COURT: Alrighty.

20 Mr. Jimenez, I think I may have -- I've unmuted a
21 202, and then there was another line that I unmuted.

22 Mr. Jimenez?

23 MR. JIMENEZ: Thank you, Your Honor. Andrew
24 Jimenez for the United States Trustee.

25 So, Your Honor, my only comment is that you had

1 expressed earlier the concern that there was no evidence in
2 the Record about the consent of these equity holders, and I
3 think that's why you're -- you were proposing that they file
4 something with the Court. It's important because that
5 provides the evidentiary record. If something is just
6 tweaked in the order, we still are not going to have the
7 evidentiary record, Your Honor.

8 THE COURT: My understanding --

9 MR. JIMENEZ: And that's what concerns me.

10 THE COURT: No, no. My understanding is that I --
11 the order -- I'm just thinking this out loud with everyone.
12 If the affirmative consent is provided on the Docket, and
13 then I sign the order later, then I think it works. In
14 other words, there's something on the Docket that confirms
15 it, and then you got it there.

16 If not, then the order is going to have to say, by
17 February 25th, these parties have until February twenty --
18 in other words, that there's going to have to be language
19 that, in one way, gives them the week, or they're not bound,
20 unless there's, you know, something on the Docket, or you
21 get it on the Docket and then I sign the order. But if I'm
22 signing -- in other words, that there's got to be -- the
23 language just has to work consistent with the ruling.

24 But I understand what you mean, Mr. Jimenez.

25 There's someone else's line I have unmuted and --

1 Ms. Jones, it may be you.

2 MS. JONES: Yes. Good evening, Your Honor. Can
3 you hear me okay?

4 THE COURT: Just fine.

5 MS. JONES: Great. Thank you. Your Honor,
6 Elizabeth Jones of Kirkland & Ellis on behalf of the
7 Generate Parties.

8 I just wanted to clarify and make sure. So your
9 request for us is just to file something on the Docket
10 saying, pursuant to the settlement, Generate intended to
11 both be a released and a releasing party.

12 THE COURT: I think that would get me comfortable,
13 yeah.

14 MS. JONES: Okay.

15 THE COURT: Just something on the Docket from you
16 and just -- and identifying, you know, the names, the
17 specific entities --

18 MS. JONES: Yes.

19 THE COURT: -- by -- just so it's --

20 MS. JONES: Yeah, we --

21 THE COURT: -- really clear --

22 MS. JONES: -- have that --

23 THE COURT: -- on the Docket --

24 MS. JONES: -- in the --

25 THE COURT: -- so that somebody can then look on

1 the Docket and say yes, these entities -- and you can -- you
2 know, Ms. Jones filed something on the Docket and identified
3 these five entities, and they wanted to be bound, and so we
4 can all look to exactly who they are and there's something
5 on the Docket.

6 MS. JONES: Okay. So similar, Your Honor, to
7 Docket 1377, the notices, the settlement, we would then just
8 reference those exact same parties in an additional filing?

9 THE COURT: That would make sense to me.

10 MS. JONES: Okay.

11 THE COURT: Yeah. But just --

12 MS. JONES: Just wanted to --

13 THE COURT: -- have the --

14 MS. JONES: -- we had --

15 THE COURT: -- magic language about Released
16 Parties, releasing parties and -- under the plan kind of in
17 there.

18 MS. JONES: Okay. Understood.

19 THE COURT: All right. Let me take a look at
20 1377, just to make sure that I don't have any -- oh, yes.
21 That was the notice and agreement, right? That you filed?

22 MS. JONES: Yeah. Yes.

23 THE COURT: Yes, that's exactly right.

24 MS. JONES: Okay.

25 THE COURT: Okay.

1 MS. JONES: Just to reiterate that, now, our
2 intent is to remain bound by the Plan, as is, as a Released
3 Party and releasing parties.

4 THE COURT: Uh-huh. Uh-huh. And -- yep. So that
5 way, if someone comes later and says, I -- you know, I
6 wasn't supposed to be bound by it, there's something on it
7 that works both ways, you know, that they've agreed to be
8 bound and that they are bound by it, as well, and we can all
9 look to something affirmative, one way or the other.

10 MS. JONES: Okay.

11 THE COURT: That gets me comfortable.

12 MS. JONES: Okay.

13 THE COURT: Is there anything else?

14 MS. JONES: Yes, sir. Thank you, Your Honor.

15 THE COURT: Okay. All right, folks. Get me an
16 order. I thank everyone for their time.

17 Thank you very much. Have a good evening.

18 UNIDENTIFIED: Thank you, Your Honor.

19 (Proceedings concluded at 5:26 p.m.)

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1 I certify that the foregoing is a correct
2 transcript to the best of my ability produced from the
3 electronic sound recording of the ZOOM/telephonic
4 proceedings in the above-entitled matter.

5 /S/ MARY D. HENRY

6 CERTIFIED BY THE AMERICAN ASSOCIATION OF
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10 DATE FILED: MARCH 3, 2026
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UNITED STATES BANKRUPTCY COURT
DISTRICT OF NEW JERSEY

IN RE: . Case No. 26-10258-MEH
. .
. .
STG LOGISTICS, INC., . M.L.K. Federal Building
. 50 Walnut Street
Debtors. . Newark, NJ 07102
. .
. May 18, 2026
. 2:04 p.m.
.

TRANSCRIPT OF HEARING ON PLAN CONFIRMATION
BEFORE HONORABLE MARK E. HALL
UNITED STATES BANKRUPTCY COURT JUDGE

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produced by transcription service.

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- - -

I N D E XEXHIBITS

	<u>ID.</u>	<u>EVD.</u>
D-1 Voting Report from Emily Young	11	11
D-2 Declaration of David Barr	11	11
D-3 Declaration of Jason Keyes	11	11
D-4 Declaration of Thomas Higbee	11	11

1 THE COURT: All right. Good afternoon, everybody.
2 We are here today in the STG Logistics, Inc. case, specifically
3 as it relates to plan confirmation.

4 I'm going to proceed by asking for the debtor's
5 counsel to please make appearances, and then other folks,
6 please, you make your appearances when you're ready to speak.
7 Just raise your hand or on Zoom. I'll call on you when your
8 time comes. I want to hear from everybody.

9 So, anybody who has anything to say related to
10 confirmation, you will be heard. But, I just want to start by
11 taking appearances from debtor's counsel, please.

12 MR. SANDERS: Hi, Judge. This is Seth Sanders,
13 counsel for the debtors. And joining me is Mr. Salloum, who I
14 believe just joined, and Mr. Shankar.

15 THE COURT: Okay. I think I see all three of you.
16 Good afternoon. Welcome. Anybody else want to make an
17 appearance for the debtor?

18 MS. YUDKIN: Good afternoon, Your Honor. Felice
19 Yudkin, Cole Schotz P.C., co-counsel to the debtors.

20 THE COURT: Okay. Good afternoon, Ms. Yudkin. Okay.
21 Well, why don't I do this? Just check in with debtor's counsel
22 on the status of where things stand. The Court obviously has
23 received and reviewed various submissions, including over the
24 weekend, related to today's hearing.

25 I also received several objections that are referred

1 to in those submissions, including the memorandum of law that
2 was filed in support of the plan by the debtors. So, if I
3 could just get an update from the debtor's counsel as it
4 relates to where things are generally, and specifically as it
5 relates to the status of the objections.

6 MR. SALLOUM: Good afternoon, Your Honor. Yusuf
7 Salloum from Kirkland & Ellis on behalf of the debtors. Your
8 Honor, first thing I just want to note up front, thank you very
9 much. We appreciate you and your staff accommodating us on a
10 quick turnaround between the objection deadline and
11 confirmation hearing. We did file a lot of documents in
12 support of confirmation with not a lot of time for chambers to
13 review. So, thank you very much.

14 In regards to the objections, Your Honor, without
15 limiting any party's rights, I believe we are resolved with
16 every objecting party, except for the Office of the United
17 States Trustee. We do appreciate the Office of the United
18 States Trustee working with us to narrow the scope of their
19 objection. But, I do believe that that objection is still
20 unresolved.

21 We do have, I would say, a few more -- some language
22 to add to the confirmation order, it's a late breaking
23 resolution of certain objections that we will sort of talk
24 through in more detail, and of course submit to chambers after
25 the hearing.

1 THE COURT: Okay. Thank you, Mr. Salloum. I
2 appreciate that update. So, just to make sure we're all on the
3 same page, did Mr. Salloum get that correct as it relates to
4 the objections? Putting aside the U.S. Trustee's objection,
5 which will be addressed.

6 But, do any other parties have any standing
7 objections that are not -- already been resolved by way of
8 discussion and agreement with the debtor?

9 (No audible response)

10 THE COURT: Okay. Hearing none. And I know -- I
11 just want to note for the record, I see Mr. Gerardi is here. I
12 did receive correspondence from Mr. Gerardi as it relates to
13 the United States Trustee's intention to rely on their written
14 submission as their objection, without the intent to supplement
15 that with oral argument. But, I just want to confirm that's
16 the case, Mr. Gerardi.

17 MR. GERARDI: Good afternoon, Your Honor. I almost
18 said good morning just out of habit. Good afternoon. I do
19 appreciate debtor's counsel working with us. We resolved a
20 number of issues. But, outstanding is third party releases,
21 injunction, and gatekeeping.

22 But, what Mr. Salloum said is correct. These are not
23 novel issues. We've argued them in front of this Court before.
24 Not much has changed, frankly, in our position, and we will
25 rely on our papers, but thank you, Your Honor.

1 And, again, I thank debtor's counsel and all the
2 parties who worked together to get to this point.

3 THE COURT: Okay. Well, thank you, Mr. Gerardi. I
4 appreciate that update, and of course appreciate your office
5 working with the debtors and other parties in interest to
6 narrow the issues to the best of your ability. I know a lot of
7 work obviously goes into that.

8 So, as it relates to our proposed witnesses and
9 testimony, considering that there are no objections outside of
10 the U.S. Trustee's, is it fair to assume that no parties will
11 be looking to cross examine the witnesses for today?

12 (No audible response)

13 THE COURT: Maybe that was awkwardly phrased. But, I
14 think that the silence means that we have four declarations
15 that were submitted over the weekend in support of confirmation
16 today, and the Court's final approval of the disclosure
17 statement, and it doesn't seem like anyone wants to cross
18 examine those declarants.

19 So, I just want to thank the declarants for their
20 submissions. I assume that counsel will move those into
21 evidence in a moment or two. But, I just wanted to clarify
22 whether there would be any testimony.

23 Okay. Why don't I turn it back over to Mr. Salloum
24 or other debtor's counsel?

25 MR. SALLOUM: Thank you very much, Your Honor. I'll

1 cede the podium to my colleague, Mr. Sanders, to take us
2 through the debtor's case-in-chief.

3 THE COURT: Okay, great. Mr. Sanders?

4 MR. SANDERS: Excuse me. Thank you, Your Honor. And
5 thank you, Mr. Salloum. Seth Sanders from Kirkland & Ellis,
6 counsel to the debtors. I just wanted to echo Mr. Salloum's
7 comments. Thank you to all of the parties involved for their
8 collective efforts in getting us to where we are today on the
9 consensual path.

10 I especially wanted to thank the company's management
11 team, including Mr. Holtgreven, who is our first declarant and
12 is on the Zoom today.

13 Thanks to the management team for working around the
14 clock and supporting the debtor's restructuring efforts, but
15 also, you know, simultaneously operating the business.

16 Thank you as well to the Office of the United States
17 Trustee, Mr. Gerardi and Ms. Steele, for working constructively
18 with us on issues since Day 1, and even before the petition
19 date.

20 Your Honor, there's no question that this transaction
21 that's, you know, commemorated under the plan and the
22 confirmation order is for the benefit of all the stakeholders
23 here. That's been confirmed by a very strong showing from the
24 creditors in the voting on the plan, who all nearly unanimously
25 voted in favor of the plan, over 99 percent both in number and

1 amount.

2 As previewed, there's only one objection outstanding
3 by the Office of the U.S. Trustee. That's filed at Docket
4 Number 784.

5 There are the four other objections filed on the
6 docket. One by the New Jersey DOL, Department of Labor, filed
7 at Docket Number 746. One by Ms. Montoya (phonetic) at 798.
8 One by the Chubb Companies at 799. And then one by two of the
9 debtor's landlords filed at Docket Number 800.

10 We've worked with each one of those parties to
11 include language in the confirmation order. So we're, as far
12 as we understand, all resolved on those fronts aside from the
13 United States Trustee.

14 So, I did want to pause right there and ask Your
15 Honor if he had any questions up front about what was recently
16 filed or any questions on the process to date.

17 THE COURT: No. Thank you, Mr. Sanders. I did -- I
18 will note for the record that the Court has reviewed the second
19 amended plan with the red line version attached, which
20 obviously identifies changes that impact some of those -- I
21 would imagine changes noted in response to the objections
22 filed.

23 MR. SANDERS: Thank you, Judge. And I did want to
24 just thank you -- thank the New Jersey Department of Labor, in
25 particular, for their, you know, constructive efforts in

1 negotiating with us on the terms of their claim. And we're,
2 you know, very optimistic that we can get a full resolution
3 with them in the coming days.

4 With that, Your Honor, I'd like to get into, you
5 know, the remaining objection. But, first, to lay the
6 evidentiary groundwork as you previewed, I'd like to request
7 admission into evidence the four declarations in support of
8 confirmation.

9 There's one from Mr. Keyes, a partner and director --
10 managing director at AlixPartners, the debtor's financial
11 advisor. That's at Docket Number 808.

12 Next from Mr. Thomas Higbee, a partner at PJT, the
13 debtor's investment banker, filed at Docket Number 809.

14 The voting report from Ms. Emily Young, director at
15 Epiq, the debtor's claims and noticing agent, is at Docket
16 Number 806.

17 And then finally, there's a declaration from Mr.
18 David Barr, sole member of the Special Committee of the
19 debtors, filed at Docket Number 807.

20 They are -- each one of those declarants are
21 available on the Zoom today. You know, as mentioned, they're
22 available for cross examination. But, at this point, Your
23 Honor, I'd like to move those declarations into evidence.

24 THE COURT: Okay. Thank you, Mr. Sanders. Any
25 opposition to those being moved into evidence?

1 (No audible response)

2 THE COURT: Okay. Hearing none, and also noting that
3 no parties wanted to cross examine the witnesses as requested
4 -- or as offered earlier in the hearing. We'll go ahead and
5 admit those into evidence.

6 I'm going to mark those D-1 through 4 for purposes of
7 evidence. But, I'm going to mark them D-1 through 4 starting
8 in the order of the way they were filed. So, I believe Ms.
9 Young's was filed first at Docket 806. That'll be D-1. Mr.
10 Barr's was filed at 807. That'll be D-2. Mr. Keyes at 808 is
11 D-3. And Mr. Higbee at 809 is D-4.

12 MR. SANDERS: Thank you, Your Honor. You know, just,
13 next to move quickly to our case-in-chief. You know, our
14 confirmation brief was filed at Docket Number 811. It goes
15 into great detail into how we've complied with Sections 1125,
16 26, and 29 of the Bankruptcy Code.

17 I will note that even though certain of the classes,
18 such as the first-lien third-out claims at Class 5 or the
19 general unsecured claims in Class 7A, are not recovering under
20 the plan. We have still, you know, we propose that we've met
21 all the cramdown confirmation requirements. The plan is still
22 fair and equitable. It does not discriminate unfairly.

23 And I'm happy to address any of the requirements of
24 confirmation in detail. But, if no questions, I would propose
25 we'd move next to very briefly addressing the United States

1 Trustee objection.

2 THE COURT: Okay. Thank you, Mr. Sanders. The Court
3 doesn't have any questions.

4 I will note for the record that the debtor certainly
5 thoroughly identified the justification and rationale for
6 those bases to find that the plan is confirmable and the
7 disclosure statement should be approved in its final form in
8 their submissions filed in the last couple days. But, I don't
9 have any specific questions right now. Thank you.

10 MR. SANDERS: Okay. Thank you, Your Honor. And
11 just, again, to quickly address the U.S. Trustee objection. We
12 understand that they already stated that they would rest on the
13 papers, so I'll try to keep this brief. They did object to the
14 third party release provisions of the plan, as well as the
15 injunction and gatekeeper provisions in Article 8 of the plan.

16 Your Honor, the U.S. Trustee relies on Purdue in
17 claiming that the third party releases under the plan are not
18 consensual. However, the Supreme Court in Purdue did
19 specifically choose not to define what constitutes a consensual
20 opt-out.

21 This court of the district -- courts in this district
22 have repeatedly and consistently held that third party releases
23 like the ones contained in this plan are consensual and
24 appropriate. Most recently, for example, in Pretium or the CCA
25 Construction case.

1 We've, you know, we've shown through the record that
2 we've provided notice and due process to all these parties in
3 interest. Provided the language conspicuously throughout all
4 the notices and ballots, et cetera, that were provided to the
5 parties.

6 I do want to note that 38 parties did avail their
7 opportunity to opt out, and they did elect to opt out. So, we
8 do believe that the process was successful. We also think it's
9 a crucial element of the plan and that the DIP and funded debt
10 pre-petition lenders would not have agreed to the plan without
11 the inclusion of those third party releases.

12 I also want to note that they're mutual releases, so
13 the released parties are -- or excuse me, the releasing parties
14 are released parties. So, that anyone who has not opted out
15 still gets the benefit of that release.

16 So, for those reasons, and we also addressed their
17 gatekeeper and injunction provisions in our brief. I'll keep
18 it there and request that, you know, that objection be
19 overruled and that you enter the confirmation order absent any
20 issues.

21 THE COURT: Okay. Thank you, Mr. Sanders. Well,
22 that was certainly a efficient presentation, so thank you for
23 that. And the Court has, of course, read through everything.
24 So, I feel as though I understand your arguments in full, as
25 well as the U.S. Trustee's objection.

1 But, at this point, does anyone have anything else
2 they'd like to add before I render my decision as it relates to
3 the U.S. Trustee's objection?

4 MR. SCHWARTZ: Yes, Your Honor. For the record,
5 Joseph Schwartz, Riker Danzig, and I'm appearing on behalf of
6 Axos Financial and Siemens Financial, which Your Honor has
7 heard from us a lot up to date. And we've referred to
8 ourselves as minority lenders.

9 Your Honor, I'm not going to belabor this. I know
10 that Mr. Sanders was very efficient and I don't want to ruin
11 that efficiency. But, I wanted to point out some of the things
12 in this case that -- and I know Your Honor has a black line
13 version of the plan, so I know Your Honor has reviewed in
14 detail the settlement and the settlement terms that are
15 contained in the plan.

16 And I'm not -- I'm certainly not going to repeat all
17 the terms of the settlement which Your Honor heard on the 27th,
18 on April 27th. But, I wanted to highlight a few terms of
19 particular importance to the minority lenders, which are set
20 forth more fully in the revised plan, mostly in Article 4(b) of
21 the plan.

22 And, Your Honor, were it not for the fact that Judge
23 Drain and the parties were so professional and assisted with
24 respect to the mediation in arriving at the settlement, we
25 would be here at a contested hearing and this process wouldn't

1 be as efficient. And so, kudos to everyone involved.

2 But, I want to make sure that Your Honor fully
3 understands the arduous task over the last few weeks that we
4 have been involved, because the devil's always in the details
5 with respect to a settlement. And although we could put the
6 terms of the term sheet on the record, there's a lot that has
7 taken place behind the scenes the last few weeks in arriving at
8 the exact language.

9 And so, obviously, the settlement between the parties
10 and minority lenders provide for a settlement payment of cash
11 in the amount of \$12 million to be paid on a pro rata basis to
12 my clients, with Axos to receive 58.29 percent, and Siemens to
13 receive 41.71 percent of the settlement payment. And that's
14 found, Your Honor, in Article 4(b)(1)(2) of the amended plan.

15 Article 4(b)(2)(a) of the modified plan contains very
16 broad releases to which the reception purchaser settlement
17 parties shall be bound. And those releases however pertain to
18 a broad release of claims relating to STG and the STLMT dispute
19 only.

20 And importantly, Your Honor, while the releases are
21 very broad, those mutual releases expressly exclude any causes
22 of action unrelated to the debtors and to the business
23 relationships among the other settlement parties.

24 And so, for sake of clarity, in Article (b)(2) --
25 Article 4(b)(2)(a) of the revised plan, we included, among

1 other things, an illustrative, which would make hopefully
2 crystal clear that there's a carveout to the mutual releases
3 which would exclude from the scope of those releases any
4 dispute among the minority lenders and any other non-debtor
5 settling party related to another potential liability
6 management transaction not involving STG or its business should
7 one arise.

8 Article 4(b)(1)(4 to 6) of the revised plan specifies
9 that the pending minority lender litigation, which includes the
10 Illinois action, the New York action, and the adversary
11 proceeding that's pending before this Court, will be withdrawn
12 and dismissed with prejudice.

13 And importantly, Your Honor, the revised plan
14 specifically states that any excusable delay in effectuating
15 from the withdrawal and/or dismissal in Articles 4(b)(1)(4)
16 through (6) shall not constitute a breach that could
17 potentially give rise to the remedies contemplated in Article
18 4(b)(2)(h) of the plan.

19 Moreover, Your Honor, Article 4(b)(1)-(9) of the
20 revised plan provides that in the event of any inconsistencies
21 between the releases that are set forth in Article 8, and
22 that's the section, Your Honor, that pertains to third party
23 releases, and the mutual releases contained in Article
24 (b)(2)(a) of the plan, while the releases are cumulative, to
25 the extent there's an inconsistency, the provisions of Article

1 4(b)(2)(a) shall control.

2 So, the more specific mutual releases shall prevail
3 over the third party releases to the extent there's an
4 inconsistency.

5 Additionally, Your Honor, Article 4(b)(2)(e) of the
6 plan contains a highly negotiated covenant not to sue. And,
7 Your Honor, critically for the minority lenders, the covenant
8 not to sue contains negotiated language which protects the
9 minority lender's ability to comply with their ordinary course
10 regulatory reporting obligations and preserves their ability to
11 respond to routine regulator inquiries, including matters that
12 might pertain to STG.

13 Finally, Your Honor, there are two additional matters
14 that are unrelated to the settlement, the LMT settlement, that
15 are important to note. The confirmation order that Your Honor
16 was presented with contains two specific provisions regarding
17 claims held by affiliates of Axos and Siemens which are not
18 being released.

19 And in particular, Your Honor, first, the debtors had
20 a pre-petition contractual relationship with Verdant Commercial
21 Capital, which is an affiliate of Axos Financial, pursuant to
22 an equipment financing lease, which is being assumed by the
23 debtors in which there is an agreed upon cure claim. And the
24 confirmation order contains specific agreed upon language under
25 heading VV, which is found in Paragraph 177 on Page 89 of 174,

1 that specifies the terms of the party's resolution.

2 Second, Your Honor, with respect to Siemens, the
3 debtors also had a pre-petition contractual relationship with
4 Siemens Industry, Inc. Smart Infrastructure Division that was
5 entered into as of August 1st, 2022. The contract was called
6 an industry energy management agreement, and that contract is
7 also being assumed by the debtors in which there is was also an
8 agreed upon cure claim.

9 And the confirmation order also contains proposed
10 specific agreed upon language under the heading BBB, Paragraph
11 Number 188, specifying the terms of the party's resolution.
12 And that's on Pages 95 through 96 of 174 of the proposed
13 confirmation order.

14 So, Your Honor, importantly, the confirmation order
15 provides that the releases that are contained in Article 4 do
16 not pertain to and do not impact these claims that I just
17 identified with respect to these affiliates.

18 And so, again, Your Honor, I'd be remiss if I did not
19 thank the Court, as the debtors did, for the Court's time and
20 effort in preparing and getting up to speed and presiding over
21 the disputes. And with that, I'll rest, unless Your Honor has
22 any questions.

23 THE COURT: Okay. Thank you, Mr. Schwartz. I
24 appreciate your comments. Mr. Carr?

25 MR. CARR: Good afternoon, Your Honor. Can you hear

1 me?

2 THE COURT: Yes.

3 MR. CARR: I have a real simple response to your
4 question, and that is with respect to the opt-out and third
5 party releases.

6 First of all, for the record, James Carr of Kelley
7 Drye & Warren. And with me, appearing today on behalf of the
8 Committee, is Kristin Going and Steven Szanzer of McDermott
9 Will & Schulte.

10 Your Honor, we believe that the Committee letter that
11 went out with the plan was very clear on the effect of the opt-
12 out provision, and therefore we think that it's appropriate in
13 this context, Your Honor, to approve the plan as -- as
14 currently contemplated.

15 Your Honor, we also -- we also appear today to
16 support the plan, which is the culmination of extensive
17 negotiations with the debtor, the Ad Hoc Lender Group, and the
18 plaintiffs in the adversary proceeding.

19 And, Your Honor, there are five -- five topics I'd
20 like to explain -- to explain why the Committee supports the
21 plan. First of all, what did the Committee do? What were the
22 Committee efforts in this case? Secondly, Committee's
23 investigation. Third, what were the results of the Committee's
24 investigation. Fourth, and probably most importantly, is
25 litigation considerations. And then finally with the

1 settlement of the Committee's claims.

2 So, following the formation of the Committee on
3 January 28th, the Committee worked quickly to understand the
4 debtor's business, the liquidity constraints and viability of a
5 go forward business.

6 The Committee worked collaboratively with the debtors
7 on the second day motions, and particularly the DIP financing,
8 critical vendor motion, and assumption and rejection
9 procedures.

10 We also worked closely with the debtors in marketing
11 the company to maximize the sale value of the company.

12 And then, Your Honor, we proceeded -- we participated
13 in the global mediation that resulted in the settlement of the
14 Committee's claims.

15 So, to fill -- to fulfill its fiduciary obligations,
16 the Committee investigated certain transactions to determine
17 the existence of potential sources of value for unsecured
18 creditors. This included investigation of the pre-petition
19 liens to determine whether there was any unencumbered assets.

20 This included the Committee -- the company's March
21 2022 acquisition of the North American Intermodal Division of
22 XPO Logistics, and related transactions between the debtors on
23 the one hand, Wind Point Partners, Oaktree Capital, and
24 Duration Capital Partners on the other hand.

25 Your Honor, the Committee also examined the third,

1 fifth, and sixth amendments of the credit agreement, which
2 raised additional debt and provided benefits to certain
3 management members and equity holders.

4 And then finally, we examined the October 2024
5 liability management transaction.

6 In addition to its own investigation, the Committee
7 monitored the investigation conducted by the Special Committee
8 and its counsel, White & Case.

9 The Committee obtained information and documents from
10 the Special Committee, as well as summaries of witness reviews
11 and interviews conducted by the Special Committee. And we also
12 conferred with the Special Committee regarding its findings,
13 ultimately also receiving the report by the Special Committee.

14 So, what were the results of our investigation? So,
15 Your Honor, the investigation of the pre-petition liens
16 determine that they were properly perfected, except for certain
17 isolated deposit accounts.

18 The Committee's investigation into the historical
19 transactions which I just mentioned uncovered potential -- I
20 emphasize the word potential, colorable, estate causes of
21 action.

22 So, as we uncover these potential causes of action,
23 we're going to the next phase, and that is litigation
24 consideration. So, what do we consider? Well, first of all,
25 to obtain derivative standing, the Committee would have to

1 demonstrate that the debtors unjustifiably refused to pursue
2 these claims. Difficult to accomplish with the Special
3 Committee's report of its investigation. Not impossible, Your
4 Honor, but difficult.

5 So, then we looked at what value would be realized if
6 we proceeded. What value would be realized by unsecured
7 creditors after considering the merits, the defenses,
8 litigation risks, cost associated with litigation delay,
9 collectibility issues? Those are all the factors we examined,
10 Your Honor.

11 But, most importantly, even if you put those factors
12 aside for a second, Your Honor, general unsecured creditors sit
13 behind more than one billion in secured debt, including up to a
14 hundred and fifty million advanced by the DIP lenders.

15 Considering all these factors, the Committee reached
16 a settlement that is favorable to unsecured creditors. And
17 what are those factors and why did we reach an agreement? And
18 these are incorporated in the plan, Your Honor.

19 First of all, you have payment of \$55 million, of at
20 least \$55 million of pre-petition trade claims under the
21 critical vendor order.

22 We also worked with the debtor and the
23 lender/purchaser now in terms of assumption of as many
24 contracts and leases, also with payment of cure claims.

25 We have a waiver of the participating lender's

1 deficiency claims eliminating about seven hundred and fifty
2 million of potential unsecured claims.

3 We also have a release of preference claims against
4 general unsecured creditors.

5 And then finally, Your Honor, creation of a
6 convenience class which is funded at \$975,000 in cash for those
7 unsecured creditors which elect to participate in the
8 convenience class.

9 The plan also restructures the debtor's business with
10 a improved capital structure that will benefit go forward
11 vendors and landlords.

12 So, Your Honor, in closing, the Committee believes
13 that the plan represents a good result for unsecured creditors
14 in what was a highly challenging and complex case with a
15 compressed timeline.

16 The Committee would like to thank the Kirkland,
17 Gibson Dunn, and White & Case teams for their cooperation. And
18 most importantly, we'd like to thank Your Honor and Your
19 Honor's chambers whose efforts made it possible to achieve the
20 consensual resolution that we have before Your Honor today.

21 Unless Your Honor has any questions, I have no
22 further comments with respect to the Committee's support of the
23 plan.

24 THE COURT: Okay. Thank you, Mr. Carr. I have no
25 questions, but I do want to note that the Court appreciates the

1 Committee's response at Docket Number 805 that was filed over
2 the weekend in support of the plan, and as highlighted by some
3 of your comments, and I thank you for that.

4 All right. Mr. Fitzgerald?

5 MR. FITZGERALD: Thank you, Your Honor. Rob
6 Fitzgerald of Gibson, Dunn & Crutcher on behalf of the Ad Hoc
7 Group. I'm joined by my colleagues, Mr. Jason Goldstein and
8 Mr. Lee Wilson, as well as our local counsel of the Porzio
9 firm.

10 We support final approval of the disclosure
11 statement, confirmation of the plan, and entry of the proposed
12 confirmation order that was docketed yesterday.

13 With respect to the plan and confirmation order, I'll
14 just note that Mr. Schwartz highlighted some of the language.
15 I won't belabor all the language in the documents. The
16 documents say what they say. They stand on their own.

17 You know, all I would like to note is that
18 exclusion of one piece of language on the record should not be,
19 you know, inclusion of language on the record shall be excluded
20 for the rest of the documents.

21 As Your Honor knows, the plan is the product of a lot
22 of hard work and thoughtful compromise among the various
23 parties in the case.

24 We're grateful to our clients for their availability,
25 flexibility, and thoughtful approach to these cases.

1 We also appreciate the efforts of the debtors and the
2 other constituents in the case for helping us get to where we
3 are today.

4 We, of course, thank Your Honor and Your Honor's
5 staff for your accommodations in scheduling throughout the
6 process. And we look forward to supporting the company to
7 enable a prompt emergence from Chapter 11.

8 Unless Your Honor has anything else, then I'll cede
9 the podium.

10 THE COURT: I don't have any questions, but thank
11 you, Mr. Fitzgerald. I appreciate your comments.

12 MR. FITZGERALD: Thank you.

13 THE COURT: Anybody else like to be heard?

14 (No audible response)

15 THE COURT: Okay. Well, with that, I just -- I ask
16 that you bear with me as I read my decision into the record
17 today. In part because the citations I cite at times will
18 certainly be tedious, but I think they're important for the
19 record. And also because I am honestly cobbling together some
20 notes that were made over the last few days and the past few
21 hours based on recently filed documents with the Court. So, I
22 appreciate your patience.

23 With that said, this matter comes before the Court
24 upon the request of STG Logistics, Inc. and its 64 affiliates,
25 collectively the debtors, for final approval of the first

1 amended disclosure statement relating to the first amended
2 joint plan of reorganization of STG Logistics, Inc. and its
3 debtor affiliates at Docket Number 618, and confirmation of the
4 second amended joint plan of reorganization of STG Logistics
5 and its debtor affiliates pursuant to Chapter 11 of the
6 Bankruptcy Code. We're going to call that the plan. And
7 that's filed at Docket Number 804.

8 On April 15th, 2026, this Court conditionally
9 approved the disclosure statement, solicitation procedures,
10 forms of ballots, and notices in connection therewith, and
11 certain dates with respect thereto. That's the disclosure
12 statement order. And they all bear on the present iteration of
13 the plan. And the disclosure statement order can be found at
14 Docket Number 620.

15 As a threshold consideration, this Court has
16 jurisdiction over the matter pursuant to 28 U.S.C., Sections
17 1334, 28 U.S.C., Section 157, along with the standing order of
18 reference of the United States District Court for the District
19 of New Jersey, dated July 23rd, 1984, as amended September
20 18th, 2012, and is further amended June 6th, 2025, referring
21 all bankruptcy cases to the Bankruptcy Court.

22 This matter constitutes a core proceeding pursuant to
23 28 U.S.C., Section 157(b)(2)(l) because it relates to
24 confirmation of a plan.

25 Further, venue is proper here pursuant to 28 U.S.C.,

1 Sections 1408 and 1409. I note that venue is not contested in
2 this case.

3 I will not belabor the record today by going through
4 the extensive background and summary of the case and the
5 various issues. But instead, I direct the listener and later
6 on, the reader, to the debtor's comprehensive memorandum of law
7 filed yesterday, May 17th, in support of final approval of the
8 disclosure statement and the second amended plan. That's at
9 Docket Number 811, along with the various declarations
10 submitted by the debtor in either May 16th or May 17th of this
11 year in support of the second amended plan.

12 Specifically, those declarations were submitted by
13 Emily Young, David Barr, Jason Keyes, and Thomas Higbee at
14 Dockets Number 806 through 809 respectfully. And those
15 declarations were earlier admitted into evidence as -- as
16 identified as D-1 through D-4 respectfully.

17 The Court adopts the debtor's recitations and its
18 memorandum of law in support of the plan at Docket Number 811,
19 and finds that all requirements under Sections 1125 and 1129 of
20 the Bankruptcy Code, as applicable to this case, have been met.

21 Further, for the reasons that will be detailed
22 shortly, the Court further finds that the debtor's second
23 amended plan satisfies Section 1123(b) of the Bankruptcy Code.

24 I'm going to go through some of the facts as I think
25 that are significant to the issue before us that's contested by

1 the U.S. Trustee. So, bear with me, but I think these are
2 important.

3 As explained throughout the disclosure statement and
4 the plan solicitation materials, the third party releases apply
5 to the effective claimants unless they elect not to consent,
6 i.e. they opt out of the third party releases by submitting a
7 form or a ballot with a checked out box, or by filing an
8 objection to the third party releases.

9 Under the plan's opt-out procedure, unless the
10 claimant has filed an objection to the third party releases,
11 whether the claimant has or has not checked the opt-out box on
12 a timely and properly submitted form or ballot is paramount and
13 a primary indicator of whether the claimant has opted out of
14 the third party releases.

15 To that end, claimants in the non-voting classes,
16 while not eligible to vote on the plan, can still opt out
17 of the third party releases by checking the opt-out box on a
18 timely and properly submitted opt-out form.

19 Claimants in the non-voting class who do not
20 otherwise timely and properly submit an opt-out form with the
21 opt-out box checked are deemed to consent to the third party
22 releases.

23 As for claimants in the voting classes, those who
24 vote to reject the plan or who abstain from voting on the plan
25 can likewise opt out of the third party releases by checking

1 the opt-out box in a timely and properly submitted ballot.

2 Conversely, claimants in the voting classes who
3 timely and properly vote to reject the plan or who abstain from
4 voting on the plan are deemed to consent to the third party
5 releases when they do not check the opt-out box on a timely and
6 properly submitted ballot.

7 Claimants in the voting classes who timely and
8 properly vote to accept the plan are deemed to consent to the
9 third party releases and cannot opt out.

10 The plan and disclosure statement prominently
11 featured this information regarding the third party releases
12 and instructions on the procedures to opt out of them.

13 This information always appears -- also appears
14 nearly always in bold, capitalized, and/or underlined font on
15 the ballots, the notice of non-voting status, which includes
16 the opt-out form, the cover letter, the confirmation hearing
17 notice, the plan supplement notice, the notice of assumption of
18 executory contracts and unexpired leases, and the notice of
19 rejection of executory contracts and unexpired leases.

20 Moreover, claimants in the voting classes and non-
21 voting classes received only those forms appropriate for their
22 class designation.

23 Claimants in the voting classes received ballots that
24 included information regarding the third party releases,
25 instructions on opting out of the third party releases, and a

1 box to check in order to opt out of the third party releases.

2 Claimants in the non-voting classes received a notice
3 of non-voting status that included information
4 regarding the third party releases, instructions on opting out
5 in the third party releases, and an opt-out form with a box to
6 check in order to opt out of the third party releases.

7 Now, here, the United States Trustee's objection
8 primarily challenges the characterization of the plan's third
9 party release provision as consensual, and therefore binding on
10 the releasing parties. See Docket Number 784.

11 The U.S. Trustee asserts that the opt-out procedures
12 under which consent to the third party release provision is
13 presumed unless a claimant takes specific affirmative action to
14 withdraw from it, operates on a system of silence, or failure
15 to act, which state contract law does not recognize as a
16 manifestation of assent to an agreement.

17 The U.S. Trustee asserts that in this regard, the
18 third party releases in the debtor's plan are non-consensual,
19 and therefore unauthorized by the Bankruptcy Code and
20 prohibited by the Supreme Court's decision in Purdue.

21 In Harrington v. Purdue Pharma L.P., the Supreme
22 Court held that the Bankruptcy Code, quote, "Does not authorize
23 a release and injunction that is part of a plan of
24 reorganization under Chapter 11, effectively seeks the
25 discharge claims against the non-debtor without the consent of

1 affected claimants," end quote. See 603 U.S. at 227.

2 The Supreme Court made clear that its holding was
3 narrowly focused on the impermissibility of non-consensual
4 releases and that, quote, "Nothing in what we have said should
5 be construed to call into question consensual third party
6 releases offered in connection with a bankruptcy reorganization
7 plan," end quote; Id. at 226. Remarking that, quote, "As
8 important as the question we decide today are ones we do not,"
9 end quote.

10 The Court left open the question of what procedures
11 sufficiently establish consent to qualify as a consensual
12 release; Id. Declining to, quote, "Express a view on what
13 qualifies as a consensual release or passes on a plan that
14 provides for the full satisfaction of claims against a third
15 party note non-debtor," end quote.

16 Now, Bankruptcy Courts and practitioners in the wake
17 of Purdue have had to grapple, quote, "With how parties may
18 manifest their consent to third party releases," end quote.
19 That's from In re Spirit Airlines, Inc., 668 B.R. 689, Pinpoint
20 701, from the Bankruptcy Court of the Southern District of New
21 York in 2025.

22 At the forefront of this discussion and a source of
23 some division amongst Bankruptcy Courts throughout the country
24 is whether the use of opt-out mechanisms like those utilized in
25 the debtor's plan here are sufficient to establish consent to

1 third party releases in a Chapter 11 plan; see In re Pat
2 McGrath Cosmetics LLC, Number -- Case Number 26-10772. That's
3 at 2026 Westlaw 1088157, Pinpoint Pages 4 through 5, from the
4 Bankruptcy Court of the Southern District of Florida from April
5 21st, 2026.

6 The Third Circuit has not yet opined on whether post-
7 Purdue a consensual third party release may be implemented
8 through an opt-out mechanism, and thus there is no precedent
9 that binds this Court on this particular issue.

10 There is however extensive, persuasive authority in
11 this district that overwhelmingly, and as far as this Court can
12 tell, unanimously approves the use of informed opt-out
13 procedures to reflect consent. See, for example, In re New
14 Rite Aid, LLC, Case Number 25-14861.

15 This is all -- these are all from the Bankruptcy
16 Court of the District of New Jersey. So, I'm just going to --
17 that's clear throughout the rest of this block citation, so
18 bear with me.

19 But, the Rite Aid decision's from November 24th,
20 2025. That's Docket Number 3409, from November 24th, 2025, the
21 hearing transcript at 57:18 through 58:86.

22 Now, that particular decision is quoted as followed,
23 "To be clear, this Court's pre-Purdue position has not changed
24 and joins other courts in this district, the Circuit, and the
25 93 other districts which approve the use of informed opt-out

1 procedures to reflect consent to proposed consensual releases
2 under the Chapter 11 plan.

3 Indeed, in the District of New Jersey, our courts
4 have been rather uniform in recognizing opt-out provisions as
5 fundamentally fair and consistent with due process in
6 applicable bankruptcy law," end quote.

7 See also In re Eddie Bauer LLC, Case Number 26-11422.
8 That's from April 16th, 2026 at Docket Number 474, April 26th,
9 2026 hearing transcript, Page 31:14 through 24. See also In re
10 Sam Ash, Case Number 24-14727, August 15th, 2024. That's
11 Docket Number 492, and the hearing transcript at 53 through 54.
12 See also In re BowFlex Inc., Case Number 24-12364, August 19th,
13 2024 at Docket Number 631, hearing transcript at Pages 65
14 through 70.

15 See also In re United Site Services, Inc., Case
16 Number 25-23630, February 27th, 2026, Docket Number 344. Also
17 In re CCA Construction, Inc., Case Number 24-22548, February
18 11th, 2026, Docket Number 698. And In re DirectBuy Home
19 Improvement, Case Number 23-19159, April 19th, 2024 at Docket
20 Number 533. Again, those are all from the District of New
21 Jersey Bankruptcy Court cases.

22 Indeed, the United States Trustee acknowledges the
23 decisions from courts in this district concerning opt-out
24 provisions in these types of plans.

25 Notwithstanding those rulings, the U.S. Trustee has

1 objected to these provisions on the belief that they are not in
2 fact consensual because applicable state law requires
3 claimant's affirmative assent, not silence or an action, to be
4 bound to third party releases.

5 The U.S. Trustee's objection ultimately raises two
6 questions that the Court must consider. Quote, "Number 1, does
7 state or federal law determine whether the claimants consented
8 to third party releases, and Number 2, what does consent
9 require under the applicable law," end quote. In re Container
10 Store Group, Inc., 676 B.R. 356, Pinpoint 374, Southern
11 District of Texas (2026).

12 To preview this Court's answer, quote, "Courts
13 permitting opt-out releases begin from a different premise,"
14 end quote, than the U.S. Trustee, and view the question of
15 their permissibility, quote, "as arising not in ordinary
16 bilateral contract formation, but in the context of a court
17 supervised Chapter 11 process governed by the Bankruptcy Code,
18 the Federal Rules of Bankruptcy Procedure, fiduciary
19 obligations, disclosure requirements, and due process," end
20 quote. That's from In re Pat McGrath Cosmetics LLC, 2026
21 Westlaw 1088157 at Pinpoint Page 5.

22 See also In re Container Store Group, Inc., 676 B.R.
23 356, Southern District of Texas (2026) and In re Spirit
24 Airlines, Inc., 668 B.R. 689, Bankruptcy Court, Southern
25 District of New York (2025).

1 Quote, "Under that approach, the controlling inquiry
2 is not whether the creditor affirmatively checked an opt-in
3 box, but whether the creditor received clear and conspicuous
4 notice of the release, understood the consequences of an
5 action, and had a meaningful opportunity to decline the release
6 by opting out," end quote. In re Pat McGrath Cosmetics, 2026
7 Westlaw 1088157 at Page 5.

8 Turning then to the first question the United States
9 Trustee objection poses. This Court agrees with the courts
10 both in and outside of this district that have held that
11 federal bankruptcy law, not state contract law, governs the
12 appropriateness of opt-out consent procedures to third party
13 releases.

14 See, for example, In re Pat McGrath Cosmetics LLC,
15 2026 Westlaw 1088157 at Pages 5 through 6, In re Eddie Bauer
16 LLC, Case Number 26-11422, Bankruptcy Court, District of New
17 Jersey, April 16th, 2026, Docket Number 474, April 16th, 2026
18 hearing transcript.

19 And see also In re United Site Services, Inc., Case
20 Number 25-23630, Bankruptcy, District of New Jersey, February
21 25th, 2026, Docket Number 347 and In re Container Store Group,
22 Inc., 676 B.R. 356, Pinpoint 374 through 383, Southern District
23 of Texas (2026).

24 As the Court in In re United Site Services explained,
25 quote, "Confirmation authority arises under 11 U.S.C., Section

1 1129, and the enforceability of plan provisions is evaluated
2 under federal statutory standards, constitutional due process
3 principles, and controlling Circuit precedent," end quote. In
4 re United Site Services, Inc., Case Number 25-23630,
5 Bankruptcy, District of New Jersey, February 25th, 2026, Docket
6 Number 347, hearing transcript Page 36:21 through 24.

7 The same Court further explained in In re New Rite
8 Aid that opt-out consent procedures in a plan inherently,
9 quote, "Involve questions concerning balance, structure,
10 disclosure adequacy, plan solicitation, and release mechanisms,
11 and they are therefore governed by Sections 1125 and 1126 in
12 Federal Rules of Bankruptcy Procedure 3007 and 3018," end
13 quote. In re New Rite Aid, LLC, Case Number 25-14861,
14 Bankruptcy Court, District of New Jersey, November 24th, 2025,
15 Docket Number 3409, hearing transcript Page 58, Lines 15
16 through 19.

17 To that end, quote, "Applying federal law ensures the
18 consistency of the administration of the bankruptcy law
19 throughout the United States," end quote; In re Container Store
20 Group, 676 B.R. at 382.

21 To apply state law, quote, "would destroy
22 uniformity," end quote, and subject creditors nation wide to
23 different assent requirements, ultimately resulting in what,
24 quote, "would be a non-uniform, unmanageable Chapter 11
25 landscape violating the uniformity requirements inherent in the

1 Bankruptcy Code," end quote. It's In re United Site Services,
2 Inc., Case Number 25-23630, Bankruptcy, District of New Jersey,
3 February 25th -- February 25th, 2026. That's at Docket Number
4 347, hearing transcript at Page 37, Lines 7 through 15.

5 See also In re Eddie Bauer LLC, Case Number 26-11422,
6 Bankruptcy Court, District of New Jersey, April 16th, 2026,
7 Docket Number 474, hearing transcript Page 35, Lines 19 through
8 Page 36, Line 18, agreeing with the In re United Site Services
9 case.

10 And as to the second question the United States
11 Trustee objection poses, what does consent require under the
12 applicable law? This Court is guided like its fellow courts in
13 this district have been by the persuasive reasoning in In re
14 Container Store.

15 In re Container Store -- in In re Container Store,
16 the Court relying on the Supreme Court's decision in Phillips
17 Petroleum Company v. Shutts, 472 U.S. 797 (1985), concluded
18 that, quote, "Courts can infer consent in appropriate
19 circumstances from the failure to opt out after proper notice,"
20 end quote; see Pinpoint Page 388.

21 Thus, courts have looked to the totality of the
22 circumstances, that is, quote, "The unique facts and
23 circumstances of the case at issue, including the clarity of
24 the language used, the history of the case, and the incentive
25 for the effective creditors to engage in the bankruptcy case,"

1 end quote, to determine whether the opt-out procedures
2 comported with due process and sufficiently apprise interested
3 parties of the action and forwarded them the opportunity to
4 object; see In re Spirit Airlines, 668 B.R. at Pages 703
5 through 705; also Page 714. See also In re Pat McGrath
6 Cosmetics LLC, 2026 Westlaw at 1088157 at Pinpoint 7 and In re
7 Container Store, 676 B.R. at Pages 384 through 385. Also In re
8 Eddie Bauer LLC, Case Number 26-11422, Bankruptcy Court, New
9 Jersey, April 16th, 2026, Docket Number 474, Pages 37 --
10 hearing transcript Page 37, Lines 7 through 22.

11 Applying those principles here, this Court finds that
12 the proposed opt-out procedures in this plan are permissible,
13 and consequently the third party releases are consensual in
14 light of several observations.

15 First, all claimants receive clear and conspicuous
16 notices of the third party releases through the Bankruptcy
17 Court approved ballots and opt-out forms, publication notices,
18 and the confirmation hearing notice.

19 In addition to the notices of non-voting status and
20 opt-out form, the debtor's cause, the publication -- of the
21 publication notice in the New York Times, National Edition and
22 Columbus Dispatch, and that confirmation hearing notice was
23 also posted on the debtor's case website maintained by the
24 claims and noticing agent. See debtor's confirmation brief,
25 Paragraph 154 at Docket Number 811.

1 The balance and the opt-out forms contain the full
2 text of the third party release and the related defined terms.
3 The balance and opt-out forms clearly and conspicuously inform
4 creditors of the consequences of failing to opt out of or
5 object to the third party releases.

6 The publication notice advised all stakeholders to,
7 quote, "Review and consider the plan carefully because your
8 rights may be affected thereunder," end quote, and inform them
9 how they may obtain copies of the plan, the disclosure
10 statement, and other documents filed in these Chapter 11 cases
11 free of charge. See debtor's confirmation brief, Paragraph 154
12 at Docket Number 811.

13 In addition, each ballot in these Chapter 11 cases
14 inform creditors that a vote in favor of the plan included an
15 agreement to be bound by third party releases contained
16 therein. See debtor's confirmation brief, Paragraph 154,
17 Docket Number 811.

18 Further, there is a small but relevant group of some
19 38 parties who did in fact make the opt-out elections by -- I'm
20 sorry, make the opt-out elections by or on the voting and opt-
21 out deadline reflecting the effectiveness of the solicitation
22 process.

23 And I'll note that, in particular, Exhibit C, filed
24 to -- filed to -- Exhibit C filed to the declaration of Ms.
25 Young, that's at Docket Number 806, Exhibit C specifically

1 lists the opt-out parties.

2 And the Court notes that there is a variety of types
3 of claimants and parties that are opting out of the third party
4 releases in this plan, which the Court finds to be influential.
5 These parties include insurance companies, state agencies,
6 private companies, and individuals.

7 The Court notes that those factors, along with the
8 fact that the Committee has supported the plan, which includes
9 the opt-out mechanisms, is persuasive in determining that this
10 Court joins with its colleagues in the district and finds that
11 the opt-out mechanism that was adopted by the debtors in this
12 case are appropriate, and the U.S. Trustee's related objection
13 on that issue is overruled.

14 Next, the United States Trustee argues that the plan
15 -- the plan includes over broad and impermissible injunction
16 language. See opposition at Paragraph 65 from the U.S.
17 Trustee. That's Docket Number 784.

18 The U.S. Trustee asserts that because the Bankruptcy
19 Code protects the debtor by continuing the automatic stay and
20 by binding all parties to the terms of the plan, the injunction
21 provision is unnecessary and should be removed.

22 However, courts within this district have routinely
23 approved Chapter 11 plans in complex cases that contain an
24 injunction provision permanently preventing parties from
25 asserting released claims against released parties.

See, for example, In re Eddie Bauer, Case Number 26-11422, Bankruptcy, District of New Jersey, April 20th, 2026; Pretium Packaging LLC, Case Number -- Case Number 26-10896, Bankruptcy, District of New Jersey, February 23rd, 2026; In re New Rite Aid, LLC, Case Number 25-14861, Bankruptcy Court, District of New Jersey, November 26th, 2025; In re Invitae Corp., Case Number 24-11362, Bankruptcy Court, District of New Jersey, August 2nd, 2024; In re Thrasio Holding, Inc., Case Number 24-11840, Bankruptcy Court, District of New Jersey, June 13th, 2024; In re WeWork Inc., Case Number 23-19865, Bankruptcy Court, District of New Jersey, May 31st, 2024; In re Cyxtera Tech, Inc., Case Number 23-14853, Bankruptcy Court, District of New Jersey, November 17th, 2023; In re BlockFi Inc., Case Number 22-19361, Bankruptcy Court, District of New Jersey, October 3rd, 2023; and In re Bed Bath & Beyond Inc., Case Number 23-13359, Bankruptcy Court, District of New Jersey, September 14th, 2023.

Here, the Court finds that the injunction provisions included in the plan are not over broad nor impermissible, and accordingly will overrule the U.S. Trustee's objection on this issue.

The Court finds that the injunction provision is in fact a protective mechanism against frivolous lawsuits which would in turn require such parties to expend resources unnecessarily and undermine a primary purpose of Chapter 11,

1 which is to bring certainty and finality to parties in
2 interest. See, for example, transcript of record at Pages 38,
3 39, Eddie Bauer LLC case, Case Number 26-11422. That's Docket
4 Number 474.

5 The injunction provision allows the Court to enforce
6 the discharge, release, and exculpation provisions that are
7 necessary to this plan. Therefore, the Court finds that the
8 injunction provisions here are appropriate and are hereby
9 approved.

10 Turning last to the gatekeeping provisions. The
11 United States Trustee argues that the Court should deny
12 confirmation because the plan hasn't properly included certain
13 gatekeeping provisions.

14 The Trustee asserts that the Bankruptcy Court lacks
15 jurisdiction and statutory authority to enter such an
16 injunction, and there has been no showing that the injunctive
17 relief is warranted; see Paragraph 68 of the U.S. Trustee's
18 objection at Docket Number 784.

19 Additionally, the Trustee argues because there is no,
20 quote, "related to," end quote, jurisdiction over the non-
21 debtor claims, the Bankruptcy Court lacks jurisdiction both to
22 enter the injunction to perform the gatekeeping function the
23 plan would exclusively assign to it; see Id. at Paragraph 69.

24 The Trustee notes, even if, quote, "related to," end
25 quote, jurisdiction existed, granting the Bankruptcy Court

1 exclusive authority to decide whether these non-debtor claims
2 may proceed conflicts with Congress's grant of concurrent
3 jurisdiction over such claims.

4 Further, the Trustee argues that the gatekeeping
5 provisions would create inefficient piecemeal litigation
6 undermining the purpose of, quote, "related to," end quote,
7 jurisdiction by burdening courts, increasing cost and delay,
8 and unnecessarily interfering with other court's jurisdiction
9 and case management; see Id. at Paragraph 71.

10 However, like the injunction provisions, gatekeeping
11 provisions are not a novel issue and courts within this
12 district have routinely granted these provisions. See, for
13 example, United States Services, Inc., et al., Case Number 25-
14 23630, February 20th, 2026. This is approving a similar
15 gatekeeping provision.

16 Also see Multi-Color Corporation, et al., Case Number
17 26-10910. That's from April 16th, 2026. See also In re New
18 Rite Aid, LLC, Case Number 25-14861 from November 26th, 2025;
19 In re Invitae Corp., Case Number 24-11362, August 2nd, 2024;
20 In re Thrasio Holdings, Inc., Case Number 24-11840, June 13th,
21 2024; In re WeWork Inc., Case Number 23-19865, May 31st, 2024;
22 In re Cyxtera Tech, Inc., Case Number 23-14853, November 17th,
23 2023; In re BlockFi Inc., Case Number 22-19361, October 3rd,
24 2023; In re Bed Bath & Beyond, Case Number 23-13359, September
25 14th, 2023; and In re National Realty Advise, Case Number 22-

1 14539, August 10th, 2023. And that case provided, the
2 Bankruptcy Court maintained exclusive jurisdiction to
3 adjudicate matters related to the Chapter 11 case on a post-
4 effective date basis.

5 See also In re Princeton Alternative Income Fund,
6 L.P., Case Number 18-14603. That's March 13th, 2020,
7 explicitly applying the Barton Doctrine to post-confirmation
8 suits.

9 Just for sake of clarity and for the record, all of
10 those citations I just listed are from the Bankruptcy Court for
11 the District of New Jersey.

12 Gatekeeping provisions provide a threshold level of
13 review following confirmation of a Chapter 11 plan. Pursuant
14 to these provisions, the Court interprets its own order in the
15 first instance and determines whether a litigant has a claim
16 that remains assertable following confirmation of the plan.
17 See In re Essar Steel Minnesota LLC, 47 F.4th 193, Pinpoint
18 197, Third Circuit (2022), citing Travelers Indemnity Company
19 v. Bailey, 557 U.S. 137, Pinpoint 151 (2009).

20 That's where the Supreme Court recognized that the
21 Bankruptcy Court, quote, "Plainly has jurisdiction to interpret
22 and enforce its own prior orders," end quote.

23 Here, the Court finds that the gatekeeping provisions
24 are necessary, and accordingly will overrule the U.S. Trustee's
25 objection on this point.

1 The gatekeeping provisions are an exercise of this
2 Bankruptcy Court's power under Sections 105, 1123(b)(6), and
3 1141(a), (b), and (c) of the Bankruptcy Code.

4 The Court agrees with recent rulings from this
5 district approving gatekeeping provisions, including in both
6 United Site Services, Inc. and Multi-Color Corporation; see
7 Case Numbers 25-23630 from February 20th, 2026, and for Multi-
8 Color Corporation, Case Number 26-10910 from April 16th, 2026.

9 The gatekeeping provisions are an appropriate case
10 administration feature designed to ensure that post-effective
11 date litigation proceeds consistently with the plan and does
12 not undermine the release and discharge -- releases and
13 discharge through a form of collateral attack; see transcript
14 of record in the United States Services case, 25-23630,
15 February 20th, 2026 at Docket Number 347.

16 The gatekeeping provisions are in fact a procedural
17 mechanism that funnels disputes related to plan to the
18 Bankruptcy Court preventing duplicative or collateral
19 litigation; see transcript of record, 16 through 17, Multi-
20 Color Corporation, Case Number 26-10910, Docket Number 782.

21 In particular, in cases like this where the plan is
22 complex, the Bankruptcy Court is the appropriate forum to
23 interpret and enforce the plan provisions because it is
24 proficient at understanding the plan and the confirmation
25 order.

1 Therefore, the Court finds that the gatekeeping
2 provisions proposed in the second amended plan here are
3 material and necessary terms of that plan, and are appropriate
4 pursuant to the Bankruptcy Court's authority under the
5 Bankruptcy Code.

6 I also want to point out that the debtor's
7 confirmation brief at Docket Number 811, in Pages 85 through
8 92, there's a lot of specific references on the gatekeeper
9 provision.

10 I will not belabor the record by reading all of it
11 into the record, but I will note for purposes of the record
12 that there are significant examples included by the debtor that
13 the Court agrees with and believes that they're consistent with
14 why those gatekeeper provisions are appropriate generally, but
15 more specifically and more importantly, they're appropriate in
16 this case under the facts of this case.

17 Okay. So, for the stated reasons above, the Court
18 joins its fellow courts in this district and in many other
19 districts outside of New Jersey, in recognizing that under the
20 appropriate facts and circumstances like those presented in
21 this case, opt-out procedures constitute an acceptable form of
22 obtaining consent to the third party releases in a Chapter 11
23 plan.

24 The Court further finds that a permanent injunction
25 and gatekeeping provisions permissible and necessary tools to

1 enforce the plan and confirmation order's language and intent.

2 Accordingly, as set forth herein and in the
3 confirmation order proposed by the debtor, the Court approves
4 the opt-out process, permanent injunction, and gatekeeping
5 provisions set forth in the debtor's plan, and likewise
6 overrules the U.S. Trustee's objection on these fronts. I told
7 you it would be tedious.

8 Okay. So, I just wanted to get that in for the
9 record. I thought it was important. And you definitely didn't
10 want to wait for me to write all that out cleanly and for many
11 days to wait. I know how important it is for the debtor to
12 reorganize.

13 The parties came to this court, and with a
14 significant amount of litigation. And I just note, as Mr.
15 Schwartz put on the record earlier, there is a resolution in
16 that litigation that really set the parties to the path --
17 towards the path of a mostly consensual resolution.

18 And so, I just want to congratulate, first and
19 foremost, the debtors, including all their officers and
20 professionals, for steering this case through the plan
21 confirmation process today.

22 I'm going to enter the plan confirmation order, and
23 we'll get to the logistics in a moment. I know that there's
24 going to be some tweaks to the order that I've seen on the
25 docket most recently.

1 But, I also just want to commend all the parties and
2 counsel in this case. You've made exceptional efforts
3 throughout. Your professionalism has been on full display.
4 And it's either led to a full resolution of the issues or a
5 significant narrowing of the issues throughout.

6 And the Court also wants to recognize that the
7 Honorable Robert Drain, now retired, obviously served an
8 indispensable role as the mediator in this case, and I know he
9 was mentioned before by one or more of the parties in this case
10 for his efforts.

11 I know the arguments were complex. The issues were
12 ones that were clearly fought very, very adeptly from all
13 sides. And I know both his -- from directly in his mediation
14 process and then thereafter, maybe a little more indirectly,
15 but with some guidance, I think, from Judge Drain, the parties
16 were able to come to a resolution.

17 And I just want to note that this is something that
18 if you were all in the courtroom today, it would be a moment of
19 celebration. Maybe folks would even grab lunch or some form of
20 libations afterwards to celebrate the amount of work and effort
21 you put in. Because, frankly, this is not an easy task.

22 So, I just want to congratulate everybody. I've seen
23 nothing but exceptionalism throughout this case. It's made
24 this Court's job much easier.

25 I appreciate folks bearing with me as I read through

1 my findings. I just thought that it was important for the
2 record and for the case generally to make some specific
3 findings and support that with rulings from the courts across
4 the country, and specifically New Jersey, on these issues that
5 I know are much litigated.

6 So, with that, I'm going to ask the debtor's counsel
7 if -- just to go back to the, I guess, housekeeping mechanism.
8 I thought Mr. Sanders or Mr. Salloum, I don't know if you want
9 to address where we're at with tweaks to that confirmation
10 order the Court's seen and what the Court should expect.

11 MR. SALLOUM: Your Honor, we'll get that order to you
12 as soon as possible after the hearing. I'm just going to make
13 a few revisions to reflect language agreed with parties, and
14 we'll get that to chambers ASAP.

15 THE COURT: Okay. It sounds like that'll probably be
16 this afternoon then, Mr. Salloum?

17 MR. SALLOUM: That's correct, Your Honor.

18 THE COURT: Okay. Wonderful. Well, we will be on
19 the lookout for it, and we'll enter it as soon as -- as soon as
20 we receive it, unless there's some issue. But, I assume when
21 you submit it, you'll do it on a consensual basis, so I don't
22 anticipate any issues.

23 MR. SALLOUM: And just to echo everything you said,
24 Your Honor, this was only possible through you facilitating it,
25 both the actual case, as well as the mediation. So, we are

1 very much appreciative of Your Honor's efforts throughout this
2 process.

3 THE COURT: Well, you guys did all the heavy lifting.
4 Kudos to everybody. This really -- it's really -- the result
5 today is an example of how the Chapter 11 process could work.

6 All of the counsel, all the professionals that were
7 part, all of the parties, really did just an outstanding job
8 throughout the case. And I congratulate all of you and wish
9 the company the best of luck as they move forward and emerge
10 from Chapter 11, and just thank all the professionals for the
11 outstanding work in this case. It's made the job of the Court
12 significantly easier, so thank you.

13 MR. SALLIUM: Thank you, Your Honor.

14 THE COURT: Okay. Anything from anybody else before
15 we adjourn?

16 (No audible response)

17 THE COURT: Okay. As a quick side note, I don't have
18 a gavel, but I borrowed one when I was the mock trial judge for
19 my niece's high school mock trial last week. And they were all
20 asking me, like, could you use your gavel? I said, we don't
21 use a gavel. But, at the end of the proceedings, I banged the
22 gavel that I borrowed from one of my colleagues, and they all
23 got excited. I don't have a gavel though. I gave it back.

24 But, I just want to say, we're adjourned, and thank
25 you again. Have a great day.

1 UNIDENTIFIED ATTORNEY: Thank you, Judge.

2 THE COURT: Thanks.

3 UNIDENTIFIED ATTORNEY: Thank you, Your Honor.

4
5 * * * * *

6
7 **C E R T I F I C A T I O N**

8 I, KIM WEBER, court approved transcriber, certify
9 that the foregoing is a correct transcript from the official
10 electronic sound recording of the proceedings in the above-
11 entitled matter, and to the best of my ability.

12
13 /s/ Kim Weber

14 KIM WEBER

15 J&J COURT TRANSCRIBERS, INC.

DATE: May 20, 2026

x- - - - - x Case No. 24-11840 (CMG)
IN THE MATTER OF: . Chapter 11
 . Trenton, New Jersey
THRASIO HOLDINGS, INC., ET AL .
 . June 10, 2024
Debtors, .
- - - - - .

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Proceedings recorded by electronic sound recording, transcript
produced by transcription service.

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I N D E X

1		
2		
3	ORAL ARGUMENT	PAGE
4	BY MR. PETRIE	7
5	DECISIONS	
6	Admission of four Declarations	14
7		
8	ORAL ARGUMENT	
9	(Objections to plan)	
10	MR. PETRIE	14/43
11	BY MR. MANNAL	22
12	BY MR. JAFFE	29
13	BY MR. BAKER	30
14	BY MR. THOMPSON	31
15	BY MR. SPONDER	33/47
16	DECISION (Confirmation)	48
17	DECISION (5th cash management order)	54
18	DECISION (final creditor matrix order)	56
19	DECISION (removal motion)	57
20	DECISION (Bristol 6 motion to seal)	58

1 THE COURT: I have the notice of agenda in front of
2 me for Thrasio. And we can start. Why don't we start with
3 appearances from you first. And then we'll get the US Trustee
4 and a few others.

5 MR. PETRIE: Great, good morning, Your Honor, Francis
6 Petrie from Kirkland on behalf of the Debtors. I'm joined here
7 with my colleague Mary Catherine Young in the courtroom, Bill
8 Arnault, my partner Matt Fagen is available on Zoom in believe.

9 THE COURT: Okay.

10 MR. FAGEN: Good morning, Your Honor. Thank you for
11 having us.

12 THE COURT: Good. I guess we can hear you really well
13 Mr. Fagen.

14 MR. PETRIE: Yes, perhaps we should lower the volume
15 in the courtroom.

16 THE COURT: Good. All right, good morning, okay,
17 thank you. Mr. Sponder.

18 MR. SPONDER: Good morning, Your Honor, Jeff Sponder
19 and Lauren Bielskie on behalf of United States Trustee.

20 THE COURT: Good morning. I note Ms. Yudkin is here
21 for local counsel.

22 MS. YUDKIN: Good morning, Your Honor, Felice Yudkin,
23 Cole Schotz PC on behalf of the Debtors.

24 THE COURT: Thank you. I saw Mr. Reisman. You can
25 enter your appearance from there, Mr. Reisman.

1 MR. REISMAN: Thank you, I appreciate that. Steven
2 Reisman, Katten Muchin, on behalf of independent directors
3 Stefan Selig and Tony Horton. Mr. Horton is in the courtroom
4 today, Your Honor.

5 THE COURT: Okay, thank you. And we have, who is
6 here for the Committee today?

7 MR. MARINUZZI: Good morning, Your Honor, Lorenzo
8 Marinuzzi from Morrison and Foerster here with Doug Mannal, on
9 behalf of the Committee.

10 THE COURT: Good morning, thank you. Who -- ad hoc,
11 first lien group.

12 MR. ZUJKOWSKI: Good morning, Your Honor, Joe
13 Zujkowski, Gibson Dunn, on behalf of the Ad Hoc Group.

14 THE COURT: Good morning. And is anyone here from
15 Bristol 6?

16 MS. BROOK: Yes, Your Honor, Anna Brook from Culhane,
17 and I'm here with James Till and John Schafer from the Till Law
18 Group.

19 THE COURT: All right, thank you. And then I have --
20 would there be appearances from Your Homes Good, Inc.? It
21 looks like they're presenters this morning.

22 MR. PETRIE: They're a Committee member.

23 THE COURT: A Committee member?

24 MR. PETRIE: Yes.

25 MS. GAMBALE: Good morning, Your Honor, I don't know

1 why my video is not -- Good morning, Your Honor, Alexis Gambale
2 on behalf of Your Home Goods, Inc. And I have Henry Jaffe here
3 as well.

4 THE COURT: Okay, thank you. And then finally, Mr.
5 Liechtenstein or Mr. Thompson.

6 MR. THOMPSON: Good morning, Your Honor
7 (indiscernible-audio skip) along with my colleague Mark
8 Lichtenstein of Akerman, LLP, on behalf of (indiscernible-audio
9 skip)

10 THE COURT: Okay, you're breaking up a little bit.
11 I'm not sure -- are you on a landline?

12 MR. THOMPSON: I'm not Your Honor, I'm on a cellular
13 connection, so perhaps my partner Mr. Lichtenstein can make the
14 appearance if you can't hear me.

15 THE COURT: Yes, I mean we can hear bits and pieces,
16 but not fully. So maybe it would be better if -- Mr.
17 Lichtenstein, can you hear us?

18 MR. THOMPSON: Your Honor, how is that without the
19 video?

20 THE COURT: That works. That sounded very clear.

21 MR. THOMPSON: It's probably better for everybody
22 anyway. John Thompson and Mark Lichstenstein, Akerman, LLP on
23 behalf of Joshua Silberstein.

24 THE COURT: Okay, thank you. I think that's -- I
25 think we got everybody. So go ahead, Mr. Petrie.

1 MR. PETRIE: Great, Your Honor, good morning.
2 Francis Petrie of Kirkland, counsel for the Debtors. As I
3 mentioned, I'm joined here in the courtroom with my colleague
4 Ms. Young from Kirkland, and co-counsel from Cole Shotz, Ms.
5 Yudkin. At the outset on behalf of the Debtor advisor team and
6 the company, we'd like to thank the Court and staff for all of
7 your efforts throughout these cases and especially over the
8 last several weeks where we had status conferences almost on a
9 weekly basis in order to keep these cases progressing and
10 moving forward.

11 And we also recognize you've been very accommodating
12 to our timing with filing documents. We filed some revised
13 documents on the docket as recently as this morning. Those
14 incorporate some additional changes between the parties.

15 I'd also like to take this opportunity to express
16 gratitude to all the groups involved with getting us here
17 today. Thrasio's Board of Directors and all of the companies'
18 employees, as well as Thrasio's management team, including
19 Gregg Greely, Josh Burke and Mike Fahey, each of whom worked to
20 keep this business stable and make tough decisions during at
21 time of uncertainty. And whose efforts have positioned Thrasio
22 for a future success.

23 The first lien lenders represented here by Mr.
24 Zujkowski played a major role in supporting the company and
25 funding both these cases and the go forward business with their

1 skilled representation. And the disinterested directors of the
2 Board, Mr. Selig and Mr. Horton, and their counsel at Katten
3 who helped drive the process forward through their independent
4 investigation and assisted us with reaching the appropriate
5 scope of releases. And to the Committee and their advisors, who
6 despite the occasionally contentious posture that you may have
7 witnessed, constructively worked with both our team, the
8 independent directors and the first lien lenders, towards
9 reaching a settlement.

10 But the main reason we're here before Your Honor
11 today is to finally request approval of the Debtors' plan.

12 THE COURT: Okay, I'm adding my thanks to my chambers
13 and the Clerk's Office, I know they did a fantastic job. So I
14 appreciate that. And I have to say that I was at my oldest
15 grandson's birthday party in a backyard with like 75 people all
16 day yesterday, so I read in the morning and I came back to read
17 last night, and I was starting to get a little aggravated. But
18 I thought, these people have all these people, US Trustee's
19 Office included, have worked so hard on this. I can't -- I
20 enjoyed reading last night to tell you the truth. So thank
21 you, thanks for everybody here.

22 MR. PETRIE: Great, happy to hear, Your Honor. And
23 of course I'd be remiss not to thank the Office of the US
24 Trustee, who we have worked constructively with, and have
25 narrowed their objection down to a few open points that we'll

1 get into later.

2 THE COURT: Yes, and they always get stuck last
3 minute, you know, reading all the last minute stuff.

4 MR. PETRIE: They always love to talking to me, yeah.

5 THE COURT: That's my fault. But go ahead.

6 MR. PETRIE: Anyway, in today's market, it's not
7 everyday that counsel can say this, but what's before you is a
8 Chapter 11 plan of reorganization. And it's one that maximizes
9 recovery available to creditors and contemplates a delevered
10 streamlined go forward Thrasio that's positioned for success.

11 We do have a presentation that I'm not sure if it's
12 too onerous to bring it up or not. But can we add Matt Waldrup
13 (phonetic) as the screen share?

14 THE COURT: Yes, he started sharing his screen.

15 MR. PETRIE: Great. Okay, Your Honor. So let's go
16 to the next slide. I'm sure you read this in our papers. But
17 I am very happy to report that the Plan that we seek approval
18 of today is highly consensual. After our voting results came
19 in we received overwhelming approval by each of the voting
20 classes. 100 percent of first lien lenders submitted ballots
21 approving the Plan. 99 percent in amount of general unsecured
22 claims, as well as 92 percent by number also accepted, for a
23 headline number of 99 percent of voting creditors submitted
24 ballots seeking to accept this plan.

25 So with these results the creditor body has clearly

1 spoken. And we're not surprised by this massive consensus
2 either. We do believe that the Plan presents the best path
3 forward for Thrasio. And on the early days of these cases we
4 did promise a fair and quick process. The voting results show
5 that that's precisely what we delivered.

6 Under this set of facts we clearly met Section
7 1129(a)(10)'s requirement for having one impaired class approve
8 the Plan for confirmation.

9 And I'll spare the Court a detailed discussion of the
10 additional 1129 factors, which are all laid out in our papers.
11 The brief that was filed on Friday at docket number 1101, we do
12 go into each of them in very long detail. But we do meet each
13 of them and no party has really suggested otherwise.

14 So passed that, the additional governing documents
15 that we seek approval of today include the Plan at docket
16 number 1112, which is styled as the first amended plan with
17 further technical modifications. We did file a proposed
18 confirmation order on the docket. It is likely that we're
19 still going to be sorting out some language in that
20 confirmation order. So we'll submit a final version once we
21 have sign off from all parties to chambers, as has been our
22 tradition in this case.

23 And we did file a revised agenda this morning, that
24 it does sound like Your Honor had the opportunity to look at.
25 That shows the status of the matters going forward. And as you

1 can see on that agenda, we have resolved a number of the formal
2 objections through contracts in the Plan and confirmation
3 order.

4 So I think that leaves us with the two objecting
5 parties. We have resolved with many of the ones that have been
6 at issue in these cases, including Bristol 6. But that leaves
7 us with two open items. The US Trustee, who as I said before,
8 I'm happy to report we engaged with, and we were able to
9 resolve many of their office's issues. But still outstanding
10 are arguments primarily about the scope of releases contained
11 in the Plan and the gatekeeper provision, which I'll speak
12 about in a little, and a co-founder of the company who is a
13 party who is excluded from the release, whose limited
14 objections surrounds the scope of those releases.

15 We'll come to discuss those later in the
16 presentation. In some ways they are interrelated issues, about
17 the appropriateness of the scope of the Plan's release
18 provisions.

19 But first before we get into that, let's highlight
20 the features of the Plan that's before Your Honor today. The
21 Plan serves as the final step in Thrasio's transformative
22 efforts that were put into place by its new management team.
23 After emerging -- after engaging in an aggressive operational
24 restructuring, the purpose of the Plan is to right size the
25 company's balance sheet. The Plan will delever this company

1 by approximately \$495 million. And upon emergence, the DIP
2 will convert. 90 million of the new money loans convert into a
3 first lien term -- first out term loan facility. And 270
4 million of the roll up loans will convert into a second out
5 term loan facility. The conditions of which, including the
6 ability to make payments in kind, will allow the company the
7 requisite liquidity that it needs for future success.

8 It's not secret that companies operating in the
9 aggregator space have been very challenged in the last couple
10 of years. Thrasio is the largest in the industry. And
11 hopefully through this plan we can create some healing within
12 this turbulent market. We truly believe that a more stable
13 Thrasio can have a major role in helping solve the systemic
14 problems in this field.

15 And just as importantly, as described in the status
16 conference several weeks ago, the Debtors and first lien
17 lenders reached a settlement with the Committee that resolved
18 the issues that they previously raised surrounding confirmation
19 of the Plan.

20 With the assistance of the report of the independent
21 directors, we were able to formulate an agreeable settlement
22 between all three groups. Under the settlement construct, the
23 releases in the Plan were modified to exclude certain parties
24 and causes of action aligning with the findings of the
25 independent directors. A bankruptcy remote Trust was formed,

1 which has the sole authority to investigate, prosecute, and
2 settle causes of action that are not released under the current
3 plan. This process will be headed by an administrator that's
4 overseen by a five person board, with designees from various
5 constituents that are described in the Plan.

6 And on the effective date, the Trust will be
7 capitalized with \$5 million, and any future proceeds that come
8 out of those causes of action will be distributed in accordance
9 with the splits set forth in the Plan.

10 The Committee is also now a released and releasing
11 party. They will not pursue their threatened standing motion.
12 And they support the Plan before Your Honor today. The result
13 here is one that embodies how Chapter 11 is supposed to work.
14 The Committee did their job representing the general unsecured
15 creditor body, and we were able to negotiate a deal that was
16 fair to all parties once sufficient information came to light.

17 We've analyzed the remaining objections and in our
18 assessment these are almost entirely legal in nature. No
19 objection seems to raise disputes about the facts at hand. With
20 that said, we did file four declarations in support of
21 confirmation. The declaration of Tony Horton, who is one of the
22 independent directors, which sets out the investigation process
23 and the results. Terrence Grossman who is the bankruptcy
24 administration officer of the Debtors, also of Alix Partners,
25 did the liquidation analysis. And his declaration supports the

1 1129 factors, best interest test and feasibility. Whit Graham
2 of Centerview, whose declaration describes the underlining
3 valuation for the Plan. And James Lee of KCC, whose
4 declaration sets out the votes and tabulation procedures.

5 All of these individuals are here in the courtroom,
6 and are available to cross examined if needed. So at this
7 time, we'd like to admit all four of these declarations into
8 evidence to ensure that we meet our burden.

9 THE COURT: Okay, any objections to admitting the
10 certifications? They're so admitted.

11 MR. PETRIE: Thank you, Your Honor. So for the
12 record, by our count, we now have two remaining objections that
13 I'll address right now, with the expectation that I can reserve
14 time to respond to any arguments that come up from these
15 objecting parties.

16 THE COURT: Yes.

17 MR. PETRIE: So I'll start first with the good news,
18 which is that we've largely narrowed the issues raised in the
19 US Trustee's objection. There are changes in the amended plan
20 that deal with the definition of exculpated parties, language
21 on the injunction provision, case closing protocols, and other
22 revisions to the confirmation order surrounding references to
23 Section 9019.

24 But the US Trustee as we understand it, still takes
25 issue with some of the other pieces of the Plan, in particular

1 the release provisions. However, Your Honor, the Debtor
2 release is not overly broad, and it's compliant with applicable
3 law. The Debtor release that's contained in the Plan is a
4 critical piece of that plan. It's undeniable that the Debtor
5 release is in the best interest of creditors. And without its
6 inclusion we would not have the support of the people we need
7 to effectively reorganize.

8 We set this out in our brief, but courts in this
9 jurisdiction analyze Debtor releases under the Zenith factors,
10 which include an inquiry into five different prongs, all of
11 which we meet here and are laid out in the brief. The identity
12 of the interest between the Debtor and the nondebtor.
13 Certainly the parties that are released are stakeholders in
14 these cases and share a common goal with the Debtors to
15 reorganize. Contributions to the Plan. The parties played an
16 integral role in the formulation of the Plan and contributed to
17 not only by expending a significant time and resources in
18 negotiating that plan, they do plan to continue to work at the
19 reorganized company, or accept a reduced recovery in order to
20 allow for the implementation of the Plan.

21 The necessity of the release. The Debtor release is
22 essential to the success of this plan. Absent that release
23 it's highly unlikely that the released parties would have
24 agreed to support or highly unlikely the Plan would exist at
25 all. And the overwhelming acceptance of the Plan and release

1 by creditors. We have that here. We have all these individuals
2 voting in favor of this plan. And we should not second guess
3 the judgment of 99 percent of the voting body. As well as
4 payment of all or substantially all of the claims of the
5 creditors. The Plan provides the highest amount that's
6 available for these claims, including through distribution of
7 future Trust proceeds, so the fifth factor is also met.

8 Passed that, the standard is very lenient here. It
9 is within the Debtors' business judgment and the breadth of the
10 Debtor release is consistent with those regularly approved in
11 this jurisdiction and others.

12 Okay, continuing and related to this, is the limited
13 objection of Josh Silberstein. I would not it's a surprise
14 that as a primary target of the investigation he's not happy
15 that he's carved out of the release. And we understand his
16 perspective. But there were several stages during which we had
17 put Mr. Silberstein and all creditors on notice about the scope
18 of the releases and how they could narrowed in the future.
19 We'd always broadcast the ability to narrow these releases in
20 the Plan. And an explicit disclaimer was provided in the Plan
21 that we filed on February 28th, that the releases were wholly
22 subject to the results of the investigation. All noticing in
23 these cases was proper and we never once asked to shorten any
24 of the deadline or notice periods as provided under the
25 Bankruptcy Code or rules.

1 But I'd like to reemphasize that what we are not
2 doing right now is making judgments about guilt or innocence.
3 So this is not a question of due process. And it's not one of
4 prejudice. No judgment will be rendered against any party
5 tomorrow simply because they are not party to the releases.
6 Any regular way litigation claim against Mr. Silberstein, or
7 others, would still require parties to adhere to the proper
8 service and notice requirements, as well as due process.

9 The confirmation order does nothing to impair any of
10 that. Mr. Silberstein's rights are preserved, including any
11 legal defenses he would like to raise. And I'm certain that if
12 any party chooses to bring a claim or cause of action against
13 him, he will get his day in court.

14 However, the goal today is to insure that value is
15 preserved for the Estates. The investigation report showed
16 that these causes of action against Mr. Silberstein may be an
17 Estate asset. And so the standard we are being held to again
18 is business judgment. And the reality of that is that based on
19 the evidence presented to the Debtors, and as a term of entry
20 into the settlement, preserving the ability to bring these
21 causes of action is appropriate.

22 The voting results also confirm support for releases
23 that have this scope. The voting deadline came after the
24 filing of the settlement term sheet, and after the
25 investigation report was publicly available. So what the

1 voting results show is that the overwhelming creditor support
2 is for releases that are tailored in this fashion, based on the
3 results of the investigation report and negotiations with the
4 Committee. And that is what was approved.

5 So that brings us to the third party release and opt
6 out. The opt out and the third party release is reasonable and
7 appropriate, and wholly consistent with the decisions not only
8 of this Court but of the Circuit more broadly. First, the
9 third party release language is clearly and conspicuously
10 included in virtually every document we filed since February.
11 It was in the initial plan, it was in the ballots, it was on
12 opt out forms, and each of those were sent to parties in
13 connection with solicitation.

14 The Committee even emphasized this choice for
15 creditors in its letter opposing the Plan, initially urging
16 them not to check this box, which was sent to all parties in
17 interest through the solicitation packages. So the obligation
18 to affirmatively check a box to opt out appears in all these
19 documents, and should come as no surprise to any parties in
20 these cases.

21 The law is clear that a release is consensual where
22 parties have received sufficient notice of a plan's release
23 provisions and have had an opportunity to object to or opt out
24 of the release and failed to do so, including when a holder
25 abstains from voting all together.

1 Accordingly, there's no question that all applicable
2 stakeholders had proper notice of their rights, and could have
3 chosen to opt out of the third party release. With this ample
4 opportunity and process that was made clear to claim holders,
5 we've had a number of parties in interest who have availed
6 themselves of the opt out. North of 60 people did so,
7 according to the voting declaration as it stands, which further
8 demonstrates that the process not only worked as intended, but
9 was clear and understood by parties who chose to protect their
10 rights and participate.

11 However, the overwhelming weight of authority in this
12 District suggests that these releases are permissible. And
13 most Judges in this District have found that opt out
14 mechanisms, such as the one included in the Plan, constitute
15 consensual releases.

16 Recent cases, including WeWork, Cyxtera, Blockfi and
17 Bed Bath and Beyond have all upheld the notion that a nondebtor
18 release is consensual where, as here, holders of claims in
19 interest are provided an opportunity to opt out. Courts
20 throughout the Circuit follow similar reasoning.

21 The US Trustee also objected to what's labeled as the
22 gatekeeper provision of the Plan. What this feature does is
23 that to the extent any individual seeks to assert a claim or
24 cause of action against a released party, that entity must
25 first obtain an order from this Court determining that its

1 authorized to bring such a claim. It's not contemplated
2 necessarily that this Court, the gatekeeping Court, is ruling
3 on the underlying merits of the action. The Court is making an
4 inquiry into whether or not there's an ability to bring the
5 cause of action, or if it has been addressed as part of the
6 Plan or confirmation order.

7 Therefore, what we're asking for this Court to answer
8 is an initial threshold inquiry and engage in the construction
9 of the terms of the Plan and confirmation order. And clearly
10 this Court is the best forum to accurately construe the
11 language of its own orders. Though true that Bankruptcy Courts
12 are of limited jurisdiction, interpreting its own orders is
13 certainly within Your Honor's authority.

14 And if there is a real direct claim against released
15 parties, then the claim will have to be defended on the merits.
16 But we'll note that this mechanism has been approved in this
17 District in many recent cases. WeWork and Blockfi for instance
18 had this same formulation.

19 The burdens that are implemented through the system
20 are appropriate. Creditors showed that they're willing to
21 accept whatever burden this present by overwhelmingly voting in
22 favor of the Plan, that contained this mechanism.

23 But on this topic of burdens, odds are that if there
24 were an issue about releasing claims, the dispute would likely
25 be in front of the Bankruptcy Court regardless. The plaintiffs

1 would be brought here by the defendants, to interpret the order
2 and enforce the confirmation order or plan, arguing that they
3 were released or not.

4 So I argue that what this mechanism does is it
5 preserves the future company's resources that otherwise would
6 be waste defending frivolous actions that are going to be
7 brought improperly.

8 And likewise, that structure benefits everyone.
9 Individual claimants may have no idea whether their claims are
10 enjoined or released by the Plan, and clearing up this inquiry
11 in this Court, which is more accessible than the vast majority
12 of forums in this country, will let individuals know whether
13 their claim can be properly brought.

14 And it prevents Courts from -- it prevents us from a
15 situation where Courts across the country are going to
16 inconsistently construe the Plan and confirmation order, which
17 would especially be at issue here.

18 This mechanism is now common in this jurisdiction.
19 And that is for a good reason. It's a feature that offers
20 protection, consistency and fairness. It's inclusion and
21 structure here were negotiated with the Committee and its
22 inclusion in the Plan was overwhelmingly accepted by all voting
23 creditors.

24 So that's all for my presentation. With that Your
25 Honor, I'm ready to conclude. I do imagine the Committee, that

1 Katten, and objecting parties will also want to speak. And
2 accordingly as I mentioned, before, I'd like to reserve some
3 time to respond to their arguments as appropriate.

4 THE COURT: Of course.

5 MR. PETRIE: Okay, so unless Your Honor has any
6 questions for me, I'm happy to turn the podium over.

7 THE COURT: No, thank you, Mr. Petrie. What about
8 Mr. Marinuzzi or Mr. Mannel, do you want to --

9 MR. MANNAL: Good morning, Your Honor, this is Doug
10 Mannel from Morrison and Foerster, on behalf of the Committee.
11 Hopefully you can hear me.

12 THE COURT: I can, very well, thank you, Mr. Mannel.

13 MR. MANNAL: Great, thank you, Your Honor. My
14 apologies for not being there in Trenton, but I was up very
15 late last night and I was informed that this was going to be a
16 virtual hearing. I hope to see you in the future.

17 THE COURT: Yes, it's not that we didn't want you
18 here. Nobody was trying to keep you out. Nice to see you.

19 MR. MANNAL: Okay, nice to see you too. I want to
20 highlight a few provisions of the amended plan and emphasize
21 some of the remarks made by Debtors' counsel. First, the
22 amended plan is based on a settlement that was achieved between
23 the Committee, the lenders and the Debtors. And integral to
24 the Committee's settlement is the creation of the Thrasio
25 Legacy Trust. As Debtors' counsel said, the Trust will be

1 funded with a \$5 million contribution from the Debtors'
2 Estates. And shall be vested with the right to pursue and
3 settle certain causes of action and claims against parties who
4 are not receiving a release under the Plan. And those are
5 referred to as excluded parties under the Plan.

6 In addition, the Trust is empowered with pursuing
7 claims and causes of action for fraud and willful misconduct.
8 These are referred to as vested causes of action in the Plan.

9 And I think it's important to walk the Court through
10 the definition of excluded parties to make clear who is an
11 excluded party not getting a release under the Plan. In
12 accordance with the Committee's settlement, excluded parties
13 means in each case, in all capacities, Joshua Silberstein,
14 Carlos Cashman, and pardon the pronunciation, Joseph Falcao,
15 Daniel Bookckvar, Mounir Ouhadi, and Aditya Rathod.

16 In addition, transferees of Thrasio's assets in
17 connection with the transactions involving the Yardline Capital
18 transaction between April 2020 and January 2022, including but
19 not limited to Mr. Ari Horowitz.

20 In addition, the cooperating parties subject to
21 Article 4(j)(9) of the Plan. Now the cooperating parties are
22 uniquely situated. The cooperating parties have separately
23 been identified and disclosed to the Committee and agreed upon.
24 And the Trust will not pursue claims and causes of action
25 against the cooperating parties, so long as they enter into the

1 cooperation agreements with the Trust, and perform in
2 accordance with the terms of those agreements.

3 If however the cooperating parties fail to adhere to
4 their obligations under the cooperation agreements, we'll be
5 back before Your Honor consistent with the provisions in the
6 Plan and the confirmation order. And we'll be pursuing claims
7 against them.

8 In addition, Your Honor, excluded parties include the
9 family members, related trusts, investment vehicles,
10 affiliates, successors and assigneds, of those persons
11 identified in clauses 1, 2, and romanette iii, of the defined
12 term excluded parties.

13 Provided that excluded parties shall not include any
14 current or former directors and officers of the Debtors, the
15 reorganized Debtors, or otherwise identified in clauses 1, 2,
16 and 3.

17 Now this clause 4, rather, Your Honor, is a bit
18 complex. And I want to make sure that the Court is aware of
19 how it works. The reason for this clause is to pickup the
20 related parties of those persons identified in romanettes i,
21 ii, iii of the definition of excluded parties. But it's not
22 intended to sort of backdoor and pickup the former officers and
23 directors who are getting a release, such that they are not
24 dragged into the excluded party definition in clause 4.

25 And I think that's an important point, Your Honor.

1 And it's very clear that those parties identified, and those
2 persons identified in romanettes i, ii, and iii, are not
3 getting a release under the Chapter 11 Plan, as they are
4 excluded parties.

5 Your Honor, the confirmation order provides
6 notwithstanding anything contained in the Plan, any ballot, any
7 prior order of the Bankruptcy Court, or otherwise, none of the
8 excluded parties shall be released parties, releasing parties,
9 related parties, and/or exculpated parties under the Plan.

10 Importantly, the Trust is vested with the right to
11 pursue any and all claims, any and all claims, Your Honor,
12 against the excluded parties, in any of their capacities,
13 without any limitation. The lenders and the nondeficiency
14 unsecured creditors have agreed to divide the interest in the
15 Legacy Trust 50/50. And this agreement was the subject of hard
16 fought negotiations, with the lenders and the Unsecured
17 Creditors Committee. But as co-owners of the Trust, Your
18 Honor, we believe that the parties will work constructively
19 together, post-effective date, overseeing the Legacy Trust.

20 Meta, an experienced Trustee firm, shall be the
21 Thrasio Legacy administrator under the Plan. The Trust will be
22 overseen by a Board comprised of two representatives of the
23 lenders, and two representatives selected by the Committee.
24 Meta will be the fifth Board member for the Trust.

25 Any proceeds distributed out of the Trust will be

1 distributed as follows. First, to repay the reorganized
2 Debtors the \$5 million that will be transferred to the Trust on
3 the effective date. And to do this the Trust will take 80
4 percent of the first dollars it receives to repay the
5 reorganized Debtors, and 20 percent will be maintained within
6 the Trust. Second, until the lenders receive three and a half
7 million dollars, the proceeds shall be split 70/30 between the
8 lenders and the other general unsecured creditors. And
9 thereafter, Your Honor, the Trust proceeds will be split 50/50.

10 Your Honor, this has been a remarkably quick
11 bankruptcy case. Yet a significant amount has been
12 accomplished in a very small amount of time. We began these
13 cases with unsecured creditors receiving their pro rata share
14 of \$250,000. And we told Your Honor at the outset that the
15 Committee did not believe such a Plan was remotely reasonable
16 or confirmable. It was only after performing a substantial
17 investigation done by the Committee on the pre-petition
18 activities of the Debtors, that the Committee was able to
19 improve the potential recoveries to unsecured creditors
20 reflected in the agreed upon Plan today.

21 We want to make clear that the confirmation order
22 remains subject to further review and comment by the Committee,
23 Your Honor. As Debtors' counsel said at the outset, we are
24 still working through the order. And we expect to provide you
25 a fully consensual order that will be presented to you after

1 today's hearing.

2 For example, Your Honor, we are in discussions with
3 the Debtors on exactly how the gatekeeper mechanic contained in
4 the Plan, in the confirmation order, will impact the Trustee's
5 ability to bring claims against released parties. We don't
6 believe that there will be any issues, but if there are we will
7 of course be back before Your Honor.

8 I'd like to take this time to thank all the parties
9 that assisted us to reach the point where we are today.
10 Including Your Honor, the fully volunteer members of the
11 Unsecured Creditors Committee, who donated their time to
12 improve recoveries for all unsecured creditors.

13 Your Honor, the Committee members took their roles as
14 fiduciaries very seriously. And they met with their
15 professionals at least once a week, often more than once a
16 week. And there were several one off calls that we had with
17 the Committee members. I have rarely worked on a case where the
18 Committee members were more engaged and more attentive.

19 And finally, Your Honor, I'd like to thank the Court
20 staff for their flexibility and responsiveness, and to Your
21 Honor for your attentiveness and guidance overseeing this case
22 and the numerous court hearings and conferences we had on
23 shortened notice.

24 Your Honor, those are my remarks for today. I'm
25 happy to answer any questions.

1 THE COURT: All right, thank you, Mr. Mannal. I have
2 no questions. Anyone else to comment here?

3 MR. PETRIE: Your Honor, just one point of
4 clarification on the cooperating parties, to clear something
5 up. If the cooperating parties don't adhere to the terms of
6 the Plan, that does not mean they automatically get sued in
7 this court, or it's no admission that there's colorable claims
8 against them. They would just become excluded parties and
9 excluded from the release. Just to clarify, in case that got
10 lost, Your Honor.

11 THE COURT: You good with that, Mr. Mannal?

12 MR. MANNAL: That's correct. I think the Plan and
13 the confirmation order will speak for themselves.

14 THE COURT: Okay. All right, thank you. Who else do
15 we want to hear from? Mr. Reisman, do you want to add --

16 MR. REISMAN: Your Honor, Steven Reisman, I'm sorry,
17 I'll rise. I'll reserved until evidence is closed here, and
18 then I'll be happy to make a statement.

19 THE COURT: Okay.

20 MR. REISMAN: Thank you.

21 THE COURT: Mr. Zujkowski, do you --

22 MR. ZUJKOWSKI: Your Honor, nothing to add. The Ad
23 Hoc Group reserves all rights with respect to the final
24 confirmation order and we join our -- or add to the
25 appreciation expressed to Your Honor and to Your Honor's staff

1 for all their work over the course of these cases.

2 THE COURT: All right, thank you. And you're welcome
3 for all that. That's what we're here for. How about, Your Home
4 Goods, Inc.? As a presenter, Ms. Gambale?

5 MR. JAFFE: Your Honor, this is Henry Jaffe. I am --
6 can you hear me, Your Honor?

7 THE COURT: I can, yes.

8 MR. JAFFE: Yeah, I'm counsel, Henry Jaffe, of
9 Pashman Stein Walder Hayden, I'm counsel for Your Home Goods.
10 We are a Committee member. Actually we signed up just as one
11 would in a courtroom that I do appear. However, I want to just
12 say something very quickly. I want to express my appreciation
13 for all the parties for working cooperatively. The lenders
14 really did work with the Committee here, and the Debtors
15 permitted this process to move forward. We saw it from a
16 distance in many cases as Committee members. But we appreciate
17 it.

18 The other thing I wanted to mention is just, because
19 nobody is really going to say it, except perhaps we Committee
20 members, but the extraordinary job done by Committee counsel,
21 both Morrison and Foerster and Kelley Drye. It was something
22 to behold really. The amount of work they did, the focus. And I
23 would add our advisors, Provence, they also did an outstanding
24 job.

25 And I really don't have anything material to add to

1 Mr. Mannal's comments. We agree with them all and echo them,
2 and thank them for everything they've done for the unsecured
3 creditors.

4 And finally, the only thing I would have to say is,
5 we too would like to review the final confirmation order, and
6 of course we'll be in consult with the Committee as necessary
7 to reflect those comments. I want to thank Your Honor for the
8 time.

9 THE COURT: All right, thank you.

10 MR. BAKER: Your Honor, if I may, Nicholas Baker from
11 Simpson Thacher and Bartlett.

12 THE COURT: Yes, go ahead, Mr. Baker.

13 MR. BAKER: Thank you, Your Honor. For the record we
14 represent Royal Bank of Canada, who is the administrative agent
15 on the pre-petition loan facility of Thrasio. Again, just not
16 to belabor the point, we obviously thank everyone in the
17 courtroom and Your Honor and your staff for getting us here.

18 Just similar to the other parties, we do want to
19 reserve all of our rights on the confirmation order, as well as
20 the Plan supplement documents. We've obviously seen term
21 sheets, but until those documents are done and signed, we're
22 going to reserve rights on those. But we have no doubt that
23 we'll get to a place that's consistent with the restructure and
24 support agreement.

25 THE COURT: All right, thank you. Mr. Petrie, I'm

1 sure you're sharing the confirmation order and all of the
2 documents with folks that are going to want to review and
3 comment.

4 MR. PETRIE: Yes. Certainly. Correct, yes, we are,
5 Your Honor.

6 THE COURT: All right. Thank you, Mr. Baker.

7 MR. BAKER: Thank you, Your Honor.

8 THE COURT: All right. Anyone else? I don't think
9 -- why don't we go then to Mr. Thompson.

10 MR. THOMPSON: Yes, Your Honor. If it's okay, just
11 to make things easier, I'll just make my presentation orally as
12 opposed to video, as it seems to be a problem in making me more
13 choppy, my voice.

14 THE COURT: That's fine.

15 MR. THOMPSON: If you can hear me okay.

16 THE COURT: I can hear you fine, thank you.

17 MR. THOMPSON: Thank you, Your Honor. Again, John
18 Thompson of Akerman on behalf of Joshua Silberstein.

19 Your Honor, I was, in anticipation of hearing the US
20 Trustee present on what remaining objections they may have, I
21 was going to associate myself with that, with those comments,
22 to make more brief my presentation. And I think I'll just try
23 to do that only because I know that there are outstanding
24 issues with respect to -- that Debtors' counsel referenced with
25 respect to the US Trustee concerns about the, about the

1 releases.

2 I would only say a few things, Your Honor, before
3 reserving. And that's just to hopefully keep things short and
4 understand that there are a lot of people in the courtroom and
5 a lot of people online. And I think we all know where this is
6 headed.

7 So it is regrettable that we did not have more
8 fulsome or frankly any discussions with the Debtors in
9 anticipation of the decision to, have Mr. Silberstein included
10 as an excluded party, given his previous relationship with the
11 company. And the fact that he left what will be three years
12 ago as of September.

13 We do understand what's happening, we do understand
14 the reservation of rights, and I think while that is
15 concerning, and we do have concerns about others being more
16 directly or proximately involved in the running of the company
17 over the course of the last two and a half years, from two and
18 a half years through from his departure through the bankruptcy
19 filing, I think we would just reserve all of our rights with
20 respect to both the confirmation order and any Plan supplement.
21 And with that, Your Honor, I think I'll rest.

22 THE COURT: All right, thank you. I guess the only
23 thing I can add to that is, I don't, well I don't agree
24 obviously with your limited objection. It seems to me that
25 there's been no due process violation. Your client has every

1 opportunity, when and if he's brought in, to explain his lack
2 of liability here. So I don't think it's a problem with
3 allowing the release as to excluding certain parties.

4 But let me hear from Mr. Sponder about the issues,
5 the general issues of gatekeeping and releases in general,
6 please.

7 MR. SPONDER: Thank you, Your Honor. Good morning,
8 Jeff Sponder from the Office of the United States Trustee.
9 Your Honor, the US Trustee filed an objection to the first
10 amended joint Plan of reorganization at docket 1073, on the
11 basis that the exculpation clause is impermissibly broad. The
12 Debtor releases are over broad. The opt out clause is
13 insufficient. The nondebtor third party releases are not fair
14 and necessary to the reorganization. The injunction provisions
15 are impermissible. The Plan is not a settlement subject to
16 approval under 9019. And the gatekeeping provision should be
17 removed.

18 In addition, Your Honor, the US Trustee objected to
19 the statutory fee language in the Plan, as well as other
20 miscellaneous issues more fully set forth in our objection.

21 Since the filing of the objection, over the weekend,
22 the Debtors filed a first amended joint Plan with technical
23 modifications, a proposed confirmation order, a confirmation
24 brief, and amended Plan supplement, a first amended Plan with
25 further technical modifications, and I'm sure I'm missing some.

1 As counsel mentioned, Your Honor, as a result of the
2 discussions between the United States Trustee and the Debtors,
3 certain issues raised in the objection have been resolved.
4 Including language in the definition of exculpated parties,
5 which is at Article 1(a), paragraph 76 of the Plan, with
6 further technical modifications. I think that's 1112 docket
7 number. And the exculpation provision which is at Article 8(g)
8 of the Plan with further technical modifications.

9 The definition of exculpated parties now only
10 includes specific Estate fiduciaries and the exculpation
11 provision is limited to acts occurring prior to the effective
12 date.

13 In addition, Your Honor, the Debtors have agreed to
14 alternate language and the removal of any language in the Plan,
15 that the Plan is a 9019 settlement. However, Your Honor, it
16 does not appear that such language was revised in Article 8(a)
17 of the Plan with further technical modifications, as it still
18 makes reference to 9019. So we'll discuss that with counsel
19 after confirmation.

20 THE COURT: It sounds like that's going to be removed
21 though right?

22 MR. PETRIE: In the confirmation -- yes. I don't
23 know what the specific Article he's referencing, but yes,
24 references that are offensive to Mr. Sponder will be removed.

25 THE COURT: Okay. So I guess it would be easier if

1 the Debtor could -- I know it's been a difficult case, but
2 pretty much that's what we would end up with, exculpation
3 anyway I'm guessing. So to be able to notify the US Trustee
4 sooner than Sunday night or before the hearing to save a little
5 bit of time for the US Trustee.

6 MR. SPONDER: No, appreciate that Your Honor, and we
7 work well with Debtors' counsel, and have. The other issues
8 resolved, Your Honor, that there will be separate Bankruptcy
9 Court approval to close any of the cases, that's in Article
10 12(k) of the Plan with further technical modifications.
11 However, I note that Article 4(r) of the Plan with further
12 modifications is, also discusses closing cases and has the
13 other language, and I think that that language needs to be
14 consistent in both provisions, or one of the provisions
15 removed. So that's something that we can discuss prior to the
16 confirmation order being entered.

17 The minimum distribution, Article 6(d)(4) of the Plan
18 will be reduced from \$250 to 100. And the United States
19 Trustee withdraws his objection as to the injunction, as this
20 is a reorganization plan not a liquidation plan. And pursuant
21 to Section 1141, upon confirmation the Debtors receive a
22 discharge, which provides that injunction language.

23 Your Honor, the US Trustee has also resolved issues
24 concerning the statutory fee language in the Plan with the
25 Debtors and the Committee. That involves assessments of

1 quarterly fees against the Trust and that the Trust rights to
2 contest the assessments and/or the amount of fees will be
3 specifically preserved.

4 Moving back to the issues that remain outstanding,
5 Your Honor. First, the Debtors seek to release certain parties
6 included in the definition of the released parties. However,
7 the Plan does not establish that each of the proposed released
8 parties are providing adequate consideration in exchange for
9 receiving the Debtor releases.

10 In addition, Your Honor, the Debtors have not
11 established the necessity of the Debtor releases under
12 applicable law, including the Zenith Electronics court case.

13 Next, Your Honor, the US Trustee understands that the
14 current law in this Circuit as to nonconsensual third party
15 releases is the Continental case. However, as Your Honor
16 knows, we await a decision by the Supreme Court on these issues
17 in the Perdue Farm case where the United States Trustee
18 objected on the basis that third party releases are not
19 authorized under the Bankruptcy Code.

20 With that backdrop, Your Honor, this Plan provides
21 for the third party releases for the benefit of the released
22 parties. The nondebtor third party releases are referred to as
23 consensual, but third party releases in Article 8(f) of the
24 Plan cover those who do not affirmatively opt out of the
25 releases, including claimants that vote to reject the Plan,

1 claimants do not vote on the Plan and do not return a ballot,
2 and claimants deemed to reject the Plan.

3 The United States Trustee submits that those parties
4 who vote to reject the Plan, and do not affirmatively opt out
5 of the releases provided by the Plan, are not agreeing to
6 consensual third party releases and thus, including them in the
7 definition of releasing party is contrary to applicable case
8 law, including the standards set forth in the Washington Mutual
9 and the other cases cited in our brief.

10 The United States Trustee submits that creditors who
11 rejected the Plan but did not affirmatively opt out of the
12 releases did not provide affirmative consent. To the contrary,
13 parties that rejected the Plan rejected the entirety of the
14 Plan, which includes the releases, in all likelihood believed
15 nothing further was required. Mark in the rejection box should
16 establish a complete rejection of the Plan including the
17 releases.

18 Accordingly, Your Honor, the United States Trustee
19 submits that those holders of claims who rejected the Plan but
20 did not affirmatively opt out of the releases, should be
21 deleted from the releasing parties. As to those creditors who
22 voted to reject the Plan, it is hard to imagine that they would
23 choose to consent to the third party releases. In addition,
24 Your Honor, a creditor that takes no action should not be
25 treated as giving affirmative consent.

1 Your Honor, to the extent that the third party
2 releases are nonconsensual, they may only be approved under
3 special circumstances, if the release are fair, necessary to
4 the reorganization, and the Debtors present facts sufficient to
5 enable the Court to make those findings. Under Continental the
6 success of the Plan must be based on the releases, and the
7 Debtors must make a showing that sufficient consideration was
8 given to creditors whose claims were to be released, and that
9 such consideration renders the Plan feasible.

10 In other words, Your Honor, to establish the
11 necessity of such releases, the Court declared that the Debtors
12 were required to demonstrate that the success of its
13 reorganization was related to such nonconsensual releases, and
14 the releasees provided a critical financial contribution that
15 was necessary to render the Plan feasible.

16 Under Genesis Health, the Court in discussing
17 Continental considered whether the nonconsensual releases were
18 necessary to the success of the reorganization, the releasees
19 providing a critical financial contribution to the Debtors'
20 Plan, the releasees' financial contribution is necessary to
21 make the Plan feasible, and the release is fair to the
22 nonconsenting creditors. For example, whether the
23 nonconsenting creditors received reasonable compensation in
24 exchange for the release. Here, Your Honor, the Debtors have
25 not established the necessity of the third party releases if

1 they are deemed nonconsensual.

2 Next, Your Honor, as to the gatekeeping provision, as
3 set forth in our objection, the United States Trustee submits
4 that this provision represents an inappropriate burden on the
5 claim holder and should be deleted. As provided in the
6 objection, there is no reason why a Court in which a relevant
7 action has been filed between nondebtors cannot make the
8 determination as to whether the claim was released under the
9 Plan. Again we ask the Court to follow Judge Owens' decision
10 in the In Re: Gulf Coast Healthcare case which we included
11 attached to our objection.

12 Next, Your Honor, the amended Plan supplement was
13 filed that includes as Exhibit J, the Thrasio Legacy Trust
14 administrator agreement. We just learned from hearing from
15 Committee counsel who the administrator is, that's Meta, I
16 don't know what Meta is, but that's the administrator. And we
17 don't know, since it hasn't been disclosed who the Committee
18 members are. The United States Trustee requests that that
19 information be provided prior to confirmation being granted.

20 Next, Your Honor, Section 1129(a)(5) requires the
21 Debtors to disclose prior to confirmation that, the identity of
22 any directors or officers of the Debtors, and to the extent any
23 directors or officers are insiders that will be retained by the
24 Debtors, the nature of their compensation. In Exhibit K to the
25 amended Plan supplement, the Debtors disclosed that Stephanie

1 Fox, the current COO, will become the Debtors' CEO. And Steven
2 Nee, the current senior vice president of finance, will be the
3 CFO.

4 Although paragraph 76 of the Debtors' confirmation
5 brief provides, and I quote, "the Plan satisfies Section
6 1129(a)(5)(A)(i) of the Bankruptcy Code, because the Debtors
7 will disclose the identities of the new Board as well as the
8 responsibilities and compensation thereof in the Plan
9 supplement", the Debtors have not provided any information as
10 to the nature of the insiders' compensation.

11 I understand that they will be paid a salary
12 consistent with their prior roles with the Debtors, but that's
13 nowhere in the documents.

14 Next Your Honor, the Plan sets forth that the
15 confirmation order shall be deemed final approval of the exit
16 facilities and the exit facilities documents, and all
17 transactions contemplated thereby, and all actions to be taken,
18 undertakings to be made, and obligations to be incurred by the
19 reorganized Debtors in connection therewith, including the
20 payment of all fees, indemnities, and expenses provided for
21 therein, and authorization of the reorganized Debtors to enter
22 into and execute the exit facilities' documents, and such other
23 documents as may be required to effectuate the exit facilities.

24 However, Your Honor, the Plan supplement only
25 includes a term sheet for the exit facilities and exit

1 facilities' documents. As such, the Debtors seek confirmation
2 of their Plan and final approval of these documents which have
3 not been disclosed to the Court, the United States Trustee, or
4 any parties in interest.

5 Next, Your Honor, Exhibit C of the Plan supplement
6 contains the restructuring transactions memorandum. The
7 restructuring memorandum sets forth that it remains under
8 discussion, and that I quote, the Debtors and the consenting
9 term lenders reserve the right to modify the restructuring
10 transaction memorandum at any time, including after the Plan
11 effective date, and the restructuring transactions remain
12 subject to modification, refinement, and change in all respects
13 at any time subject to the consent rights in the Plan, and the
14 restructuring support agreement. The Debtors and consenting
15 term lenders should be not be allowed to alter or modify the
16 restructuring transaction memorandum without notice and an
17 opportunity to be heard.

18 Next, Your Honor, the Debtors sought to require a
19 motion for reconsideration to be filed seven days after a
20 determination is made estimating a duplicate claim. And have
21 --

22 THE COURT: Estimating a duplicate?

23 MR. SPONDER: A duplicate claim, and have agreed to
24 extend that to ten days. However, we don't believe there's such
25 a requirement under the Code or the Rules, 9024, to put a limit

1 on when a reconsideration motion can be filed.

2 And last, the United States Trustee is not sure that
3 the modifications to the Trust language in the Plan constitute
4 technical modifications in both the first one and the second
5 one. There are a lot of changes to the Trust agreement. But
6 with that said, 99 percent of the people that voted on the Plan
7 voted in favor of the Plan.

8 So with that, Your Honor, of course we reserve our
9 rights with respect to the confirmation order, and we thank
10 Your Honor.

11 THE COURT: All right, thank you, Mr. Sponder. The
12 last thing that you mentioned, the, that -- it wouldn't be an
13 issue, for me anyway.

14 MR. SPONDER: Okay.

15 THE COURT: I think that the establishment of the
16 Legacy Trust, any information with regard to that clearly is
17 going to provide, hopefully will provide more of a return for
18 unsecured creditors here than anything else would at this
19 point. And the fact that we had disinterested directors
20 investigation, and the investigation of the, the hard work done
21 by the Unsecured Creditor Committee, I'm comfortable that the
22 unsecured creditors have gotten what they can out of this case.
23 So, thank you.

24 MR. SPONDER: Understood, Your Honor.

25 THE COURT: But I do have a few -- Mr. Petrie, I'm

1 sure you have responses, and I could use a little bit of
2 explanation to some of the points that Mr. Sponder has made.

3 MR. PETRIE: Sure, Your Honor So again for the
4 record, Francis Petrie of Kirkland. I would not say that
5 anything that I just heard changed my initial views of the
6 objections. But I can refute some of the specific points that
7 were just discussed by Mr. Sponder.

8 The disclosure points, the compensation of the go
9 forward officers will be consistent with what they were
10 previously paid at the company. But they will be subject to
11 increases by the MIP. The MIP was --

12 THE COURT: Okay. The --

13 MR. PETRIE: The management incentive plan.

14 THE COURT: Okay.

15 MR. PETRIE: And that was described in the Plan and
16 the Plan supplement. That will be further supplemented as
17 those details finalize.

18 The identity of the Trust administrator is going to
19 be Meta, that wasn't decided until very much -- until this
20 morning, based on agreement between the UCC and the Ad Hoc
21 Group. We only learned about that ourselves. The Plan did
22 contain information on the selection process, and designation
23 process, for the administrator and the oversight board. And
24 that was accepted by the voting creditors. So that information
25 was I believe sufficient as these details were finalized.

1 Of course any more information that comes to light
2 that we believe would be appropriate or material we would file
3 in a Plan supplement. And if there's any questions from Mr.
4 Sponder's office, we're always happy to respond to those.

5 The exit facility's term sheet was filed in a Plan
6 supplement back in May. Plan exit facility credit agreements
7 don't finalize until the last minute before you go effective.
8 But all parties are on notice of the substance of what the exit
9 facilities are going to look like, which were actually
10 predetermined the first day of these cases. And in the final
11 DIP order as well.

12 And the restructuring --

13 THE COURT: So but what happens if they change?

14 MR. PETRIE: If they change materially?

15 THE COURT: Yes.

16 MR. PETRIE: I mean we'll be filing the exit facility
17 credit agreement and it's going to substantially look like the
18 DIP credit agreement. If something changes it would be -- I
19 mean there's going to be changes at the edges of course.
20 Nothing material. And if they are changing it is for the better
21 and will inure to the benefit of all unsecured creditors there.

22 THE COURT: But what if it doesn't?

23 MR. PETRIE: If it's a material adverse change then
24 we will come back to the Court and we'll discuss such changes
25 with Mr. Sponder. And if we do have to come back before Your

1 Honor to get a ruling to insure that that is not a problem, we
2 will.

3 THE COURT: Perfect.

4 MR. PETRIE: Okay.

5 THE COURT: Okay, thank you.

6 MR. PETRIE: Is that what you wanted to hear, Your
7 Honor?

8 THE COURT: That's what I wanted to hear.

9 MR. PETRIE: Anyway, that and the restructuring
10 transaction memo is kind of the same story. If -- that will
11 change between now and the effective date. If so it will become
12 more tax favorable, that's very common. It will be filed in a
13 Plan supplement before going effective. And it will be subject
14 to the same standard.

15 THE COURT: Okay.

16 MR. PETRIE: Okay, so past that, I'll rest on my
17 earlier presentation and our papers and maintain that no
18 objection that we heard here presents a bar to confirmation.
19 The Debtor release is appropriate, releases of this nature are
20 common place in this Court and Circuit. But moreover it is
21 within the business judgment of the Debtors to present a
22 release with the scope. And this release was tailored with the
23 support of the independent directors' report. Any causes of
24 action that are excluded from the release are Estate assets
25 that we've determined need to be preserved.

1 And to the extent Mr. Silberstein's due process
2 rights are, you know, exist and can be refuted, he will still
3 have his day in court.

4 For the third party release, we again submit that
5 that's reasonable and appropriate under the circumstances. The
6 main question that Your Honor needs to answer there is whether
7 or not notice of the release was sufficient. And you should
8 find that based on the declaration presented by Mr. Lee, as
9 well as the fact that reference to the release was contained in
10 many, many documents filed over the last five months. And as
11 well as the process for what it actually took to opt out. If
12 Your Honor is able to find that then the third party release is
13 considered consensual under governing law.

14 And the same for the gatekeeper provision, it's now
15 common in the District of New Jersey. Its inclusion and
16 structure were accepted overwhelmingly by all voting classes.

17 But I'd like to just zoom out slightly here. I know
18 we've been speaking at a granular level right now about these
19 legal issues. We should not lose sight, and I don't think we
20 have, of the massive consensus that is before Your Honor today,
21 and the support that all parties have afforded to this Plan.
22 The fact that 99 percent of voting creditors voted in favor
23 here, the fact that we have parties funding this case with
24 millions of dollars in the hopes of supporting a go forward
25 business, and the fact that we reached a global settlement with

1 the Committee, are all testament to the fact that confirming
2 this Plan today would be the right decision. Nothing that was
3 said in the objections today should serve as a bar to that.

4 I do believe that this is an outstanding result
5 coming out of a very difficult case.

6 THE COURT: All right, thank you, Mr. Petrie.

7 MR. PETRIE: Thank you, Your Honor.

8 THE COURT: I agree with you. The Plan certainly
9 will be confirmed. Oh, reply?

10 MR. SPONDER: I'm sorry, Your Honor. Just one thing,
11 Your Honor. Just one thing, Your Honor. The, again Jeff
12 Sponder from the Office of the United States Trustee. The exit
13 facilities and the restructuring transaction memorandum, why
14 they're different is one is being approved by Your Honor today
15 without any documentation, and one doesn't have that language.
16 That's our issue.

17 Our issue is, you know, we appreciate that. We can
18 look at it. But it's already approved by this confirmation
19 order. So I think --

20 THE COURT: The RSA is.

21 MR. SPONDER: Excuse me?

22 THE COURT: The RSA is.

23 MR. SPONDER: No, the exit facilities, the Plan sets
24 forth that the confirmation order is deemed final approval of
25 the exit facilities. So --

1 THE COURT: As it stands, and if they're --

2 MR. PETRIE: If they're materially adverse --

3 THE COURT: If there's material adverse changes to
4 that exit facility, creditors need notice of that.

5 MR. SPONDER: Perfect, thank you, Your Honor.

6 THE COURT: And an opportunity to be heard. That can
7 go into the confirmation.

8 MR. SPONDER: Thank you.

9 THE COURT: That can go into the confirmation order.
10 So yes, I mean, when you look at that big picture, as you said,
11 Mr. Petrie, this started off pretty difficult. It started off
12 in a good way with pretty large deleveraging of the company.
13 And a good work on the RSA to get parties involved and
14 supportive of the Plan. And then the work with the Committee
15 brought even more. I mean I know when the Debtor first came in
16 with the \$250,000 to the unsecured creditors, I thought this is
17 a bit of a joke. But what are we doing. I guess a lot of what
18 we do might be a bit of a joke. But they did, you came up with
19 a great result with negotiations with the Unsecured Creditor
20 Committee.

21 I like, I feel comfortable or feel much more
22 comfortable with the way this all worked, as far as the
23 disinterested directors' investigation provides me comfort.
24 The investigation by the Unsecured Creditor Committee provides
25 me comfort. I think over -- and then as you mentioned,

1 overwhelming support from the creditors who voted.

2 Addressing the issues that Mr. Sponder and the United
3 States Trustee's Office has brought up, you all know, Mr.
4 Sponder knows as well, what my colleagues think about these.
5 And I have to say, as I was reading through the papers, I was
6 making notes for myself about what my beliefs are, because I
7 knew these were going to be the issues that came up.

8 When I think about third party releases, releases in
9 general, I mean, when you first started, when the Courts first
10 started about releases in Chapter 11, they were going to be
11 very limited in scope, et cetera, et cetera. It was also to
12 encourage parties who weren't very happy with each other to
13 work together and make concessions and come to the Court and
14 work together in the Bankruptcy Court. And releases are a huge
15 part of that. And I'm very interested, obviously we all are,
16 to see what, now the Supreme Court comes out on that. But as
17 of today the Supreme Court has not said anything about it. And
18 I think that releases and third party releases as well, are
19 important to this whole process.

20 I'm taking the declaration filed by Mr. Horton and
21 representations made by the Debtor as to, in finding my support
22 for the Zenith factors and the Master Mortgage factors, that
23 clearly the people who are being considered for releases here
24 have worked hard on the, on this result, on this great result.

25 There's been contributions from nondebtors that

1 worked together and monetary contributions to the Plan. And
2 I've discussed the necessity of the release to Plans in general
3 and to this Plan specifically. Again the overwhelming
4 acceptance of the Plan by the creditors, and the fact that the
5 Unsecured Creditors Committee came up -- and the disinterested
6 directors, all working together, came up with what looks to be
7 the maximum distribution that could be provided to unsecured
8 creditors here.

9 So certainly the releases will be allowed. I do find
10 that the third party releases are consensual. I don't, I'm not
11 so sure, I mean I think generally the opt out, when this first
12 came out I had questions about it in my own head about opt
13 out/opt in. Just based on the number of documents or mailings
14 I get myself, not considering that I'm a Bankruptcy
15 practitioner or a Bankruptcy Judge, just these long lists of
16 documents that you have to read through and you kind of say, I
17 think I'm going to make myself something eat. I'm not going to
18 read through all this. So I see that.

19 But in this case, and in the opt out cases that I've
20 looked at, like I was really glad that you guys like every
21 notice that went out, every notice of filing that went out, had
22 in bold print, inside a box, right above the signature line,
23 the fact that the language in bold print, that set off -- that
24 warned creditors, be aware, this Plan is going to contain
25 exculpations and releases. This could clearly affect your

1 rights. You might want to look a little bit more carefully at
2 it. The fact that it's been -- we had the claims administrator
3 website, which as a ton of information about the case easily
4 accessible. We had the court website which has a ton of
5 information about the case. The Court's been accessible, the
6 attorneys, of which there are tons here, have been accessible
7 for -- and that's offered in every document as well. If you
8 have questions, call so and so at this number.

9 The initial Plan and disclosure statement, which
10 included all the release language, was filed on the day that
11 the petition was filed. So it's been out there. There's been
12 changes to it, but not really material changes. I guess if the
13 material changes were positive material changes for any
14 unsecured creditor. So it's been around for three and a half
15 months or so now.

16 The fact that the opt out forms were provided to
17 every single creditor, whether they voted -- whether they were
18 required to vote, or I should say allowed to vote or not, was a
19 good thing. We had the publication in international
20 newspapers. I understand that the burden then is put on the
21 creditor to opt out. And like I said, it might oftentimes might
22 come down to I think I'm going to make myself something to eat
23 instead of reading through all this.

24 But the simple, the simple notices that kept going
25 out, if you can't pay attention to that, and that doesn't catch

1 your eye, nothing is going to catch your eye. So I think what
2 I feel about the opt outs, and in this case in particular, it's
3 not a difficult burden to check the box. I don't want to be
4 included in these releases. All you've got to do -- it's all
5 provided for you, check the box and send it back in.

6 So I find that the opt out provision in the Plan and
7 the notice and advertising of all this that went out, was
8 sufficient to support a finding of consensual third party
9 releases. And since they are at this moment allowable, they're
10 going to be allowed in this Plan.

11 Then when I look at the gatekeeping issue, I really
12 like the gatekeeping idea. I think it's good. I think, I agree
13 with Judge Kaplan's analysis and other Courts' analysis, of the
14 gatekeeping being like a, a bit like the Barton Doctrine. It's
15 sort of the same principle. It makes, to me it makes sense to
16 apply the concept of gatekeeping to the parties who have been
17 released through this Plan, to consider potential underlying
18 claims before they're brought.

19 Obviously in this case, and all cases, the Court
20 retains jurisdiction to make sure the Plan is carried out
21 successfully, that the Plan, the assets are distributed in
22 accordance with the Plan, what everybody agreed to, what
23 everybody expects. I think gatekeeping can help feasibility of
24 the Plan. You don't -- and not to be, not to brag, but we do
25 this. Like the, I've been, I've read everything in this case.

1 I know what this case is all about. I'm going to be on the
2 bench for a few more years. I think it would be easier for me
3 to take a look at it if somebody is bringing, wants to bring a
4 cause of action. I think it would be easier for me to do it
5 than for any of my colleagues to do it, than for State Court
6 Judges, for anybody.

7 So, and I do agree Mr. Petrie, with the fact that
8 different Courts can decide differently, especially State
9 Courts that are not -- we do this every day. We do this all
10 the time. So I think we're in a better position to make an
11 assessment there. So I'm going to allow the gatekeeping to go
12 through in this Plan.

13 And I think I've addressed everything. Anybody, if
14 there's anything I've missed let me know, Mr. Petrie.

15 MR. MARINUZZI: Your Honor, I'm sorry, Lorenzo
16 Marinuzzi, for the Committee. Just for good order.

17 THE COURT: Yes.

18 MR. MARINUZZI: I know we have some witnesses that
19 submitted declarations, some are in the courtroom. I don't
20 know that we've officially moved those declarations into
21 evidence. Although I don't smell the prospects of an appeal
22 here, I just want to make sure the record is clear.

23 THE COURT: We did admit them into evidence. But
24 what I didn't ask was whether anybody had questions for the
25 folks that are in the courtroom. So thank you, Mr. Marinuzzi,

1 for bringing that up.

2 MR. MARINUZZI: The only other point that I want to
3 make, Your Honor, again thank you very much, thank the Court
4 staff for the time here. Thank you Your Honor's scheduling
5 conflict that pushed the confirmation hearing to today.
6 Because I really think the handful of days that we gained from
7 that really made the difference between getting to a settlement
8 and litigating today instead. So thank you for that.

9 THE COURT: You're welcome. Any questions for the
10 three or four declarations we admitted into evidence? You
11 don't see anybody on Zoom, Mike, do you, that wants to ask a
12 question? No one in the courtroom. All right, so they're
13 admitted, no objection.

14 MR. PETRIE: For good record, can we close the
15 evidentiary record after this admission?

16 THE COURT: Yes. The evidentiary record is closed.
17 Plan is confirmed.

18 MR. PETRIE: Great. We actually have a few more
19 orders that are sort of hanging out that my colleague will
20 present right now.

21 THE COURT: Yes. Thank you, Mr. Petrie, good job.

22 MR. PETRIE: Thank you, Your Honor.

23 MS. YOUNG: Good morning, Your Honor, Mary Catherine
24 Young with Kirkland for the Debtors. I believe we can wrap up
25 these last few items very quickly. But the next item on

1 today's agenda is the entry of the Debtors' fifth interim cash
2 management order. This Court entered the fourth interim cash
3 management order on May 23rd 2024. After negotiations and
4 discussions with the US Trustee the Debtors have incorporated
5 their comments into a fifth interim cash management order.

6 These comments include a provision noting that
7 Debtors will have until the effective date of the Plan to come
8 into compliance with 345(b) of the Bankruptcy Code. And given
9 this language that the Debtors are fully resolved with respect
10 to the fifth interim cash management order, and following
11 today's hearing will submit a proposed order to chambers. And
12 we respectfully request entry of that order.

13 THE COURT: All right, thank you.

14 MS. YOUNG: Thank you.

15 THE COURT: Order to be submitted. I did notice that
16 you, the Bristol 6 motion to seal was, did you have comments on
17 that, Mr. Sponder?

18 MR. SPONDER: Always, Your Honor.

19 THE COURT: I know, that's what I figured, because
20 it's resolved, but not with -- did you work it out?

21 MR. SPONDER: No, Your Honor, I didn't know if you
22 wanted to go through Ms. Young's list and go back or if you --

23 THE COURT: Okay. We can, we can. So I'm not
24 interrupting you, I'm sorry. I'm just looking at the order of
25 the list here.

1 MS. YOUNG: No, not at all.

2 THE COURT: But go ahead.

3 MS. YOUNG: Thank you, Your Honor. The next matter
4 is the Debtors' final creditor matrix order. Again we've
5 incorporated comments from the US Trustee to the proposed final
6 order. And we do believe that we're fully resolved there as
7 well. So unless you have any questions, we'd also respectfully
8 request entry of the order.

9 THE COURT: Yes, can you just tell me what the issue
10 was?

11 MS. YOUNG: Sure, it was limiting redaction of
12 personally identifiable information to just home and email
13 addresses, of natural persons.

14 THE COURT: Okay.

15 MS. YOUNG: And so we've done that here under these
16 circumstances.

17 THE COURT: Great. Okay. Thank you.

18 MS. YOUNG: Thank you, Your Honor.

19 THE COURT: And you'll be submitting an order on
20 that?

21 MS. YOUNG: That's correct. Yes.

22 THE COURT: Okay.

23 MS. BIELSKIE: Your Honor, just one thing on that.

24 THE COURT: Yes, Ms. Bielskie.

25 MS. BIELSKIE: Laurent Bielskie, Office of United

1 States Trustee. I also understand that certain amendments will
2 be filed with regards to certain schedules where information
3 that was redacted that can be unredacted is going to be done as
4 well. Just want to be clear.

5 MS. YOUNG: Yes, that's correct, Your Honor. That's
6 our understanding as well.

7 THE COURT: Okay, good, thank you.

8 MS. YOUNG: And finally is the Debtors' removal
9 motion. You know, we don't believe that this motion is
10 strictly necessary given that the, Your Honor has confirmed the
11 Plan. But we wanted to bring it to Your Honor's attention to
12 make sure we're not leaving any loose ends untied.

13 We don't believe that the issue of removal will come
14 up in between now and the Plan effective date. But given that
15 we're currently relying on the bridge, the removal deadline
16 lapsed on May 28th. We think it's best to, you know, for the
17 Court to enter the -- enter the order which would extend the
18 removal period to September 25th 2024.

19 THE COURT: That's fine with me.

20 MS. YOUNG: Okay. Thank you, Your Honor. And that's
21 it for me. But I'll turn it back over to Mr. Petrie for
22 closing remarks.

23 THE COURT: Okay, thank you very much.

24 MS. YOUNG: Thank you.

25 MR. PETRIE: On the motion to seal, I will just say

1 -- Francis Petrie for the record on behalf of the Debtors. We
2 did have an agreement with Bristol 6 that their objection would
3 be withdrawn. Perhaps that would just solve this issue if they
4 withdraw everything that they had on the docket, including the
5 motion to seal.

6 THE COURT: That would be -- well?

7 MR. SPONDER: Jeff Sponder --

8 THE COURT: I was going to say that would be easy,
9 but it's not, is it, Mr. Sponder?

10 MR. SPONDER: No.

11 THE COURT: Go ahead.

12 MR. SPONDER: Jeff Sponder from the Office of United
13 States Trustee. Since it was filed and it's on the docket, I
14 understand how withdrawing it makes it easy. But it still was
15 on the docket and the redactions are an issue. I think we've
16 had this issue before, Your Honor. Basically here, Bristol 6
17 is redacting information provided by the Debtors, that the
18 Debtors have marked confidential. But there's no finding or any
19 information as to how that's commercial information under 107,
20 which allows it to be redacted.

21 But more importantly, Your Honor, I wasn't sure if
22 what was -- if anything was filed on the docket yet, that's
23 what I wanted to find out. Because I think they were asking to
24 file the redacted version on the docket, but that they sent to
25 chambers the unredacted. So I'm just not sure what happened.

1 If that's the case, then I don't know if it needs to be on the
2 docket. But if something has been filed on the docket, already,
3 I just don't --

4 MR. PETRIE: It's the former, so there was only a
5 motion to seal filed publicly on the docket. No other
6 documents in redacted form or otherwise were filed.

7 MR. SPONDER: So Your Honor, I mean we -- if it's
8 going to be withdrawn, and I think as I'm thinking now, I think
9 it's fine to just have it withdrawn and we move on. But in the
10 future I would hope that what, that that gets requested but
11 that the redacted, you know, gets filed at the same time so
12 that parties have at least the redacted portion.

13 THE COURT: Right, I didn't see a redacted portion. I
14 just, I saw, I read the unredacted and it does contain -- I
15 would think that it would need to be, some redactions at least.
16 But if the motion is going to be withdrawn. Ms. Brook?

17 MS. BROOK: Yes, so that's fine, thus and we have
18 resolved the issues with the Debtors. You know, not to
19 consider how to preserve our rights, but if for reason there's
20 a -- but at this time we're fine with withdrawing. There was no
21 redacted version filed up until now.

22 THE COURT: Okay. So your objection -- the motion to
23 seal is withdrawn.

24 MS. BROOK: Withdrawn.

25 THE COURT: Motion to seal and --

1 MS. BROOK: Yes. And then the underlying documents
2 yes.

3 THE COURT: Underlying documents, yes okay.

4 MS. BROOK: Yes.

5 THE COURT: Okay. Objection withdrawn. Okay.

6 MS. BROOK: Thank you.

7 THE COURT: Thank you, Ms. Brook.

8 MR. PETRIE: Hearing nothing else, we'll work on the
9 revised confirmation order with all parties. And we'll plan to
10 submit that to chambers once we have agreement with everybody.

11 THE COURT: Okay.

12 MR. PETRIE: Okay.

13 THE COURT: That's it, we just --

14 MR. PETRIE: I do believe that's it for the agenda
15 today.

16 THE COURT: Oh, that's the last one. Okay, perfect,
17 got it. All right.

18 MR. PETRIE: All right.

19 THE COURT: Congratulations to you and all your
20 partners and associates, and everybody else in the courtroom
21 that worked so hard on this. Take, we're supposed to have a
22 couple of nice days, please take some time off.

23 MR. PETRIE: Thank you, Your Honor.

24 ATTORNEY: It's a great idea, thank you, Your Honor.

25 THE COURT: You guys scare me.

1 ATTORNEYS: Thank you, Your Honor.

2 * * *

3 C E R T I F I C A T I O N

4 I, Patricia Poole, court approved transcriber, certify
5 that the foregoing is a correct transcript from the official
6 digital audio recording of the proceedings in the above-
7 entitled matter.

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9
10 /S/PATRICIA POOLE

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12 TRACY GRIBBEN TRANSCRIPTION, LLC June 13, 2024

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IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS (DALLAS)

IN RE: . Case No.: 25-80069-MVL-11
. .
. (Jointly Administered)
ZIPS CAR WASH, LLC, *et al.*, .
. .
Debtors. . Friday, April 18, 2025
. 9:36 A.M.

TRANSCRIPT OF CONFIRMATION HEARING RE: CHAPTER 11 PLAN FILED
BY DEBTOR ZIPS CAR WASH, LLC (16)

BEFORE THE HONORABLE MICHELLE V. LARSON
UNITED STATES BANKRUPTCY COURT JUDGE

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Proceedings recorded by electronic sound recording;
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INDEX

Page

MATTERS HEARD

MOTION TO APPOINT TRUSTEE FILED BY DEBTOR MULTIBAND FIELD
SERVICES, INC. (8)

Court's Ruling**63**

WITNESSES

KEVIN NYSTROM

Cross-Examination by Ms. Kippes

24

Examination by the Court

43

EXHIBITS

ID

EVD

1 through 8 (Found at Docket Number 356)

10

11

9 through 12 (Found at Docket Number 356)

23

23

1 (Proceedings commenced at 9:36 a.m.)

2 THE CLERK: All rise.

3 The United States Bankruptcy Court for the Northern
4 District of Texas, Dallas Division is now in session. The
5 Honorable Michelle Larson presiding.

6 THE COURT: Please be seated.

7 Good morning, everyone. We're here on our 9:30
8 docket. And we have one matter on the docket this morning,
9 and that's Case Number 25-80069, Zips Car Wash, LLC, here for
10 confirmation.

11 I'll take appearances for the record, and I'll
12 start with those in the courtroom.

13 MR. FIEDLER: Good morning, Your Honor.

14 Ross Fiedler of Kirkland & Ellis on behalf of the
15 Debtors. I'm joined by, virtually, my partner, Josh
16 Sussberg, who apologizes. Judge, he was not able to be here
17 in person, as well as my partner, Rich Howell, Kent Hayden,
18 my colleague, Lindsey Blumenthal, and our friends at Gray
19 Reed, Mr. Brookner.

20 THE COURT: Anyone else wish to make an appearance?
21 Ms. Kippes.

22 MS. KIPPES: Good morning, Your Honor.

23 Meredyth Kippes on behalf of the United States
24 Trustee. Also in the courtroom is Kendra Rust, one of our
25 analysts, and I believe that Reinhard Freimuth is also on the

1 Webex --

2 THE COURT: All right.

3 MS. KIPPES: -- observing today. Thank you.

4 THE COURT: It's been years, Ms. Rust. Nice to see
5 you.

6 MR. PERSONS: Good morning, Your Honor.

7 Charles Persons, Paul Hastings, on behalf of the Ad
8 Hoc Secured Lender Group. Joining me in the courtroom today
9 are my partners, Justin Rawlins and Robbie Nussbaum.

10 THE COURT: Good morning. I'm healing fine,
11 Mr. Persons, in case you were wondering.

12 MR. CARRUTH: Good morning, Your Honor.

13 THE COURT: Mr. Carruth.

14 MR. CARRUTH: Jeff Carruth on behalf of Landlord
15 Patrick Cullen, C-U-L-L-E-N. And when we get to that point,
16 our objection is resolved.

17 THE COURT: Okay. Excellent. Thank you,
18 Mr. Carruth.

19 Anyone else in the courtroom wish to make an
20 appearance?

21 (No audible response)

22 THE COURT: Hearing no takers. On Webex from the
23 electronic roll, I have Mr. Michael Myers with Ballard Spahr
24 on behalf of a series of Landlords, Broadstone, ZCW
25 Portfolio, FSC, ZCW Lynchburg, et cetera. Each of those are

1 | noted by the notice of appearance.

2 | On behalf of the Unsecured Committee of Creditors,
3 | I have with Pachulski Stang, Ms. Judith Elkin, Mr. Paul
4 | Labov, and Mr. Brad Sandler.

5 | Is there anyone else who wishes to make an
6 | appearance?

7 | MS. POWERS: Yes, Your Honor. Good morning, Your
8 | Honor.

9 | Meagan Martin Powers on behalf of Landlords BVLY
10 | Partners CLTZ Tyvola, LLC and BVLY Partners CLTZ Wilkinson,
11 | LLC.

12 | THE COURT: We'll just call them your clients.

13 | MS. POWERS: I'm sorry?

14 | THE COURT: I said, we'll just call them your
15 | clients.

16 | MS. POWERS: I think that works. Thank you, Your
17 | Honor.

18 | THE COURT: Good morning. Thank you.

19 | Anyone else wishes to make an appearance?

20 | (No audible response)

21 | THE COURT: Hearing no further responses. If
22 | there's anyone on the phone, you can dial *6 to unmute.

23 | With that, Mr. Fiedler.

24 | MR. FIEDLER: Great. Thank you, Your Honor.

25 | Again, for the record, Ross Fiedler of Kirkland &

1 Ellis on behalf of the Debtors. It's really nice to be
2 before Your Honor in person, especially for our first time to
3 the Dallas courtroom.

4 As you noted, yesterday we filed an agenda at
5 Docket Number -- an amended one, at Docket Number 355. There
6 is only one item up for today, and that is final approval of
7 the disclosure statement and confirmation of the Debtors'
8 Chapter 11 plan.

9 I won't bury the lead. I'm happy to report that
10 we've resolved all formal and informal objections with
11 respect to those items, except with respect to one issue in
12 the U.S. Trustee's objection relating to the third-party
13 release and the opt-out. And we'll get to that just in a
14 moment.

15 But first, I'd like to quickly introduce the court
16 to some folks that are in the courtroom and on the line
17 virtually. In the courtroom, we have Mr. Kevin Nystrom, the
18 Company's chief transformation officer who was our first day
19 declarant and who also submitted a declaration in support of
20 confirmation.

21 We also have Mr. Jeffrey Liu from Evercore, the
22 Company's investment banker. Mr. Alex Orchowski, who's on
23 the line, a director at Kroll, the Company's claims noticing
24 and solicitation agent.

25 And last but not least on the line, Mr. Scott

1 Vogel, who serves as a disinterested director on the special
2 committee of the Company's board and also has put forth a
3 declaration, a narrow one, in support of the Debtor release
4 and confirmation of the plan.

5 Your Honor, before I make some brief remarks about
6 these cases and how we got here today, I'd like to just move
7 each of those declarations into evidence that are supporting
8 confirmation. Those are Mr. Nystrom's declaration that was
9 filed at Docket Number 351. This supports the 1129 factors,
10 as well as the best interest test, as Mr. Nystrom was
11 intimately involved in the preparation of the liquidation
12 analysis.

13 Next declaration is from Mr. Liu at Docket Number
14 349. Oh, excuse me, Your Honor, 352. That demonstrates the
15 feasibility of the plan. Then a declaration from
16 Mr. Orchowski filed at Docket Number 349 that evidences the
17 voting results. And lastly, from Mr. Vogel, filed at Docket
18 Number 350, which details the special committee investigation
19 and provides support for the Debtor release.

20 As I mentioned, they're either in the courtroom or
21 on the line today and available to testify if necessary.
22 Unless Your Honor has any questions, I would ask that the
23 declarations be admitted into evidence subject to, I
24 understand Ms. Kippes would like to cross Mr. Nystrom at the
25 relevant time.

1 THE COURT: Fair enough. Is there any objection to
2 the admission of what's marked at the witness and exhibit
3 list filed at 356 as Exhibits 9, 10, 11, and 12?

4 MS. KIPPES: No objection, Your Honor. And I do
5 intend to cross Mr. Nystrom. I'm not sure if I'll need to
6 cross somebody else. If I can't get everything I need from
7 him, I might need to talk to somebody else.

8 THE COURT: Fair enough.

9 MS. KIPPES: Thank you.

10 THE COURT: Fair enough. And again, as we just
11 established, each of them are here in some shape or form and
12 available for cross-examination. So with that, the Court
13 will admit Exhibits 9 through 12 filed at Docket 356, which
14 were also filed on the docket as noted by Mr. Fiedler.

15 (Debtors' Exhibit Numbers 9 through 12 admitted into
16 evidence)

17 THE COURT: Thank you very much.

18 MR. FIEDLER: Thank you, Your Honor.

19 So, Your Honor, it's been just over 70 days since
20 we entered these cases. And at the first day hearing, we
21 provided the Court with a summary of what really precipitated
22 the need to file these cases. That was also spelled out in
23 Mr. Nystrom's declaration.

24 And without delving back too far into the details,
25 there's a few factors that really stood out. First, our real

1 | estate portfolio. You know, the Company has effectively
2 | grown its fleet of car wash locations over the last 20 years
3 | and really exponentially in the last 5 years. And the result
4 | of that is increased, you know, EBITDA and revenue.

5 | But in recent years, that portfolio has become
6 | overextended. And there's a significant chunk of our
7 | locations that really could not carry the burden of higher
8 | occupancy costs, mainly as a result of off-market lease
9 | liabilities and lease obligations.

10 | The second issue is our debt burden. You know, the
11 | capital structure was really over-levered. We had nearly
12 | \$700 million of debt which was 14 times the Company's annual
13 | earnings. And in recent years, higher interest rates really
14 | led to higher rates on our floating rate debt which led to
15 | increases in our annual debt interest expense and really
16 | limited the Company's ability to reinvest in the business.

17 | And lastly, Your Honor, there was a softening in
18 | the consumer of Zips. And this mainly stemmed from higher
19 | levels of inflation, but also a significant increase in the
20 | capital that was flowing into the car wash industry. And so
21 | in areas that we historically had a high degree of density,
22 | you know, we saw less traffic as more competitors came to
23 | those areas.

24 | And so we filed these cases really with two
25 | principal goals. First was deleveraging the capital

1 structure, really putting in place a capital structure that
2 did not carry the ongoing cash interest burden that would
3 limit the Company's ability to operate.

4 The second was right-sizing our portfolio. And the
5 Company was laser-focused on being able to avail itself of
6 the tools in bankruptcy, you know, to shed on profitable
7 locations and renegotiate those locations that were subject
8 to overburdensome leases. And part of that exercise was
9 really right-sizing the footprint in a way that focused on
10 certain areas that the Company, historically, has excelled
11 in.

12 And so with all of that said, Your Honor, I think
13 we stand here today ready to confirm a plan and effectuate a
14 reorganization that accomplishes both of those goals. And,
15 you know, with respect to the capital structure, the plan is
16 going to shed about \$275 million of funded debt.

17 The Term Loan Lenders will fully equitize their
18 claims and get 100 percent of the equity in the new
19 reorganized Company. They're also going to receive two forms
20 of take-back paper, Your Honor, approximately \$230 million of
21 new term loan debt at the Opco level and \$150 million of new
22 Holdco debt at the Holdco level.

23 The key aspect of this, Your Honor, is the Holdco
24 level debt will not require any cash interest. It will be --
25 interest will be paid in kind over the life of the loan. And

1 with respect to the term loan, there won't be any cash
2 interest for the first three months.

3 And then for the next year, the Company will have
4 the option to pay interest in kind to the extent it can meet
5 certain conditions. So that really will give the Company
6 additional cushion and flexibility to operate.

7 As for the real estate portfolio, Company, with
8 Hilco at the helm, has been in constant dialogue with our
9 Landlord base. And I think Mr. Sussberg previewed that for
10 Your Honor at the first day hearing. And those efforts have
11 been super successful, and they've just concluded in the last
12 few days. As Your Honor may have seen, we filed a plan
13 supplement last night which amended the assumed lease list to
14 reflect those leases that we were able to get to a commercial
15 resolution on an amendment.

16 And just to provide Your Honor with some numbers
17 that speak to how successful this process has been, we've
18 amended over 60 leases. Some of those are master leases. So
19 in total, they cover nearly 200 of the Company's locations.
20 We've rejected and exited over 80 underperforming leases
21 which will eliminate tens of millions of go-forward lease
22 liabilities.

23 All told, Your Honor, this footprint
24 rationalization effort, which began months ago and before we
25 even filed, is expected to increase the Company's earnings on

1 an annual basis by 15 million. So a real achievement and a
2 testament to the work of both the Company and the Landlords
3 that came to the negotiating table.

4 And I do want to stress, I think part of the reason
5 we were able to get resolution on the leases is not just the
6 idea that potentially they would have to be rejected, but a
7 Committee that was very commercial in coming to a resolution
8 with us. Two of our largest Landlords, Realty Income and
9 Broadstone, sit on the Committee. And their willingness to
10 come to the negotiating table showed their commitment to the
11 long-term growth and future of the Company. So we just want
12 to thank them, as well as the Committee, for their
13 cooperation.

14 I think we presented the Committee settlement right
15 at the disclosure statement hearing, but it really provides a
16 meaningful recovery for General Unsecured Creditors. As
17 we've noted in our disclosure statement, they'll be given the
18 opportunity to recover about 20 to 25 percent on account of
19 their claim. So really meaningful for the GUC class.

20 And I think all of these accomplishments really
21 speak to -- are reflected by the voting results. You know,
22 we have near unanimous support for the plan. We have 100
23 percent of our Term Loan Lenders voting in favor and nearly
24 100 percent of Class 4 general unsecured claims that have
25 also voted to accept the plan.

1 So notwithstanding the fact that we have every
2 stakeholder supporting the plan, we do have one limited
3 objection to the plan. The full objection was filed at
4 Docket Number 338. I first want to thank Ms. Kippes because,
5 you know, we could be going forward on a number of other
6 issues. And so she and her office were very constructive in
7 narrowing the issues, and they've really been a delight to
8 work with throughout these cases.

9 THE COURT: You've lost your edge, Ms. Kippes.

10 MR. FIEDLER: But the issue that remains is the
11 third-party release and the opt out, and really whether that
12 opt out structure is sufficient to satisfy the requirement to
13 establish actual consent for the third-party release. So
14 really just a legal issue. And we believe it does, Your
15 Honor.

16 The third-party release is set forth in Section 8-D
17 of the plan. And as this Court has made clear on a number of
18 occasions before, if there's sufficient notice where parties
19 have received the opt out, they've had the opportunity to
20 review it and consider what they're being asked to do and the
21 options that they're being given, then consent can be
22 established.

23 So here, the third-party release language is
24 clearly and conspicuously included in the ballots, the
25 combined hearing notice, and the opt out forms that were sent

1 to parties in connection with solicitation. The noticing
2 process that we've used here is really analogous to that
3 which has been approved by a number of federal and state
4 courts, both in Texas and in New York.

5 So this really is a well-established process with
6 well-established law behind it. And I just note the process
7 worked, Your Honor. There were a few parties that elected to
8 avail themselves of the opt out process and will not be
9 giving release. And I think the weight of authority, Your
10 Honor, in this circuit particularly, this Court really lends
11 favorably to the idea that the opt out works and that it's
12 sufficient to imply consent.

13 So this was seen most recently, as Your Honor is
14 aware, in the CareMax, the KidKraft, and the Sunland Medical
15 cases. But there are a number of others in the Fifth Circuit
16 and this Court that have been approved that had similar opt
17 out structures, both pre and post the Purdue decision.

18 So I would also highlight that the opt out form we
19 used is substantially similar to that which was used in the
20 CareMax cases. And that was at the request of the United
21 States Trustee. So we've really tried to do all we can to
22 conform the opt out to what has been approved previously.

23 Your Honor, the third-party release really is an
24 integral part of the plan. The released parties have made
25 significant concessions and commitments that will benefit the

1 estate and the go-forward business. And in return for that,
2 they are receiving a degree of finality that will allow them
3 and the Debtors to have a fresh start upon emerging.

4 So each released party is also going to be a
5 releasing party. So there's a mutuality of consideration
6 that's being given that I think is important that supports
7 the releases.

8 And finally, Your Honor, every stakeholder supports
9 the third-party release. That includes the Committee and the
10 various members that are on it. So I guess with that, Your
11 Honor, we would otherwise rest on what's in our brief, what's
12 in the various declarations that we've proposed in support of
13 confirmation.

14 But, you know, suffice it to say, we believe
15 there's adequate information in the disclosure statement. I
16 don't think any party has contested otherwise. And as we've
17 made clear in our brief and in Mr. Nystrom's declaration, we
18 believe each of the 1129 factors has been satisfied or is
19 otherwise inapplicable, and the plan is both feasible and
20 satisfies the best interest test.

21 So, Your Honor, we don't believe that the objection
22 to the opt out should hold up final approval of the
23 disclosure statement and confirmation of plan which, as I
24 said, enjoys unanimous support across the capital structure.
25 So, you know, to the extent Your Honor has any questions or

1 | comments, I'm happy to address them. Otherwise, I'd cede the
2 | podium to anyone who would like to be heard.

3 | THE COURT: Okay. Thank you very much,
4 | Mr. Fiedler. I think what I'll do is I'll hear anyone else
5 | who wishes to make any sort of opening arguments, and then I
6 | will move into evidence.

7 | MR. FIEDLER: Okay, great. Thank you.

8 | THE COURT: I think that what I'll do is I'll first
9 | open the floor to any, which I think are all resolved or
10 | settled by this time. Is there anyone who filed any of the
11 | more narrow objections relative to any of the Landlord claims
12 | or anything like that that wish to be heard?

13 | Mr. Carruth, I'll start with you. And then I will
14 | go to the Committee. I'll go to each of the stakeholders.
15 | Mr. Carruth?

16 | MR. CARRUTH: Thank you, Your Honor. We did file a
17 | limited objection. The Debtor last night did accept our
18 | proposed cure amount of almost \$25,000. That was in the plan
19 | supplement filed last night. We've received confirmation,
20 | verbal confirmation today that there's nothing in the plan
21 | that will prevent the enforcement of the tax provision to the
22 | lease when the taxes come due later this year.

23 | We are trying to finalize and drill down on what
24 | the precise amount of rent is each month just to confirm
25 | that. They've agreed to work with us on that. And so with

1 that, our objection is resolved. And I would ask that I can
2 be excused for the rest of the hearing.

3 THE COURT: Excellent. I understand that there's
4 resolution on both sides. So, yes, you may be excused.

5 MR. CARRUTH: All right. Thank you, Your Honor.

6 THE COURT: Thank you, Mr. Carruth.

7 Any of the other cure-related or Landlord claim-
8 related parties wish to be heard? Okay.

9 Hearing no other takers, I'll now turn to the
10 Committee. Ms. Elkin?

11 MS. ELKIN: Good morning, Your Honor. How are you?

12 THE COURT: I'm excellent. How about you?

13 MS. ELKIN: I'm doing well. Sorry we can't be
14 there in person.

15 THE COURT: That's fine.

16 MS. ELKIN: It's certainly more cost-effective.
17 I'd like to reiterate what Debtors' Counsel said because I
18 think what is remarkable about this case is the level of
19 collaboration and cooperation between all the parties.

20 And it is significant to note that while the heavy
21 lifting did occur just prior to the disclosure statement
22 hearing, there was a lot of negotiating going on. And this
23 plan started as a zero-recovery plan for unsecured creditors
24 and is now between 20, 25 percent.

25 So I certainly take credit for me and my firm

1 working hard to get something for our clientele, but also for
2 the Lenders' Counsel, Debtors' Counsel, all the Landlords,
3 everybody working together to get this case to the finish
4 line, not only quickly, but successfully. So I just, I
5 support confirmation and final approval of the disclosure
6 statement. And as the vote indicates, our clients do as
7 well.

8 THE COURT: Thank you very much, Ms. Elkin. The
9 Court was very, I guess, surprised is the right word, to see
10 that the recovery go from where we started at, I think at
11 zero in the first days, to 20 to 25 percent. That is
12 incredibly meaningful. And so that is all good news.

13 And so I'm happy that the Debtors and the Committee
14 and their professionals were able to work so fruitfully
15 together, especially in a case where, obviously, a lot of
16 hard decisions have to be made with respect to realty. So
17 thank you very much.

18 I'll now hear from the Term Loan Lenders.

19 MR. RAWLINS: Thank you, Your Honor.

20 Justin Rawlins of Paul Hastings on behalf of the
21 Term Loan Lenders. We also wanted to thank the Debtors and
22 the Committee and all the other professionals involved for
23 their efforts in the plan.

24 The Term Loan Lenders are still reviewing the most
25 recent plan supplements, the plan supplements. We're looking

1 forward to moving to the effective date as soon as possible.

2 Thank you.

3 THE COURT: Excellent. Let me see if there was any
4 other. I believe that leaves you, Ms. Kippes. I just wanted
5 to make sure there were no other constituencies.

6 MS. KIPPES: No other, as Judge Jernigan calls
7 them, friendlies.

8 THE COURT: The friendlies.

9 MS. KIPPES: Thank you, Your Honor. Meredyth
10 Kippes on behalf of the United States Trustee. I will agree
11 with everyone here that everyone has been remarkably
12 cooperable. Is that a word? Everybody's worked well
13 together. I also agree with Ms. Elkin that the work they did
14 to go from zero to 2025 is, as she said, remarkable.

15 Mr. Fiedler is correct. We're down to one issue,
16 and that is the opt-out third-party release. I will be
17 asking some questions of at least Mr. Nystrom, and others if
18 I can't get everything that I think I need from Mr. Nystrom.

19 When the time is right, when we get to closing, the
20 Court can expect me to largely rest on the U.S. Trustee's
21 papers, but there are some points that I would like to
22 discuss outside of that. Finally, I just wanted to ask
23 whether Mr. Fiedler would like to offer any evidence, or I
24 can, the Debtors' Exhibits 1 through 8.

25 THE COURT: That was my next -- when we got to

1 evidence, that was going to be my question of whether or not
2 we were going to get to the other exhibits.

3 MS. KIPPES: Okay. Thank you, Your Honor.

4 THE COURT: Thank you very much.

5 With that, we'll begin the remainder of the
6 evidentiary supporting portion of the hearing, since we've
7 already admitted the declarations.

8 So, Mr. Fiedler?

9 MR. FIEDLER: Thank you, Your Honor.

10 For the record, Ross Fiedler of Kirkland & Ellis on
11 behalf of the Debtors. I think we will largely rest on our
12 papers, as well. I will ask the Court to move into evidence
13 the witness and the exhibits, I think it's 2 through 8 that
14 were filed last night.

15 THE COURT: Any objection to the admission of
16 Debtors', you said 2 through 8?

17 MR. FIEDLER: I believe that's right.

18 THE COURT: Okay. Let's see what Number 1 was.

19 MR. FIEDLER: Yeah, 1 through 8.

20 THE COURT: Okay, 1 through 8 it is. Any
21 objections?

22 MS. KIPPES: No objection, Your Honor.

23 THE COURT: Hearing no objections, Debtors'
24 Exhibits 1 through 8 are hereby admitted. And again, those
25 can be found at Docket 356.

1 (Debtors' Exhibit Numbers 1 through 8 admitted into
2 evidence)

3 MR. FIEDLER: Thank you, Your Honor. I'll cede the
4 podium to Ms. Kippes.

5 THE COURT: Please. Ms. Kippes, would you like to
6 call your first witness?

7 MS. KIPPES: Yes, Your Honor. Let me grab another
8 notebook.

9 THE COURT: Take your time.

10 MS. KIPPES: Yes, Your Honor. The United States
11 Trustee would call Mr. Kevin Nystrom.

12 THE COURT: Mr. Nystrom, if you could approach the
13 stand, I'll swear you in. And I understand there's a witness
14 and exhibit list to the extent that he needs one there.

15 MS. KIPPES: Yes, Your Honor. The U.S. Trustee's
16 book is there, and so is the Debtors'.

17 THE COURT: Okay. Excellent. Good afternoon, or
18 good morning.

19 KEVIN NYSTROM, DEBTORS'S WITNESS, SWORN

20 THE COURT: Thank you very much. Please be seated.
21 I'm ready when you are, Ms. Kippes.

22 MS. KIPPES: Thank you, Your Honor.

23 CROSS-EXAMINATION

24 BY MS. KIPPES:

25 Q Good morning, Mr. Nystrom.

1 A Good morning.

2 Q We met earlier, but --

3 A Yes.

4 Q -- I'm Meredyth Kippes. I'm a trial attorney with the
5 Office of the United States Trustee. And I'm going to ask
6 you a few questions. We're going to be focusing on the
7 definitions of releasing parties and related parties. They
8 can be found at Debtors' Exhibit 1. That's the black
9 notebook. You can look in the black notebook. Exhibit 1.
10 And I believe if you turn to at the top of the page, Page 20
11 of 134, that's where you'll find these definitions.

12 A Page 21?

13 Q 20 --

14 A Pardon.

15 Q -- of 134.

16 A Yes.

17 Q Are you there? Okay. All right. So there are a number
18 of parties in definition 143 as you'll see who are releasing
19 parties. And we're just going to go through those really
20 quickly. With regard to the DIP secured parties, what sort
21 of claims do they have against the Class 1 General Unsecured
22 Creditors?

23 A Ask your question again. What sort of claims?

24 Q Okay. The DIP secured parties are a releasing party.

25 A Yes.

1 Q And they are also a released party. And so are all
2 holders of claims who do not affirmatively opt out other
3 releasing parties. So what I'm asking you, since they're
4 going to give this mutual release, what the Debtor is calling
5 a mutual release, I'm asking what kind of claims they're
6 releasing.

7 A They have the claims, and you're referring to the DIP
8 claim.

9 Q The DIP secured parties.

10 A Yes.

11 Q What claims do they have against any General Unsecured
12 Creditor?

13 A Oh, against any unsecured creditor?

14 Q Yes.

15 A None that I'm aware of. Their collateral is of the
16 Debtors' estate.

17 Q Okay. And what sort of claims do the DIP secured
18 parties have against the Section 510(b) claimants, any of the
19 Section 510(b) claimants, that's Class 7?

20 MR. HAYDEN: Your Honor, I just note an objection
21 to the foundation to this line of questioning.

22 THE COURT: Ms. Kippes?

23 MS. KIPPES: Your Honor, these are classes that
24 were either sent a ballot to opt out or an opt out notice.
25 And the Debtor, as Mr. Fiedler has said, is arguing that this

1 is a mutual release. And under contract law, there has to be
2 value for consideration.

3 So if there is no value to the mutual release, then
4 it's not even a peppercorn, Your Honor. That's why I'm
5 asking these questions. There's no value. If the DIP
6 secured parties have no claims against the General Unsecured
7 Creditors, they are releasing nothing against the General
8 Unsecured Creditors.

9 THE COURT: I'll let you -- I'll overrule the
10 objection. I'll let you explore it a little further. And
11 we'll address the legal issue in argument.

12 MS. KIPPES: Yes.

13 THE COURT: But I'll let you explore this line of
14 questioning.

15 MS. KIPPES: Thank you, Your Honor.

16 BY MS. KIPPES:

17 Q Okay. So the Section 510(b) claimants, do the DIP
18 secured parties have any claims against them?

19 A I'm not aware of any claims against the 510(b)
20 claimants.

21 Q By the DIP secured parties.

22 A By the secured parties. Can I clarify the answer to
23 your prior question?

24 Q Regarding General Unsecured Creditors? Sure.

25 A To the extent that the estate has any claims for

1 whatever reason against a vendor which is a General Unsecured
2 Creditor, whether it's performance of duty, things like that,
3 then the DIP lenders may have a claim because that would be
4 an asset of the estate.

5 Q Okay. Okay. And what sorts of claims do the DIP
6 secured parties have against the preferred equity interests?

7 A I'm not aware of any.

8 Q Okay. What sort of claims do the DIP secured parties
9 have against common equity?

10 A I'm not aware of any significant claims.

11 Q Okay. What sort of claims do the exit facility secured
12 parties have against General Unsecured Creditors?

13 A Ask that question again. It sounds similar to the --

14 Q Well, but it's a different -- if you look at Exhibit --
15 let's see. Exhibit in front of you, Definition 143. We've
16 got C, DIP secured parties and holders of DIP claims. D,
17 each of the exit facility secured parties. So, that's my
18 question.

19 If they overlap, I'm asking with regard to exit facility
20 secured parties. What kind of claims do they have against
21 General Unsecured Creditors?

22 A It's -- if there are claims that the post-petition
23 Company has against vendors, then the post-petition credit
24 facility would have a lien on that.

25 Q Okay. And you're talking about the post-petition

1 estate's claim against pre-petition vendors.

2 A Oh, okay. Now I understand your question.

3 Q Because this is -- we're talking about Class 4 under the
4 plan. That's pre-petition claims.

5 A Okay. I'm not aware of any.

6 Q Okay. What sort of claims do the exit facility secured
7 parties have against the Section 510(b) claimants?

8 A I'm not aware of any.

9 Q Okay. And what sort of claims do the exit facility
10 secured parties have against preferred equity interests?

11 A I'm not aware of any.

12 Q Okay. How about common equity interests? Do they have
13 any claims against common equity interests?

14 A I'm not aware of any.

15 THE COURT: Ms. Kippes, is common giving or
16 receiving a release?

17 MS. KIPPES: I believe they received an opt-out
18 notice. Let me go grab the --

19 THE COURT: No. I mean, if you received it, you
20 received it. But my question is whether or not common is
21 anywhere in the definition of released or releasing. I
22 didn't find it there.

23 MS. KIPPES: Your Honor, I'll agree with the Court.

24 THE COURT: Okay.

25 MS. KIPPES: Because in released parties, we have

1 holders of claims. Now, in releasing parties, we have
2 holders of claims or interests. So --

3 THE COURT: But holders of claims or interests that
4 are deemed to accept, right?

5 MS. KIPPES: That vote to accept the plan who do
6 not affirmatively opt-out. Yes.

7 THE COURT: But holders of interests are deemed to
8 reject, right?

9 MS. KIPPES: Yes. And if you look on the next
10 page, all holders of claims that are deemed to reject this
11 plan and who do not affirmatively opt-out of the release
12 provided by this plan. It's at the top of Page 21 of 134.
13 Okay. That's claims, though. You're right. No interest
14 there. You're correct, Your Honor.

15 Okay. Okay. So, that shortens some questions.
16 Okay.

17 BY MS. KIPPES:

18 Q Term loan secured parties, what kind of claims do they
19 have against General Unsecured Creditors? That's pre-
20 petition General Unsecured Creditors, Class 4.

21 A I'm sorry. Say that again.

22 Q The term loan secured parties, what claims do they have
23 against Class 4 General Unsecured Creditors?

24 A I'm not aware of any other than just general claims the
25 Debtor has against unsecured creditors that would be

1 collateral to the term loan.

2 Q Okay. Okay. What sort of claims do the term loan
3 secured parties have against preferred equity interest?

4 A I'm not aware of any.

5 Q Okay. And what about the sponsor? What sort of claims
6 does the sponsor have against Class 4 General Unsecured
7 Creditors?

8 A I'm not aware.

9 Q Okay. And I can't remember, I've got to go switch back.
10 Term loan secured parties, I cannot remember if I asked you
11 this, what kind of claims they have against 510(b) claimants?
12 Class 7.

13 A You didn't ask, and I'm not aware of any.

14 Q Okay. Okay. And you said you're not aware of any
15 claims the sponsor has against General Unsecured Creditors?

16 A Ask that question again.

17 Q Okay. Does the sponsor have any claims against Class 4
18 General Unsecured Creditors?

19 A Not that I'm aware.

20 Q Okay. And does the sponsor have any claims against
21 Section 510(b) claimants, Class 7?

22 A I'm not aware of any.

23 Q And what about preferred equity interest? Does the
24 sponsor have any claims against preferred equity interest?

25 A I wouldn't know that. I'm not aware of any.

1 Q Okay. Can't identify any. You don't know.

2 A (No audible response)

3 Q Okay. Each member of the ad hoc term lender group, what
4 sort of claims do they have against Class 4 General Unsecured
5 Creditors?

6 A To the extent the Debtor has claims against those
7 unsecured creditors, that would be an asset of the estate
8 and --

9 Q Okay. Okay. Do each member of the Ad Hoc Term Lender
10 group have claims against Section 510(b) claimants?

11 A I am not aware.

12 Q Okay. And what about preferred equity interest? What
13 kind of claims do they have against preferred equity
14 interest?

15 A I'm not aware.

16 Q Okay. All right. Now, senior preferred equity
17 interests, these are the same as the preferred equity
18 interest that are at Class 8. Is that correct?

19 A I would need to go back to the definitions of the --

20 Q Okay.

21 A -- preferred equity interest in Paragraph 8 on Page 22.
22 Is that what you're talking about?

23 Q Paragraph 8 on Page 22? Are you talking about 158?

24 A I'm asking what you're referring to.

25 Q Okay. Well, I'm -- there's the defined term senior

1 preferred equity interest holders in Paragraph 143, Section
2 143. But yes, if you flip over to Page 22, definition 158,
3 senior preferred equity interest holders means holders of
4 senior preferred equity interest.

5 A Yeah.

6 Q And are those the same as are in the preferred equity
7 interest class in Class 8?

8 A I'm still not following. Do you want to show me on this
9 page? I see the preferred equity interest definition.

10 Q Yes. Where do you want me to show you what?

11 A In Exhibit 1. Which group are you referring to?

12 MS. KIPPES: Okay. Your Honor, may I approach the
13 witness?

14 THE WITNESS: I'm sorry.

15 MS. KIPPES: It's okay. I understand.

16 THE COURT: Yes, you may approach.

17 MS. KIPPES: Thank you.

18 BY MS. KIPPES:

19 Q Okay. All right. You're way past. So that's why it's
20 confusing. We're just in the definition for right now. So
21 143 has senior preferred equity interest holders.

22 A Okay.

23 Q And then 158, actually 159, senior preferred equity
24 interest holders means holders of senior preferred equity
25 interest.

1 A I see. Now I know, but go back and ask your question,
2 please.

3 Q Yeah. Lots of paper. Sometimes wrong page. So now
4 that we're on the same metaphorical and physical page, are
5 the senior preferred equity interest holders that show up in
6 the definition of releasing parties on Page 143, are those
7 the same as the Class 8 preferred equity interest?

8 A I believe so.

9 Q Okay. All right. So they would not have any claims
10 against themselves, as far as you know.

11 A Correct.

12 Q Okay. What kind of claims would they have against Class
13 4 General Unsecured Creditors?

14 A I'm not aware of any, nor would I know their claims.

15 Q Okay. Okay. And what sort of claims would senior
16 preferred equity interest holders hold against Section 510(b)
17 claimants?

18 A I'm not aware of any, but I wouldn't know their claims.

19 Q Okay. And so the next defined term is the Unsecured
20 Creditors Committee and its members. Do they have any claims
21 against the General Unsecured Creditors? Class 4.

22 A Ask that question again. Do the --

23 Q Okay. The Unsecured Creditors Committee and its
24 members, do they have claims against the Class 4 General
25 Unsecured Creditors?

1 A Are they the same party?

2 Q Well, the Committee represents the larger body of
3 General Unsecured Creditors.

4 A Oh, you're talking -- that I don't know.

5 Q Okay. Okay. And does the Unsecured Creditors Committee
6 have any claims against the Section 510(b) claimants in Class
7 7?

8 A I don't know.

9 Q Okay. What about preferred equity interest in Class 8?

10 A I don't know.

11 Q Okay. Okay. So now we get down to all holders of any
12 other claims or interests in the Debtor. Very broad group of
13 people.

14 A Do -- the question is --

15 Q Are you aware of claims that holders of claims or
16 interests, other claims or interests that we haven't talked
17 about yet, might have against General Unsecured Creditors?

18 A I don't know.

19 Q Okay. And would your answer be the same with regard to
20 Section 510(b) claimants?

21 A Yes.

22 Q And would your answer be the same with regard to
23 preferred equity interest claimants, Class 8?

24 A Yes.

25 Q Okay. All right. I'm going to short circuit my

1 questions. On the next bit, we're going to talk about
2 related parties. And the definition of related parties is on
3 that Page 20 of 31. It's on the same page as the definition
4 of releasing parties. It's definition 140.

5 A Uh-huh.

6 Q Okay. And so there's a long list of related parties
7 listed there. Are you aware of any claims that any of these
8 defined related parties -- we'll go piece-by-piece. So debt
9 secured parties, related parties as defined here, are you
10 aware of any claims those folks may have against Class 4
11 General Unsecured Creditors?

12 A I wouldn't know, so I'm not aware of anything.

13 Q Okay. Okay. With regard to exit facility secured
14 parties, their related parties, are you aware of any claims
15 that they might have against Class 4 General Unsecured
16 Creditors?

17 A Only to the extent that if the Debtor has a claim
18 against an unsecured party for whatever reason, and that is
19 collateral to the secured creditors, that would be it.

20 Q Okay. So, for instance, let's just pick one of these.
21 Do you think that such claims would extend to affiliated
22 investment funds or investment vehicles? That's one of the
23 related parties.

24 A I don't know that.

25 Q Okay. So it's hard to define what kind of claims

1 related parties of the exit facility parties might have.

2 A Correct.

3 Q Okay. And that's true of General Unsecured Creditors,
4 Section 510(b) creditors, preferred equity.

5 A Correct.

6 Q Okay. And with regard -- this will hopefully make it
7 faster. With regard to DIP secured parties, I'm going back,
8 it's hard to tell -- you cannot identify claims that related
9 parties of DIP secured parties might have against General
10 Unsecured Creditors, Section 5(b) claimants, and preferred
11 equity interest.

12 A Correct.

13 Q Okay. Same question with regard to term loan secured
14 parties, their affiliates. You're not able to identify
15 claims that affiliates of term loan secured parties may have
16 against General Unsecured Creditors, 510(b) claimants, and
17 preferred equity interest.

18 A I wouldn't know.

19 Q Okay. The sponsor, you're not aware of any claims that
20 affiliates of the sponsor as defined in related parties,
21 related parties of the sponsor may have against General
22 Unsecured Creditors, Section 510(b) claimants, or preferred
23 equity interest.

24 A I am not aware of any specific claims.

25 Q Okay. And each member of the Ad Hoc Term Lender group,

1 | their related parties, you are not aware of or cannot
2 | identify any claims those parties might have against General
3 | Unsecured Creditors, Section 510(b) claimants, or preferred
4 | equity.

5 | A I am not aware, nor would I be aware.

6 | Q Okay. Senior preferred equity interest holders. Are
7 | you aware that the related parties of senior preferred equity
8 | interest holders, are you aware of any general unsecured
9 | claims that they might have against General Unsecured
10 | Creditors for Section 510(b) claimants?

11 | A I wouldn't know and I'm not aware.

12 | Q Okay. And we've already established that senior
13 | preferred equity wouldn't have claims against themselves,
14 | correct?

15 | A I would think not.

16 | Q And so their affiliates probably don't either. Would
17 | you agree?

18 | A I wouldn't be aware of it.

19 | Q Okay. The Unsecured Creditors Committee, their related
20 | parties, are you aware of any claims that their related
21 | parties may have to General Unsecured Creditors, Section
22 | 510(b) claimants, or preferred equity interest?

23 | A I wouldn't be aware of it and am not aware of it.

24 | Q Okay. The unsecured creditors, repeating myself, and
25 | then all other holders of claims or interests in the Debtor,

1 again that broad category, their related parties, are you
2 aware of any claims that those folks' related parties may
3 have against the General Unsecured Creditors, Section 5(b)
4 claimants, or preferred equity interest?

5 A I'm not aware of it.

6 Q Okay. Thank you. With regard to -- you had answered
7 with regard to debt secured parties, you indicated that they
8 might have a claim against some General Unsecured Creditors
9 to the extent the estate has any claims against a vendor.
10 You recall that testimony?

11 A If the Debtor has a claim against the vendor, and that
12 claim is an asset of the estate, that may be collateral to
13 the DIP lenders.

14 Q Okay. Are you aware of any specific claims like that?

15 A There is every day. You know, in working with vendors,
16 there's claims back and forth.

17 Q Okay. Have you done, have you, the Debtor done -- as
18 the chief transformation officer of the Debtor, have you or
19 someone under your authority done an investigation into that?

20 A We, every day, look at claims. And generally we net
21 that out, if it's appropriate to net --

22 Q Okay.

23 A -- against the claims that the -- those vendors have
24 against the estate.

25 Q Okay. So if someone has filed a proof of claim for

1 \$5,000, and the Debtor has a claim back against them for
2 \$2,000, you net that out?

3 A If it's the correct estates, the correct time frame,
4 yes.

5 Q Okay. All right. We are mercifully through that. Just
6 a few more questions and then I'll let Mr. Fiedler have you.
7 Okay. Let's go to Debtors' Exhibit 6. Okay. Are you there?
8 Okay. And this is the certificate of publication notice in
9 the Dallas Morning News. Is that correct?

10 A Yes.

11 Q Okay. Could you turn to Page 7 of 8 at the top? It has
12 the Case Number, the Docket Number, and it's got, underneath
13 it says Exhibit 6, 7 of 8.

14 A Yes.

15 Q Okay.

16 THE COURT: In the publication notice?

17 MS. KIPPES: Yes.

18 THE COURT: Okay.

19 MS. KIPPES: In the publication notice. Okay.

20 BY MS. KIPPES:

21 Q So, this big block of text here on the right side of the
22 page, that's the publication notice of the Zips case.

23 A Yes.

24 Q Okay. Can you read this?

25 A No.

1 Q Okay. Neither can I. Do the Debtors intend to have the
2 third-party release enforced against those who received
3 publication notice?

4 A Ask that question again. I'm sorry.

5 Q Do the Debtors intend to have the third-party release
6 enforced against those who received only publication notice?
7 No other type of notice.

8 A It was -- when you say no other type of notice, it's in
9 our plan documents --

10 Q They didn't receive anything by email. They didn't
11 receive anything by mail. It was just published in the
12 paper. They might have a claim.

13 A I'm not certain if it was included in the plan documents
14 and they received plan document if they were a noticed party.

15 Q Okay. I am going to attempt to read.

16 A I understand, you can't read this.

17 Q Okay. On the first column there, it says "Critical
18 information regarding objecting to the plan. Article A of
19 the plan contains release, exculpation, and injunction
20 provisions. And Article 8-D contains a third-party release.
21 Thus, you are advised to review and consider the plan
22 carefully because your rights may be affected thereunder."

23 So, and then it defines -- it goes on to give all the
24 definitions of those types of releases.

25 THE COURT: Mr. Brookner?

1 MR. BROOKNER: I was getting the wi-fi, sorry.

2 MS. KIPPES: I trust you.

3 BY MS. KIPPES:

4 Q Okay. And then at the end, it gives information. It's
5 on the third column. It gives information about how to
6 obtain the solicitation package. So, again, do the Debtors
7 intend to have the third-party release enforced against those
8 who received only publication notice?

9 A I can't answer that.

10 Q Okay. Okay. If the Debtors do intend to have the
11 third-party release enforced against those who received only
12 publication notice, how would you know they actually received
13 this?

14 A I don't know if people read this ad. Is that what
15 you're --

16 Q Okay. And you just said you don't know if people
17 actually read the ad. Okay. And opt-out forms were not
18 delivered to people who received only publication notice,
19 correct?

20 A I'm not aware.

21 Q Okay. Well, it's not in the paper, right?

22 A (No audible response)

23 MS. KIPPES: Okay. Okay. No further questions,
24 Your Honor.

25

1 THE COURT: Thank you very much, Ms. Kippes.

2 Is there anyone else who wishes to question
3 Mr. Nystrom before I turn him back over to the Debtors?

4 (No audible response)

5 THE COURT: Mr. Fiedler, Mr. Hayden? Any
6 questions?

7 MR. FIEDLER: No redirect, Your Honor.

8 THE COURT: Okay. Give the Court a second. Just
9 one moment, Mr. Nystrom.

10 EXAMINATION

11 BY THE COURT:

12 Q So, Mr. Nystrom, obviously Ms. Kippes went through a
13 series of various questions relating to the potential for
14 claims against various parties. And I appreciate your
15 truthful testimony. I guess the question is claims could
16 exist between these parties that the Debtors may not be aware
17 of.

18 A Yes, that's correct.

19 THE COURT: Okay. That's the Court's only
20 question. Thank you.

21 Any further questions based on the Court's
22 questions?

23 MR. FIEDLER: No.

24 THE COURT: Thank you very much for your testimony.
25 You may step down.

1 (Witness excused)

2 THE COURT: Ms. Kippes? Ready when you are to
3 call, if you have another witness.

4 MS. KIPPES: No other witness, Your Honor.

5 THE COURT: No other witness?

6 MS. KIPPES: No.

7 THE COURT: Okay. Thank you. Is there anyone else
8 who wishes to put on any further evidence in respect of
9 confirmation? Okay. Hearing no further evidence, the Court
10 is prepared to hear closing arguments.

11 I'll give the Debtor the final word with respect to
12 closing arguments, unless you're opting to go first,
13 Mr. Fiedler?

14 MR. FIEDLER: No. That's all right, Your Honor.

15 THE COURT: No? Okay. So, I'll give the Debtor
16 the final word. Is there anyone who wishes to be heard with
17 respect in closing? Obviously, I know I'm going to hear from
18 the United States Trustee. I know I'll hear from the
19 Debtors. Is there anyone else who wishes to be heard by way
20 of closing?

21 MR. MYERS: Your Honor, Michael Myers. I'd like to
22 be heard just briefly, if I may.

23 THE COURT: Please.

24 MR. MYERS: Thank you, Your Honor. Michael Myers
25 with Ballard Spahr. I represent a number of the Landlords.

1 I believe our Landlords hold the vast majority of the
2 locations in the case, over 200. And we represent two of the
3 Landlords that were on the Committee, Broadstone and Realty
4 Income.

5 I did want to thank all the parties in this case
6 for the hard work and professionalism. There have been a lot
7 of lease amendments in the case, some of which are still
8 being papered, but all the parties have worked hard to get to
9 where we're at today.

10 I do want to just confirm that our Landlord's
11 objection is resolved. That was resolved by the inclusion of
12 language in the confirmation order, as well as the amendment
13 of the plan supplement that now includes all of the Ballard
14 Landlords in the assumed lease schedule.

15 Our objection, though, did include an opt-in of the
16 third-party release. And so that does stand out in the
17 resolution of all the other issues. And other than that, I
18 just wanted to thank everyone for their time. And thank you,
19 Your Honor, for letting me appear remotely.

20 THE COURT: Thank you, Mr. Myers. I appreciate it.

21 Anyone else wish to be heard by way of closing?

22 Committee, Term Loan Lenders, DIP Lenders, anyone?

23 (No audible response)

24 THE COURT: Okay. That will narrow it to the

25 United States Trustee's Office and the Debtors. Before we

1 begin closing arguments, does anybody need a short break?

2 MR. FIEDLER: No, Your Honor.

3 MS. KIPPES: Your Honor, I'd like to step out and
4 get a little drink of water.

5 THE COURT: You know you're welcome to. The Court
6 will take a ten-minute recess, and then we'll come back and
7 we'll proceed to closing.

8 MS. KIPPES: Thank you.

9 THE CLERK: All rise.

10 (Recessed at 10:37 a.m./Reconvened at 10:49 a.m.)

11 THE CLERK: All rise.

12 THE COURT: Please be seated. We're going to go
13 back on the record in Case Number 25-80069. And we were
14 going to proceed to closing arguments. And so I think I
15 called for takers earlier. So I'll turn to you, Ms. Kippes.

16 MS. KIPPES: Thank you, Your Honor.

17 Meredyth Kippes on behalf of the United -- I talked
18 too much today, Your Honor. On behalf of the United States
19 Trustee.

20 As I mentioned earlier, Your Honor, the U.S.
21 Trustee is largely going to stand on her argument set forth
22 in the U.S. Trustee's objection to the disclosure statement
23 at Docket Entry Number 213 which was incorporated by
24 reference into the U.S. Trustee's conformation objection at
25 Docket Entry Number 338.

1 The United States Trustee does object to construing
2 a failure to opt out of a third-party release is a knowing
3 and voluntary consent to the release and contends that such
4 releases, when there is a failure to opt out, is a violation
5 of the Supreme Court precedent in Purdue that basically
6 summarizes the 43-page document at Docket Entry Number 213.
7 There are --

8 THE COURT: You're saying 213. I think that your
9 objection's at 135.

10 MS. KIPPES: Maybe it is 235, Your Honor.

11 THE COURT: One-three-five is what I have in front
12 of me.

13 MS. KIPPES: Okay, 135. I'm going to --

14 THE COURT: 213 is a Committee objection, I'm
15 fairly certain.

16 MS. KIPPES: All right. One-three-five. I only
17 wish I could co-op Ms. Elkin's objection. Thank you, Your
18 Honor. I'm going to blame being nearsighted.

19 Okay. So, Your Honor, there are a few points, as I
20 mentioned earlier, that the U.S. Trustee would like to cover.
21 And the first is the release of releasing parties, the mutual
22 release makes the universe of who is actually being released
23 unknowable. Here's why.

24 Purdue says releases must be consensual. And I
25 think we all in the courtroom agree that a release is a

1 contract. And state law says, whether you're using New York
2 law which is what applies to the plan, or Texas law, you need
3 to know what you are releasing, who you are releasing, and
4 you have to have consideration.

5 And Purdue says you have to do all of that
6 affirmatively. You have to -- you cannot have it forced on
7 you like with the Sacklers. So the question is who are you
8 releasing when you're releasing a, "failure to opt out"
9 releasing party because you can't know who may not opt out or
10 who is related to the people who may not opt out.

11 And that's who the Debtors are asking the Court to
12 release, a group of unknowable people really. You cannot
13 know at the time of the opt out, the time you, for the sake
14 of argument, choose not to send in your opt out. You cannot
15 know who the other people are who will fail to opt out and
16 who their related parties are.

17 And so going back to the elements of contract, you
18 can't have a contract if you don't know who or what you're
19 contacting for, or who or what you're releasing. They cannot
20 have consent here as to the release of the failure to opt out
21 releasing/released parties and their related parties because
22 you could not know who you were releasing or what you're
23 releasing at the time you did not opt out.

24 You can only know who those failure to opt out
25 releasing parties are, if at all, upon the expiration of the

1 opt out deadline, at which point it's too late to decide
2 whether or not you want to release them, the other failure to
3 opt out parties and their related parties because the
4 deadline is past.

5 THE COURT: Is the onus not then on the recipient
6 of the opt out notice to opt out if it is, as you've
7 described in there and you don't know the who or you don't
8 know the what, isn't that the objection, to opt out?

9 MS. KIPPES: I'm not sure you know whether or not
10 you want to opt out.

11 THE COURT: But wouldn't conservatism say opt out
12 then?

13 MS. KIPPES: I mean, the most conservative thing in
14 that instance would be to have an opt in where people
15 actually get to decide that they want to release somebody
16 rather than they don't want to release a bunch of people you
17 don't know who you might be releasing.

18 And so, you know, sure, the second best option
19 would be to opt out, but that's, again, you don't know who or
20 what in your -- and that's the other thing, Your Honor, is in
21 this scenario, we are assuming that everybody who received
22 the opt out chose not to send the opt out in because they
23 definitely wanted to give these people a release. That's the
24 assumption. It's knowing consent. It's affirmative consent.

25 There's not a situation where it was misdirected.

1 There's not a situation where it was delivered late such that
2 the failure to opt out wasn't really a choice. It was just
3 some sort of other failure that kept somebody from opting
4 out.

5 THE COURT: Well, those are due process problems.
6 I'm not sure that if a debtor wanted, or any other party for
7 that matter, a third party I guess in this instance, a third
8 party wanted to use as a defense a release and say that the
9 release was consensually given if the counterparty to the
10 release never received, would never receive an opt out
11 notice, received it late, received it after the hearing.

12 Well, all of those things, those are due process
13 problems. I mean, we have mechanisms for that. I always
14 have the ability to interpret my own confirmation order. I
15 always have the ability to go back and determine whether the
16 strictures -- of noticing the strictures of essentially, what
17 is it, Article 8 of the plan had been complied with.

18 I mean, it specifically says in exchange for good
19 and valuable consideration. What you're saying is there was
20 a failure of due process. Well, no considerations given at
21 that point if there's a failure of due process.

22 MS. KIPPES: Okay.

23 (Pause)

24 MS. KIPPES: Okay. Just making a note of the
25 Court's wise words. Thank you. The second --

1 THE COURT: Words. Words for sure.

2 MS. KIPPES: Okay. The second thing I want to
3 touch on is what I touched on, mainly with Mr. Nystrom.

4 THE COURT: Sure.

5 MS. KIPPES: And I don't have to remind the Court
6 of the Court's ruling in CareMax with regard to the equity.

7 THE COURT: Sure.

8 MS. KIPPES: But I'll remind people in the
9 courtroom. The Court found that the third-party release was
10 not binding on equity for basically two reasons. One, the
11 notice of the non-voting status was confusing, and the equity
12 in CareMax was receiving no consideration.

13 There had been a suggestion by one of Debtors'
14 counsel that maybe consideration wasn't required, and the
15 Court rightly pointed out that the plan says, I mean, it's
16 the same phrase as in --

17 THE COURT: Right.

18 MS. KIPPES: -- the Zips plan.

19 THE COURT: Right.

20 MS. KIPPES: In exchange for good and valuable
21 consideration. So I have to say here now that the U.S.
22 Trustee does not concede that classification and payment
23 under a plan is consideration. Rather, classification and
24 distribution under a plan are what every creditor in a
25 bankruptcy case is entitled to under a Chapter 11 plan,

1 whether or not they're given a release. Whether or not they
2 give a release.

3 But the U.S. Trustee recognizes that the Court
4 viewed the proposed payments to the unsecured creditors
5 committee in CareMax as negotiated by the unsecured creditors
6 committee in that case as consideration for -- as part of the
7 General Unsecured Creditors package. And the Unsecured
8 Creditors Committee in this case has also negotiated a, as we
9 said earlier, a remarkable deal for unsecured creditors. So
10 we acknowledge all of that.

11 With regard to the 510(b) claimants in preferred
12 equity, they're receiving no distributions. And so the only
13 consideration for them would be this purported mutual
14 release. And the U.S. Trustee posits that that's really not
15 good and valuable consideration.

16 Mr. Nystrom could not identify any claims for most
17 of the categories of entities that I asked about except for
18 the DIP secured parties, the exit facility secured parties,
19 and the term unsecured parties with regard to possible debtor
20 claims against unsecureds that might be collateral of any of
21 those categories.

22 But other than that, Mr. Nystrom couldn't identify
23 claims that those other parties may have against general
24 unsecured 510(b) claimants or preferred equity. And so
25 they're not -- we don't know what they're worth, we don't

1 know whether they exist. We think maybe they could, maybe,
2 possibly.

3 But, I mean, Your Honor, the idea that the former
4 manager of -- or a successor in interest, that's somebody in
5 the future, that's one of the related parties, may have a
6 claim against Joe Blow secured equity holder, I mean, I think
7 the odds of that sort of thing are vanishingly small.

8 So, you know, perhaps at a minimum, though the U.S.
9 Trustee would like this to be struck entirely, perhaps at a
10 minimum, the definition of related parties really needs to be
11 narrowed, at a minimum. The U.S. Trustee --

12 THE COURT: And that was the agreement in CareMax,
13 right, that the definition for related party was narrowed?

14 MS. KIPPES: Yes. And I believe the Court said
15 that if the Debtor did not narrow it enough, that she would
16 line item veto. I also think the Court said that, as
17 written, the definition of related parties might refer to the
18 Court. So --

19 THE COURT: That sounds like something I would say.

20 MS. KIPPES: I giggle. So the U.S. Trustee views
21 this mutual release as a fig leaf. It's not even a
22 peppercorn because you can't identify the claims, and it's
23 valueless.

24 With regard to the other consideration for the
25 third party release described in the Debtors' brief at

1 Paragraph 124, and I think 125. I won't go through them, but
2 there -- it's a lot of value added things for the estate,
3 increasing the value of the estate, and those sorts of
4 things.

5 And none of them are -- could be forms of
6 consideration for classes that aren't receiving a
7 distribution under the plan. Maybe for the General Unsecured
8 Creditors class, but not for the 510(b) and preferred equity.
9 So that fails as consideration for 510(b) and preferred
10 equity. They're getting nothing out of this except for a
11 release of some claims that cannot be identified, that may or
12 may not exist.

13 The last thing I'd like to touch on, Your Honor, is
14 Republic Supply v. Shoaf. In the confirmation brief at Page
15 54, the Debtors misconstrue Shoaf, which is a case from 1987,
16 for the proposition that it sets out a standard for approval
17 of third-party releases.

18 Shoaf is not about third-party releases. Shoaf is
19 about the res judicata effect of an unappealed confirmation
20 order confirming an unobjected-to plan. In Shoaf, the
21 creditor, Republic Supply, failed to object to a release in a
22 plan and then failed to appeal the confirmation order.

23 Later, Republic Supply, in a different court,
24 sought to hold, the guarantor against, Dr. Joseph Shoaf, the
25 former principal of the Debtor. And Republic Supply

1 challenged this court, the bankruptcy court's authority. It
2 wasn't this Court. We were much too young. But the
3 bankruptcy court's authority to approve the release.

4 And again, Republic Supply had not objected and
5 they didn't appeal the plan for confirmation order. And the
6 Debtors quote, or cite from -- quote the Shoaf saying that
7 the Fifth Circuit found that the Bankruptcy Code does not
8 preclude a third-party release provision, quote, where it has
9 been accepted and confirmed as an integral part of the plan
10 of reorganization. And this takes that phrase out of
11 context. Again --

12 THE COURT: That same phraseology can be found in
13 Zale in some of the other Fifth Circuit's more recent than
14 1987 cases that essentially, one of the questions for
15 releases is if they are an integral part of the plan.

16 MS. KIPPES: Yes. But again, that's not what Shoaf
17 says. What Shoaf says, although Section 524 has generally
18 been interpreted to preclude release of guarantors by
19 bankruptcy court, the statute does not by itself, but by its
20 specific words preclude the discharge of a guarantee, quote,
21 when it has been accepted and confirmed as an integral part
22 of the plan.

23 Now in this particular case, it was not consensual.
24 And so we have now Purdue which basically knocks that out.
25 That doesn't --

1 THE COURT: If you're not consensual, correct.

2 MS. KIPPES: Right. If it's not consensual. So
3 the Fifth Circuit goes on in that same paragraph to say,
4 regardless of whether the provision is inconsistent with
5 bankruptcy law, or with the authority of the bankruptcy
6 court, it's nonetheless included in the plan which was
7 confirmed by the bankruptcy court without objection.

8 And later in the case, the Fifth Circuit says, and
9 this is Shoaf at 1051, it says the issue presented here, in
10 other words, the bankruptcy court is telling us what the
11 issue in Shoaf was, is the res judicata effect of a
12 bankruptcy court's final and unappealed order of confirmation
13 that by its express terms releases a guarantor.

14 So in Shoaf, the Fifth Circuit was not passing on
15 the propriety of the third-party release. The Fifth Circuit
16 was determining whether an unobjected to, unappealed
17 confirmation order long after the fact has res judicata
18 effect. And the Fifth Circuit said that it did.

19 And so Shoaf just doesn't apply here today. We
20 haven't reached res judicata yet. We're still in the res.
21 And the Court's got to judicata before we can get to Shoaf.

22 And maybe the Debtors could argue Shoaf down the
23 line if somebody comes along and says hey, this third-party
24 release you did, it's no good. It doesn't apply to me. And
25 then they would have a trial about the res judicata effect,

1 probably what the Court mentioned earlier, due process,
2 things like that. But Shoaf doesn't apply today. Thank you.

3 THE COURT: Thank you. Mr. Fiedler.

4 MR. FIEDLER: Thank you, Your Honor.

5 For the record, Ross Fiedler of Kirkland & Ellis on
6 behalf of the Debtors.

7 Your Honor, I'm going to be very brief. I think
8 we'll rely on the arguments made in our brief, the evidence
9 that's been submitted. I do want to point out just some of
10 the back and forth that happened with Ms. Kippes and
11 Mr. Nystrom. I -- and I think Your Honor was getting at
12 this, but the mere fact that the Debtors' chief
13 transformation officer is not aware of third-party claims
14 that may be held against other third parties does not mean
15 that there's no value or consideration that's being given.

16 You know, part of the third-party releases, it's an
17 integral part of the plan. I think Ms. Kippes touched on a
18 few of the parties that were giving and getting a release.
19 And I just want to clarify, right. With respect to the DIP
20 secured parties, they're providing \$30 million of new money
21 to fund these cases. So that should not be lost on the
22 Court.

23 With respect to the term loan lenders, right, not
24 only are they agreeing to also provide the DIP, but they've
25 consented to the creation of the GUC trust, right. There's a

1 significant amount of consideration that's going to that
2 trust for the benefit of unsecured creditors. And they're
3 waiving what would otherwise be a very large deficiency claim
4 that they could have otherwise shared in the recovery with
5 other General Unsecured Creditors. So --

6 THE COURT: And I follow you, Mr. Fiedler. I
7 recognize everything that's been given to the general
8 unsecureds by the DIP lenders, by the term loan lenders. The
9 question remains that which remained in CareMax, which is if
10 you are getting a goose egg, okay, you are deemed to reject,
11 you are deemed to be canceled, what are you getting? What's
12 your consideration? What is good or valuable about that?

13 MR. FIEDLER: Yeah. So, Your Honor, for the
14 minority equity holders, I think this is specified in the
15 language in the plan, but they're not required to opt out of
16 the release. So they are not --

17 THE COURT: Right, right. For comment, right.

18 MR. FIEDLER: -- going to be subject to the
19 releases. Now --

20 THE COURT: So what about the 510(b)s, and what
21 about the --

22 MR. FIEDLER: With respect to the --

23 THE COURT: -- senior preferred?

24 MR. FIEDLER: -- sponsor and the senior preferred,
25 I mean, they have been trusted fiduciaries for this business

1 since day one, and they have exercised their fiduciary duties
2 throughout, especially during this process, right. They've
3 been focused on preserving the value of the Company to
4 smoothly transition the ownership to the term loan lenders
5 upon emergence.

6 And I don't think that should be lost on the Court.
7 I think that's in the record already. It's part of the
8 reason Mr. Vogel submitted his declaration, which essentially
9 said there's no claims here worth pursuing against the
10 sponsor or against the preferred equity holders. And I
11 think, you know, their stewardship of this business
12 throughout this process is a big contribution to the Debtors'
13 estate and is benefiting the go-forward business plan that
14 the Company is going to be relying upon to improve it, you
15 know, its overall revenue and EBITDA going forward.

16 So I think, you know, there is certainly
17 consideration that they have been giving to the estate
18 through their time, and through their stewardship of the
19 Company that I think really justifies the release.

20 THE COURT: So you believe that the senior
21 preferred equity holders are receiving a release, and that
22 that is the valuable consideration that they're getting?

23 MR. FIEDLER: So let's be clear, the Debtor
24 release, they are being given a release.

25 THE COURT: No. I understand that.

1 MR. FIEDLER: And that is supported --

2 THE COURT: And I don't think there's an objection
3 to the Debtor release.

4 MR. FIEDLER: Right.

5 THE COURT: The question would be third parties who
6 are receiving a release from senior preferred equity and
7 receiving a release from 510(b) claimants, what are the
8 510(b) claimants and the senior preferred equity receiving in
9 return?

10 MR. FIEDLER: Yeah. So I think what they've been
11 getting is a smooth transition of the ownership of this
12 Company through confirmation of the plan. These parties have
13 been involved in the development of the business plan, the
14 development of the footprint rationalization plan that is
15 benefiting all of the Company stakeholders.

16 And so I think the time, the knowledge, the
17 expertise that's gone into the formulation of those plans is
18 really benefiting all of the Company stakeholders. And I
19 think that is kind of the consideration that's being given.
20 But as Your Honor --

21 THE COURT: So you're smoothly being given nothing?

22 MR. FIEDLER: Say that again, Your Honor?

23 THE COURT: You're smoothly receiving nothing? I
24 mean, I'm trying to understand what is the benefit. What is
25 the benefit to senior equity of any measure? What is the

1 consideration?

2 MR. FIEDLER: Well, you're right, Your Honor. The
3 senior equity holders are getting wiped out under the plan.

4 THE COURT: Right. And 510(b) gets wiped out under
5 the plan.

6 MR. FIEDLER: The --

7 THE COURT: And I understand classification-wise
8 why they're there. And I understand waterfall-wise,
9 priority-wise, why they're getting zeroed out. My question
10 is, you're asking them to give a release to a lot of people
11 and a lot of entities because, I mean, as the related party
12 definition includes everybody and their brother.

13 MR. FIEDLER: Well, I just wanted to clarify that.
14 We actually revised the related party definition to conform
15 largely to what was approved --

16 THE COURT: In CareMax?

17 MR. FIEDLER: In CareMax.

18 THE COURT: Okay.

19 MR. FIEDLER: So we did pay attention to that, Your
20 Honor.

21 THE COURT: Okay.

22 MR. FIEDLER: I don't see any of the senior
23 preferred equity holders here objecting to the release.

24 THE COURT: Sure. This is true.

25 MR. FIEDLER: So they are consenting to it. And I

1 think that's a big part of this, as well. But like I said in
2 my intro remarks, Your Honor, the plan is a global compromise
3 between everyone, and it is in the best interest of the
4 Company. I think the record is very clear on that. And, you
5 know, the third-party release is just part and parcel of that
6 compromise. It'll provide a fresh start, not just to the
7 Debtor, but all of the other parties that are participating
8 in it.

9 And I want to be clear, there was some discussion
10 earlier about whether parties were able to read the
11 publication notice. If a party received the opt out, they're
12 bound by the release if they did not opt out. If they didn't
13 receive an opt out, then there's no ability to bind them to
14 any release because they weren't given the due process
15 afforded by getting the opt out. So --

16 THE COURT: And the United States Trustee wants to
17 go on record as doing away with publication notices. I think
18 I can get there. I got to tell you that.

19 MR. FIEDLER: Okay, Your Honor.

20 THE COURT: I think that ship sailed many decades
21 ago.

22 MR. FIEDLER: Yeah. So, I mean, that concludes my
23 argument, Your Honor. We'll rest on the brief, the various
24 declarations that we've submitted. And we do believe that
25 confirmation of this plan is eminently reasonable and in the

1 best interest of the estate.

2 THE COURT: Thank you very much, Mr. Fiedler. With
3 that, the Court will take a brief recess and I'll come out
4 and give my ruling.

5 THE CLERK: All rise.

6 (Recessed at 11:15 a.m./Reconvened at 11:41 a.m.)

7 THE CLERK: All rise.

8 THE COURT: Please be seated. Do we have everyone?
9 Has everybody returned?

10 MR. FIEDLER: Yes. We're good, Your Honor.

11 THE COURT: Okay. Excellent. I just wanted to
12 make sure.

13 First, with respect to confirmation, obviously, I
14 want to compliment the parties. Again, the results going
15 from zero to 20 to 25 cents to unsecured is both remarkable,
16 as I think Ms. Elkins said, and admirable. I know that takes
17 a lot of work on behalf of the professionals.

18 And also, I recognize the considerable concessions
19 that the term loan lenders had to make over the course of
20 this case, apparently both pre- and post-petition to get us
21 here. And I think that that is also to be commended both
22 from a professional perspective and to the lenders
23 themselves.

24 I also recognize that each of the parties, the
25 Debtors' counsel, their professionals, the advisors, same for

1 the Committee, Hilco, everyone's been working towards this
2 result, and I compliment the parties. I also think this case
3 was run very efficiently. You certainly brought me more
4 resolutions than you did contests, and I think that as
5 stewards of the estate, your time was wisely spent.

6 Before the Court is the confirmation of the
7 Debtors' plan. The Court would start with the greater
8 portion that was not objected to in this case, and that's the
9 1129 and 1123 factors. The Court finds that the plan
10 satisfies 1129 of the Bankruptcy Code as it pertains to
11 confirmation.

12 Most of the fight in this case and today,
13 obviously, has specifically been with respect to the
14 third-party releases that are found in the plan. And again,
15 I appreciate the work of the United States Trustee's Office
16 and of the Debtors and the other constituencies working
17 together to narrow the contest to only essentially the
18 releases.

19 This Court, in particular, has approved opt-out
20 releases in a number of cases. I have always said facts
21 matter and due process matters. I don't have the same due
22 process issues that I had a small piece of in CareMax, for
23 example, with respect to one noticing issue with respect to
24 equity. I didn't have any contested testimony by the
25 servicing agent, Kroll, and with respect to any service

1 issues that I had in CareMax.

2 I'll state early on, and I'll turn to it a little
3 bit later, we also have a different plan here than we had in
4 CareMax. Specifically, there is a mutuality to the giving
5 and receiving of releases under this plan that did not exist
6 in CareMax.

7 Obviously, the Court strives for consistency in my
8 rulings. So, on recess, I wanted to take a little bit of
9 time looking through the definitions in the CareMax plan, as
10 well as the plan itself, to see if there is any differences.
11 And there is critical difference, that is that releasing
12 parties and released parties are giving and receiving mutual
13 releases.

14 So harkening back again to opt-outs, there was no
15 occasion for the Supreme Court in Purdue, in this Court's
16 estimation, to take a view on what constitutes a consensual
17 release. The Supreme Court confined its decision to the
18 question presented, which was about non-consensual releases.
19 When I have approved opt-outs here in my court, it's always
20 been based upon the evidence that the affected parties were
21 afforded constitutional due process and a meaningful
22 opportunity to opt-out.

23 As I noted in my CareMax oral ruling, and I'll note
24 again today, the Fifth Circuit recently came down with the
25 Serta opinion, and it says a whole lot of stuff. But one of

1 the things that it says in there speaks to the Fifth Circuit
2 in particular and the issue of implied consent. It speaks to
3 a situation in which a party was presented with an
4 opportunity to object and did not object.

5 And so from this Court's perspective, based upon
6 cases within the broader state of Texas, and within this
7 district in particular, the Court has gotten comfortable with
8 opt-out provisions as it pertains to a reorganization. In
9 this instance, I believe the Debtor received maybe
10 approximately 30 votes in the general unsecured class and I
11 think 5 to 6 opt-outs. That's a very high percentage. It's
12 in the neighborhood of 20 percent of opt-outs. That means
13 the system worked specifically with respect to General
14 Unsecured Creditors.

15 With respect to the consideration issue, obviously
16 based upon the Court's questions, Counsel will recognize that
17 I have a bit of angst there. I ruled in CareMax as part of
18 at least a three-part ruling of why I disapproved of the
19 common equity releases. There was due process problem.
20 There was a balloting issue. And in addition, there was a
21 consideration issue because there was no mutuality of release
22 there.

23 In this case, the Court finds, based upon the
24 evidence and the declarations, that third-party releases are
25 an integral part of the plan. They were heavily negotiated.

1 Again, when it comes to the DIP, when it comes to the term
2 loan lenders, there was a lot that was given by these parties
3 over the course of achieving confirmation. I do believe that
4 the third-party releases in this case were a central and
5 critical piece towards confirmation.

6 I do appreciate the amendment to the related party
7 definition. It's still broad, but it does conform to what
8 the Court approved in CareMax.

9 I won't go very deep on the opt-out themselves.
10 What I'll say is that parties in interests were provided
11 detailed notices about the plan, the deadline to object to
12 the plan, the voting deadline, and the opportunity to opt-
13 out. The language was bolded. The language was conspicuous.
14 I do believe that parties had an adequate opportunity to opt
15 out.

16 I won't go into publication notices. As I quipped
17 before, I'm not sure why we're still doing those. I can't
18 wait to rule on that one case where the only thing that's
19 being relied upon is that time that it was put in a paper in
20 the New York Times.

21 But I am going to approve the third-party releases
22 with respect to the 510(b) claims and the preferred equity as
23 follows. First, I am going to insert into the releases that
24 this is being done to the maximum extent provided under
25 existing Fifth Circuit authority or Fifth Circuit precedent.

1 I just point out to the Debtors that your plan says
2 in exchange for good and valuable consideration. I'm going
3 to approve the plan. But as I've said many, many times
4 before, the value, the efficacy, and the enforceability of a
5 release really does come down to due process consideration,
6 and then the process of the opt-outs.

7 I note, I don't think that I'm going to address
8 anything in terms of gatekeeping. I don't want to trip into
9 Highland by any measure. But what I would say for purposes
10 of the record that is under Article 11 of this particular
11 plan, Sections 7, 9, 11, and probably 23 and 24, give the
12 Court all of the authority and ammunition, so to speak, to
13 interpret the Court's own orders.

14 So whatever I am approving as part of this
15 confirmation order, if a situation should arise down the
16 road, a la Shoaf, a guarantor or anyone else or some third
17 party that's in the related party definition were to claim a
18 release, well it's going to have to come back to this Court
19 probably for interpretation of its orders.

20 Again, a larger part of the Court's ruling is based
21 upon the mutuality of the releases given between the
22 releasing parties and the released parties. Something's
23 being given. I can't tell you definitely what the value of
24 it is today, but I guess it is at a minimum a peppercorn
25 because if, as Ms. Kippes laid bare, there is no claims or

1 causes of action so to speak between two parties and they're
2 giving releases, then I go back to the due process issue
3 where someone received the ability to opt out.

4 They received the bold and conspicuous language,
5 and they chose for whatever reason not to opt out. Perhaps
6 it is because they didn't value their peppercorn that much.
7 Perhaps it's for some other reason. But if they received the
8 opportunity to speak up and didn't, then the Court is
9 comfortable based upon its prior rulings with respect to
10 opt-outs that that constitutes a consensual release by act or
11 knowing affirmative inaction.

12 Is there any other questions or concerns with
13 respect to the form of order or anything else? Anything in
14 the Court's ruling that's unclear?

15 MR. FIEDLER: No, Your Honor.

16 THE COURT: Okay. So with that, I will look to you
17 to make sure that the final form of the plan is the one that
18 you're approving in your confirmation order, and to make that
19 one insertion which the third-party releases are to note that
20 is going to be approved according to the maximum extent
21 allowable under existing Fifth Circuit precedent.

22 MR. FIEDLER: Thank you, Your Honor.

23 Ross Fiedler, for the record, on behalf of the
24 Debtors. I just want to thank Your Honor, your staff, your
25 entire team for what's been a very seamless Chapter 11 case.

1 We really appreciate your effort, your coordination.

2 It is our first time here, and I'm sure we'll be
3 coming back. So thank you so much. We appreciate it.

4 THE COURT: Well, thank you very much. I
5 appreciate the kind words, especially for my staff. They do
6 work exceptionally hard. And we've been a little short
7 staffed, not on my team but on other teams. And so
8 Ms. Harden and Ms. Jeng, who you're probably used to seeing
9 in the court, have been working it's not even double duty
10 anymore. It's probably quadruple duty. And so we appreciate
11 the kind words. Thank you very much.

12 MR. FIEDLER: Of course, Your Honor.

13 THE COURT: Thank you. With that, the Court stands
14 adjourned for the day. You guys have a good one. I'll be on
15 the bench for a minute.

16 THE CLERK: All rise.

17 THE COURT: So, thanks.

18 (Proceedings adjourned at 11:55 a.m.)

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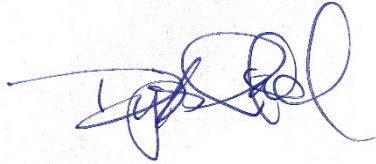
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C E R T I F I C A T I O N

I, DIPTI PATEL, court-approved transcriber, certify that the foregoing is a correct transcript from the official electronic sound recording of the proceedings in the above-entitled matter, and to the best of my ability.



DIPTI PATEL, AAERT CET-997

Expires: December 6, 2026

Liberty Transcripts

Date: April 24, 2025